

AGENCIES OF THE SECRETARY OF FINANCE

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2011**



AUDIT SUMMARY

This report summarizes our fiscal year 2011 audit results for the five agencies under the Secretary of Finance and arises from our work on the Comprehensive Annual Financial Report.

Audit Results

Overall our audit for the year ended June 30, 2011, found the following:

- Proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the agencies' accounting systems.
- Matters requiring management's attention that are included in the section entitled "Comments to Management".
- Adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

System Modernization Projects

This report also includes a status of the Commonwealth's efforts to modernize its accounting and budgeting systems in the section entitled "Comments to Management".

- The Commonwealth implemented Phase 1 of the Cardinal System project in December 2011 with the implementation of the Department of Transportation's financial system. Plans remain intact for phase two of the implementation where the Department of Accounts (Accounts) will go-live in October 2012. Phase three, which involves an incremental roll out to all state agencies, will occur over the next several years.
- The Commonwealth implemented Phase 1 of the Performance Budgeting System in September 2010, which addressed four functional areas: budget development (operating and capital), six-year financial planning, and budget execution. Management temporarily suspended Phase 2 of the project, which addresses agency spending plans and strategic planning, but re-started this phase in December 2011 and has an anticipated completion date of March 2012.
- The Commonwealth has not finalized the funding methodology to support system maintenance and operation costs for these new systems. While the 2011 Appropriation Act introduced a new internal service fund that Accounts will manage to capture fees to support enterprise system administration, the Secretary of Finance and Accounts have not finalized the method for assessing the fee.

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COMMENTS TO MANAGEMENT

Status of System Modernization Projects

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

Cardinal System

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

The first implementation phase of the project occurred in December 2011 with the implementation of Transportation's financial system. Plans remain intact for phase two of the implementation where the Department of Accounts (Accounts) will go-live in October 2012. Phase three, which involves an incremental roll out to all state agencies, will occur over the next several years. Phases two and three of the implementation will provide the Commonwealth's base financial system and will consist of general ledger and accounts payable modules. These modules will provide the foundation for a modern financial system for the Commonwealth with the ability to add other modules and expand functionality in future phases.

The project development and implementation cost budget is \$58 million for phases one and two and Transportation and a working capital advance of approximately \$7.3 million are funding this phase. Transportation is currently funding all operating costs. As of December 2011, project expenses totaled approximately \$49 million. The project development and implementation cost budget is \$57 million for phase three and a working capital advance will fund this phase. Charges through an internal service fund will fund operating costs and repayment of the working capital advance.

Performance Budgeting System

During fiscal year 2011, Planning and Budget and the Virginia Information Technologies Agency (VITA) Enterprise Applications Division continued their efforts to implement the Performance Budgeting System to replace the legacy budgeting systems, Program Budget System (PROBUD) and Form 27 Automated Transaction System (FATS), as well as other ancillary databases, spreadsheets, and documents previously supporting the Commonwealth's strategic planning and budgeting processes. In September 2010, phase one implementation occurred and addressed four functional areas: budget development (operating and capital), six-year financial planning, and budget execution.

In June 2011, management temporarily suspended the phase two implementation, addressing the remaining two areas of agency spending plans and strategic planning. Phase two was originally scheduled for completion in April 2011. This decision allowed the project team to focus on correcting and adding enhancements to the phase one functionality and stabilizing that environment in time for the fall 2011 budget season. The project team re-started phase two activities in December 2011 and anticipates completion of this phase and overall project close out by March 2012. After project close out the system will enter the maintenance phase of the system development life cycle.

Funding for this \$15 million project comes from a working capital advance administered by VITA. The Appropriation Act directs the repayments of the advance from enhanced collections, cost recoveries, inter-agency collaborative projects, and other initiatives. No repayment from these sources has occurred to date.

Enterprise Applications Internal Service Fund

The Commonwealth has not finalized the funding methodology to support system maintenance and operation costs for these new systems. Item 250.10 of Chapter 890, 2011 Acts of Assembly, provides the authority for a new internal service fund that Accounts will manage and authorizes the Secretary of Finance to establish a fee charged to agencies to support enterprise system administration. However, the Secretary of Finance has not finalized the method for assessing the fee. Future changes to these fees will require the Joint Legislative Audit and Review Commission's approval.

