# AGENCIES OF THE SECRETARY OF FINANCE

## REPORT ON AUDIT

## FOR THE YEAR ENDED

## JUNE 30, 2005

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

# AUDIT SUMMARY

This report summarizes our fiscal year 2005 audit results for the five agencies under the Secretary of Finance. The report also includes an analysis of budget and actual activity during the year for each of the agencies.

Overall, our audits of finance agencies for the year ended June 30, 2005, found:

- matters involving internal control and its operations at the Department of Planning and Budget that we communicated to management in the separately issued report entitled "Report on Budget and Appropriation Processing Control System, For the Fiscal Year Ended June 30, 2005";

- recommendations for improving the financial accounting and control operations of the State Comptroller, which we communicated to management in a separately issued report entitled "Review of the Financial Accounting and Control Operations of the State Comptroller, Final Report November 2005"; and

- no instances of noncompliance or other matters with applicable laws and regulations tested that are required to be reported under Government Auditing Standards.

Our report also includes a status of recommendations we made in prior audits to the Departments of Accounts and Treasury to improve the process used to prepare the Comprehensive Annual Financial Report (CAFR). In light of new standards that the American Institute of Certified Public Accountants has proposed, we believe Accounts and Treasury should place additional emphasis on improving the financial reporting process.

If these standards were in place today, there is the potential for a material weakness in the internal controls over the preparation of the annual report due to the number of adjustments that we proposed. A material weakness is the worst category of internal control weakness. A material weakness indicates that internal controls are not sufficient to ensure that the financial statements are free of material misstatements.

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## FINANCE SECRETARIAL OVERVIEW

The Departments of Accounts, Planning and Budget, Taxation, and Treasury and the Treasury Board report to the Secretary of Finance. These agencies manage the financial and budgetary transactions of the Commonwealth of Virginia (Commonwealth), from collecting taxes and processing payroll expenses, to distributing aid to localities. Responsibilities include, but are not limited to:

- maintaining the Commonwealth's centralized operating systems;
- preparing the Commonwealth's year-end financial statements;
- distributing certain state revenues to localities;
- overseeing the Commonwealth's strategic planning and performance measurement efforts;
- preparing and executing the Commonwealth's budget;
- forecasting and collecting revenues;
- administering tax laws for individuals and corporations; and
- managing the Commonwealth's cash, investments, and debt.

General Funds are the primary resource for these operations and account for approximately 69 percent of the overall budget for the finance area. The original operating budget for agencies in the finance secretariat totaled nearly $130 million. Agencies requested various budget adjustments that the Department of Planning and Budget approved, which resulted in a final operating budget of approximately $159 million, an increase of $29 million. The increase was primarily due to the Department of Taxation and included a $14.5 million increase in the Technology Partnership Fund for contract payments related to the implementation of the Integrated Revenue Management System and a $2.8 million increase in the Contractor Collection Fund to fund contracts between Taxation and private collection agencies. In addition, $2 million is attributable to an increase in the Department of Account's budget for payments to the federal government for internal service fund over-recoveries. The remaining increase is due to $6.3 million in reappropriations to carry forward cash balances and $3.4 million in miscellaneous changes at various agencies.

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 2005

| | Original Budget | Final Budget | Expenses |
|---|---|---|---|
| Secretary of Finance | $ 443,954 | $ 507,046 | $ 488,642 |
| Department of Accounts | 8,224,413 | 10,759,755 | 10,399,067 |
| Department of Planning and Budget | 5,801,734 | 6,248,333 | 5,807,417 |
| Department of Taxation | 98,665,228 | 121,558,335 | 111,959,418 |
| Department of the Treasury | 16,650,344 | 20,081,689 | 18,444,580 |
| Total – Finance Agencies | $129,785,673 | $159,155,158 | $147,099,124 |

*Source: Commonwealth Accounting and Reporting System*

## SECRETARY OF FINANCE AUDIT RECOMMENDATIONS

### Obtain Assurance over Security and Information Technology Infrastructure

*Agencies:* *Department of Accounts, Department of the Treasury, Department of Planning and Budget, and Department of Taxation*

State Information Technology Policy makes all agency heads, including the Tax Commissioner, the Comptroller, the Treasurer, and the Director of Planning and Budget, responsible for the security and safeguarding of all databases, information, and information technology assets. Over the past two years, the Commonwealth has moved the information technology infrastructure supporting these databases and information to the Virginia Information Technology Agency (VITA). As part of this transfer, the agencies also transferred many of the staff who had the expertise to advise the agency heads on these matters.

Since VITA has assumed responsibility for the information technology infrastructure, the agency heads must have VITA provide assurance that their infrastructure provides the safeguards to protect information and databases required by state policy. We believe that the agencies cannot solely ensure that their data has the proper level of security to protect it from unauthorized changes, disclosure, or loss now that these resources and authority have been shifted to VITA.

The agency heads need to evaluate the agencies' capabilities for determining the level of assurance needed from VITA. Since the agencies retain ownership and maintain the application systems and databases that gather information, the agencies' internal staff has full responsibility for access controls to these systems. If these systems operate in a shared environment, the provider of the shared services would need to assure the agency heads of the adequacy of those controls. This shared environment is the same as the mainframe data center operation that VITA and its predecessors offered. While the agencies and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in this shared environment, the current MOU does not address the security levels required by the individual agencies.

For the secure transmission of information to and from the database, the agency heads must address whether the agencies have the expertise to assess this issue. Inherent within this question is whether the agencies have the resources to maintain the level of expertise capable of adapting to the changing infrastructure environment. There are two potential approaches to this issue. The first assumes the agencies have the expertise and the resources to understand the changing infrastructure and can therefore specifically address all security needs. The second approach requires that the agencies explain in detail, to VITA, the security needs for each of their systems and databases along with what access controls they currently provide. VITA then must provide the agency heads assurance that the infrastructure provides the level and depth of security necessary to meet state policy.

Under this second approach, VITA and the agency heads clearly share responsibility for the security of information and databases. It is our opinion that while the agencies may currently have the resources to undertake the first approach, the long-term changes at VITA dictates that the agency heads use the second approach. Each agency should continue developing an MOU with VITA to define the security levels required for their data and require that VITA provide, at least annually, written assurance so the agency heads can fulfill their responsibilities related to security requirements.

# STATUS OF PRIOR YEAR RECOMMENDATIONS

## *Review of Statewide Reporting Process*

In March 2005, we issued a report entitled 'Review of Statewide Reporting Process,' which included recommendations for Accounts and Treasury to improve the process used to prepare the CAFR. Since we issued this report, the American Institute of Certified Public Accountants has proposed several auditing standards that place additional emphasis on internal controls over financial reporting.

If these standards were in place today, there is the potential for a material weakness in the internal controls over the preparation of the annual report due to the number of adjustments that we proposed. A material weakness is the worst category of internal control weakness. A material weakness indicates that internal controls are not sufficient to ensure that the financial statements are free of material misstatements.

Once these standards become effective with the fiscal year ended June 30, 2007, it becomes even more imperative that Accounts and Treasury implement these recommendations especially in the area of improving agency guidance and relationships since several of our adjustments were to correct erroneous information Treasury and other agencies provided. While this is not the first year in which we have made material adjustments to the financial statements, Accounts experienced turnover in its Financial Reporting Division, which resulted in delays in providing us information to audit and may have contributed to the number of adjustments in the current year.

Under the new standards, Accounts will need to change its current process to identify and correct erroneous information before submitting it for audit and not rely on the audit as a key review of agency data submission and the financial statements. We appreciate the opportunity to provide input before Accounts implements significant accounting and reporting changes. However, the audit cannot serve as a substitute for the Comptroller's responsibility to ensure staff in all agencies, including Accounts, have appropriate training and information about the financial statement preparation process.

Accounts and Treasury have made progress in improving the financial reporting process and continue to evaluate and implement our recommendations from the prior year and we recognize that these changes cannot occur in a short period of time. In light of the new standards discussed above, we believe Accounts and Treasury should place additional emphasis on improving the financial reporting process. We commend the agencies on their efforts to address this issue thus far and anticipate continuing progress in response to our recommendations. Below we have provided a status of the recommendations made in each of the identified areas.

*Prior Year Recommendation:* *Automate Processes*

*Financial Reporting for the State Non-Arbitrage Program (SNAP)* – Accounts met with Treasury to discuss and review the SNAP financial information provided by the new SNAP administrator and to determine how to report the information in the annual report. While Accounts and Treasury addressed our specific recommendations, Treasury should evaluate and report to the Department of Accounts SNAP Program activity on an on-going basis to determine if changes in accounting and reporting are necessary. This may lead to a change in reporting in future financial statements and could result in a restatement of prior year activity. We continue to recommend that Accounts and Treasury be proactive in reviewing and communicating the nature of their operations to ensure they appropriately report financial activity.

