



DEPARTMENT OF EDUCATION INCLUDING DIRECT AID TO PUBLIC EDUCATION

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2017

Auditor of Public Accounts
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AUDIT SUMMARY

Our audit of the Department of Education and Direct Aid to Public Education; collectively referred to as “Education” throughout this report, for the fiscal year ended June 30, 2017, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth’s accounting and financial reporting system; however, as is noted in the finding titled “Design and Implement Sound Internal Controls over Fiscal Activities,” we discontinued testing transactions in the Education’s internal accounting system (internal system) and as a result do not provide a conclusion on the amounts therein;
- two deficiencies which we consider to be material weaknesses in internal control;
- additional matters involving internal control and its operation necessary to bring to management’s attention; and
- instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

This report includes a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of financial information will not be prevented, or detected and corrected on a timely basis. As a result, these findings are considered material to Education and the Commonwealth’s Comprehensive Annual Financial Report (CAFR). The material findings relate to Education’s controls over fiscal operations and are located in the report section titled “Audit Findings and Recommendations.”

–TABLE OF CONTENTS–

	<u>Pages</u>
AUDIT SUMMARY	
AUDIT FINDINGS AND RECOMMENDATIONS	1-12
INDEPENDENT AUDITOR’S REPORT	13-16
AGENCY RESPONSE	17-20
AGENCY OFFICIALS	21

AUDIT FINDINGS AND RECOMMENDATIONS

Why the APA Audits Fiscal Processes and Financial Information

Education receives approximately \$8 billion in funding to perform its necessary operations. Education utilizes an internal accounting system to process its financial transactions, which interfaces with the Commonwealth's accounting and financial reporting system. To determine the extent of procedures needed to ensure Education's financial information is materially correct, we perform tests of controls over fiscal processes.

Design and Implement Sound Internal Controls over Fiscal Activities

Type: Internal Control

Severity: Material Weakness

Repeat: No

Education implemented an internal system with a material control weakness and has not established a compensating control. As a result, an individual was able to record and authorize, without detection by management, a cash rollover transaction totaling \$5.56 billion. Additionally, all reconciliation documents for the internal system and the Commonwealth's accounting system, are housed on a shared drive that is accessible to and can be modified by any fiscal staff, including those that can enter and approve transactions in the internal system without detection.

Separation of duties between recording, authorizing, and reconciling must exist for financial transactions as part of any sound system of internal controls. Per the Commonwealth Accounting Policies and Procedures (CAPP) Manual Topic 20905, "agency management is responsible for instituting internal control over the recording of financial transactions that is designed to provide reasonable assurance regarding the reliability of those records."

Management is not able to provide proof that it would detect a material error or fraud in its internal system caused by providing its employees system access to record and authorize transactions along with access to modify reconciliation records. Because management designed and implemented controls surrounding its internal system with material weaknesses, the Auditor of Public Accounts determined that it would discontinue testing transactions in the internal system and would focus audit procedures on amounts recorded in the Commonwealth's accounting system from Education to determine if an opinion could be issued for the Commonwealth's Comprehensive Annual Financial Report (CAFR). In the future, this weakness in internal controls may lead to Education uploading a material error from its internal system to the Commonwealth's accounting system. If the error is not corrected, it could result in a modified opinion for the Commonwealth's CAFR.

During fiscal years 2016 and 2017, Education completed an update and enhancements, respectively, to its internal system but did not dedicate resources to detect and correct the weakness in the internal system that allows General Ledger Supervisors and certain users the ability to record and

authorize transactions. Additionally, because several individuals are involved in the reconciliation process, management placed the supporting records on a shared drive, but did not deploy the principle of least privileges.

Education must dedicate the necessary resources to design, implement, and monitor a system of sound internal control over fiscal activities, including, but not limited to, access controls within its internal system and reconciliation controls to provide assurance that financial data is properly recorded. With respect to the internal system, Education has two possible options it should consider to reduce the risk of future internal control weaknesses, which are:

- Design and implement effective internal controls within the internal system to provide separation of duties for transactions, or;
- Work in collaboration with the Department of Accounts to develop a plan for transition to solely using the Commonwealth's accounting system and its controls for all accounting transactions.