Other Reports

Our "Progress Report on Selected Systems Development Projects in the Commonwealth" report, which we plan to issue in February 2012, will include additional details about the status of the Cardinal and Performance Budgeting Systems projects. Further, we are currently performing a separate project to follow up on the progress of the Commonwealth in developing data standards and plan to issue a report on our findings in March 2012.

Modernization of Financial Reporting Processes

Applicable to: Department of Accounts

As we have previously recommended, while a modern financial system will provide some of the flexibility and technology needed, without changing its current financial reporting processes, due to the changing accounting and regulatory environment and reduced administrative personnel at the agency level, there is the risk of the Commonwealth issuing inaccurate financial reports or not being able to comply with state or federal mandates for more comprehensive and timely reporting. We recognize that it takes time to implement these changes and that Accounts has focused their efforts primarily on the development and implementation of the Cardinal System. However, as the Commonwealth moves closer towards implementing the Cardinal System at the statewide level, we continue to stress the importance of Accounts reexamining the Commonwealth's financial reporting process to identify opportunities for improving their use of technology, communication with agencies, and analysis of financial activity.

Improve Contract Administration

Applicable to: Department of Treasury

Treasury's Division of Risk Management (DRM) does not have adequate procedures for documenting and assessing the third party auto claims administrator's compliance with contract provisions. In addition, annual evaluations of the contractor reflect adequate performance. This documentation is not consistent with DRM's action to require changes to the contract prior to its renewal.

Treasury should ensure all contract administrators are performing assessments and evaluations of service contracts using the contract deliverables. Contract administrators should maintain a system for documenting compliance and noncompliance with stated contract terms. Evaluations should reflect the contractor's performance with respect to the terms of the contract agreement. Treasury has taken action to ensure staff formally address contract issues in contract files.

Improve IT Risk Management and Contingency Planning Process

Applicable to: Department of Treasury

Treasury is paying \$117,000 annually for contingency Information Technology (IT) services that, in part, the Commonwealth's IT Infrastructure Partnership with Northrop Grumman is already contractually providing to all agencies. Treasury's current IT services use an outdated business impact analysis and risk assessment that staff prepared before its transition to the Partnership.

Excluding a declared disaster, the IT Infrastructure Partnership is contractually obligated to restore services within four hours if a server fails at the Commonwealth Enterprise Solutions Center, or within eight hours, if a server is on an agency's premises. Both of these timeframes fall within Treasury's indicated business requirements, but are not in its current business impact analysis and risk assessments.

The Commonwealth's Information Security Standard, SEC501-06, requires agencies to update their business impact analysis and risk assessments every three years, or earlier, if the agency's IT environment undergoes a significant change. These analyses and assessments are part of the update to the contingency and disaster recovery plans. Treasury developed the current business impact analysis and risk assessment in July 2008, and since then, Treasury has undergone a significant change in its IT environment as the agency has transformed its IT infrastructure to the IT Partnership.

Treasury started the process to review and update its business impact analysis and IT risk assessment based on the new IT environment in August 2011 and anticipates to have updated all documents, including the continuity of operations and disaster recovery plans, by July 1, 2012. This will allow Treasury to more accurately determine its IT contingency services needs from the Partnership, and avoid paying for unnecessary services.

FINANCE SECRETARIAL OVERVIEW

The Secretary of Finance assists the Governor in the management and direction of the finance agencies and performs program coordination, policy planning, and budget formulation activities. We performed an audit of the financial activity of the Secretary of Finance for the year ended June 30, 2011, and reported our audit results in a separate audit report entitled “The Governor’s Cabinet Secretaries” issued in November 2011.

The Departments of Accounts, Planning and Budget, Taxation, and the Treasury and the Treasury Board report to the Secretary of Finance, and they primarily serve other agencies within the Commonwealth in a central support capacity. The individual audits of these agencies primarily support the audit of the Commonwealth’s CAFR for the fiscal year ended June 30, 2011. These agencies perform critical functions in the Commonwealth’s statewide financial management system, working closely together in the budgeting, management, and reporting of the Commonwealth’s financial resources. Additionally, the agencies provide administrative services to other agencies throughout the Commonwealth. An overview of these activities is included below along with the interaction of the agencies within the Finance Secretariat while performing these activities.

Planning, Budgeting, and Evaluation Services

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

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

During fiscal year 2011, the administrative adjustments processed by Planning and Budget resulted in a \$6.9 billion increase to the Commonwealth’s operating budget and a \$4.2 billion increase to the capital budget. These increases were primarily federal stimulus funding appropriations, re-appropriations of prior year’s balances, and increases for items not estimated in the original budget. We provide more detail on the adjustments in the “Review of Budget and Appropriation Processing and Control System” report referred to below.