*Debt Database* – Accounts and Treasury relied on the debt database, which helped improve the efficiency of the financial statement preparation process. However, due to differences between the information in the database and the accounting system, Accounts had to perform additional procedures to determine the proper reporting of the information. While there will always be differences between the database and accounting system, Accounts should work with Treasury to minimize reconciling differences and determine the most efficient method to reconcile this information. Further, the database does not contain financial activity related to bond premiums and discounts, which Accounts accumulated manually. Accounts and Treasury should determine the most efficient way to track and accumulate this information.

*Program Automation* – We recommended that Accounts and Treasury consider purchasing accounting software to increase the efficiency of the financial statement preparation process and utilizing a web-based approach to accumulate financial information that agencies submit. Accounts evaluated our recommendation and does not plan to implement either of these options at this time.

The Commonwealth's primary accounting system limits Accounts' ability to expedite the financial reporting process since it is basically a general ledger and cash receipts and disbursement system, and therefore does not provide much of the information such as accounts receivable and long-term financial obligations that is necessary to prepare the annual report. During the past year, the Governor received and accepted a private/public partnership proposal to re-engineer state processes and develop an enterprise architecture that could replace all current statewide systems and some agency based systems. Therefore, Accounts does not want to expend resources on purchasing new accounting software or developing a web-based system since this project is underway.

Treasury is currently researching other investment systems to account for the investments of the Local Government Investment Pool and the Treasurer's General Account in a more efficient and cost effective manner. Treasury is also exploring the procurement of an off-the-shelf general ledger package to provide accounting and financial reporting for the Virginia College Building Authority and the Virginia Public Building Authority. We recommend that Treasury consider whether it should continue to pursue this option in light of the project to develop an enterprise architecture for the Commonwealth.

If Accounts and Treasury choose to wait on the development of a new system, then at a minimum, they should fully consider and communicate to the appropriate parties the financial reporting requirements as part of the system development process. Accounts and Treasury should emphasize to decision makers the importance of financial reporting and its impact on the Commonwealth's bond rating. Further, both Accounts and Treasury should look for ways to fully utilize the capabilities that are currently available using Microsoft Excel, consider obtaining additional data accumulation and analysis software and tools, and obtain training for its staff on using these tools to achieve efficiencies in accumulating and analyzing data.

*Recording Financial Transactions* – Accounts worked with agencies to ensure that they recorded the necessary entries in the fixed asset system, which eliminated the need for Accounts to prepare the manual journal entries. We continue to recommend that Accounts identify opportunities for improving the manner in which agencies record data to reduce the manual processes needed to accumulate and properly reflect activity in the financial statements.

*Prior Year Recommendation: Methods of Collecting Financial Information*

Accounts determined that its primary concern for financial reporting is accuracy and believes that using alternative methods of gathering financial data could reduce the accuracy of the annual report. We continue to believe that if Accounts worked with agencies to devise methodologies for estimating and tracking activity instead of waiting for actual data, they would receive data in a more timely manner. This would enable Accounts to better analyze data and identify errors, which would result in more accurate financial reporting.

*Prior Year Recommendation: Agency Guidance and Relationships*

Accounts has determined that the primary reason for inefficiencies in the financial statement preparation process is the quality of financial information received from the agencies, which results in adjustments that make both preparing and auditing the information inefficient. Therefore, Accounts provided mandatory financial statement directive training for all agencies submitting financial information. Accounts has compiled a list of agencies that have historically submitted numerous revisions and/or erroneous information and plans to provide customized training for those agencies. Accounts continues to develop its quality assurance function and has identified several areas to concentrate its efforts when working with the agencies. We recommend that Accounts continue to work with agencies to ensure they understand their role in the financial statement preparation process and to identify ways to improve the accuracy and timeliness of the information they provide to Accounts.

Accounts and Treasury have worked together to further understand each other's role in the financial statement preparation process. However, several material audit adjustments were still necessary in order to properly reflect activity for which Treasury was responsible. Accounts and Treasury should evaluate the areas where we proposed audit adjustments and determine why the adjustments were necessary, how to prevent these issues in the future, and whether there are other potential areas with similar issues.

Accounts has worked with both the Department of Human Resource Management and the Virginia Retirement System in its efforts to determine the impact of a new accounting standard that the Commonwealth will be required to implement beginning in fiscal year 2008 related to post employment benefits other than pensions. Further, Accounts has drafted language to be included in the Appropriation Act to establish irrevocable trust funds to account for some of this activity. We recommend that Accounts continue its approach to ensuring successful implementation of and compliance with the new accounting standard.

*Prior Year Recommendation: Update Procedures in a Timely Manner*

Accounts updated its procedures timely and provided them to the auditors. However, we noted areas where the procedures did not accurately reflect the process Accounts' staff used to prepare the financial statements. While we recognize Accounts improvements in this area, we recommend that Accounts continuously review and update its procedures and solicit input from the agencies that provide significant data as to any changes either in the nature of the activity for their agency or the method in which they will accumulate and provide information to Accounts. In addition, we recommend that Accounts ensure its staff is appropriately following the procedures since they serve as an important internal control over the financial reporting process.

*Prior Year Recommendation: Schedule of Expenditures of Federal Awards*

We made several recommendations related to Accounts preparation of the Schedule of Expenditures of Federal Awards. We are currently auditing the 2005 schedule and therefore are still evaluating Accounts' progress on implementing our recommendations. We have noted improvements in the current year process in that we have made only minimal changes and have noted no issues with the operation of the database that Accounts uses to accumulate the information. In addition, Accounts is actively seeking training opportunities for its staff on federal regulations. Now that Accounts has resolved some of the issues with accuracy, they should concentrate on making the process more efficient, which would enable them to complete the schedule at an earlier date. This would provide us additional time to conduct our audit and meet the federally mandated audit deadline.

*Prior Year Recommendation: Management Structure*

As part of its 2006-2008 biennial budget package, Treasury requested funding for an additional senior level accounting position to assist with the agency's financial accounting and reporting responsibilities. In addition to adding this new position, in fiscal year 2006 management divided Trust Accounting responsibilities between two accounting managers that both report to the division director to provide a more equitable distribution of work.

Treasury has also created a cross-training plan that when fully implemented will have a trained backup person for every task. Treasury should ensure that backup staff performs the task at a minimum of once every six months.

*Prior Year Recommendation: Performance Management*

As Treasury continues to automate their accounting and reporting processes, management should also ensure its monitoring of performance is efficient.

## INDIVIDUAL AGENCIES

The following provides more detailed information for each of the finance agencies, including the original budget, final budget, and actual results. The report presents this information in two tables as discussed below.

Analysis of Budgeted and Actual Funding by Source – This table shows resources included in the original budget, final budget, and actual funding for the fiscal year ended June 30, 2005. The funding sources for the original budget, final budget, and actual funding results come from the Commonwealth Accounting and Reporting System.

Analysis of Budgeted and Actual Expenses by Program – This table shows original budgeted expenses by program, final budgeted expenses by program, and actual expenses by program for the fiscal year ended June 30, 2005. The original budgeted expenses, final budgeted expenses, and actual expenses by program come from the Commonwealth Accounting and Reporting System.

### Secretary of Finance

#### *Audit Scope*

We performed an audit of the financial activity of the Secretary of Finance for the year ended June 30, 2005. We reported our audit results in a separate audit report entitled "The Governor's Cabinet Secretaries" issued in September 2005.

#### *Financial Summary*

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. The following schedules provide information on the operating budget and expenses for fiscal year 2005.

Analysis of Budgeted and Actual Funding By Source

| Funding source: | Original Budget | Final Budget | Actual Funding |
|---|---|---|---|
| General Fund appropriations | $443,954 | $507,046 | $507,046 |

The Secretary's budget increased by approximately $63,000 due to additions from the 2005 General Assembly Session, a deficit loan per §4-3.01a(2c) of Chapter 4, salary and fringe benefit increases, and other adjustments.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

| | Program Expenses | | | Funding Sources |
|---|---|---|---|---|
| Program: | Original Budget | Final Budget | Actual Expenses | General Fund |
| Administrative and support services | $443,954 | $507,046 | $488,642 | $488,642 |

## Department of Accounts

### *Agency Overview*

The Department of Accounts (Accounts) provides a uniform system of accounting, financial reporting, and internal controls adequate to protect and account for the Commonwealth's financial resources. Accounts' major activities include the following:

1) Maintaining a complete general accounting system to record the financial transactions of every state department, division, officer, board, commission, institution, or other agency owned or controlled by the Commonwealth.

2) Preparing the CAFR as a whole.