Improve Support and Review of Financial Recording

Type: Internal Control

Severity: Material Weakness

Repeat: No

Education could not provide adequate support for adjusting entries affecting Education's internal system. We found the following issues with the initial requested support:

- Education staff provided us the support for a different journal voucher than the one we requested. Both journal vouchers appeared to be for the same transaction. Each journal voucher was for \$5,560,873,275, but no clarification for the different journal vouchers was provided.
- A journal voucher for \$5,560,873,274 had an effective date of January, but was not posted until March.
- The support for a journal voucher for \$548,110 contained two internal system/Commonwealth accounting system reconciliation pivot tables with differing amounts. The internal system and Commonwealth accounting system reports only supported one of the reconciliations, which was not used in the adjusting entry.
- No explanation was documented in the support explaining why two separate transactions both with the same journal name for \$29,146 each were necessary.

- A transaction and its corresponding reversal and subsequent re-posting, each for \$199,347,523, did not have Commonwealth accounting system reports attached to support the reconciliation. Based on email support, the re-posting was incorrectly performed.
- A transaction for \$126,109,407 did not have Commonwealth accounting system reports to support the reconciliation.
- Support for a \$101,148 transaction shows that the entry was posted twice with no explanation. There were no reconciliation documents to support a change.

Auditor followed up with Education to get additional clarification and support. Education was able to offer explanations for some of the entries; however, due to the material weakness over the internal system's controls as noted in this year's management point titled "Design and Implement Sound Internal Controls over Fiscal Activities" and lack of physical support, further follow-up was not performed to validate the explanations or obtain additional audit evidence.

Per the CAPP Manual Topic 20905, "agency management is responsible for instituting internal control over the recording of financial transactions that is designed to provide reasonable assurance regarding the reliability of those records. Reliability of financial records means that management can reasonably make several assertions as to the completeness and accuracy of the financial records." Additionally, CAPP Manual Topic 20905 states: "when documenting a detailed reconciliation process, an element of that detail is a list of any summary and transaction-level reports that are used, including reports from Commonwealth accounting system, as well as those produced by the agency's systems." Education must have the Commonwealth accounting system and internal system reports for all reconciliations to support the numbers in its reconciliation pivot tables.

Lack of management review and adequate supporting documentation increases the risk of Education recording inaccurate entries into its internal system. Also, if proper supporting documentation is not maintained for these entries, management may not be able to determine if accounting records are complete and accurate.

Education attributed most of the problems with its support to critical systems implementations during the fiscal year, such as the chart of accounts conversion. Several reversals and corrections were needed to resolve errors after conversion. A lack of oversight and review on these unusual entries seemed to correspond with the incomplete support. The cause of these issues is consistent with the prior year management point titled "Improve Oversight and Review of Financial Reporting."

Education should ensure its financial recording procedures provide sufficient direction for personnel regarding the support needed to submit entries into the internal system, including the specific reports needed to support any reconciliations; and adequate oversight and review to prevent or detect and correct errors or omissions.

Perform Adequate Due Diligence before Authenticating and Paying Vendors

Type: Internal Control

Severity: Significant Deficiency

Repeat: No

In January 2017, the Education paid two invoices to Patent Trademark Bureau, a fraudulent vendor. These invoices, totaling \$1,850, alleged being for retention of two Infinite Learning Lab trademarks that Education maintains.

State agencies are entrusted with taxpayer dollars and are expected to perform due diligence to ensure all purchases are reasonable. Per CAPP Manual Topic No. 20310, “disbursements of State funds are made to businesses or individuals that furnish goods or services to the Commonwealth.” Since the fraudulent vendor did not provide any goods or services, Education should not have disbursed the funds. Without proper controls surrounding vendor payments, Education increases the risk of paying fraudulent invoices.

