# APA

## Auditor of
## Public Accounts
### COMMONWEALTH OF VIRGINIA

## 2005
## Report to the
## General Assembly

*The Auditor of Public Accounts serves Virginia citizens and decision-makers by providing unbiased, accurate information and sound recommendations to improve accountability and financial management of public funds.*

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October 17, 2005

Members of the General Assembly:

# A Year in Review

One of the most effective measures of an audit organization is its ability to affect change. Using this measure, this Office had a banner year. A number of our reports have resulted in both short and long term changes on how the government performs.

The following reports have led to changes in government:

### Review of Deferred Maintenance in the Commonwealth - Interim Report

A statewide effort is underway to change how Virginia state government deals with maintaining its buildings and structure. Beginning with the 2006-2008 budget, any agency or institution requesting capital outlay funds must conduct a detailed facility assessment of the building for which it is requesting funding.

### Review of the Commonwealth's Capital Outlay Process

A statewide effort is underway to review the capital outlay process. A working group is undertaking a complete change in the capital outlay process including realizing that maintenance is an essential part of the asset.

### Virginia Election and Registration Information System (VERIS)

The Board and Virginia Information Technology Agency has increased its oversight and monitoring of the Contractor's performance on the new election and voter registration system.

### Department of Transportation: Follow-up on the Special Review of Cash Management and Capital Budgeting Practices

Transportation has a more realistic six-year plan and has changed its operations to increase its planning and delivery system for new construction as well as for repairs and

maintenance. The previous Commissioner indicated that the recommendations also assisted in improving on-time completion.

### Jamestown-Yorktown Foundation

The Foundation has employed a consultant to develop an internal control plan and determine staffing levels. Additionally, the Foundation is improving its systems.

### Department of Veterans Services and the Veterans Services Foundation

The agency has taken steps to improve and strengthen its accounting, purchasing, payroll and other fiscal operations.

### Secretary of Natural Resources Agencies including the Department of Game and Inland Fisheries

The Game and Inland Fisheries Board is reasserting its control over the Department. The Board has realigned the duties of the Chairman and established a committee to oversee and set policy and key processes for the various operating sections.

### Office of the Governor

For the first time in nearly four biennia, the Governor's Office's budget in the Appropriation Act reflects the actual cost of operating the Office. Additionally, there have been budget adjustments to several of the Cabinet Secretaries so their budgets reflect actual cost of operations.

A report we issued two years ago on fleet management has resulted in a new Executive Order governing the Commonwealth's management of all of its motor vehicles; both within the central garage and under agency management. Additionally, the Department of General Services has purchased a new fleet management system that is available to all agencies that operate vehicles.

Since June 30, we have issued several reports that will affect the management and oversight of the automated administrative system implementations at Longwood University and Virginia State University. We have also suggested a consolidation of the administrative functions of the state supported museums to reduce their overhead and concentrate on providing services.

Reports from this Office serve not only to improve financial and asset management, but also serve as a safeguard or first alert of potential problems. Timely and active response to our reports allows the Commonwealth to have a strong system of internal controls that protect the Commonwealth's assets.

# The Auditor's Office

Our Specialty Teams provide us with the expertise to issue reports like those highlighted above. Within this report we will discuss each specialty and the reports they have worked on during the year.  Their assessment of risk and their specialized knowledge continues to allow us to address and focus on those financial issues facing the Commonwealth.

AUDITOR OF PUBLIC ACCOUNTS

# Capital Asset Management

*Significant reforms are occurring with the Commonwealth's operating, maintenance and capital outlay budget processes; especially for facility maintenance, renewal, and renovation. The Capital Asset Management team is actively working on an enterprise solution for a Facility Inventory and Condition Assessment System.*

*This enterprise system will provide information to decision makers for managing the Commonwealth's buildings. Our work will significantly change how the Commonwealth plans, budgets, and performs facility maintenance, renewal, and capital outlay to provide safer and more efficient facilities.*

## Deferred Maintenance Interim Report

The Commonwealth owns over 11,000 buildings and surrounding infrastructure with a current replacement value of over $12.6 billion. The Commonwealth's buildings are in a constant state of deterioration and, as they age, the buildings often do not fulfill the needs of the agencies' and institutions' current missions. The Commonwealth's funding and performance of facility operations, maintenance, renewal, and new construction are critical to the condition, efficiency, and effectiveness of all state-owned facilities.

We compared the Commonwealth's life cycle of a building to the ideal life cycle and made numerous recommendations. These recommendations included reforming the Commonwealth's operating, maintenance, and capital outlay budget processes; providing a means of accountability for the maintenance and renewal of facilities; and establishing new methods to fund maintenance and capital renewal activities.

We implemented a Facility Inventory and Condition Assessment System (FICAS) to enable state agencies and institutions to collect the data necessary for us to determine the amount of deferred maintenance in the Commonwealth. This process is ongoing and the results will be included in our final report in December 2005.

During this audit, the Capital Asset Management team members worked in conjunction with numerous agencies; including the Departments of General Services and Planning and Budget and staff from House Appropriations and Senate Finance to purchase and implement FICAS. In addition, team members worked with representatives from the Secretary of Administration's office to coordinate the objectives of the audit of Deferred Maintenance with the Governor's real estate initiative.

In response, the General Assembly established a study committee to implement the recommendations of our interim report.

## Department of Transportation

Since the Department of Transportation is one of the largest asset owners in the Commonwealth, we annually audit the Department's capital assets, including equipment, buildings, roads, and bridges to support the Commonwealth's Annual Financial Report. During fiscal years 2002 and 2003, we identified a material weakness in the internal controls surrounding capital assets. As a result of the recommendations we made during those audits, Transportation began improving its capital asset internal controls and financial reporting processes. However, because these problems were so pervasive, we acknowledged that it would take Transportation several years to eliminate all capital asset internal control issues. There has been a proactive attitude and an increase in accountability within Transportation to ensure accurate financial reporting of capital assets for fiscal year 2004.

Transportation has improved its capital asset and financial reporting processes, eliminating the material weakness; however, there are several areas that Transportation should continue to improve. Transportation should continue its establishment and definition of roles and responsibilities within the new Capital Asset and Inventory Control Division. This definition will help enhance communication between individuals, divisions, and districts. However, communication still needs improvement, specifically relating to the Asset Management Division. In addition, Transportation does not have a reconciliation process for reclassifying assets from one category to another. Transportation did not monitor asset acquisitions to ensure proper capitalization during fiscal year 2004. Although the Asset Management Division performed fuel and equipment inventories, the Capital Asset and Inventory Control Division did not include the Asset Management Division in its asset inventory efforts because Transportation has not yet defined the relationship between the two divisions. Transportation should also finalize its methodology to capture and capitalize the cost of improvements other than buildings for existing assets.

Overall, the adjustments made during this audit were minimal in comparison to the prior years. The net effect of all capital asset audit adjustments totaled $1.7 million. This was a significant improvement from last year. The changes seen at Transportation were due to our identification of the issues and ensuing recommendations, the dedication and commitment of the Transportation management and staff, and the time we spent working with Transportation to help develop the best solutions to the problems. We expect to see continued improvement in this area during the fiscal year 2005 audit.

**Objective of the Capital Asset Management Team**

The Capital Asset Management specialty team's main objective is to ensure the proper management, control, and valuation of capital assets; infrastructure; depreciation; preventive, corrective, and deferred maintenance; leases and installment purchases; and historic treasures. The Capital Asset Management team was formerly the Property and Materials Management team. Through reorganization, the Capital Asset Management team took on responsibility for capital outlay. By bringing capital outlay to the Capital Asset Management team, this team now audits all stages of a building's life-cycle.

To enable the team to accomplish its objective, the team members receive training in all specialty areas. Specifically the team's goal is to have every member become a Certified Construction Contracting Officer. In addition, we receive training on the Commonwealth's fixed asset and lease systems and in the areas of accounting and financial reporting for capital assets, life-cycle analysis, facility maintenance and management, and project management.

By developing and retaining qualified and skilled staff, the team is able to support the Office in its requirement to audit the Commonwealth's Comprehensive Annual Financial Report and ensure that agencies and institutions of higher education are properly managing and capitalizing their fixed assets, buildings, infrastructure, and leases.

**Fiscal 2006 Projects**

Audit of Deferred Maintenance - In the final phase of this project, the Capital Asset Management team will provide state agencies and institutions of higher education with access to and training for the Facility Inventory and Condition Assessment System (FICAS). This will allow the agencies to inventory their buildings and enter information for required life cycle and facility condition assessments. The Capital Asset Management team will audit the processes to collect and enter this data and the resulting deferred maintenance costs in FICAS and provide a report on this information by December 2005. These results will help reform how the Commonwealth plans, budgets, and performs facility maintenance, renewal, and capital outlay.