Accounts has eight divisions including Administrative Services, State Payroll Operations and Charge Card Administration, the Payroll Service Bureau, General Accounting, Financial Reporting, the State Internal Auditor, and two Information Resource Management Divisions. The Payroll Service Bureau processes agency level payroll, leave accounting, and certain benefits data entry functions for selected agencies. The Division of State Internal Audit administers the Fraud, Waste, and Abuse Hotline, coordinates training for agency internal auditors, and assists in the review of statewide internal controls and procedures. Information Resource Management consists of two divisions within Accounts that provide "check and balance" controls over Accounts' systems. The Systems Analysis and Programming Division develops and maintains applications. The Database Administration Division operates the production environment, which includes hardware, software, and systems security. Accounts' remaining divisions are discussed in more detail below.

### *Central Systems*

Accounts, under the direction of the State Comptroller, maintains the Commonwealth's centralized automated accounting, payroll, and fixed asset systems. The Commonwealth Accounting and Reporting System (CARS) is a cash-basis accounting system, used to record 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 leases. Accounts ensures there are adequate controls over the centralized systems.

### *Administrative Services*

The Administrative Services Division within Accounts provides support services such as accounting, human resources, and payroll and benefits administration to Accounts as well as several other agencies. The agencies to which they provide services include the Department of the Treasury, the Department of Planning and Budget, the State Council on Higher Education of Virginia, the Commonwealth Health Research Board, and Virginia College Savings Plan. The Division also is responsible for the storage and management of public records and for publishing and maintaining several publications on Accounts' website.

Administrative Services has also taken over the responsibility for processing Line of Duty Act payments to beneficiaries of certain public safety officers who die or become disabled from work related causes. Under this Act, the death of certain public safety officers entitles their beneficiaries to receive a lump sum payment. The Division also makes monthly payments for health insurance for surviving spouses, disabled officers and their spouses, and dependents, which has significantly increased the workload required to administer this Act.

### *State Payroll Operations and Charge Card Administration*

The State Payroll Operations and Charge Card Administration Division operates and maintains CIPPS and is responsible for all aspects of the payroll process including payroll production, payroll and benefits accounting, and agency assistance and training. This Division grants and monitors system access to the various agencies and institutions that utilize CIPPS and performs a daily reconciliation of all payroll disbursements recorded in CIPPS to amounts recorded in CARS. In addition, the Division administers the Commonwealth's purchase and travel charge card programs.

### *General Accounting*

The General Accounting Division's primary responsibilities concern the operation and maintenance of CARS as required by the Code of Virginia. General Accounting activities include developing and issuing policies and procedures for entering transactions in CARS and offers periodic training courses. The Division also monitors CARS activity, provides assistance to agencies, performs daily cash reconciliations, and resolves errors as necessary. They also process 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 the Department of the Treasury on the Commonwealth's cash and investments as required by the Code of Virginia and Appropriation Act.

General Accounting also calculates and distributes certain revenue collections 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 the year:

| | |
|---|---|
| Sales and use tax for education | $ 988,183,990 |
| Recordation taxes | 18,320,855 |
| ABC profits | 4,150,000 |
| Wine taxes | 4,350,000 |
| Rolling stock taxes | 5,208,920 |
| Public facilities rebate tax | 606,463 |
| Other | 111,884 |
| Total | $1,020,942,112 |

*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 $20,545,401 and $1,133,742, respectively.

*Financial Reporting*

The Financial Reporting Division's primary responsibilities are the preparation of various financial reports and schedules related to the Commonwealth's financial activity including the following:

- the CAFR
- the General Fund preliminary report
- the Popular Annual Financial report
- the federal and full-costing Statewide Indirect Cost Allocation Plan, as required by the Appropriation Act
- the Statewide Schedule of Expenditures of Federal Awards

The Division annually issues a series of financial statement directives with guidelines for agencies, higher education institutions, and authorities for submitting information to the Division for use in the report preparation process. The Division also uses data from the CARS in preparing its reports. The Division provides assistance to agencies, as necessary, throughout the year on financial reporting issues. In addition, Financial Reporting operates and maintains FAACS and LAS and provides guidance to agencies concerning the recording and reporting of capital assets and leases through policies and procedures and training it offers periodically.

*Audit Scope*

We performed an audit of the Department of Accounts' financial operations for the fiscal year ended June 30, 2005. We also performed an audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2005. We followed up on recommendations made in the prior year report related to a review of the statewide reporting process used by Accounts, which is included in the report section entitled "Status of Prior Year Recommendations."

During the year, we issued a separate audit report entitled "Review of the Financial Accounting and Control Operations of the State Comptroller – Final Report," which also covers the operations of Accounts. We included numerous recommendations for improving the financial accounting and control operations practices of the State Comptroller.

*Financial Summary*

The following schedules provide information on Accounts' operating budget and expenses for fiscal year 2005.

Analysis of Budgeted and Actual Funding By Source

| Funding source: | Original Budget | Final Budget | Actual Funding |
|---|---|---|---|
| General Fund appropriations | $8,182,413 | $10,717,755 | $10,717,755 |
| Special Revenue Funds | 42,000 | 42,000 | 42,000 |
| Total resources | $8,224,413 | $10,759,755 | $10,759,755 |

During the fiscal year, Accounts' General Fund appropriations increased by approximately $2.5 million. Approximately $2 million of the increase is attributable to payments to the federal government for internal service fund over-recoveries. The Appropriation Act contains the authority for Accounts to make these payments, but does not include a budget amount since the payments can vary significantly from year to year. The schedule below illustrates this variance at the program level.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

| | Program Expenses | | | Funding Sources | |
|---|---|---|---|---|---|
| Program: | Original Budget | Final Budget | Actual Expenses | General Fund | Special Revenue Funds |
| Administrative and support services | $2,736,977 | $ 4,882,889 | $ 4,872,243 | $ 4,872,243 | $ - |
| Financial systems development and management | 1,702,329 | 1,721,476 | 1,556,346 | 1,556,346 | - |
| Accounting services | 3,397,749 | 3,736,904 | 3,562,657 | 3,522,332 | 40,325 |
| Service center administration | 387,358 | 418,486 | 407,821 | 407,821 | - |
| Total uses | $8,224,413 | $10,759,755 | $10,399,067 | $10,358,742 | $40,325 |

## Department of Planning and Budget

### *Agency Overview*

The Department of Planning and Budget is the central budgeting agency for state government and is responsible for developing and administering the state budget, which allocates money for state agencies and institutions. Planning and Budget conducts policy analyses and evaluations of state programs and services, and coordinates statewide strategic planning and performance measurement efforts. In addition, Planning and Budget operates a budget system to ensure that agencies conduct their activities within fund limitations provided in the Appropriation Act (Act) and in accordance with gubernatorial and legislative intent. Planning and Budget receives General Fund appropriations for all standard operating expenses.

The Governor and Planning and Budget have certain statutory authority to increase, decrease, or transfer funds and personnel positions during the fiscal year within constraints set forth in the Act. Section 4-1.00 of the Act is the primary source of this authority, but there are also general statutory requirements and other requirements throughout the Act.

During fiscal year 2005, Planning and Budget processed over 5,500 budget adjustments with the net effect of a $3.1 billion increase to the Commonwealth's operating budget and a $3.7 billion increase to the capital budget. These increases were primarily reappropriations of prior year's balances, increases for additional revenues collected not included in the original budget, and increases for items not estimated in the original budget.

### *New Performance Management Structure*

At the direction of the Council on Virginia's Future, Planning and Budget is in the process of developing a new performance management structure to provide a link between strategic planning and resource allocation. The new structure, effective for the 2006-2008 biennium, will use a service area approach for budgeting and accounting, as well as strategic planning and performance measurement. Agencies previously used a structure of programs and subprograms for budgeting and accounting while they based agency strategic planning and performance measurement on activities.

### *Central Systems*

The Web-based Budget Entry and Report System (Web BEARS) allows state agencies to develop and submit their budget requests to Planning and Budget over the Internet. Planning and Budget replaced its online Program Budgeting System (PROBUD) with Web BEARS. The only active component of PROBUD is the Form 27 Automated Transaction System (FATS). FATS is the mechanism for executing budget actions (funding and employment levels) authorized through the Act. Web BEARS allows Planning and Budget analysts to enter budget recommendations. Web BEARS also handles capital requests and recommendations, and it provides Planning and Budget staff with a variety of balancing reports that they extracted from online PROBUD in past years.

Planning and Budget maintains the Electronic Fiscal Impact Statement System (EFIS). Planning and Budget and other selected state agencies use EFIS to assign, track, develop, and submit Fiscal Impact Statements (FIS) on proposed legislation. The agencies generally use the system during the Virginia General Assembly session. FIS documents are accessible to the public on the General Assembly's Legislative Information System.