Education did not recognize an invoice from a fraudulent vendor and did not stop its payment process when it received contradictory information. Education’s Fiscal Services Department received invoices in November 2016 from the fraudulent vendor and sent them to the Office of Technology and Virtual Learning for approval, as is standard practice. During the time between receipt of the invoices and the payment to the fraudulent vendor, the Office of Technology and Virtual Learning Director received a letter in December 2016 from the law firm that represented Education when the patent was originally filed. The letter indicated that the maintenance filings were due to the United States Patent and Trademark Office, and that the law firm could handle the filing and registration for a cost of \$3,100. After receiving the legitimate letter from the law firm, which Education had done business with in the past; Education did not identify the contradictory information and recognize that the invoices were for a fraudulent vendor.

Education should not pay an invoice before ensuring its legitimacy. Education should improve its internal controls to perform a more complete review of vendor payments, specifically looking for fraudulent indicators to ensure they are valid items requested by the agency. Also, before proceeding, Education should re-evaluate its decisions when contradictory information arises.

Why the APA Audits Budgetary Processes and Systems

Education receives and disburses approximately \$5.76 billion in Standards of Quality (SOQ) funding to Local Education Agencies (LEAs). Education establishes policies and procedures to ensure that budgetary adjustments are properly implemented. We test to ensure that policies and procedures are complete and properly followed.

Establish and Implement Policies and Procedures for Accessing Budgetary Information

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: No

An Education employee not responsible for budgeting was granted read/write access to the local shared drive that is used for establishing state funding amounts for local school divisions. Additionally, an Education employee in the Budget Department (Budget), who separated from employment in March 2017 retained their read/write access to the drive until at least July 2017.

The Commonwealth Security Standard (Security Standard), Section 8.1 AC-1, requires agencies to develop, document, disseminate, and review and update annually, an access control policy that addresses purpose, scope, roles, compliance, and responsibilities; and formal documented procedures to facilitate the implementation of the policy and associated access controls. Additionally, Section 8.1 AC-2 requires that “the organization reviews accounts for compliance with account management requirements on an annual basis or more frequently if required to address an environmental change.”

The local shared drive houses a critical budgetary spreadsheet, which is a complex workbook that contains funding calculations for local school divisions. Employees with read/write access could manipulate the data in this spreadsheet, which could lead to incorrect allocations of funding to local school divisions.

Although the Virginia Information Technologies Agency (VITA) is responsible for executing the access changes authorized by Education, Education has not taken responsibility for developing a process for authorizing and monitoring whom has access to the local shared drive. As a result, Budget does not have written policies or procedures related to granting or monitoring access to the drive.

Budget should establish and implement written policies and procedures for managing access to the local shared drive that complies with the Security Standard. At minimum, the policies and procedures should address the principle of least privileges and the monitoring of the access listing for any necessary updates.

Retain Evidence of Approval for Changes in Local Funding

Type: Internal Control

Severity: Significant Deficiency

Repeat: No

None of the change control forms for fiscal year 2017 funding for local school divisions contain the signature/authorization of the Director or Associate Director of Education's Budget Department (Budget).

Education has designed controls for a critical budgetary spreadsheet, which is used to implement SOQ requirements set by the General Assembly. These controls include separation of duties by requiring that all changes to the spreadsheet be documented on a change control form. Each change control form is required to contain the signature of the Director or Associate Director of Budget as evidence that they reviewed the change for accuracy and authorized it before implementation. Without implementing the review and authorization control as designed, Education increases the risk of errors in its execution of SOQ funding to local school divisions.

Budget developed an electronic change control form; however, it did not develop a process for capturing and controlling digital signatures and the corresponding dates. Additionally, Budget prints the change control forms, but the appropriate individual does not sign and date the forms to confirm their review and authorization.

Budget should develop a process for capturing and controlling signatures and the corresponding dates within the electronic change control forms or have the printed copies physically signed and dated by the appropriate individual before implementing the change.

Why the APA Audits Federal Reimbursements

Education disburses approximately \$1.07 billion of federal funds. Education is responsible for properly drawing down and disbursing federal funds. Education uses its grants management system to communicate federal awards and approve federal reimbursement payments to LEAs. To ensure that Education is properly processing federal reimbursement requests, we reviewed transactions for reasonableness and proper approval by Education.