Statewide Review of Capital Outlay - The Commonwealth is spending vast amounts of funds on new construction and renovations throughout the state. The Capital Asset Management team plans to collect and analyze capital project data at a statewide level to ensure agencies are properly using funds and capitalizing assets. The team members will provide data and suggested audit procedures to any audit testing capital outlay to increase the efficiency and effectiveness of the audit. In addition, we will test capital projects at several specific agencies in support of the CAFR.

Statewide Review of Inventory - The Capital Asset Management team, with the Acquisition and Contract Management team, is completing a statewide review of supplies and materials inventory. This review will enable us to gain an understanding of supplies and materials inventory in the Commonwealth and what comprises inventory at the various agencies. We will determine whether items are properly included/excluded as inventory versus fixed assets. The team members will evaluate inventory management including forecasting, planning, reorder levels, stock levels, and inventory reduction.

Review of Higher Education Capital Projects - The Capital Asset Management team will develop a life-cycle budget analysis as required by item 4-4.01n.3.b of the 2005 Appropriations Act. This item applies to institutions of higher education that have met the requirements set forth by Senate Bill 1327/House Bill 2866 for additional operational and administrative autonomy. These institutions of higher education must provide the Governor and Chairmen of the House Appropriations and Senate Finance Committees a life-cycle budget analysis, in a form prescribed by the Auditor of Public Accounts, of each capital project at least 30 days prior to the initiation of a project.

**Ongoing Activities**

Capital Asset Management team members actively participate in two committees created by the General Assembly to implement the results of our Interim Deferred Maintenance and Capital Outlay reports issued in 2004. As a result of our Statewide Review of Agency-owned Vehicles report issued in 2004, team members have followed the development of Executive Order #89 "Purchase, Assignment and Use of State-owned Vehicles" and consulted with the Department of General Services' Office of Fleet Management Services as they reform policies and procedures over the centralized fleet. We plan to perform a follow-up audit in 2006 once the new Executive Order and reformed policies go into effect.

**Working with Others**

General Assembly - Throughout the Audit of Deferred Maintenance, the Capital Asset Management team members have worked closely with members of House Appropriations and Senate Finance staff to develop a program that will meet the needs of the members of the House and Senate to enable them to make more informed decisions surrounding buildings and their funding.

Secretary of Administration - We worked with the Secretary and her staff to ensure that the Deferred Maintenance program and the Governor's real estate initiative complemented each other and did not duplicate efforts.

VFA Multi-state User Group - In performing the Audit of Deferred Maintenance, the Capital Asset Management team is working with Vanderweil Facility Advisors, Inc. (VFA) from whom we purchased FICAS. VFA is working with several other states to implement statewide assessment programs. VFA has invited the Capital Asset Management team members to participate in a multi-state user group to discuss ongoing issues and share information and ideas on the assessment programs in each state. Participation could result in additional improvements and accomplishments in the Commonwealth.

Department of Accounts - The Capital Asset Management team often consults with the Department of Accounts on policy changes related to capital assets, leases, and capital outlay.

# Acquisition and Contract Management

*The Commonwealth is working to change the capital outlay process based on our recommendations. These changes and the Office's other work on deferred maintenance will significantly change how the Commonwealth plans, budgets, and controls the capital outlay process.*

## Capital Outlay

In the past five years, the Commonwealth has spent $3 billion on capital projects and $246 million on maintenance projects. In fiscal year 2004, the Commonwealth has spent $680 million on capital projects and $30 million on maintenance projects. The manner in which the Commonwealth invests and monitors the acquisition, construction, improvement, and maintenance of these assets is significant.

We compared the Commonwealth capital outlay process to general business practices and suggested best practices for government. We identified four areas where changes in the process could provide decision makers with more accurate information and increase budget and accountability oversight without adding substantial cost to the process.

In response, the General Assembly approved establishing a study committee to implement the recommendations made by our report.

## Homeland Security

The Commonwealth has received over $219 million in federal awards for homeland security between fiscal years 1999 and 2004. During the same period, the Commonwealth has spent over $123 million towards that effort.

In performing our review, we found that the Commonwealth expects federal funding for most Homeland Security programs to decrease over the next several years. While current grants allow recipients and subrecipients to use a certain percentage for administrative costs, the expected

decrease in funding may prevent some state and local entities from hiring additional staff to administer and monitor these grants. Consequently, both the Commonwealth and localities have limited resources to perform these duties and must make the decision to either accept additional risk or hire additional staff using state and local funds, if adequate federal funds are not available.

The anticipated decrease in federal funding will also affect the replenishment and maintenance of equipment and training purchased with federal homeland security funds. Over time, much of the equipment and supplies will require maintenance or replacement. With decreased federal funding, the Commonwealth and localities will have to decide whether or not to provide funds towards this effort and choose whether or not to maintain and replenish certain equipment or supplies. Not maintaining equipment and supplies could negatively impact the Commonwealth's ability to respond to terrorist events, and negate the effects of resources already spent on homeland security efforts.

**Objectives of the Acquisition and Contract Management Team**

The Commonwealth spends almost $4 billion each year on goods and services, and maintains inventories of over $211 million. The Commonwealth needs to administer its procurement and manage its inventories in an efficient, effective, and accountable manner.

The Acquisition and Contract Management team helps ensure the Commonwealth's purchasing function meets its objectives, complies with laws and regulations, and supports the agencies' mission. The team also helps ensure agencies properly manage, control and value their inventories.

**Fiscal 2006 Projects**

Small Purchase Charge Card Study - Because of inherent risks of the Small Purchase Charge Card Program (SPCC), this is a continuing project for the team. We plan to follow-up on issues raised during the prior review related to the required use of eVA and the provision of automated reconciliations. We will also collect and analyze statewide data to identify areas of risk and perform detailed test work. Additionally, we will review any changes made to the statewide SPCC procedures.

Review of Contract Management Procedures - The team will perform a statewide review to determine what services the Commonwealth procures, itemize the vendors and types of services used, and determine the method of selection. As part of our study, we will determine if the Commonwealth has an adequate process to evaluate outsourcing options. We will determine whether or not agencies use reliable cost estimates or cost benefit studies to adequately assess and decide what savings would occur for outsourced activities. We will also determine if the Commonwealth has a method to monitor contract compliance for services.

Review of Public/Private Partnerships Activities - The team will work with the Financial Management team to perform a study to compare the costs and risks of financing through alternative methods such as Share in Savings and Public/Private Partnership contracts to the costs and risks of financing through standard up-front appropriations. We will determine how agencies and institutions implement these contracts and if the Commonwealth is providing proper guidance

regarding these agreements. We will also determine the effect of these contracts on the Commonwealth's budget prioritization and resource allocation.

**Ongoing Activities**

The team will continue to monitor changes in procurement laws and regulations and keep current on acquisition and contract management issues in the Commonwealth, in other states, and on the federal level. We will also review changes to the Agency Purchasing and Surplus Property and Commonwealth Accounting Policies and Procedures manuals, which provide guidance to agencies and institutions. The team will use their knowledge and experience to identify, evaluate and report on issues affecting procurement, inventory and contract management.

**Working with Others**

Department of Accounts - The Department of Accounts obtains information from the Acquisitions and Contract Management team to update SPCC policies and procedures, and develop specifications to solicit SPCC and travel card services.

# Information Systems Development

*The Virginia Information Technologies Agency (VITA) has implemented improvements in its strategic planning, policy development, rate setting, and project management oversight based on our recommendations. Additionally, the team's monitoring of nearly every major information technology project in the Commonwealth has made recommendations that have helped prevent system development failures.*

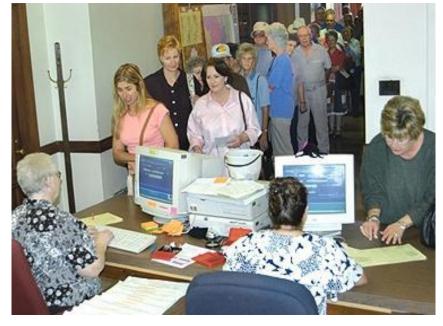## Virginia Election and Registration Information System (VERIS)

The State Board of Elections is implementing a new system, VERIS, to meet the requirements of the Help America Vote Act (HAVA) passed by Congress in 2002. HAVA has provided $12 million in federal funding, covering the entire project budget; however, it has a strict deadline of January 1, 2006, for completion. The most significant risk to the Commonwealth is the potential loss of this funding.

We have monitored the VERIS project to ensure it is progressing on time, within budget and satisfying all defined project deliverables; and that the Commonwealth's interests are adequately protected from loss. Unisys, the vendor hired to develop VERIS, missed every major project milestone in the original project schedule between February and May, placing the VERIS project and its funding at risk.

To bring the project back on track, Elections and VITA have worked with Unisys to develop a revised project schedule to ensure VERIS implementation by the deadline. Contingency plans are in place to address further schedule slippage; however, implementation of the contingency plans would dramatically increase the project's risk for failure.