*The Virginia Regulatory Town Hall*

The Town Hall website exposes Virginians to regulations. It provides interested parties with access to a wide range of documents, including text of proposed regulations, background documents, economic impact analyses, guidance documents, an online means for commenting on regulations, and an opportunity to sign up to receive e-mail notifications about regulations and meetings.

*Virginia Results*

Virginia Results is the Commonwealth's main site for information on the performance of government agencies. It is comprised of two primary processes - strategic planning and performance measurement. These processes work together to better manage the performance of state government. Virginia Results is a Planning and Budget requirement as outlined in the Code of Virginia Section 2.2-1501. The Department is in the process of replacing Virginia Results with a new system that will incorporate information from the new service area budget structure presented in the Governor's proposed biennial budget.

*Audit Scope*

We performed a review of the budget and appropriation processing control system administered by the Department of Planning and Budget for the fiscal year ended June 30, 2005, as part of our audit of the Commonwealth's CAFR. We reported our audit results and internal control findings in a separate audit report entitled "Report on Budget and Appropriation Processing Control System for the Fiscal Year Ended June 30, 2005" issued in February 2006.

*Financial Summary*

The following schedules provide information on Planning and Budget's operating budget and expenses for fiscal year 2005:

Analysis of Budgeted and Actual Funding By Source

| Funding source: | Original Budget | Final Budget | Actual Funding |
|---|---|---|---|
| General Fund appropriations | $5,551,734 | $5,998,333 | $5,998,333 |
| Special Revenue Funds | 250,000 | 250,000 | - |
| Total resources | $5,801,734 | $6,248,333 | $5,998,333 |

Analysis of Budgeted and Actual Expenses by Program and Funding Source

| | Program Expenses | | | Funding Source |
|---|---|---|---|---|
| Program: | Original Budget | Final Budget | Actual Expenses | General Fund |
| Planning, budget, and evaluation services | $5,801,734 | $6,248,333 | $5,807,417 | $5,807,417 |

During the fiscal year, Planning and Budget's General Fund appropriations increased by approximately $450,000. This increase was primarily due to a $300,000 transfer from central appropriations to fund the Council on Virginia's Future expenditures related to its administrative and research duties. The original and final budgets also provided $250,000 for Planning and Budget's costs of providing staff and operational support to the Commonwealth Competition Council in the event that the Council implemented cost savings. However, Planning and Budget did not receive funding because there were no certified cost savings that resulted from the Competition Council's work.

## Department of Taxation

### *Agency Overview*

The Department of Taxation administers and enforces the tax laws of the Commonwealth. Taxation performs research and analyses on tax policy for the Commonwealth, and provides assistance for the localities and local assessors pertaining to valuation and assessment. Taxation provides services related to tax return processing, compliance audits and collections, and appeals and rulings, and assists the Office of the Attorney General in enforcing the Tobacco Master Settlement Agreement.

### *Overview of the Revenue Forecast and Collections*

#### Revenue Forecast

Taxation develops the General Fund revenue forecast for the Governor, so that he may provide the General Assembly with the six-year revenue forecast. General Fund revenues come primarily from five major revenue sources, and the two largest sources are the individual income tax and sales and use tax. Other major revenue sources are corporate income taxes, recordation taxes, insurance premiums, and miscellaneous taxes. Below is a summary of the forecast and actual revenues collected for fiscal year 2005:

Fiscal Year 2005 General Fund Collections: Actual and Forecast
(Dollars in Millions)

| Source: | 2005 Forecast | 2005 Actual Revenue | Dollar Variance | Percent Variance |
|---|---|---|---|---|
| Withholding | $ 7,490.4 | $ 7,513.0 | $ 22.6 | 0.3 |
| Non-withholding | 1,809.1 | 2,073.5 | 264.4 | 14.6 |
| Refunds | (1,296.8) | (1,234.2) | 62.6 | 4.8 |
| Net individual | 8,002.7 | 8,352.3 | 349.6 | 4.4 |
| Sales and use tax | 2,938.0 | 2,946.1 | 8.1 | 0.3 |
| Corporate income tax | 549.0 | 616.7 | 67.7 | 12.3 |
| Insurance premiums | 381.0 | 373.6 | (7.4) | (1.9) |
| Public service | 87.4 | 88.3 | 0.9 | 1.0 |
| Wills, suits, deeds | 512.8 | 596.1 | 83.3 | 16.2 |
| All other taxes and revenue | 671.8 | 714.2 | 42.4 | 6.3 |
| Total | $13,142.7 | $13,687.3 | $544.6 | 4.1 |

Source: Actual General Fund Revenues for Fiscal Year 2005 and the State of the Virginia Economy as presented by John M. Bennett, Secretary of Finance, August 29, 2005.

Actual General Fund revenue collections for fiscal year 2005 exceeded the General Fund forecast by $544.6 million or 4.1 percent. The majority of this growth occurred in three revenue sources: individual nonwithholding, corporate income taxes, and recordation taxes. Lower refunds also contributed to the increase in actual revenue collections during the fiscal year. These revenue sources are highly volatile and depend on economic and non-economic conditions. Many other states experienced similar total General Fund revenue growth. According to the National Association of State Budget Officers, revenues exceeded expectations in 45 states and nationwide revenue growth increased 4.2 percent in fiscal year 2005

Total individual nonwithholding payments exceeded the forecast by $264.4 million or 14.6 percent. These payments consist of estimated and final payments. Nonwithholding increases are largely due to growth in final payments made by taxpayers, caused in part by the reduction in the capital gains tax to 15 percent, which in turn caused an increase in capital gains realized. In addition, non-wage income also contributed to the increase in nonwithholding payments. Due to the unavailability of federal tax return data, a precise explanation of why the increase occurred in non-wage income is not available.

Corporate income tax receipts exceeded the forecast by $67.7 million or 12.3 percent. Fiscal year 2005 corporate tax revenues were the strongest on record. Corporate payments from the retail sector nearly doubled the amount received during fiscal year 2004. Corporate payments from defense-related firms and housing-related firms had a significant impact on corporate income tax revenue.

Recordation taxes are the third component that had a major impact on the increase in revenues. Home sales, home refinancing, and price appreciation all affect recordation taxes. Low interest rates are the main reason for the housing boom that the Commonwealth has experienced. Home appreciation remained strong, in addition median home prices are up substantially over the past year in Northern Virginia (up 24 percent), Norfolk (up 27 percent), and Richmond (up 18 percent).

Revenue Collections

Taxation is the largest collector of Commonwealth revenues. During fiscal year 2005, Taxation collected $14.8 billion in revenue, depositing $13.3 billion into the General Fund. Taxation distributed the remaining revenues to taxpayers as refunds or as transfers to other state agencies or to localities for taxes collected on their behalf. The largest sources of General Fund revenues are individual and fiduciary income taxes and state sales and use taxes. Individual and fiduciary income taxes include taxes collected from employer withholdings, estimated taxes paid, and individual income tax returns. The table below summarizes the total General Fund revenue collected during fiscal years 2004 and 2005 by Taxation and other agencies as well as localities.

Fiscal Year 2004-2005 General Fund Revenue Collections
(Dollars in Millions)

| Source: | 2005 Actual Revenue | 2004 Actual Revenue | Actual Variance | Percent Variance |
|---|---|---|---|---|
| Withholding | $ 7,513.0 | $ 7,039.3 | $ 473.7 | 6.7 |
| Non-withholding | 2,073.5 | 1,562.8 | 510.7 | 32.7 |
| Refunds | (1,234.2) | (1,217.2) | (17.0) | 1.4 |
| Net individual | 8,352.3 | 7,384.9 | 967.4 | 13.1 |
| Sales and use tax | 2,946.1 | 2,562.3 | 383.8 | 15.0 |
| Corporate income tax | 616.7 | 425.7 | 191.0 | 44.9 |
| Insurance premiums | 373.6 | 351.3 | 22.3 | 6.3 |
| Public service | 88.3 | 86.9 | 1.4 | 1.6 |
| Wills, suits, deeds | 596.1 | 340.6 | 255.5 | 75.0 |
| All other taxes and revenue | 714.2 | 766.2 | (52.0) | (6.8) |
| Total | $13,687.3 | $11,917.9 | $1,769.4 | 14.8 |

Source: Actual General Fund Revenues for Fiscal Year 2005 and the State of the Virginia Economy as presented by John M. Bennett, Secretary of Finance, August 29, 2005.

Collections increased $1,769.4 million or 14.8 percent in fiscal year 2005. The increase is due to tax changes adopted by the 2004 General Assembly as well as the favorable economic conditions discussed above. As a part of the 2004 legislation, the sales and use tax rate increased from 4.5 percent to 5 percent, resulting in an additional $147 million in revenue. A change in the recordation tax also impacted the increase in revenues collected during fiscal year 2005. The recordation tax increased from 15 cents to 25 cents per $100 value, providing approximately $210 million in additional revenue.