Drawdown Federal Grant Funds as Instructed and Update Loan Request with Important Facts

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: No

Education Fiscal Services did not, as instructed, set up a Health and Human Services (HHS) Payment Management System (PMS) account to draw down funds for a Substance Abuse and Mental Health Services Administration (SAMHSA) grant approved in fiscal year 2014. Additionally, by omitting important facts on its request, Education was able to obtain a \$1.6 million Treasury loan to cover SAMHSA payments to localities.

The grant Notice of Award (NOA), received by Education upon its approval for the grant in September 2014, specifies that grant payments are made using HHS' PMS and that the grantee's business office is responsible for drawing down funds. Also, the NOA contained a hyperlink to the PMS website, where further instructions are provided on how to open an account. Additionally, in January 2016, a SAMHSA program official reiterated to Education that it needed to open a PMS account to properly drawdown the funds and again provided Education with a web link to instructions on how to open and obtain access to a PMS account.

After being placed under a restrictive program review by HHS in January 2017, Education needed funds to cover non-HHS funds it paid to localities for the SAMHSA program or request the localities return the funds. Education decided to submit a request to the Department of Accounts (Accounts) for a Treasury loan. Within its loan application, Education did not disclose the reason why HHS placed Education under a restrictive review.

In October 2017, Education received approval from SAMHSA to begin drawing reimbursements for prior payments made to localities. SAMHSA reimbursed Education \$19,938 and \$149,819 in October and November 2017, respectively. Education has not identified how they will pay back the loan if HHS disallows any of the remaining outstanding reimbursements.

Education did not follow the grant requirements and subsequent instructions by HHS to drawdown SAMHSA funding. When requesting its Treasury loan, management at Education believed they did not need to disclose the actions by Education that caused HHS to restrict Education's SAMHSA funding until HHS completed its review.

Education should ensure staff understand and adhere to grant requirements (i.e., drawdown and reporting procedures) and are following internal procedures and federal guidance. Education should provide Accounts with updated loan documents for evaluation and, in the future, should provide Accounts with sufficient information to avoid confusion or misinterpretation.

Establish Sound Budgetary Controls over Disbursements

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: No

Education paid one public school system \$27,920 in excess of its award for the federal Individuals with Disabilities Education Act (IDEA) Part B, Section 611 grant. Education's grants management system and internal system show that the locality received IDEA payments in excess of Education's award for this locality and federal program.

Education receives money from the United States Department of Education and is the pass-through entity for distributing these federal funds. Education awards funds to localities based on a number of variables. To ensure the subrecipients do not overspend their allocated award, Education sets up a budget for each subrecipient in the grants management system. As a result, subrecipients should not receive payments in excess of the limit in the system.

Education only receives a certain amount of federal dollars for each grant. Education cannot receive more money from the federal government beyond what it is awarded; therefore, if the records show that one subrecipient received more than its award, federal funding may not be available to fully fund another subrecipient or Education may need to request that the locality return the funds.

Education designed a control within the grants management system to prevent overpayment; however, this control failed for the reimbursement to a public school system. Per the Director of Fiscal Services, Education has determined that a "coding glitch" in the system allowed this overpayment, but believes this is an isolated incident.

For this instance, Education should gain a better understanding of its controls in the grants management system and determine how this overpayment occurred and ensure that Education did not pay other entities more than their budgeted amount. Going forward, Education should monitor and regularly test controls in the grants management system to ensure they are implemented and working as designed. Finally, if management believes system controls are unstable or changed because of system upgrades, conversions, etc., Education should establish additional detective controls to ensure payments are within its budgetary limits.

Why the APA Audits Employee Retirement Data

While Education is not one of the Commonwealth's largest employing agencies, we perform testing at certain agencies each year to ensure the Commonwealth is correctly reporting its liabilities related to retirement benefits. To ensure that Education's records agree to amounts in the Commonwealth's calculations, we test Education's review of submitted information and, if any, subsequent adjustments.