Unless Unisys continues to promptly deliver the remaining contracted deliverables, the VERIS project could fail. Given Unisys' previous lack of performance and VERIS' ambitious project timeline, we have significant concern of whether they can meet the January 1, 2006 deadline. Even so, given the HAVA requirements, Elections cannot abandon their efforts. Regardless of the ultimate funding source, the Commonwealth must comply with HAVA.

We reported our findings to Elections. They shared our audit report with the project oversight committee who agreed with our conclusions and the need for those involved to remain focused, diligent, and keep everyone informed about events affecting the project schedule and deadline. We continue to monitor the progress of this and other major projects in the Commonwealth.

## Virginia Information Technologies Agency

Beginning July 1, 2003, the Commonwealth consolidated its information technology agencies, and transferred personnel, equipment, and the technology infrastructure from individual executive branch agencies into the Virginia Information Technologies Agency (VITA). Over the past year, we released two audits of VITA, one focused primarily on accounting and compliance and the other on operational activities.

We reviewed operational activities in light of VITA's current strategic plan which is several years old. The age of this document affects many of VITA's operational activities. We believe an updated plan that sets the Commonwealth's long-term goals and creates a vision for Virginia's IT future would provide a framework upon which VITA could base their operational decisions.

We also found that:

- VITA's Security Services Division has not established an understanding with agencies regarding their roles and responsibilities related to security and compliance with VITA standards;

- Security Services has not established a process to identify databases and their risks nor have they developed an audit schedule based on those risks;

- The Project Management Division needs to improve their oversight and monitoring of project development;

- Management regularly reports savings amounts that will never transfer to the Technology Infrastructure Fund;

- The Physical IT Asset system does not contain all VITA-owned assets; and

- The Financial Reporting Division needs to develop written policies and procedures for granting and terminating access to the accounting system.

In response to our reports, VITA has developed action plans with responsible individuals and due dates for each area of concern. Progress towards completing the action plan is reviewed with the Information Technology Investment Board at every Board and Finance Sub-Committee meeting. The Commonwealth's CIO expects to complete the updated strategic plan by March 31, 2006.

## eVA Auditability and Security Review

The Code of Virginia requires the Auditor of Public Accounts to ensure all systems developed are adequate for the purposes of audit and financial control. Because we are involved with many projects from the conceptual design phase, we have the opportunity to review planned controls and audit trails designed in the system to ensure they sufficiently protect data and log activities.

The Department of General Services launched eVA, the Commonwealth's electronic procurement system in March 2001. We followed eVA's implementation and issued two interim reports addressing areas needing attention. With implementation complete and the operating environment stabilizing, we completed a review of eVA security management as it existed in January 2005. The reported results of this review primarily address central security administration activities performed by General Services; however, the review has also provided the foundation to address individual agency security administration activities in the upcoming year.

Overall, we found that General Services has established strong policies and procedures, but there are areas for improvement over eVA security administration. We recommended that General Services:

- develop exception-based queries to analyze user access on a regular basis. General Services should communicate exceptions and their resolution to agency security officers;

- make monitoring tools available to agencies on-line so agencies can more efficiently and effectively meet their monitoring responsibilities;

- periodically assess agency security practices and their compliance with the eVA security manual; and

- provide formal security training to security officers on a regular basis and develop a formal strategy to increase security delegation to agencies.

General Services has stated that their ultimate goal is to delegate advanced security administration functions to agencies that have sufficient, qualified resources to fulfill these responsibilities. By improving each of these areas, General Services will move closer to their overall goal of delegating advanced security functions, while ensuring the integrity of eVA.

General Services substantively agreed with our findings and has implemented several corrective actions in response to this report, including the addition of resources to review and update their policies and procedures and guide them in developing a security awareness program. They also asked for our continued involvement in developing meaningful monitoring reports.

## Objectives of the Information System Development Team

The Systems Development Team's Objectives are:

- To ensure all systems developed will process financial information accurately and efficiently, and create a usable audit trail.

- To ensure all planned systems include safeguards (called controls) that will promote accuracy, dependability, and security.

- To ensure projects are progressing on schedule, within budget, toward success.

## Fiscal 2006 Projects

Through the years, there has been an increasing amount of money spent on successful and unsuccessful system development projects. Some of these projects have run over budget, either in time or money, while others resulted in failure. A major goal of our early involvement in projects is to determine if and when a project is not progressing as planned. We then have the opportunity to alert any chief parties of the impending issues, thereby mitigating the potential for failure at the earliest point possible. We view our involvement as one of early detection and prevention, and work with the project manager, agency management, and VITA's Project Management Division to foster a collaborative relationship.

The following list highlights those major projects we believe require diligent attention to ensure success and minimize risk to the Commonwealth. As each project is in a different phase of development, we have provided a brief description of the project and the nature of our involvement.

Virginia Information Technologies Agency - This work will include following VITA's strategic planning process, project management oversight, database security audits, and the development of rates, policies and procedures, asset tracking, and new service offerings. We will also continue to

follow the Public/Private Partnership for the replacement of central accounting and administrative systems to include CARS, CIPPS, FAACS, BES, and Probud.

Department of Taxation - We will continue to follow the implementation of the Integrated Revenue Management System (IRMS), which replaces the old STARS system. We will review the conversion and reconciliation processes immediately after "go-live," scheduled for August 2005, and also assist in the design of audit procedures over the new system for fiscal 2006.

State Board of  Elections - As previously highlighted, the federal money available under the Help America Vote Act (HAVA) to pay for the $12 million VERIS system is contingent upon implementing the system by January 1, 2006. We issued an interim report expressing concerns about meeting this deadline and will therefore continue to monitor the project.

Higher Education System Implementations - Higher Education system implementation activities present a unique opportunity for system development monitoring and auditability assessment because of the shared commercial off-the-shelf financial and administrative application, Banner. During 2006, we will follow the implementation of the Banner administrative system at Virginia Commonwealth University, Virginia State University, and Longwood University, as well as a new student information system at the University of Virginia. We will continue to determine the best approach for auditing these systems. We will also continue our involvement in the University of Virginia Medical Center's implementation of a new medical records and administrative system known as CareCast.

**Ongoing Activities**

In addition to those projects noted above, we regularly attend project management meetings and review project documents for the following major projects.

> Department of Transportation, FMSII Upgrade
> Department of Criminal Justice Services, Integrated Criminal Justice Services System
> Departments of Emergency Management, Criminal Justice Services, and Supreme Court,
>   Joint Emergency Response System
> Department of Motor Vehicles, Integrated Systems Re-design
> Department of Education, Education Information Management System
> Department of Rehabilitative Services, Integrated Case Management System
> Department of Health, new WIC and two WebVision Modules
> Department of Corrections, Offender Management System
> Department of Social Services, Child Care Development System
> Virginia Employment Commission, Mid-Atlantic Career Consortium

**Working with Others**

The Information Systems Development team works closely with many agencies to help mitigate system development failures. If we note concerns, we first contact the project manager and agency head for resolution. If we do not receive adequate corrective response, we escalate the issue to the responsible Secretary and VITA's Project Management Division. We view our involvement as one

of early detection and prevention and work with the project manager, agency management, and VITA's Project Management Division to foster a positive working relationship.

The Information Systems Development team has identified several organizations within state government with whom we can collaborate to help ensure projects are progressing on time, within budget and satisfying all defined project deliverables; and that there is adequate protection from loss of the Commonwealth's interests.

We work closely with VITA's Project Management Division to share our work and avoid duplicating efforts. Historically, the Project Management Division has had limited resources to assign to monitor projects and instead relied on agency self-reporting. We informally communicate with the Division when we find concerns that bring the self-reported information into question. When appropriate, we also suggest their involvement in suspending a project.

We assist VITA's Security Division in fulfilling their statutory responsibilities regarding database security audits. We share our annual work plan with them to avoid duplication and allow them to use our security audit results. We provide input on policy development and communicate concerns over governance decisions.

We have fostered a close working relationship with the Joint Legislative Audit and Review Commission (JLARC) as it relates to VITA and other major systems development projects. We provide them information as requested and also review and comment on documents related to items such as VITA's rate approval requests.

We actively monitor the activities of organizations impacting systems development at the statewide level, such as public-private partnership arrangements. We regularly attend meetings of the Information Technology Investment Board, Commission on Technology and Science, and the Joint Commission on Technology and Science and their sub-committees. We provide them with information and review and comment on documents, as requested.

# Reporting and Standards

*The Reporting and Standards Team reviewed the reporting processes of the Comptroller and Treasurer's offices and suggested changes to achieve efficiencies and streamline the processes used to prepare statewide reports.*

## Review of the Statewide Reporting Process

The Department of Accounts prepares several statewide reports including the Commonwealth's Comprehensive Annual Financial Report (CAFR) and the Statewide Schedule of Expenditures of Federal Awards (SEFA). The Department of Treasury provides a significant amount of data to Accounts for the CAFR preparation process. This report contains an overview of the processes used to prepare these reports and suggestions to improve the current process.