Other legislative changes that had an impact on the revenues collected during fiscal year 2005 include the requirement for pass-through entities to file tax return information, age deduction limitations, the elimination of sales tax exemptions for certain public service corporations, including electric suppliers, gas utilities, water and sewer utilities, telecommunication companies, telephone companies, and common carriers of property and passengers by motor vehicle, and the requirement that corporations add back intangible and interest expenses paid to related members. Taxation estimates that these legislative changes provided an additional $34.8 million in revenues during fiscal year 2005.

## *Overview of the Public-Private Partnership Project*

In 1998, Taxation contracted with CGI-AMS (formerly American Management System) to develop and implement an Integrated Revenue Management System. Taxation also contracted with Northrop Grumman Information Technology (formerly TRW Systems & Information Technology Group) to conduct periodic project performance monitoring and evaluation services. The primary justification for the Partnership Project was the replacement of Taxation's legacy revenue accounting system, STARS (State Tax Accounting and Reporting System), which was approaching 20 years of operation. The project had an original planned conversion date in summer 2003; however, due to a change order executed February 2003 to allow support of the Tax Amnesty Program and data conversion problems in the spring of 2004 related to the implementation of the Advantage Revenue system, the vendor-delayed conversion until August 2005, with final completion expected by June 2006. The implementation of Advantage Revenue is the largest milestone defined in the contract with CGI-AMS. The conversion to Advantage Revenue from STARS took place in August 2005, and production is now using Advantage Revenue.

### Partnership Project Funding

The Partnership Project funding comes from increased tax revenues generated as a result of technological solutions and improved business processes the Partnership Project developed and implemented. Originally, Taxation deposited the additional revenues into a 90 percent fund and a 10 percent fund. By contract agreement, the percentages in these funds changed to 70 percent and 30 percent during fiscal year 2004. The 90 percent/70 percent fund accumulated funds to pay CGI-AMS its contractual obligations, while the 10 percent/30 percent fund accumulated funds to pay all other expenses attributable to the project. At the end of fiscal 2004, the 90 percent/70 percent fund had accumulated sufficient funds to pay the entire CGI-AMS' contract requirements and transfer $21.1 million to the General Fund. No additional revenues were set aside during 2005.

Partnership Project Revenues

| Fiscal Year | 90 Percent/70 Percent Fund | 10 Percent/30 Percent Fund | Total |
|---|---|---|---|
| 1999 | $ 5,695,458 | $ 632,799 | $ 6,328,257 |
| 2000 | 10,487,760 | 1,165,337 | 11,653,097 |
| 2001 | 33,140,337 | 3,682,260 | 36,822,597 |
| 2002 | 39,522,127 | 4,391,347 | 43,913,474 |
| 2003 | 54,457,988 | 6,050,887 | 60,508,875 |
| 2004 | 50,592,907 | 21,682,674 | 72,275,581 |
| Total | $193,896,577 | $37,605,304 | $231,501,881 |

Source: CARS

Partnership Project Cost

Original contract costs with CGI-AMS totaled $123 million. In addition, Taxation agreed to pay CGI-AMS interest on any interim billing if the 90 percent fund did not have the resources to pay. Taxation initially estimated that interest payments would total $17 million over the life of the contract.

Due to various change orders, including Tax Amnesty, the contract price has risen to $169 million, but as of June 30, 2005, Taxation projected interest costs of $2.1 million rather than the original $17 million. This interest projection decrease resulted from the project initiatives generating revenues in a shorter-than-expected period and project expenses being incurred at a slower than expected rate.

Taxation is incurring other project costs in addition to the CGI-AMS payments discussed above. These additional costs include overhead and miscellaneous expenses such as Northrop Grumman payments supported by the 10 percent/30 percent fund, as well as Taxation staff time spent directly on the projects, primarily supported by Taxation's operating General Fund budget. Beginning July 1, 2004, Taxation has funded all additional costs through its operating budget (see additional discussion below). The Northrop Grumman contract terminated on October 15, 2005, and contract payments terminated on that date.

The following chart highlights that total anticipated costs exceed $246 million, including interest payments and Taxation payroll projections. The chart also summarizes the corresponding actual cost incurred during fiscal 2005 and for the project to date through June 30, 2005.

| | Anticipated Costs as of June 30, 2004 | Anticipated Costs as of June 30, 2005 | Fiscal Year 2005 Activity | Activity through June 30, 2005 |
|---|---|---|---|---|
| Partnership project contract cost (90 percent/70 percent fund) | $166,210,690 | $169,529,928 | $21,122,492 | $151,317,895 |
| Partnership project interest cost (90 percent/70 percent fund) | 2,075,586 | 1,875,586 | - | 1,075,586 |
| Northrop Grumman (10 percent/30 percent fund)* | 5,126,130 | 5,408,019 | 595,413 | 5,221,543 |
| Overhead/miscellaneous (10 percent/30 percent fund) | 20,492,610 | 20,492,610 | - | 20,492,610 |
| Taxation payroll (Taxation General Fund) | 37,789,811 | 43,395,071 | 10,382,159 | 41,171,970 |
| Maintenance costs and Taxation overhead (Taxation Operating Budget) | 3,882,500 | 5,897,842 | 5,425,391 | 5,425,391 |
| Totals | $235,577,327 | $246,599,056 | $37,525,455 | $224,704,995 |

* The Northrop Grumman contract terminated on October 15, 2005.

Ongoing Operating Costs

Prior to starting the project, Taxation estimated its ongoing annual operating costs would increase by $10 million as a result of the partnership project initiatives. Under the contract, CGI-AMS was responsible for carrying the added operating costs for the first five years. Taxation assumed responsibility for these costs beginning July 1, 2003.

Taxation has collected sufficient funds to cover the cost of the contract; it no longer retains revenues in the administrative account to pay for the operating cost increases. Therefore, for fiscal years 2005 and 2006, Taxation requested and received additional General Fund base appropriations to cover its ongoing operating expenses, totaling $11,387,569 and $10,868,026, respectively. Taxation does not anticipate any further increases in General Fund base appropriations as a result of the implementation of the final component, Advantage Revenue during calendar year 2005.

## *Audit Scope*

We performed an audit of the Department of Taxation's financial operations for the fiscal year ended June 30, 2005, primarily in support of the audit of the CAFR.

*Financial Summary*

In order to fund the agency's operations, Taxation receives funds from the General Fund and several Special Revenue funds. In addition to collecting and forecasting General Fund revenue, Taxation also receives and processes all tax returns, conducts audits to identify all taxes due to the Commonwealth and researches and resolves all appeals and taxpayer protests. Both General and Special Revenue funds pay the cost of these activities. The following schedules provide information on the operating budget and expenses for fiscal year 2005:

Analysis of Budgeted and Actual Funding Available By Source

| Funding source: | Original Budget | Final Budget | Actual Funding Available* |
|---|---|---|---|
| General Fund appropriations | $80,658,271 | $ 82,628,679 | $ 82,628,679 |
| Technology Partnership Fund | 11,314,222 | 29,081,352 | 53,961,280 |
| Other Special Revenue | 6,581,729 | 9,391,729 | 17,828,021 |
| Dedicated Special Revenue | 10,000 | 10,000 | 10,000 |
| Special Fund Account of Transportation District | 101,006 | 136,006 | 125,932 |
| Total resources | $98,665,228 | $121,247,766 | $154,553,912 |

Source: CARS

*Amounts represent Taxation's cash available including the prior year's cash balance, revenues collected during the fiscal year, and transfers received by Taxation for operating uses.

Overall, Taxation's budget increased $22.5 million during fiscal year 2005. Most of the increase occurred in the Technology Partnership Fund, where the General Assembly approved an additional $14.5 million to pay CGI-AMS for contractual services for the implementation of the Integrated Revenue Management System. The $54 million cash balance at June 30, 2004 funded this appropriation. Of the cash balance of $54 million, Taxation was appropriated $29 million to fund expenses during fiscal year 2005 and the remaining balance will fund future costs of the CGI-AMS contract. In addition, Taxation used $3.2 million of carry over balances from fiscal year 2004 to pay for the implementation of tax changes required under the Tax Reform Act of 2004 (HB5018).