Review the Commonwealth's Human Resource System Cancelled Records Report

Type: Internal Control

Severity: Deficiency

Repeat: No

Education is not consistently reviewing the Commonwealth's human resource system (HR System) Cancelled Record Report on a daily basis. The report is generated from the Commonwealth's retirement benefits system (Benefits System) and identifies items that are rejected during the interface between the HR and Benefits Systems, and require a manual correction. Per management, Human Resources only reviewed the Cancelled Record Report a few times during the year and did not document their review.

Per Topic 50410 of the CAPP Manual, "...employers must review the Cancelled Record Report daily to ensure all information was recorded in [the Benefits System]." Reviewing and correcting items in the Cancelled Record Report is essential to ensure that retirement benefits are accurately calculated and properly transmitted between the HR and Benefits Systems. Without reviewing the report, Education risks not finding errors in employees' records that could potentially cause complications when an employee retires.

After being made aware of the requirement to review the Cancelled Records Report as part of the prior year audit, the Human Resource Director neglected to review the report on a consistent basis in fiscal year 2017. According to the Human Resource Director, she believed that reviewing the report on a consistent basis was not necessary because she trusted that she could determine and make all manual corrections without reviewing the Cancelled Records Report.

Education should update its human resource processes to include a daily review of the Cancelled Records Report and retain a record of its review. This will provide a record of the implementation of this control and reduce the risk of reporting incorrect information to the Virginia Retirement System.

Why the APA Audits System Reconciliations

Education utilizes a federal reimbursement system to approve reimbursement requests from LEAs, which interfaces to the entity's internal accounting system. Education uses the internal accounting system to process its financial transactions, which interfaces with the Commonwealth's accounting and financial reporting system. To ensure that amounts are properly interfaced, we review supporting documentation for reconciliations between each of the systems and their related policies and procedures.

Require the Review and Approval of Reconciliations

Type: Internal Control

Severity: Significant Deficiency

Repeat: No

Education policy governing the monthly reconciliations between Education's internal system and grants management system does not include approval procedures. As a result, reconciliations do not identify who prepared the files or whether further review was performed.

As a best practice, written procedures should cover the entire reconciliation process to ensure all steps are properly performed. Additionally, as an internal control, a supervisor should review each reconciliation and its support to ensure it is properly supported and accurate.

Without sound policies and procedures over approval of reconciliations, Education increases the risk of reconciliations not being performed or variances and errors going undetected. Without documentation of approvals, it may limit Education's ability to hold employees responsible for unexplained or uncorrected variances or errors, respectively. In addition, Education risks having new employees misunderstand the reconciliation process.

While Education implemented policies and procedures over reconciliations, as result of a recommendation issued in the prior audit titled "Improve Access and Other Controls Related to Federal Reimbursements," it did not include a section on the approval process. This omission is likely caused by an oversight not to include this internal control in its practices.

Education should update and implement its reconciliation policies and procedures to include a review and approval process. For other policies and procedures, management should take the necessary steps to ensure they include, as needed, best practices and appropriate internal controls.

Why the APA Audits Information Security

Education is responsible for managing state and federal appropriations for seven programs that support public instruction. Education's Information Technology (IT) systems and practices support the financial reporting and critical functions necessary for accomplishing these business objectives. To ensure that Education's IT general and application controls are effectively designed in accordance with the Commonwealth's Information Security Standard, SEC 501-09 (Security Standard); Commonwealth's IT Security Audit Standard, SEC 502-02 (IT Audit Standard); and industry best practices, we performed testwork over the policies, procedures, and security controls supporting Education's IT environment.

Continue to Improve Information Security Program and IT Governance

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: Yes

Prior Title: Improve Information Security Program and IT Governance

Education continues to improve its information security program, but does not have the necessary controls in place to secure its mission critical systems and data. Education recently developed and approved an information security manual, which contains all the policies and certain roles and responsibilities for the information security program. However, the information security manual does not contain developed procedures that address certain required controls and approved policies for the IT environment. Specifically, Education has not developed and implemented procedures for the following:

- Deploying an IT systems hardening process;
- Deploying a complete change management process;
- Deploying a risk management process;
- Maintaining an adequate security awareness training program; and
- Conducting IT security audits over sensitive systems.

We identified and communicated these weaknesses to management in a separate document marked Freedom of Information Act Exempt (FOIAE) under §2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms.