We recommended that Accounts and Treasury further automate the processes and consider alternative methods for gathering financial information used to prepare the CAFR and SEFA. In addition, Accounts and Treasury must enhance their relationships with and continue to provide guidance to the agencies that provide information for use in preparing statewide reports to ensure they have a full understanding of each agency's role in the report preparation process. Finally, we recommended that Accounts enhance its review process to ensure the SEFA is complete and accurate and receive additional training on federal guidelines and programs in order to provide sufficient guidance to state agencies and to perform an effective desk review of agency submissions.

## Review of the Financial Accounting and Control Operations of the State Comptroller

We have completed our interim review of the State Comptroller's operations as they relate to the Commonwealth's financial accounting and control operations practices. For the interim report, we did not make final recommendations for changes in the operations of the Comptroller's Office; those will be included in our final report, which we will issue in November 2005. However, we did have several proposals based on our interim review. First, the Comptroller and the Chief Information Officer should develop a working group to begin a strategic planning effort to support the information system needs of the Commonwealth.

Second, the Comptroller should look for ways to ensure agency heads and managers understand their responsibility for establishing and maintaining accountability.  Finally, the General Assembly should consider legislative changes in the following areas:

- Line of Duty health benefits;

- Requirements for Comptroller's Preliminary Cash Basis Annual Report;

- Comptroller's duties related to unclaimed property; and

- Comptroller's operation of a fiscal service center.

## Telecommunications Tax Study

The Joint Subcommittee to Study the State and Local Taxation of the Entire Telecommunications Industry and its Customers within the Commonwealth has been reviewing ways Virginia could restructure its telecommunications taxes and fees.  In reviewing this restructuring, the joint subcommittee recognized the need for more information on the revenue impact from existing state and local telecommunications taxes and fees.  Therefore, the General Assembly requested that we collect information, before the 2005 Session, to determine whether the new tax structure will fully replace revenues provided to state and local governments by current telecommunications taxes and fees.

The results of our study found that, based on maximum rates in the legislation, projected revenue does not generate sufficient revenues to fully replace all revenues resulting from the current state and local taxes and fees that are subject to repeal.  There is an estimated $34 million deficiency between the current revenue base of $391 million and the projected revenues of $357 million.

The 2005 General Assembly requested that we determine the amount of revenues received by each county, city, and town that is included in the annual Comparative Report for the fiscal year ending June 30, 2005, for the gross receipts tax in excess of 0.5 percent, the local consumer utility tax, video program excise tax, cable franchise fee, and the 911 taxes and fees.  We will report our findings on a tax-by-tax basis to the chairmen of the House and Senate Finance Committees and the Department of Taxation by December 1, 2005.

**Objectives of the Reporting and Standards Team**

External financial reporting demonstrates financial accountability to the public and serves as the basis for investment, credit and many legislative and regulatory decisions.  The Reporting and Standards team audits the financial officers of the Commonwealth, including the State Comptroller and State Treasurer, to ensure they are following nationally accepted accounting standards in their external financial reporting.  The team strives to have this Office comply with national auditing standards when performing these audits.

National standards demonstrate that this Office maintains competence, integrity, objectivity, and independence in planning, conducting, and reporting our work.  We review the reporting process

used by state agencies and institutions and look for improvements and efficiencies available to the agency or institution. We create and maintain audit tools and provide training to our staff as new standards become effective. We keep local governments and their auditors informed of new standards and state compliance requirements through the *Uniform Financial Reporting Manual* and the *Specifications for Audits of Counties, Cities, and Towns,* and the *Specifications for Audits of Authorities, Boards, and Commissions.*

**Fiscal 2006 Projects**

Review of the Financial Accounting and Control Operations of the State Comptroller - We will complete our review of the financial accounting and control operations of the State Comptroller. Our final report will include the duties and responsibilities of a modern comptroller and the definition of a modern accounting system and recommend the most effective working relationship with other central agencies and proposals for budgetary and statutory changes as well as operational changes to recognize efficiencies.

Truth in Fees Reporting - We will review the administrative and control activities surrounding special fees charged by various agencies and determine whether there are sufficient internal controls to limit the use of these fees for the purpose originally intended and whether the administrative costs associated with collecting the fee exceed the benefit derived. In addition, we will determine whether there should be central monitoring or guidelines concerning the collection and use of the fees.

**Ongoing Activities**

Comprehensive Annual Financial Report -, Annually, we audit the State Comptroller's Comprehensive Annual Financial Report (CAFR). Bond rating agencies and others use the CAFR to determine the financial condition and credit worthiness of the Commonwealth.

Statewide Single Audit - The *Single Audit Report for the Commonwealth of Virginia* discloses the Commonwealth's compliance with requirements applicable to major federal financial assistance programs. The Report provides the General Assembly and agency management with a means to determine how internal controls affect federal funds and whether agencies are complying with federal laws and regulations.

Revenue Stabilization Fund Calculation - Annually, we are required to report on the required calculations for the Revenue Stabilization Fund including the certified tax revenues to be used in the calculation, the maximum size allowed, and the amount of the mandatory deposit to the fund. As a result of changes in the tax structure enacted by the 2004 General Assembly, there have been increases and decreases in the taxes used to calculate the mandatory deposit into the fund. The Virginia Constitution permits the exclusion, in whole or in part, of the growth in tax revenues resulting from increases in tax rates or the repeal of exemptions from the computation of the mandatory deposit for a period up to six years after the effective year of the change.

Therefore, beginning with our November 1, 2005 certification, we will calculate the mandatory deposit under two alternatives: including and excluding tax increases and exemption repeals. We will review the process used by the Department of Taxation to determine the impact of the tax

increases as we will use this information in order to calculate the mandatory deposit excluding tax increases and exemption repeals.

Comparative Report of Local Government Revenues and Expenditures - The Comparative Report of Local Government Revenues and Expenditures presents data submitted by local governments. All Virginia counties, cities, towns with a population of 3,500 or more, and towns operating a separate school division are required to submit comparative data to our office annually. The data presented represents the local government operations for the general government and enterprise activities. We publish the Comparative Reports in a printed version each spring and make it available for viewing and downloading at www.apa.virginia.gov. The on-line version of the report includes amendments, where applicable, for localities that submitted their transmittal data after the deadline for inclusion in the original printed report.

Support of Local Government and Auditors of Local Governments - To assist local governments and their independent auditors, we publish various manuals that we update annually. The *Specifications for Audits of Counties, Cities, and Towns* and the *Specifications for Audits of Authorities, Boards, and Commissions* provide guidance to local CPA firms. The *Uniform Financial Reporting Manual* provides accounting and reporting guidelines and instructions for the preparation and submission of Comparative Report transmittal forms.

We also provide training periodically to local governments and their independent auditors on new auditing and accounting standards and on the preparation of Comparative Report transmittal forms. Annually, we perform quality control reviews of select audits of local governments to ensure the auditors have done their work in accordance with auditing standards.

Monitoring and Responding to Exposure Drafts - When performing our work, we follow auditing standards set by the U.S. Government Accountability Office and the American Institute of Certified Public Accountants. The State Comptroller follows accounting standards set by the Governmental Accounting Standards Board when preparing the Commonwealth's Comprehensive Annual Financial Report. We review exposure drafts from these standard setters for the effects proposed new standards or revisions could have on state and local governments and provide comments to the issuing entities for areas we believe would potentially be problematic for Virginia or its localities. We integrate finalized new standards into our manuals and audit tools to ensure we comply with the standards. We also work with local governments in the implementation of new standards (for example, see Other Post-Employment Benefits Focus Group below) and brief the staff for the Senate Finance and House Appropriations and Finance Committees on significant upcoming changes and the ramifications for Virginia.

**Working with Others**

Other Post-Employment Benefits Focus Group - The Governmental Accounting Standards Board (GASB) issued new financial reporting standards for post-employment benefits other than pensions. We have formed a focus group of the financial reporting staff from selected localities as well as some of the certified public accounting firms who audit local governments. When we met, an actuary provided an overview of some of the requirements of the new standards, and the participants discussed the potential impact on their localities. After this meeting, we created a question and

answer document that is available on our internet site for all localities and their auditors to refer to as they plan to implement these new standards.

Consulting with Members of the General Assembly and their staff - We provide presentations and other briefing materials for the members of the General Assembly and their staff on a number of financial-related matters.  In addition to providing support to local governments guidance on Other Post Employment Benefits, we have provided briefings to the staff of House Appropriations and Senate Finance Committees on this matter.

During the year, as well as during the session, we respond to inquiries as to the accounting or financial treatment of proposed legislation including the Appropriation Act.  We have also responded to members' inquiries to explain the Commonwealth accounting and financial reporting process.