The remaining budget increase comes from an additional $2.8 million for contracts between Taxation and private collection agencies. This appropriation came from the Contractor Collection Fund, which holds funds collected by private collection agencies. Other Special Revenue funds available totaled $17.8 million, from which Taxation received an appropriation of $9 million to fund expenses during fiscal year 2005. The remaining balance will fund the Court Debt Collection program and outside collection agencies that collect debt on the behalf of Taxation.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

| Program: | Program Expenses: Original Budget | Program Expenses: Final Budget | Program Expenses: Actual Expenses | Funding Source: General Fund | Funding Source: Technology Partnership Fund | Funding Source: Other Special Revenue |
|---|---|---|---|---|---|---|
| Planning, budgeting, and evaluation services | $ 1,908,580 | $ 1,678,580 | $ 1,678,580 | $ 1,678,580 | $ - | $ - |
| Revenue administration services | 43,719,261 | 54,155,469 | 52,832,965 | 44,991,263 | - | 7,841,702 |
| Tax value assistance to localities | 838,531 | 986,031 | 971,880 | 672,502 | - | 299,378 |
| Public private partnership | 11,314,222 | 29,081,352 | 21,122,492 | - | 21,122,492 | - |
| Administrative and support services | 40,884,634 | 35,346,334 | 35,318,375 | 35,286,334 | - | 32,041 |
| Total | $98,665,228 | $121,247,766 | $111,924,292 | $82,628,679 | $21,122,492 | $8,173,121 |

Source: CARS

The Revenue Administration Services program increased approximately $10.4 million. This increase resulted primarily from two factors: salary costs and contracts with private collection agencies. Taxation increased staff to implement and comply with tax reform. Taxation transferred approximately $6.5 million of General Funds from Administrative and Support Services to Revenue Administration Services to support these increased staff costs. Taxation paid the additional costs for private collection agency services with $2.8 million from special funds.

The $17.7 million increase in the Public Private Partnership program budget is primarily due to the additional $14.5 million to pay CGI-AMS for contractual services delayed due to implementation issues related to the Integrated Revenue Management System discussed above, and $3.2 million to address tax changes required under the Tax Reform Act of 2004 (HB5018).

## Department of the Treasury

### *Agency Overview*

The Department of the Treasury (Treasury), under the direction of the State Treasurer, serves as the custodian of state funds. In addition to its General Administration Division, Treasury has the following divisions, which provide services to the Commonwealth:

- Cash Management and Investments Division
- Debt Management Division
- Division of Risk Management
- Unclaimed Property Division
- Operations Division
    - Check Processing
    - Trust Accounting
    - Bank Reconciliation

In addition, Treasury staff also provides administrative support for the following entities:

- Virginia Public School Authority
- Virginia College Building Authority
- Virginia Public Building Authority
- Debt Capacity Advisory Committee
- Treasury Board

### *Cash Management and Investments Division*

The General Account of the Commonwealth, a pool of investments representing assets of the General Fund of the Commonwealth, higher education (operating), highway maintenance, and transportation trust funds, is the largest portfolio managed by the Cash Management and Investments Division. The General Account has two pools: the primary liquidity pool and the total return pool. The Cash Management and Investments Division internally manages the primary liquidity pool, which provides the major source of liquidity for the disbursement requirements and operational needs of the Commonwealth. The externally managed total return pool seeks to generate higher total returns over time, as compared to the liquidity pool. Treasury's target allocation for the overall general account asset mix is 75 percent for the primary liquidity pool and 25 percent for the total return pool. Treasury's monthly average invested balance for fiscal year 2005 was $4.4 billion. The yield for fiscal year 2005 was 2.9 percent, which is significantly higher than the 1.1 percent return for fiscal year 2004, but still historically low.

The Cash Management and Investments Division also manages the Local Government Investment Pool (LGIP). LGIP is 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. Treasury manages the pool in compliance with SEC regulations for money market funds. Standard & Poors Corporation has assigned the pool its highest rating, which is "AAA."

Further, Treasury manages the Commonwealth's statewide banking network, monitors its own and other agencies' specialized banking services, and administers the State Non-Arbitrage Program.

*Debt Management Division*

Virginia is one of only six states with a "AAA" bond rating for general obligation debt from three rating services: Moody's Investors Service, Standard & Poors Corporation, and Fitch Ratings, Inc. The Debt Management Division is responsible for the issuance and management of debt for the Commonwealth and several of its boards and authorities. Debt Management also monitors outstanding Commonwealth debt issued by certain boards and authorities for reporting and analysis purposes, advises on the financing of state capital projects, 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. Through providing staff services to the Treasury Board, Debt Management participates in developing the terms and structure of debt issued through the Commonwealth.

*Division of Risk Management*

The Division of Risk Management is responsible for administering 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. A report issued by the Auditor of Public Accounts entitled "2005 Statewide Self-Insurance Report" provides additional information about the Division of Risk Management and the Commonwealth's other Self-Insurance funds.

Risk Management administers the following programs under Treasury:

- State Agency Programs
    - Liability Insurance
    - Property Insurance
    - Fidelity Bonds
- Constitutional Officer Programs
    - Liability Insurance
    - Fidelity Bonds
- Local Government Programs
    - Liability Insurance
    - Property Insurance

Risk Management bills state agencies, the Compensation Board, and local governments for insurance premiums to cover current and future claims. For the other programs, the risk assumed is limited to certain amounts per occurrence.

*Unclaimed Property Division*

The Unclaimed Property Division is responsible for the administration of two major types of abandoned property programs:

- Personal property
- Real property

The Unclaimed Property Act establishes the Commonwealth as custodian of certain personal properties (both intangible and tangible) until the Commonwealth can locate the owners. The Unclaimed Property Division holds funds it receives under the Unclaimed Property Act in perpetuity until the Division identifies the owner.

The Escheats Statute generally benefits localities through the sale of abandoned real estate by placing the property back on the tax rolls and paying delinquent taxes from the sales proceeds. Owners may claim the excess proceeds of a sale for up to five years after the date of the sale. After five years, the Division deposits these excess funds in the Literary Fund.

The Division identifies abandoned personal property through annual reporting requirements and the performance of audits and compliance reviews, administers the funds under the Commonwealth's control, and uses its best efforts to return the property to its owner. These efforts include a property search mechanism located on Treasury's website.

### *Operations Division*

#### Check Processing

Treasury is responsible for the printing and distribution process of all checks. The check writing function is one continuous operation from file transmission, to printer, to the output of the check document.

#### Trust Accounting

Trust Accounting performs a variety of functions for Treasury, which includes the following:

- Acting as trustee for college bond issues
- Ensuring all debt service payments are made timely
- Preparing financial statements for the Virginia Public School Authority, Virginia College Building Authority, and Virginia Public Building Authority
- Servicing Literary Fund loans for the Virginia Public School Authority
- Monitoring public depositories under the Security for Public Deposits Act
- Accounting and Reporting of the State Non-Arbitrage Program
- Accounting for securities lending transactions
- General accounting and financial reporting

#### Bank Reconciliation

Treasury reconciles all state deposits between the State Comptroller's ledger and the bank for the following accounts:

- Concentration Bank Accounts
- Regional Bank Accounts
- Special and Trust Bank Accounts

The Commonwealth's two disbursement banks are responsible for full reconciliation of check disbursement activity. Treasury employs a completely automated system to reconcile bank accounts. The Recon Plus system interfaces with other bank systems, allowing Treasury to reconcile accounts within 45 days of month end.

## *Audit Scope*

We performed an audit of the internal controls over transactions at the Department of the Treasury, including the Treasury Board, primarily in support of the audit of the Commonwealth's CAFR. We also performed the audit in support of the audits of the Local Government Investment Pool, the Virginia Public School Authority, the Virginia College Building Authority, and the Virginia Public Building Authority for the fiscal year ended June 30, 2005, for which Treasury provides administrative support. The "Independent Auditor's Report On Internal Control Over Financial Reporting and On Compliance and Other Matters" for these entities is included in this report. We followed up on recommendations made in the prior year reports, which are included in the report section, entitled "Status of Prior Year Recommendations."

Ernst & Young audited the State Non-Arbitrage Program financial statements for the fiscal year ended June 30, 2005, and issued an unqualified opinion.