The Security Standard requires agencies to use the specific controls listed above to reduce unnecessary risk to data confidentiality, integrity, and availability in systems processing or storing sensitive information. Education should improve its IT governance and should dedicate the necessary

resources to correct the control deficiencies above and implement the controls needed to align the information security program with internal policy, industry best practices, and the Security Standard.

Improve Database Security

Type: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: Yes

Education does not secure its database that stores its financial activity with some of the minimum security controls required by the Security Standard and industry best practices.

We communicated the control weaknesses to management in a separate document marked FOIAE under §2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms. The Security Standard requires the implementation of certain controls that reduce unnecessary risk to data confidentiality, integrity, and availability in systems processing or storing sensitive information. By not meeting the minimum requirements in the Security Standard and aligning the database's settings and configurations with best practices, Education cannot ensure the confidentiality, integrity, and availability of data within the database or the information it reports.

Education should dedicate the necessary resources to implement the controls discussed in the communication marked FOIA Exempt in accordance with the Security Standard and best practices in a timely manner.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
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December 15, 2017

The Honorable Ralph S. Northam
Governor of Virginia

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

We have audited the financial records and operations of the **Department of Education including Direct Aid to Public Education** (Education) for the year ended June 30, 2017. 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 audit's primary objective was to evaluate the accuracy of Education's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2017, and to test compliance for the Statewide Single Audit. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth's accounting and financial reporting system, Education's internal accounting system (internal system) and other financial information Education submitted to the Department of Accounts; reviewed the adequacy of Education's internal controls; tested for compliance with applicable laws, regulations, contracts, and grant agreements; and reviewed corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

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

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

- Federal grants management for Title IV 21st Century Community Learning Centers
- Financial assistance and incentives payments
- Appropriations
- Accounts receivables
- Accounts payables
- Information system security

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

Conclusions

We found that Education properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's accounting and financial reporting system and other financial information Education submitted to the Department of Accounts. The financial information presented in this report came directly from the Commonwealth's accounting system. As is noted in the finding titled "Design and Implement Sound Internal Controls over Fiscal Activities," we discontinued testing transactions in the internal system and as a result do not provide a conclusion on the amounts therein.

Our consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; and therefore, material weaknesses and significant deficiencies may exist that were not identified. However, as described in the section titled "Audit Findings and Recommendations," we identified certain deficiencies in internal control that we consider to be material weaknesses in internal control and other deficiencies that we consider to be significant deficiencies in internal control. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

A **material weakness** is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial information or material non-compliance with provisions of a federal program will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in internal controls over financial reporting in the section titled "Audit Findings and Recommendations," to collectively create a **material weakness**:

- Design and Implement Sound Internal Controls over Fiscal Activities
- Improve Support and Review of Financial Recording

A **significant deficiency** is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies, other than those mentioned above, and described in the section titled "Audit Findings and Recommendations," to be significant deficiencies.

Findings in the section titled "Audit Findings and Recommendations" contain the results of our tests that disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

As the findings for Education have been identified as a material weakness or significant deficiency for the Commonwealth, they will be reported as such in the "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards," included in the Commonwealth of Virginia Single Audit Report for the year ended June 30, 2017.

In addition to the material weaknesses and significant deficiencies, we detected deficiencies in internal control that are not significant to the Commonwealth's Comprehensive Annual Financial Report and Statewide Single Audit, but are of sufficient importance to warrant the attention of those charged with governance. We have explicitly identified two findings in the section titled "Internal Control and Compliance Findings and Recommendations" as deficiencies.

Education has not taken adequate corrective action with respect to the previously reported findings titled:

- Improve Information Security Program and IT Governance
- Improve Database Security

Education has taken adequate corrective action with respect to audit findings titled "Strengthen Internal Controls over Budgeting and Fiscal Processes," "Improve Oversight and Review of Financial Reporting," "Retain Evidence of and Support for Information Reported to the Federal Government," "Improve Access and Other Controls Related to Federal Reimbursements," and "Upgrade End-of-Life Technology."