# Data Analysis

*The Data Analysis Team is helping our office to find ways to identify, isolate, and evaluate problems.  This requires the use of appropriate analytical approaches and methods to increase the quality, efficiency, and effectiveness of our work.*

*The team drives the office's efforts to collect and analyze data relating to statewide or agency specific initiatives.  The team supports the office's statewide audit approach by helping to establish a risk-based approach to prioritize and conduct audits by utilizing technology and computer-assisted auditing techniques in performing audits.*

## Transportation Related Audits and Studies

Working in cooperation with other office specialty teams, the Data Analysis team planned and executed several reports that reviewed several aspects of transportation in the Commonwealth.  The reports included the Department of Transportation's "Follow-Up of the Special Review of Cash Management and Capital Budgeting Practices," the Department of Motor Vehicles' "Cost Analysis Follow-Up", and the "Commonwealth Transportation Fund Agencies of the Secretary of Transportation Report."

## Follow-Up of the Special Review of
## Cash Management and Capital Budgeting Practices

Our review of the Virginia Department of Transportation (Transportation) concluded that there has been significant progress on the recommendations made in our 2002 special report.  Complete implementation of these changes will take at least four to five more years.

Over the last two years, Transportation's management has started not only implementing recommendations; but more importantly has also begun implementing a change in the corporate and cultural structure of the organization. The success of Transportation's change will depend on whether a true structural change in the organization takes place. The measure of success will require a substantial long-term commitment by management to not only making the change, but to prevent backsliding into Transportation's old approaches.

In some ways, the accomplishments to date are the easy part of change. The harder part lies ahead in funding and implementing new systems, continuing to make the changes to get closer to capital-based budgeting process, and overcoming Transportation's corporate and cultural structure to improve project management. The success of this effort is highly dependent on management guidance and direction, and current management has demonstrated their dedication towards this effort. If any management change occurs, it is essential that they have the same commitment; otherwise, progress may be negatively impacted.

## Department of Motor Vehicles Cost Analysis Follow-up Report

The report found the Department of Motor Vehicles (Motor Vehicles) staff has made some progress in developing the structure and procedures necessary to implement the cost model recommended in the November 2003 report. However, we observed management needs to provide their staff guidance on what information is necessary for decision-making, cost control, and performance measurements. There is no clear indication of what information they need to provide for cost control and performance measurements. It is crucial to the success of this model that management establish cost control objectives and performance measurements, before designing the capture and reporting of information by the cost model. Tracking and identifying costs is only part of a performance management framework, which provides information that decision-makers can use to improve and communicate the results of government services. Without this guidance, the staff time and potential system changes will result in wasted resources of the agency and the Commonwealth.

In addition to the update on the cost model, we reviewed the general financial operations of Motor Vehicles. In connection with this review, since Motor Vehicles had not completed work on their cost model, we used our assumptions from last year to look at current operations. The cost model again illustrates the need for a balance between revenue collections and customer service. The Department of Motor Vehicles' management and decision makers must determine whether the current level of service is worth the cost to the taxpayer.

## Commonwealth Transportation Fund Report

This report discusses the financial activities of all agencies reporting to the Secretary of Transportation. The agencies are the Departments of Transportation, Motor Vehicles, Rail and Public Transportation, and Aviation; the Motor Vehicle Dealer Board; and the Virginia Port Authority.

The transportation agencies oversee land, air, and water transportation in the Commonwealth. Responsibilities include collecting revenues from taxes, licenses, and vehicle registrations to fund

operations; developing and maintaining highways, ports, and airports; and assisting in the development of private and local rail and mass transportation, highways, ports, and airports.

## A Review of Information Systems Development and Implementation Methodology at the Virginia Department of State Police

The Department of State Police has sound system development guidelines; however, they do not appear to be following them. Staffing shortages, dated technologies, reluctance to use commercially available systems, and lack of a clear vision as to where Data Processing should address the business needs of State Police are hampering operations.

Having good policies and procedures is the start of any good process or project undertaking. Not using, following, or enforcing those policies and procedures leads to fragmented development efforts, lack of user acceptance, and systems that become costly to operate.

We recommend that State Police take advantage of the resources within the Virginia Information Technologies Agency (VITA) to re-examine their agency-wide strategic plan. This collaboration should allow the agency to explain its direction, needs, and goals and then allow VITA to work with State Police on a data processing strategic plan that examines the use of current and future technologies. We believe that in the area of administrative systems alone, there is the opportunity to meet most needs from existing resources within the Commonwealth with potential lower initial and long-term operating costs.

### Trend Reports and Other Analytical Tools

The Data Analysis team works with statewide and agency specific systems to collect and analyze financial and operational indicators using automated tools and processes. The results can identify unexpected or unexplained patterns in the data, streamline the audit process, and identify potential fraud, waste, and abuse.

To ensure a comprehensive approach to auditing, the Data Analysis team is striving to establish tools and methodologies that continuously monitor systems and internal controls throughout the Commonwealth. This includes creating ongoing processes of acquiring, analyzing, and reporting on business data to identify and responding to operational and business risks.

### Objectives of the Data Analysis Team

The team's objectives are to use technology to maximize the office's audits efficiency and effectiveness by identifying, collecting, analyzing, and interpreting agency and statewide data. The team strives to develop and teach techniques that improve our products. In addition, the team attempts to identify potential fraud, waste, and abuse indicators while improving project efficiency.

Using computerized auditing techniques, the Data Analysis specialty team provides the office an extensive base on which to evaluate an entity's operations. Data Analysis also produces reports and

performs comparisons and other procedures to detect errors or irregularities. Working closely with other audit staff, Data Analysis develops new computer-assisted audit techniques.

**Fiscal 2006 Projects**

The Data Analysis team is working on several special projects. These include an Internet Database, the Personal Property Tax Relief Certification, and the Virginia State Police STARS radio system.

Development of Internet Database - The Data Analysis team is working in cooperation with the Network Operations Team to complete and maintain a searchable public database providing state expenditure, revenue, and demographic information.

Certification of Personal Property Tax Allocations - The Data Analysis team will be certifying the Personal Property Tax Relief Allocations for the tax year 2004 per Item 503 of the 2004 Appropriation Act. This certification requires coordinating efforts among our office, the Department of Accounts, Motor Vehicles and local governments.

Department of State Police – STARS Radio System - The Data Analysis team is working in cooperation with the Acquisition and Contract Management Team in following the implementation of a $300 million radio system to determine whether the system is on schedule, on budget and provides the required functionality.

# Social and Medical Services

*The Social and Medical Services team recommended changes to controls surrounding the Department of Social Services' systems to lower the risk of future frauds like the one that occurred with their food stamp program after Hurricane Isabel.*

## Virginia Department of Social Services

The Social Services administers $1.5 billion worth of programs using more than 50 different systems and 120 locally-operated social service agencies. System access and the role of the systems security officer play a major part in providing adequate internal controls over the Commonwealth's resources. Our audit found individuals having conflicting access across various systems caused by the Social Services' systems security officers not being empowered to question the access they were granting as well as not having the ability to evaluate an individual's access across all of Social Services' systems.

Federal regulations require that the Commonwealth have adequate documentation proving that it is in compliance with federal regulations. Our audits of Social Services and the Department of Medical Assistance Services found these agencies lacked adequate documentation. As a result of our audits, these issues were brought to management's attention to be corrected before they become material weaknesses and threaten future federal funding.

## Department of Mental Health, Mental Retardation and Substance Abuse Services

After Mental Health requested and received a $30 million Treasury Loan, a large increase over prior years, our team went to Mental Health to audit and investigate the root cause of the Treasury Loan increase. We reported that the increase was caused by Mental Health not including known salary increases into the projection of expenditures. Furthermore, we reported three issues that, if addressed, could help improve Mental Health management of resources. These issues are:

- Change the Budgeting Process
- Review Dependence on Medicaid Reimbursements
- Share Pharmacy Costs

**Objective of the Social and Medical Services Team**

The Social and Medical Services Team serves Virginia citizens and decision-makers by providing unbiased, accurate information and sound recommendations to improve accountability and financial management of public funds used in providing social and medical service programs.

**Fiscal 2006 Projects**

Eligibility Project - To determine the amount of redundant data the Commonwealth collects on recipients of social and medical services.

Study of Cost Containment Methodologies **-** To catalog Cost Containment Strategies the Commonwealth has implemented for its healthcare costs.

**Ongoing Activities**

The team will continue to audit social and medical programs to ensure that they are meeting the federal requirements to make certain the state continues to receive funding for these programs. We are working to build a diversified team with various disciplines beyond the traditional auditor in order to handle the complexities of the Commonwealth's social and medical programs and to mitigate the risk associated with them.

**Working with Others**

We worked with VDSS to rewrite the audit requirements for the independent auditors of localities to better reflect the current relationship between VDSS and the local Departments of Social Services. These new audit requirements will lower the Commonwealth's risks caused by VDSS shifting more responsibility of administering Federal Social Services programs to the local Departments of Social Services.