## *Financial Summary*

The following schedules provide information on Treasury's operating budget and expenses for fiscal year 2005:

Analysis of Budgeted and Actual Funding By Source

| Funding source: | Original Budget | Final Budget | Actual Funding |
|---|---|---|---|
| General Fund appropriations | $ 9,452,975 | $ 9,633,320 | $ 9,633,320 |
| Special Revenue funds | 722,455 | 1,073,455 | 710,096 |
| Highway construction funds | 143,454 | 143,454 | 142,461 |
| Trust and agency funds – unclaimed property proceeds | 3,772,624 | 6,672,624 | 6,545,442 |
| Trust and agency funds | 2,558,836 | 2,558,836 | 1,821,613 |
| Workforce training access fund | - | - | 281 |
| Total resources | $16,650,344 | $20,081,689 | $18,853,213 |

During fiscal year 2005, the Department of Planning and Budget reappropriated approximately $3.1 million of Treasury's unclaimed property prior year cash balances. In addition, Treasury's special revenue fund appropriations increased by $351,000 due to a legislative amendment to cover increases in the fees that private banks charge for safekeeping securities. The schedule below illustrates these variances at the program level.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

| | Program Expenses | | | Funding Sources | | | | |
|---|---|---|---|---|---|---|---|---|
| Program | Original Budget | Final Budget | Actual Expenses | General Fund | Special Revenue Funds | Highway Construction Funds | Unclaimed Property Proceeds | Trust and Agency Funds |
| Investment, trust, and insurance services | $ 8,238,157 | $ 8,434,533 | $ 7,646,612 | $5,747,838 | $ - | $142,461 | $ - | $1,756,313 |
| Revenue administration services | 8,412,187 | 11,647,156 | 10,797,968 | 3,620,582 | 566,644 | - | 6,545,442 | 65,300 |
| Total uses | $16,650,344 | $20,081,689 | $18,444,580 | $9,368,420 | $566,644 | $142,461 | $6,545,442 | $1,821,613 |

## Treasury Board

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. The Treasury Board has the responsibility to:

- Exercise general supervision over the investment of state funds
- Administer the Virginia Security for the 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

The Treasury Board also 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 bonds to trustees and agents for the bondholders.

The Treasury Board operates a tax-exempt commercial paper program to provide start-up funding for several of the Commonwealth's capital borrowing programs. As of June 30, 2005, there was no tax-exempt commercial paper for general obligation bond projects outstanding.

### *Financial Summary*

The following schedule provides information on the Treasury Board's original and final budgets and expenses for fiscal year 2005:

#### Analysis of Budgeted and Actual Expenses by Program

| Program: | Original Budget | Final Budget | Actual Expenses |
|---|---|---|---|
| Financial assistance for confinement in local facilities | $ 3,100,000 | $ 2,600,000 | $ 2,505,356 |
| Financial assistance for cultural and artistic affairs | 2,633,302 | 2,633,302 | 2,632,865 |
| Industrial development services | 5,320,297 | 5,320,297 | 5,310,682 |
| Bond and loan retirement and redemption | 296,968,894 | 277,160,744 | 271,983,869 |
| Total uses | $308,022,493 | $287,714,343 | $282,432,772 |

The Treasury Board's budget decreased by approximately $20 million, which is the result of a change in the draw schedules for previously authorized capital projects and the refinancing of outstanding debt in order to capitalize on lower interest rates.

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

March 14, 2006

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the agencies under the **Secretary of Finance** for the year ended June 30, 2005. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit objectives for the audit of the Departments of Accounts, Planning and Budget, Taxation, and Treasury for the fiscal year ended June 30, 2005, 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, the State Tax Accounting and Reporting System, the Form 27 Automated Transaction System and other central systems;

- to evaluate the accuracy of financial and budgetary transactions of the administrative activities as reported in the 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, tax and interest revenue as reported in the CARS and the State Tax Accounting and Reporting System and in supplemental information prepared by Taxation;

- to evaluate the accuracy of financial transactions related to cash and investments, debt, risk management and unclaimed property activity which is controlled by Treasury as reported in the CARS and Treasury's accounting records (including the activity of the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority);

- to evaluate whether appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;

- to evaluate the proper approval and documentation of budget adjustments; and

- to determine whether the agencies have complied with applicable laws and regulations.

We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

## 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 control 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*
CARS
Commonwealth Integrated Payroll/Personnel System
Fixed Asset Accounting and Control System

*Department of Planning and Budget*
Form 27 Automated Transaction System
Budget Execution
Budget Adjustment Process

*Department of Taxation*
Financial Reporting
Tax Return Processing
Tax Revenue Collection
Virginia Tax On-line
Lifeworks System
Computer Assisted and Data Capture System
Total Automated Capture System
Joint Electronic Filing System
State Tax Accounting and Revenue System (STARS)

*Department of Treasury (including Treasury Board operations)*

| | |
|---|---|
| Financial Reporting* | Bank Reconciliation System |
| Bond Issuance | Trust Accounting |
| Debt Service Expenditures | 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 control that we consider necessary to be reported to management 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 financial statements as indicated in the scope section of this report. We have provided an update on Accounts' and Treasury's progress on addressing recommendations included in prior year reports in the section entitled "Status of Prior Year Recommendations."

We noted no matters involving operating controls over CARS, STARS, and other central systems. However, we noted certain matters related to the security and safeguarding of all databases, information, and information technology assets maintained by the agencies within the Secretary of Finance that we consider necessary to be reported to management that require management's attention and corrective action. These matters are described in the section entitled "Secretary of Finance Audit Recommendations."

We found that the 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, STARS, 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.

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

We noted matters involving internal control and its operation at Planning and Budget related to access controls over the Form 27 Automated Transaction System and documentation of budget adjustments that we reported to management in the separately issued report entitled "Report on Budget and Appropriation Processing Control System, For the Fiscal Year Ended June 30, 2005."

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Taxation has taken adequate corrective action with respect to audit findings reported in the prior year.

## EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this letter with management of the respective agencies of the Secretary of Finance.

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.

SAH:sks
sks:68

AUDITOR OF PUBLIC ACCOUNTS

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

November 18, 2005

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited the following financial statements as of and for the year ended June 30, 2005, and have issued our reports dated as indicated below:

- Local Government Investment Pool dated October 31, 2005;
- Virginia Public School Authority dated November 18, 2005;
- Virginia College Building Authority dated November 18, 2005; and
- Virginia Public Building Authority dated November 18, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

### Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authorities' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authorities' financial statements are free of material misstatement, we performed tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reporting under Government Auditing Standards

The "Independent Auditor's Report on Internal Control Over Financial Reporting and On Compliance and Other Matters" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Authority Boards and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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sks:68

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

March 28, 2006

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 appreciates the opportunity to respond to the recommendations contained in your 2005 Secretary of Finance Audit Report. Your comments and recommendations are appreciated and are given the highest level of importance and consideration by the Administration and the Department of Accounts (Accounts) as we continue to review and improve our CAFR practices. Accounts appreciates your acknowledgement of the progress made on prior recommendations and the recognition that some of these issues take time to resolve.

**Secretary of Finance Audit Recommendations**

*Obtain Assurance over Security and Information Technology Infrastructure*

Accounts understands the state information technology policy makes all agency heads responsible for the security and safeguarding of all databases, information, and information technology assets. As you note, while agencies and VITA have entered into MOUs that define service level responsibilities in a shared environment, the current MOU does not address the security levels required by individual agencies. Accounts has sought to address this issue with VITA without success. We hope to address this issue in the process currently underway to revise the VITA service level MOU.

**Status of Prior Year Recommendations**

*Review of Statewide Reporting Process*

Thank you for acknowledging the progress we have made since you first reported on the statewide reporting process last March. While we take great pride that our CAFR has received the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting for the past nineteen years, we continually evaluate the process to enhance efficiency and effectiveness.

Accounts is cognizant of the new proposed auditing standards. The new standards will be a challenge for all state governments. The Commonwealth's large and diverse reporting entity, decentralized accounting environment and aging legacy financial management systems will make meeting the rigors of the new standards even more difficult for Virginia. Nevertheless, we have developed both short and long-term plans to strengthen our financial reporting process.

In the long-term we plan to redouble our efforts to modernize our business processes and systems under the proposed Enterprise Applications Program. Financial Management is planned to be the first business application developed under the program and we look forward to APA's involvement in this project to ensure the system will meet the rigorous new proposed audit standards.

In the short-term, we plan to review our current CAFR preparation procedures, including the review function, to ensure that every effort is made to prevent audit adjustments. While the audit is just the final of many key reviews performed in the preparation of the CAFR, we always appreciate the APA's input regarding critical accounting issues. We also plan to expand the Financial Reporting Quality Assurance and Training function through targeted use of the two additional FTE budgeted this biennium for internal control and agency oversight initiatives. This oversight will include a more robust reporting process on agency compliance with the Comptroller's Financial Statement Directives. Additionally, Accounts plans to work with Treasury to establish an inter-agency task force that meets regularly to improve inter-agency communication and financial reporting processes.

The Secretary of Finance also considers eliminating the risk of a material weakness in the internal controls over preparation of the CAFR a matter of the utmost importance. The Secretary and Comptroller plan to convene a task force of large agency finance officers and agency heads to more effectively communicate the importance of this issue. We plan to involve your office as appropriate throughout the process.

*Automate Processes*

*Financial Reporting for the State Non-Arbitrage Program (SNAP)* – Accounts will work with Treasury through the planned inter-agency task force to resolve any remaining issues related to the presentation, recording and reporting of SNAP and Debt Database financial information.