We performed a review of the budget and appropriation processing control system administered by Planning and Budget for the fiscal year ended June 30, 2011, primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2011. We plan to issue a separate report on the results of this review in February 2012. In addition, we performed a review of the accuracy, reasonableness, and completeness of key performance measure information reported on the Virginia Performs website, which Planning and Budget maintains. We plan to issue a separate report on the results of this review in March 2012.

Revenue Administration Services

Taxation administers and enforces the tax laws of the Commonwealth. Due to its tax return processing duties, Taxation is the single largest collector of Commonwealth revenue, which it primarily deposits to the General Fund. During fiscal year 2011, Taxation collected \$18 billion in revenue, depositing \$16.2 billion into the General Fund. In addition, both Taxation and Accounts collect money owed to the Commonwealth through a debt set-off program that they jointly administer in accordance with the Code of Virginia's Debt Collection Act.

Taxation collects and distributes Communication Sales and Use Tax and Motor Vehicle Fuel Sales Tax to localities and members of the transportation districts as required by the Code of Virginia. The Appropriation Act budgets these payments as part of Taxation's budget. During fiscal year 2011, Tax distributed \$443.2 million of Communication Sales and Use Tax revenues and \$66.9 million of Motor Vehicle Fuel Sales revenues.

Check Processing and Bank Reconciliation

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

Unclaimed Property Administration

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

Investment, Trust and Insurance Services

Treasury, under the direction of the State Treasurer, invests the Commonwealth's funds and provides trust and insurance services. Treasury manages and invests the Commonwealth's funds throughout the year striving to achieve the highest level of return based on the operational needs of

the Commonwealth. The largest portfolio Treasury manages is the General Account of the Commonwealth, a pool of investments representing assets of the Commonwealth's General Fund, highway maintenance, and transportation trust funds. The General Account has two portfolios: the primary liquidity portfolio and the extended duration and credit portfolio. Treasury internally manages the primary liquidity portfolio, which provides the major source of liquidity for the disbursement requirements and operational needs of the Commonwealth. The externally managed "Extended Duration and Credit Portfolio" seeks to generate higher total returns over time. Treasury's target allocation for the overall general account asset mix is 75 percent for the primary liquidity pool and 25 percent for the total return pool.

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

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

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

We performed an audit of the financial activity of the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority for the year ended June 30, 2011, and reported our audit results in a separate audit report issued in December 2011.

Bond and Loan Retirement and Redemption

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

- Exercise general supervision over the investment of state funds
- Administer the Virginia Security for Public Deposits Act
- Control and manage sinking and other funds that the Commonwealth holds as fiduciary

- Contract with an outside manager for the administration of the State Non-Arbitrage Program
- Provide advice and supervision in the financing of state buildings
- Approve the terms and structure of proposed state educational institution bond issues and other financing arrangements
- Approve the terms and structure of proposed bond issues secured by state appropriations
- Administer the regional jail financing reimbursement program
- Issue all general obligation debt of the Commonwealth
- Manage its bond issues in compliance with federal taxation and arbitrage laws

In addition, the Treasury Board makes payments to the Virginia College Building Authority and the Virginia Public Building Authority for lease payments and/or bond principal and interest on the Authorities' appropriation-supported debt. The Board also pays debt service on Article X, Section 9(b) general obligation bonds and processes debt service payments to trustees and/or paying agents on behalf of the Commonwealth Transportation Board.

Financial Systems Development and Management

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

Accounting Services

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

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

Accounts calculates and distributes certain revenues collected by Taxation to local governments as required by the Code of Virginia. The Appropriation Act budgets and Accounts records these transfer payments under a separate agency number. Accounts distributed the following amount of revenue during fiscal year 2011.

Sales and use tax for education	\$1,121,155,855
Personal Property Tax Relief Act	950,000,000
Recordation taxes	18,277,569
Other	<u>2,462,077</u>
Total	<u>\$2,091,895,501</u>

Source: Commonwealth Accounting and Reporting System

Accounts also made recordation tax transfers to the Department of Transportation for the Northern Virginia Transportation District Fund and the Transportation Improvement Set-Aside Fund in the amounts of \$8,000,000 and \$765,305, respectively.