# Financial Management

*The Financial Management Team reviewed the Commonwealth's self-insurance funds and provided suggestions that will facilitate their administration, provide accountability by monitoring third party administrators, and potentially minimize the impact of cost increases on future reserves.*

## Statewide Self-Insurance Review

The Commonwealth of Virginia operates a variety of self-insurance programs to cover risk loss exposures such as health, workers compensation, general liability, property and casualty, disability and life. We reviewed these programs at the Departments of Accounts, Corrections, Human Resource Management, Juvenile Justice, Treasury, and the Virginia Retirement System.

The most significant risk that we identified to the Commonwealth's self-insurance programs are events such as premium holidays, premium reductions, and transfers to the General Fund that create long-term solvency issues. These events coupled with the self-insurance programs' inability to avoid the rising costs of services and administration may lead to decreased benefits and increased premiums. Further analysis of the Health Insurance Fund and Workers Compensation Fund revealed that the funds did not meet standard ratio tests for liquidity. In addition, the funds have increasing negative net assets and fund balances cannot cover current claims payable. As a result, we recommended the Commonwealth develop policies that protect the funding and any future reserves of self-insurance programs to minimize the severity of cost increases and benefit decreases. The policies should also include setting adequate premium revenues, monitoring and managing liquidity levels, and funding progress.

We also recommended the Department of Human Resource Management's Office of Health Benefits implement the best practice of monitoring the operations of their third party administrator to ensure internal controls over program transactions are effective. In 2004, the third party administrator had an independent audit conducted of the services the Commonwealth relies on for the administration of health care. We will be working with staff at the Office of Health Benefits to evaluate the results of this audit to ensure the third party administrators' internal controls are effective.

**Objective of the Financial Management Team**

The Financial Management team's overall objective is to specialize in understanding the nature and risks that cash, investments, debt management, and self-insurance transactions have on the Commonwealth's operations and financial position. We obtain this understanding by hiring individuals with knowledge and experience in these areas, providing training on current issues as well as making pertinent resources available to them. This allows the team to effectively address the audit needs of the office and provide assistance to state agencies and local governments.

**Fiscal 2006 Projects**

Public Private Partnerships and Share-In-Savings Contracts – The team will work with the Acquisition and Contract Management team to compare the costs and risks of financing through alternative methods such as Share-in-Savings and Public/Private Partnership contracts to the costs and risks of financing through standard up-front appropriations. We will determine how agencies and institutions implement these contracts and if the Commonwealth is providing proper guidance regarding these agreements. We will also determine the effect of these contracts on the Commonwealth's budget prioritization and resource allocation.

**Ongoing Activities**

Comprehensive Annual Financial Report – The Financial Management team conducts three statewide projects on an annual basis related to cash and investments, long term debt, and self insurance as part of auditing the Commonwealth's Comprehensive Annual Financial Report (CAFR). This statewide approach facilitates relevant and easily understood reporting of the financial management issues in these areas such as those mentioned in our Statewide Self Insurance Review.

- *Statewide Cash and Investments* – This project audits operations related to cash and investments at the Department of Treasury, the Virginia Retirement System, the University of Virginia, the Local Government Investment Pool, and the Virginia College Savings Plan.

- *Statewide Long Term Debt* – This project examines operations related to long term debt at the Department of Treasury including Treasury Board, the Virginia Public School Authority, the Virginia College Building Authority, and the Virginia Public Building Authority. In addition, it includes the Department of Transportation and the University of Virginia.

- *Statewide Self Insurance* – This project reviews operations related to self insurance at the Departments of Human Resource Management, Treasury's Division of Risk Management, and the Virginia Retirement System.

Commonwealth Competition Council Funding Certification – Annually, the Financial Management Specialty Team certifies any savings identified by the Council and confirmed by the Department of Planning and Budget.

**Working with Others**

Other Post Employment Benefits Assistance for Local Government - The Financial Management team and the Reporting and Standards team have formed a focus group that includes participants from the Virginia Retirement System and the Department of Human Resource Management's Office of Health Benefits, in addition to a number of local governments and public accounting firms, in an effort to provide assistance to local governments implementing the new General Accounting Standards Board statements for reporting other post employment benefits.

Procuring Bond Counsel for Legislative Staff - The Financial Management specialty team assisted the Department of Legislative Services in their efforts to procure bond counsel representation.

<u>Assistance for Agencies and Local Governments</u> – The Financial Management team provides assistance to agencies and local governments related to cash management, investments and debt management. This assistance includes efforts to comply with the Government Accounting and Standards Board disclosure requirements and reviewing draft contracts and proposals to determine their financial impact.

<u>Statewide Reporting Process</u> – The Financial Management team worked in conjunction with the Reporting and Standards team to identify ways to improve the processes for preparing the Commonwealth's Comprehensive Annual Financial Report (CAFR) and other statewide reports at the Departments of Accounts and Treasury, in addition to reviewing their relationships with each other and other agencies.

# Budgeting and Performance Management

*The Commonwealth is improving the accuracy and usefulness of the Virginia Results performance information. Our recommendations have helped to improve information for decision makers as the Commonwealth moves towards a more integrated performance and budgeting structure.*

## Review of Performance Measures

Virginia Results is an internet website that provides information for both citizens and decision makers on government activities. The Department of Planning and Budget maintains Virginia Results and makes sure that it contains strategic planning and performance measure information for all executive branch agencies.

We reviewed Virginia Results' performance measures for completeness, accuracy and understandability. This was our third review and we identified problems in the accuracy and understandability of the performance measures information. We made recommendations in seven different areas aimed at improving the accuracy and understandability of the performance measure information. We also observed that many of the performance measures had limited use and relevance, and we emphasized the importance of input from the legislature, citizens, and others in government in determining which measures are appropriate for an agency or program.

As the Commonwealth moves to a new performance management structure that links budgeting and strategic planning, the emphasis on performance measures information as a means to evaluate performance will increase. Therefore, the reliability and the understandability of the information is essential.

## Office of the Governor

We continued to report on the Governor's Office's funding practices, and that the budget shown in the Appropriations Act did not accurately reflect the actual expenses of the Office. This practice had existed for several years. As a result, the need for additional funds to cover unbudgeted expenses has consistently occurred, requiring transfers from other agencies or from central accounts.

In response, the Department of Planning and Budget has changed the budgeting mechanisms to fund operations for fiscal year 2005 for the Governor's Office as well as several of the Cabinet Secretaries. In addition, the budget proposed and approved for the 2006-2008 biennium reflects a more accurate projection of actual expenses of the Governor's Office.

**Governor Warner's Proposed Amendments to the 2004-2006 Budget**

Economic Outlook & Revenue Forecast

*A Briefing for the Senate Finance, House Finance, and House Appropriations Committees*

*December 17, 2004*

**John M. Bennett**
Secretary of Finance
Commonwealth of

# Report on Budget and Appropriation Processing Control System

We reviewed the budget and appropriation processing control system administered by the Department of Planning and Budget. This work supports our audit work on the State Comptroller's statewide financial statements and ensures that it correctly shows the budget in the state's accounting system. During the year, Planning and Budget processed over 20,000 operating budget adjustments. Our report summarized these adjustments and provided details on areas with significant budget adjustments.

## Working with Others

Assistance to the Council on Virginia's Future - We continued to provide assistance to the Council on Virginia's Future as they direct long term planning and performance management efforts in the Commonwealth.

Assistance to the Governing Project - We provided the Governor's Office information for the completion of the Governing Project, which resulted in the Commonwealth receiving "The Best Managed State in the Nation" designation.

Assistance to the Department of Planning and Budget - We provided assistance to the Department of Planning and Budget in the development of the new service area budget and performance management structure.

## Objectives of the Budgeting and Performance Management Team

In state government, there is a very close relationship between budgeting, accounting and financial reporting. The budget is the mechanism for allocating resources and is the cornerstone of a government's financial management system. Additionally, in today's world, there is an increased emphasis on governmental accountability and performance management in government. Our team strives to use our specialized knowledge in budgeting and performance management to identify, evaluate and report financial management issues in the Commonwealth.

## Fiscal 2006 Projects

Review of Performance Measures – We will determine that state agencies are providing and reporting appropriate information on financial and performance measures, and to review the accuracy of the management systems used to accumulate and report the results. The Code of Virginia mandates this review.

Council on Virginia's Future – We will continue to provide assistance to the Council on Virginia's Future.

Budget and Appropriation Processing Controls – We will review statewide budget and appropriation processing controls in conjunction with our annual audit of the Commonwealth's Annual Financial Report.

Higher Education – Review of Performance Measures - We will determine that colleges and universities are providing and reporting appropriate information on financial and performance measures, and to review the accuracy of the management systems used to accumulate and report the results.

Capital Projects – Review of Performance Measures - We will determine that agencies are providing and reporting accurate financial and performance measures for capital projects. These measures are summarized and reported in the Governor's Six Year Capital Outlay Plan.

Department of Planning and Budget – Review of Strategic Planning Process – We will review and monitor implementation of the new service area budget structure developed by the Department of Planning and Budget.