*Program Automation* – Account's Financial Reporting unit will be fully involved with the development of the Enterprise Applications Program and plans to emphasize the critical nature of financial reporting. Additionally, Accounts will have an expert review the current use of Excel by Financial Reporting staff to determine additional functions and other data accumulation and analysis tools that might prove beneficial to the CAFR preparation process and identify advanced Excel training classes for Financial Reporting staff.

*Recording Financial Transactions* – Accounts has established an oversight function within our General Accounting unit to systematically review agency general ledger accounts to improve the methods employed by agencies and raise the level of consistency and reliability of the financial information agencies record in CARS. A key goal of this oversight is to reduce manual processes needed in financial statement preparation.

*Methods of Collecting Financial Information*

Accounts plans to identify additional opportunities to expedite reporting using reasonable estimation methodologies.

*Agency Guidance and Relationships*

As mentioned earlier, Accounts will continue to strengthen and expand the Financial Reporting Quality Assurance and Training Function and work with Treasury through the inter-agency task force to ensure that audit adjustments are not required in the future. Accounts will continue its work to ensure that GASB Statement 45 is properly implemented.

*Update Procedures in a Timely Manner*

Accounts updates the financial reporting procedures each spring and strives to anticipate and document what will take place in the CAFR preparation process for the following financial reporting cycle. While procedural changes due to unforeseen circumstances are likely, Accounts will ensure such changes are reviewed and approved by management and communicated to the APA prior to implementation.

*Schedule of Expenditures of Federal Awards*

While Accounts delivered the Schedule of Expenditures of Federal Awards (SEFA) to the APA on the agreed upon date of January 20, 2006, Accounts will continue to evaluate our procedures to determine additional efficiencies would allow an earlier deadline.

Thank you again for the opportunity to respond to your report and for publishing this response with your report.

Sincerely,

David A. Von Moll

DAV/bml

c: Ronald D. Necessary, Director of Financial Reporting

# COMMONWEALTH *of* VIRGINIA

*Department of the Treasury*

J. BRAXTON POWELL
TREASURER OF VIRGINIA

P. O. BOX 1879
RICHMOND, VIRGINIA 23218-1879
(804) 225-2142
FAX (804) 225-3187

March 28, 2006

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

Dear Mr. Kucharski:

The Department of the Treasury (Treasury) appreciates the opportunity to respond to the comments and recommendations in your draft Report on Audit of Agencies of the Secretary of Finance for the year ended June 30, 2005. Your comments and recommendations are appreciated and are given the highest level of importance and consideration by the Administration and Treasury as we continue to review and improve our financial reporting practices and procedures. Treasury appreciates your acknowledgement of the progress being made in several prior recommendations and the recognition that some of these issues take time to resolve.

**SECRETARY OF FINANCE AUDIT RECOMMENDATION**

**Obtain Assurance over Security and Information Technology Infrastructure**

Treasury is well aware that state information technology policy makes all agency heads responsible for the security and safeguarding of all databases, information, and information technology assets. As you noted, over the past two years the Commonwealth has moved the information technology infrastructure supporting these databases and information to the Virginia Information Technology Agency (VITA). Since VITA has assumed responsibility for the information technology infrastructure, agency heads must evaluate the agencies' capabilities for determining the level of assurance needed from VITA and have VITA provide assurance that their infrastructure provides the safeguards and controls needed to protect information and databases as required by state policy.

As noted in your report, while agencies and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in a shared environment, the current MOU does not address the security levels required by individual agencies. It is our understanding that the Auditor of Public Accounts (APA) addressed this issue with VITA and that VITA is working on draft language for agencies to use as guidance when addressing this issue. To date, Treasury has sought such assistance from VITA without success. As a result, Treasury has begun an analysis of security level safeguards and controls needed to protect our information and databases. This information will be addressed in a revised or supplemental MOU with VITA and will require VITA to provide, at least annually, written assurance related to such security requirements.

**STATUS OF PRIOR YEAR RECOMMENDATIONS**

**Review of Statewide Reporting Process**

As noted in your report, the Department of Accounts (Accounts) and Treasury have made significant progress in improving the financial reporting process and continue to evaluate and implement the APA's recommendations from the prior year. We are aware that the American Institute of Certified Public Accountants has proposed several auditing standards that place additional emphasis on internal controls over financial reporting. Treasury understands the importance of providing accurate, reliable, and timely financial reporting information.

In this regard, Treasury has requested funding for a senior level accounting position to work in concert with Accounts to coordinate the agency's extensive year-end financial reporting responsibilities, which take place under extremely tight deadlines. This position will coordinate researching and implementing new financial reporting standards affecting Trust operations, coordinate year-end financial reporting with Accounts and APA, and review the agency's financial reporting system capabilities. Additionally, as suggested by Accounts, Treasury plans to work with Accounts to establish an inter-agency working group that meets periodically to improve inter-agency communication, the financial reporting process, and other issues in your report.

**Automate Processes**

*Financial Reporting for the State Non-Arbitrage Program (SNAP)* – Since its inception, SNAP has offered two investment vehicles – the SNAP Fund, a money market mutual fund, and individual portfolios. With the change in investment management in September 2004, the new investment manager places more emphasis on the use of individual portfolios to increase investment yield. Since the transition, there has been a significant increase in the dollar value of individual portfolios in the SNAP Program and, therefore, a greater scrutiny of the accounting and auditing of these investment products. Treasury is working with Accounts and APA in the review and communication of this activity to ensure all parties have an understanding of accounting transactions relating to these investments and that this activity is appropriately reported. Treasury will evaluate the SNAP Program activity on an on-going basis to determine if changes in accounting and reporting are necessary.

*Debt Database* – Treasury will continue to use the debt database for its primary purpose of ensuring that debt payments are timely and accurate. Additionally, we will continue to use the database extracts for financial reporting purposes. Treasury has worked closely with Accounts to ensure that the data provided for the CAFR will eliminate most, if not all, duplicative efforts between the two agencies. It is recognized, however, that some additional efforts will still be necessary for both agencies to ensure that data meets the needs of the individual reporting entities. Treasury will continue to work with Accounts to ensure that the data is provided in the most efficient fashion.

It is correct that the database does not include data related to bond premiums and discounts, as this data is outside the purpose for which the database was designed. Premiums and discounts are relevant for financial reporting purposes only, and any attempt to adjust the data in the database to include this data could compromise the debt payment process. Instead, this data is maintained via Excel spreadsheets. Treasury is currently working with Accounts to develop summary level reporting of the premium and discount data to facilitate preparation of the CAFR.

*Program Automation* – Treasury is aware of the Administration's initiative to re-engineer state processes and develop an enterprise architecture that could replace all current statewide systems and some agency-based systems. As this process takes place, Treasury and Accounts will communicate to the appropriate parties the critical nature of financial reporting requirements as part of the system development process. However, based on budget constraints related to this initiative and the time that will be needed to develop this architecture, Treasury has chosen to not wait on the development initiative. Treasury is in the process of reviewing a software package that may provide a different approach to accumulating data for financial statement preparation for the VCBA and VPBA. If it is determined that such software will be more efficient for financial statement preparation, Treasury will pursue converting to that process, but in any case, it will not be implemented for the fiscal year 2006 reporting cycle. If this software is not viable, Treasury may look to other options, and may consider waiting for the development of the new enterprise architecture before taking extensive steps in this direction. Further, Treasury has done some research relating to alternative investment systems. Future research will be conducted, but not by the end of this fiscal year. Our initial explorations in this direction last year led us to conclude that the system in place was more cost effective than several other options available.

**Agency Guidance and Relationships**

Treasury will continue to work closely with Accounts to enhance the financial statement preparation process. Treasury is aware of the several adjustments made by APA. One adjustment resulted from a change in reporting methodology. With regard to the other adjustment, which relates to payables of the Virginia Public Building Authority (VPBA), we will work with Accounts to improve the timeliness of agency construction reimbursements from VPBA, which should eliminate the need for this year-end adjustment in the future.

**Management Structure and Performance Management**

Treasury concurs with APA's assessment of our continuing efforts to enhance our management structure and performance monitoring.

Again, thank you for the opportunity to respond to your comments and recommendations. Treasury believes that the establishment of an Accounts-Treasury working group to address many of the issues of mutual interest can accelerate their resolution. Please let me know if you would like to discuss our response in further detail.

Sincerely,

J. Braxton Powell

J. Braxton Powell

c: The Honorable Jody M. Wagner
Secretary of Finance

AGENCIES OF THE SECRETARY OF FINANCE

As of June 30, 2005

John M. Bennet
Secretary of Finance

David A. Von Moll
Comptroller

Richard D. Brown
Director of the Department of Planning and Budget

Kenneth W. Thorson
Tax Commissioner

Jody M. Wagner
Treasurer