Exit Conference and Report Distribution

We discussed this report with management on January 9, 2018. Management's response to the findings identified in our audit is included in the section titled "Agency Response." We did not audit management's response and, accordingly, we express no opinion on it.

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

GDS/clj



COMMONWEALTH of VIRGINIA

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January 17, 2018

Ms. Martha Mavredes
Auditor of Public Accounts
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Dear Ms. Mavredes:

I appreciate the opportunity to respond to the findings of the audit completed by the Auditor of Public Accounts of the Department of Education (DOE), including Direct Aid to Public Education, for the year ended June 30, 2017. I am pleased that the audit found that the Department properly recorded and reported all transactions, in all material respects, in the Commonwealth's financial reporting system, Cardinal. The audit did identify matters involving internal controls and instances of noncompliance with applicable laws and regulations in the areas of Internal Controls over Fiscal Activities, Financial Recording, Performing Adequate Due Diligence before Authenticating and Paying Vendors, Drawing Down of Federal Grants Funds, Budgetary Controls in DOE's Grants Management System, Improving Reviews and Approvals of Reconciliations between DOE's Grants Management System and DOE's Financial Management System, Establishing and Implementing Policies and Procedures for Accessing Budgetary Information, Retaining Evidence of Approval for Changes in Local Funding, Reviewing the Personnel Management Information Systems Cancelled Records Report, Continuing to Improve Information Security Program and IT Governance, and Continuing to Improve Database Security. The report contains several recommendations for improvement that will focus the work of agency management and staff who will implement them.

Regarding the findings related to Designing and Implementing Sound Internal Controls over Fiscal Activities, management was not aware of the breach in internal controls in the design of user roles in VDOE's internal financial management system that was implemented nearly fifteen years ago. However, as soon as management became aware of the breach, it took immediate corrective action to modify the established roles in the internal financial management system to prevent General Ledger Supervisors and certain users from recording and authorizing

transactions. The Office of Fiscal Services will continue its commitment to ensure proper internal controls over fiscal activities by performing a comprehensive role mapping to user responsibilities to ensure no users have the ability to record and authorize transactions. Fiscal Services management has implemented new monitoring efforts by performing periodic reviews of financial transactions in its internal financial management system by user ID to ensure no users are recording and authorizing their own transactions, and has continued its monitoring efforts by performing monthly reviews of user roles in its internal financial management system, and ensuring no user roles or mapped user permissions may be modified without Director of Fiscal Service's authority. Finally, Fiscal Services will be implementing password protection on electronic reconciliation files to ensure only preparers have read/write access. All other essential Fiscal Services users including reviewers/approvers will have read only access.

Regarding the findings related to Improving Support and Review of Financial Recording, management has taken immediate corrective action to ensure proper oversight of all journal entries by modifying the documents required for reclassification journal entries to require sufficient documented justification, adequate supporting documentation (including Cardinal reports and Oracle Financials reports as appropriate for reconciling journal entries), and review/approval by the Associate Director and/or Director of Fiscal Services for all journal entries prior to being entered and posted in the General Ledger. Further, all correcting or reversing journal entries must include proper supporting documentation and justification.

Regarding the findings related to Performing Adequate Due Diligence before Authenticating and Paying Vendors, the corrective actions to cure this deficiency will be a coordinated effort throughout the agency. The responsibility to ensure proper authentication of invoices prior to being processed for payment in Fiscal Services is shared throughout the agency as Program Offices are responsible to validate invoices for payment, often times requiring assistance from Procurement for purchase orders for goods and services. Fiscal Services will be partnering with the Director of Business Risk Management and the Office of Procurement to jointly develop a training outreach to all DOE employees on the proper handling and processing of vendor invoices, specifically bringing particular attention to educating end users on fraudulent indicators to ensure vendor invoices are necessary items requested by the agency.