# Information Systems Security

*Information systems security standards in the Commonwealth are weak and allow the opportunity to ignore important security features, and the Team has recommended that the Virginia Information Technologies Agency define the roles and responsibilities for information security and define standards using "industry best practice."*

## Department of Social Services

The Department of Social Services provides central statewide oversight for policies and procedures to the 120 locally-operated social service agencies. In support of the locally-operated social service agencies, the department has a number of central systems for determining and providing benefits. These central systems operate in diverse environments and include everything from mainframe applications to web-enabled systems. Both Social Services' oversight of the local social service agencies and the fragmented approach to systems development has created some significant security issues over access to the systems and their data, leading to the occurrence of several frauds during the year. Below is a partial list of the issues with the current process.

- Social Services does not maintain readily available and accurate centralized listings of who has access to their systems.

- The current procedures are inadequate for controlling user access at the local divisions. The central office needs to have adequate assurance that system access privileges are proper and delete unnecessary user access in a timely manner.

- Social Services does not receive notice when a local employee, wage employee, or contract employee terminates, resigns, or dies. With no listing of former employees, the Information Security Unit cannot delete an individual's system access timely.

- Social Services' Information Security Unit does not receive notification when an employee's duties change. If an employee changes positions and remains under the same security officer, the security officer can grant them additional system access without deletion of previous systems access capabilities. This may allow a user to have multiple systems access not needed under their current job responsibilities.

- Social Services lacks formal procedures for notifying the CARS Security Officer of position transfers and cannot provide adequate documentation that the agency reviews CARS access every six months as required by Commonwealth standards.

We recommended that the ideal solution to these issues should come from Social Services' overall strategy to replace its systems. However, in the meantime, we believe that Social Services should begin developing a personal computer-based database of employees and their access. Social Services could use this database to review and verify access for users and to conduct periodic verification of access at both the local office and central office levels.

## Virginia Information Technologies Agency SAS 70

The Commonwealth has implemented and maintained decentralized information systems security for the past 15 years. Before the creation of the Virginia Information Technologies Agency (VITA), each agency had to follow general standards created by the Department of Technology Planning (now part of VITA). These standards are non-technology or vendor specific, which leaves leeway for agencies to determine what works best in their environment. However, we also found that these standards equally leave open an opportunity to ignore detailed security features. In addition, we reviewed memoranda of agreement between VITA and their customer agencies. We found that VITA uses a generic Memorandum of Agreement (MOA) for servicing customer agencies. These agreements do not specifically address information security concerns other than to state that VITA, as custodian of customers' data, will ensure that the data is not available to unauthorized users.

We recommended that as the centralized technology agency for the Commonwealth, VITA should develop detailed security guidance for the Commonwealth based on "best practices" from the federal government and industry. VITA must also coordinate who implements and maintains security. Finally, we recommended VITA create and distribute a detailed list of roles and responsibilities for information security to its customer agencies.

In response, VITA has developed a more detailed high-level statewide security standard. Once the Information Technology Investment Board approves the standard, VITA plans to develop detailed security configuration standards. In addition, VITA is currently working with several large customer agencies to create a detailed agreement to define the roles and responsibilities for information security.

**Objective of the Information Systems Security Team**

The objective of the Information Systems Security team is to determine the adequacy and effectiveness of the security controls in place over the Commonwealth's information systems in order to protect its critical and confidential data and assets. We achieve our objective through audits and reviews of agencies' and institutions' information security plans and information systems operational and security policies and procedures.

**Fiscal 2006 Projects**

E-Commerce - The conducting of business communication and transactions over networks and through computers has become an acceptable way of doing business. Many state agencies and institutions buy and sell goods and services through digital communications. We will perform a review to determine the various technologies the Commonwealth uses to conduct e-commerce, the risks associated with the use of electronic data transmission, and best practices and controls.

<u>Statewide Security Responsibility and Guidance</u> - The team will follow the development and determine the adequacy of VITA created statewide policies, standards, and guidelines. The team will also follow the development and growth of the Information Systems security office at VITA as it takes on the responsibility for executing the security function for many information systems across the state.

**Ongoing Activities**

The team will continue to perform reviews of the information security programs at major agencies and institutions. Additionally, the team will continue to monitor VITA's development and implementation of a statewide information security program.

**Working with Others**

The Information Systems Security team audits agencies' compliance with the Commonwealth's information technology standards. The Virginia Information Technologies Agency uses our audits to meet their statutory mandate to perform security audits of government databases and data communications. Annually, we provide VITA with a listing of agencies we audited and any findings of non-compliance with state guidelines for security.

Additionally, we perform audits of the controls in place over the information technology environment at VITA. VITA has responsibility for the operation and security of the Commonwealth's data center, statewide telecommunications and executive branch information technology infrastructure. This audit provides assurance that VITA has sufficient and effective policies and procedures in place to protect customer data maintained on VITA's systems. VITA relies on us to perform this review to satisfy the audit requests of customer agencies through one audit, instead of each customer performing their own audit of VITA. VITA's customer agencies rely on us to provide an objective determination of whether VITA has sufficient security controls in place to protect customer data.

# Higher Education

*The Higher Education Specialty Team coordinates the audits of the fourteen state-supported colleges and universities and the community college system. All higher education institutions, except Longwood University, received unqualified audit opinions on their financial statements for the year ended June 30, 2004. We did have recommendations for improvement in internal controls for some universities.*

Throughout the year, Higher Education specialty team members worked with other specialty teams to complete the financial statement audits for higher education institutions. The higher education specialty team's work concentrated on the student financial aid programs, research and development, NCAA agreed-upon procedures, internal control policies and procedures, and financial reporting. Audit recommendations included improving controls over information systems, strengthening cash management and reconciliation controls, and ensuring proper documentation of policies and procedures. We also had recommendations in the areas of accounts receivable, capital assets, payroll, and the small purchase charge card program. We issued NCAA agreed-upon procedure reports on all Division I and II institutions.

## Auxiliary Enterprises Operations Project

The higher education team began work on the Auxiliary Enterprises Operations Project during this year. Each institution operates a variety of auxiliary enterprises including dormitories, dining, parking, telecommunications, student centers, and many more. This project will review the definition of an auxiliary enterprise, examine the current fee structure and reserves within these operations, and evaluate the current reporting model. We will finalize our analysis of colleges' auxiliary enterprises activities using NACUBO and SCHEV guidelines for being self-supporting and year end balances with a comparison between all public colleges and universities. We plan to issue our report on Auxiliary Enterprises Operations in the fall of 2005.

**Objective of the Higher Education Team**

The Higher Education Specialty Team provides guidance to auditors performing higher education audits as to the special nature of college and university business operations and develops a core of knowledgeable auditors to assist in the completion of these audits.  By specializing in higher education audits, team members develop best practices both in audit planning and techniques for these audits and in the financial operations of colleges and universities.  The team provides training and guidance on higher education financial reporting and compliance issues, as well as current industry changes.  The team also provides specific guidance on Student Financial Aid and Research and Development programs, and NCAA compliance issues.

The team developed a webpage within the APA intranet for use of the team members and other teams involved in higher education audits.  This page provides helpful information, audit tools, links, and updates on higher education activities.

**Fiscal 2006 Projects**

Review of One-Card Systems - Each institution has implemented one-card systems for use by the students.  These cards can act as the students' meal card, debit card with merchants and vending operations, their key to dormitories, as well as perform other functions.  We plan to review and compare the controls, policies, and procedures of the one-card systems used in the institutions.

Higher Education Restructuring Act – The 2005 General Assembly passed this Act, which provides incentive performance benefits to certain public institutions of higher education that meet the financial and administrative management standards.  We will be monitoring the effects of the Restructured Higher Education Financial and Administrative Operations Act and determining how this Office will assist in ensuring the institutions are meeting the requirements of this legislation.

Auxiliary Enterprise Operations – All institutions operate a variety of auxiliary enterprises including dormitories, dining, parking, telecommunications, student centers, and many more.  We will finalize our analysis of colleges' auxiliary enterprises activities using NACUBO and SCHEV guidelines for being self-supporting and year end balances with a comparison between all public colleges and universities.

Banner Systems – Within the next few years, nine institutions will have implemented the Banner financial system and associated modules.  We will continue working with the Data Analysis and Information Systems Development Teams to evaluate the implementation of the Banner System for determining data retrieval and analysis functions available for audit purposes.

**Ongoing Activities**

The Higher Education Team works with the Reporting and Standards specialty team on changes in auditing standards and accounting principles that affect higher education.  We monitor the activities of the following higher education professional organizations - the National Association of College and University Business Officers (NACUBO), the Association of College and University Auditors (ACUA), and the National Association of Student Financial Aid Administrators (NASFAA).

**Working with Others**

The Higher Education Team presents training to the Financial Officers of Colleges and Universities (FOCUS). This year's presentations included the new accounting standards for component units and investment reporting, changes to NCAA agreed-upon procedures, systems development projects, and deferred maintenance and other projects impacting higher education. We also worked with various institutions in the implementation of the Banner financial systems.