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

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

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

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

Service Center Administration

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

AGENCY FINANCIAL INFORMATION

The following information provides a summary of budget and actual expenses of each of the finance secretariat agencies. General Funds are the primary resource for funding the Secretary of Finance agencies' operations and account for approximately 82 percent of the overall operating expenses. The original operating budget for agencies in the Finance Secretariat totaled approximately \$134.9 million. The final operating budget for agencies totaled \$146.9 million, an increase of \$12 million as a result of various budget adjustments.

Taxation's budget increased by \$8.2 million, primarily due to changes in service rates for information technology services charged by VITA as required by Chapter 890 of the 2011 Virginia Acts of Assembly. Accounts' budget increased by approximately \$2.2 million, with the majority attributable to funding provided for the operation of an internal service fund for the Payroll Service Bureau. The remaining increase is due to other miscellaneous changes throughout the agencies. During fiscal year 2011, the actual expenses of each of the Finance Secretariat agencies was less than the final budgeted expenses primarily as a result of the agencies' efforts to reduce administrative expenses in anticipation of further budget cuts.

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

Summary of Budget and Expenses for 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Secretary of Finance	\$ 420,423	\$ 432,821	\$ 432,401
Department of Accounts	10,802,237	13,035,368	12,687,968
Department of Planning and Budget	6,980,312	7,217,906	6,280,152
Department of Taxation	98,629,115	106,870,517	99,254,576
Department of the Treasury	<u>18,107,145</u>	<u>19,322,727</u>	<u>17,366,296</u>
Total – Finance Agencies	<u>\$134,939,232</u>	<u>\$146,879,339</u>	<u>\$136,021,393</u>

Source: Commonwealth Accounting and Reporting System

The following table summarizes the type of expenses each of the Finance Secretariat agencies incurred during fiscal year 2011. The majority of expenses in the Finance Secretariat are for personal services (approximately 62 percent) and contractual services (approximately 33 percent).

Analysis of Expenses by Type
(Dollars in Thousands)

	<u>Finance</u>	<u>Accounts</u>	<u>Planning and Budget</u>	<u>Taxation</u>	<u>Treasury</u>
Personal services	\$416	\$ 9,346	\$4,755	\$61,263	\$ 8,396
Contractual services	10	1,721	1,207	34,311	7,046
Supplies and materials	2	42	15	332	319
Transfer payments	-	2	7	186	851
Continuous charges	4	465	293	2,846	606
Equipment	-	709	3	317	148
Plant and improvements	<u>-</u>	<u>403</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$432</u>	<u>\$12,688</u>	<u>\$6,280</u>	<u>\$99,255</u>	<u>\$17,366</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

January 27, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

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

We have audited the financial records and operations of the agencies under the **Secretary of Finance** for the year ended June 30, 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our primary audit objectives for the audit of the Departments of Accounts, Planning and Budget, Taxation, and the Treasury for the fiscal year ended June 30, 2011, include the following:

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

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

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

Audit Scope and Methodology

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

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

Department of Accounts

Financial Reporting*

Commonwealth Accounting and Reporting System (CARS)

Commonwealth Integrated Payroll/Personnel System (CIPPS)

Fixed Asset Accounting and Control System (FAACS)

Lease Accounting System (LAS)

Department of Planning and Budget

Performance Budgeting System

Budget Execution

Department of Taxation

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

Department of the Treasury (including Treasury Board operations)

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

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

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

Audit Conclusions

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

We found that agencies included in the Secretary of Finance properly stated, in all material respects, the financial and budgetary transactions related to their administrative activities recorded and reported in CARS. The financial information presented in this report related to the administrative activities of the agencies came directly from CARS and is recorded on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

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

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

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

We found that budget adjustments were properly approved and documented.

We noted matters at Treasury involving internal controls and compliance with applicable laws and regulations that are required to be reported under Government Auditing Standards that are described in the findings entitled "Improve Contract Administration" and "Improve IT Risk Management and Contingency Planning Process" in the "Comments to Management" report section.

We have included a status of the Commonwealth's efforts to modernize its financial and budgeting systems and financial reporting processes in the "Comments to Management" report section.

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

Exit Conference and Report Distribution

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

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

AUDITOR OF PUBLIC ACCOUNTS



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

February 3, 2012

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

Dear Mr. Kucharski:

The Department of Accounts (Accounts) appreciates the opportunity to respond to the *Comments to Management* contained in your 2011 Secretary of Finance Audit Report. We give your comments the highest level of importance and consideration as we continue to review and improve our current practices. Accounts appreciates your acknowledgement of the progress made and the recognition that some issues take significant time and resources to resolve.