Regarding the findings related to Drawdowns of Federal Grant Funds as Instructed and Updated Loan Request with Important Facts, although this finding is being cited in FY2017, the origin of the deficiency occurred in FY2016 during which time the Office of Fiscal Services experienced significant staffing shortages, resulting in a lapse of established internal controls. Additionally, due to the financial management system upgrades in FY2016, the macros and queries used to extract the data for analysis were not functioning appropriately. Fiscal Services has existing controls in place that require monthly analysis of federal expenditures and revenues to ensure federal expenditures are being drawdown timely, and revenues are being recorded timely. The macros and queries have been rewritten; and DOE has been successful in FY2017 in managing its federal cash to prevent omissions similar to what occurred with the SAMHSA funding.

Regarding the findings related to Establishing Sound Budgetary Controls over Disbursements, the Office of Fiscal Services is working with the Office of Education Information Management (EIM) as EIM provides information technology (IT) support for VDOE's grants management system, known as OMEGA. EIM staff has determined the cause of the budgetary controls failure in OMEGA and are working to correct the application code to prevent recurrences. Fiscal Services will also be hosting a Federal Program Managers' training session to reiterate the importance of monitoring at the DOE Program Office level to ensure sub-recipients grants award balances are properly reflected in OMEGA. Fiscal Services has strongly recommended and will continue to recommend that DOE Program Offices conduct (at least) quarterly analyses of sub-recipient grant awards balances to OMEGA activity to identify any irregularities or errors requiring correction.

Regarding the findings related to Requiring the Review and Approval of Reconciliations, DOE wants to clarify that this finding is related exclusively to the reconciliation between DOE's grants management system, OMEGA, and its internal financial management system, Oracle Financials. All reconciliations between Oracle Financials and Cardinal conform to state regulations and are sufficiently documented. Effective in July 2017, Fiscal Services enhanced the weekly OMEGA to Oracle Financials reconciliation process (previously developed in FY2017) by integrating the weekly reconciliation process into the monthly reconciliations process which includes documented reviews and approvals. DOE implemented a weekly reconciliation between OMEGA paid claims and Oracle Financials vouchers processed. Each weekly reconciliation is performed and retained for inclusion with the monthly reconciliation process that is reviewed/approved by Fiscal Services management as part of the monthly reconciliation process prior to certification to the Department of Accounts each month.

Regarding the finding related to Establishing and Implementing Policies and Procedures for Accessing Budgetary Information, the Budget Office will develop documented policies and procedures to ensure access to budgetary information is restricted to authorized Budget Office staff only. Budget will work with VITA to request periodic reports (from VITA) so Budget can review secured accesses and take corrective action, as needed.

Regarding the finding related to Retaining Evidence of Approval for Changes in Local Funding, the Budget Office will modify existing documented policies and procedures governing approvals for changes in local funding calculations to include a contingency plan designed to prevent recurrences should the Budget Office experience management staffing vacancies in the future.

Regarding the finding related to Reviewing the Personnel Management Information Systems Cancelled Records Report, the Office of Human Resources will review the report on a daily basis, and keep a copy of the report on file to document that it was reviewed daily and corrections were made if required.

Regarding the repeat finding related to Continuing to Improve Information Security Program and IT Governance and the new finding related to Improving Database Security, DOE is committed to resolving current and repeat findings in these areas. DOE continues to identify and dedicate as many resources as possible to this end. The agency has made progress since the 2016 audit in completing corrective actions on repeat findings and will continue to focus efforts for completion. Progress has been made with the initial development of an agency information security policy and procedures manual, as well as on requirements related to systems hardening, change controls, risk management, and security awareness. However, work continues in these areas. An MOU has been signed with VITA scheduling security audits of sensitive systems during 2018. DOE will target internal and external resources to address remaining individual findings as well as continue efforts to develop a longer-term, risk-based compliance action plan for the agency information security program. A vendor has been engaged for development of this plan.

Thank you again for the opportunity to provide an agency response to the audit report. The Department of Education is committed to focusing available staff resources to address the very important findings and recommendations identified as needing attention.

Sincerely,

A handwritten signature in blue ink, appearing to read "Steven M. Constantino".

Steven M. Constantino, Ed.D.
Acting Superintendent of Public Instruction

SC/cll

DEPARTMENT OF EDUCATION

As of June 30, 2017

Steven R. Staples
State Superintendent of Public Instruction

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