Comments to Management

Modernize Financial Systems and Processes (Status of Prior Year Risk Alert)

Financial Systems

Accounts understands the risks associated with older computer systems and ramifications of potential system failures. Additionally, Accounts appreciates your role in helping to ensure the Commonwealth is appropriately addressing these risks. As noted in previous years, Accounts has been directly involved in Cardinal project over the past several years. The State Comptroller is one of the project sponsors and the Assistant State Comptroller of Accounting and Reporting is a voting member of the Enterprise Steering Committee. Additionally, Accounts has assigned two permanent project members to the Cardinal project. Accounts is pleased with the successful implementation of Phase 1 and is actively planning for the implementation of Phase 2. Accounts also recognizes the benefits of adopting standardized data requirements and several senior management representatives are participating on the project team to develop these standardized data requirements.

Financial Reporting Processes

Accounts appreciates the recognition that the financial landscape is changing and that additional process changes are required to successfully navigate additional reporting complexities arising from new accounting standards, laws and regulations at the same time we are facing decreasing numbers of financial reporting staff in the Commonwealth. The Department of Accounts' General Accounting and Financial

Reporting Divisions are striving to identify new programs or changes to existing programs in order to evaluate the appropriate accounting and reporting treatment. Additionally, the Financial Reporting Division has incorporated, and continues to explore the expanded use of, databases into the reporting process. Accounts will continue using a risk-based approach when evaluating agency financial information. The Financial Reporting Division will continue to evaluate both efficiency and effectiveness of agency processes when performing agency reviews. Accounts will strive to continue partnership arrangements with line agencies to facilitate the agencies' understanding and process improvements. Accounts will continue to evaluate the best means of communicating with agencies and will strive to provide policies and procedures governing the Cardinal project prior to implementation.

Sincerely,

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

David A. Von Moll

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



COMMONWEALTH of VIRGINIA

Department of the Treasury

January 5, 2012

MANJU S. GANERIWALA
TREASURER OF VIRGINIA

P. O. BOX 1879
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Mr. Walter J. Kucharski
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Mr. Kucharski:

The Department of the Treasury (Treasury) appreciates the opportunity to respond to the *Internal Control and Compliance Findings and Recommendations* contained in your 2011 Secretary of Finance Report. Your comments and recommendations are appreciated and given the highest level of importance by the Administration and Treasury as we strive to continue to improve our current practices.

Improve Contract Administration

Treasury concurs with this finding to ensure all contract administrators are performing assessments and evaluations of service contracts using contract deliverables and are maintaining a system for documenting compliance and noncompliance with stated contract terms. This documentation is essential in providing an audit trail and justification for decisions and evaluations regarding contracted service providers and their performance.

Treasury maintains a procurement policy to review and evaluate each of its contracted service providers and their performance annually with a formal evaluation that is maintained in the contract files. These annual evaluations are reviewed by management prior to any contract renewals and at the maturity date of the contract. Corrective action has been taken to ensure contract administrators formally address contract issues in the contract files as they occur and to reflect such actions and subsequent resolution in the annual contractor evaluations.

Improve IT Risk Management and Contingency Planning Process

Treasury concurs with this finding and is keenly aware that the Business Impact Analysis and Risk Assessments must be reviewed and updated to reflect the current changes in our IT environment. The Business Impact Analysis and Risk Assessments will be completed no later than the end of the fiscal year. These documents will be used to update the COOP and disaster

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recovery programs to ensure Treasury resources are safeguarded and protected in the most technologically reliable and cost efficient manner available to Treasury. A review of these documents will allow Treasury to more accurately determine our IT continuity of operations and disaster recovery needs, recovery time objectives, and the feasibility and capability of our disaster recovery needs being provided by the Partnership.

Sincerely,

A handwritten signature in black ink, reading "Manju Ganeriwala". The signature is fluid and cursive, with the first name "Manju" and last name "Ganeriwala" clearly distinguishable.

Manju S. Ganeriwala

c: The Honorable Richard D. Brown, Secretary of Finance
Robert S. Young, Chief Deputy State Treasurer

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2011

Richard D. Brown
Secretary of Finance

David A. Von Moll
Comptroller

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

Craig M. Burns
Tax Commissioner

Manju S. Ganeriwala
Treasurer