The team works with management of the individual institutions on a myriad of issues facing their respective institutions. These issues include internal control matters, financial reporting topics, and federal and state compliance requirements. We are developing a working relationship with the State Council of Higher Education in Virginia (SCHEV) on financial issues affecting higher education as well as determining our individual responsibilities for the Higher Education Restructuring Act.

# Judicial Systems

*The statewide court audit reports identified specific training opportunities for court clerks to address several issues relating to court accounting and management issues.*

## Virgina Courts Statewide Reports

Our annual statewide circuit and district court reports identified six statewide audit issues that were common to several clerks' offices. As a result of our recommendations in the report, the Executive Secretary of the Supreme Court and the Education Committee of the Virginia Clerks Association, in collaboration with this office, developed and presented specific training to court staff in a series of regional meetings in October and November 2004. We expect that as more court staff receive training, we should see a corresponding reduction in the recurrence of audit findings. Better trained court staff will help protect assets by reducing the risk of fraud and errors going undetected.

## Statewide Court System Revenue and Expenses

The Team is gathering relevant information to ultimately report on the total revenues and expenses of circuit and district courts. The report will include both state and local government expenses for the courts. Sources of information for this project will include the Comparative Report of Local Government Revenues and Expenditures and the Supreme Court's Financial Management System (FMS). Depending on the availability of information, the Team hopes to expand this report in the future to include all court-related activities.

**Objective of the Judicial Systems Team**

The Judicial Systems Specialty Team promotes sound financial management and accountability for public funds through audits of the various courts and related agencies that comprise the Judicial Branch of Virginia's State Government. The Team has five regional groups visiting the more than 320 individual circuit, district, and juvenile and domestic relations courts throughout the Commonwealth at least biennially. Our audits' objectives include determining whether the internal controls are adequate to ensure accurate and timely entry of financial transactions in the courts' automated information systems; ensuring that internal controls are adequate to provide proper safeguarding and distribution of financial assets; and testing compliance with certain laws and regulations. Team members also conduct audits of local constitutional officers (state accounts) and General Receiver audits annually. Finally, with three specialty team members on the office's Fraud Task Force, we investigate reports of suspected fraudulent activity in operations of local constitutional officers.

The Judicial Systems Specialty Team also specializes in six specific areas, which include accounts receivable, magistrates, FMS/CMS, general receivers, retrieval, and legislation. Auditors specializing in these areas act as consultants to peers and management when questions arise regarding the judicial branch of Virginia's State Government.

**Fiscal 2006 Projects**

<u>Total Cost to Fund District and Circuit Courts</u> - The Judicial Systems Team is currently gathering relevant information to report on the total revenues and expenses of the Circuit and District Courts. The report will try to include both state and local government expenses for the courts. Sources of information for this project are the Comparative Report of Local Government Revenues and Expenditures, the Supreme Court's Financial Management System (FMS), and the financial information from localities. Depending on the availability of information, the Team hopes to expand this report in the future to include all court related activities (i.e. Court Appointed Defenders, Court Service Units, etc.) We plan to compile, classify, and analyze the financial data from the above sources and draft a report for issuance before the 2006 General Assembly Session commences.

**Ongoing Activities**

The Team continues to monitor changes in <u>Code of Virginia</u> statutes that affect the collection of revenue and the Supreme Court's changes to the automated system. Additionally, the Team continues to monitor the courts' fines and cost collection efforts.

Of particular significance for the current audit cycle are the new circuit court audit reporting requirements mandated by the 2004 Appropriations Act. Beginning with audits completed after July 1, 2004, the APA will report any "*internal control matter that could be reasonably expected to lead to the loss of revenues or assets, or otherwise compromise fiscal accountability*." Further, the law requires clerks to submit a corrective action plan to the APA within ten days of the exit conference addressing how they plan to remedy these types of findings. As part of the subsequent audit, we will determine and report whether the clerk has corrected the finding. Clerks with repeat findings as described above will not receive a pay raise from the Compensation Board.

The team has taken the following actions to facilitate this new reporting requirement.

- We trained Specialty staff on the new Appropriations Act requirements during our September 2004 training session.

- We have explained our new procedures to clerks across the state with presentations at all of the separate Supreme Court Fall Regional Meetings.

Another ongoing activity is the continual evaluation of our audit process to adapt to emerging issues. For example, for the current audit cycle we have developed new procedures in our audit programs to determine whether district courts consistently document the appropriate court fees and costs in those cases appealed to the circuit court. Additionally, new procedures will determine whether the courts are appropriately assessing the $25 fee for certain juvenile petitions. These new procedures have also required us to develop new data retrieval.

**Working with Others**

Members of the Judicial Systems Specialty Team represent the Auditor of Public Accounts on selected committees and task forces. Presently, we participate in two on-going activities.

Jail Cost Recovery - The 2005 Appropriations Act mandates that the Auditor of Public Accounts and the Compensation Board develop options for a revised cost recovery methodology so that the Commonwealth can recover all costs reimbursed by the Commonwealth associated with housing federal and out-of-state inmates in Virginia's jails. Options will be developed and submitted to the Governor and the legislative committees by October 15, 2005.

Clerks of Circuit Court Career Development Program - Members of the Judicial Specialty participate in a task force with the Compensation Board and the Virginia Clerks Association in developing minimum criteria for a career development program for Clerks and Deputy Clerks in the circuit courts. The criteria will span a wide range of court operations including continuing education, adopting specified administrative and human resource policies, accounting and auditing requirements. A completed program will be submitted to the Governor and the legislative money committees by November 15, 2005.

Additionally, during the 2005 legislative session, we worked with the Virginia Clerk's Association to propose legislation that would allow localities to recoup the expenses of providing copies of official court records to the public. The legislation was adopted and enacted into law and, effective July 1, 2005, localities will be able to begin recovering these costs.

# Internal Control

*Internal controls are the fundamentals of sound and complete accountability. No one can achieve accountability whether for finances or performance without a good system of internal controls to accumulate and report information.*

Our audits cover a wide range of matters that affect accountability by ensuring that agencies have sound internal controls. Earlier in the report, we discussed reports that individual specialty teams worked on, and in this section we discuss some reports that groups of auditors representing cross sections of the Office addressed.

## Jamestown-Yorktown Foundation

The Foundation is rapidly growing to meet the demands of the upcoming events, which will significantly increase the volume of activity over the next several years. These new demands on the Foundation come after a period of several years of budget reductions. Like most organizations, the Foundation trimmed administrative expenses and consolidated these operations to absorb the reductions.

With a smaller management staff, focus of operations tends to concentrate on program delivery and significant upcoming events. This management focus tends not to consider and focus on the supporting functions of an operation. Many of the basics, such as accounting and purchasing, appear to be obstacles to operations, since they do not have staff to respond to the changing demands. Further, shortcuts used to overcome budget reductions may not provide management with the proper controls to oversee and review operations and safeguard the assets within their responsibility.

Management should review and update the Foundation's internal control system to not only reflect its current operations, but provide the safeguards for the anticipated growth of the next several years. Undertaking this review and update will require consideration of how the Foundation grows and then how it will re-adjust after 2007.

## Secretary of Natural Resources Agencies
## including the Department of Game and Inland Fisheries

This report for the fiscal year ended June 30, 2004, incorporates all of the following agencies:

| | |
|---|---|
| Chesapeake Bay Local Assistance Department | Department of Historic Resources |
| Chippokes Plantation Farm Foundation | Marine Resources Commission |
| Department of Conservation and Recreation | Virginia Land Conservation Foundation |
| Department of Environmental Quality | Virginia Museum of Natural History |
| Department of Game and Inland Fisheries | Virginia Outdoors Foundation |

On May 24, 2005, the State Internal Auditor presented the findings of his investigation to the Board of the Department of Game and Inland Fisheries. Accompanying this report was a corrective action plan developed by the Secretary of Natural Resources and adopted and endorsed by the Board, with some exceptions related to the Secretary's recommendation to the Governor.

While the State Internal Auditor's report discusses some issues of Board governance, recommendations in our report included a more extensive discussion of this issue. We did not include in this report any findings or recommendations which would duplicate the State Internal Auditor's report, except for the general Board governance issues. The State Internal Auditor's report includes extensive recommendations concerning internal controls and other matters and we encourage the Board and the Acting Executive Director to implement all of these recommendations.

Included in the Secretary of Natural Resources' response to the report were recommendations to the Governor on the structure of Game and the Board. The Board did not adopt these recommendations, but agreed to consider and discuss them. Included in the report is a discussion of Games' organization and the relation of the Board, Secretary of Natural Resources and the Executive Director.

## Department of Game and Inland Fisheries

The Department of Game and Inland Fisheries (Game) manages Virginia's wildlife and inland fish to maintain optimum populations of all species to serve the needs of the Commonwealth; provides opportunity for all to enjoy wildlife, inland fish, boating and related outdoor recreations; and promotes safety for persons and property in connection with boating, hunting, and fishing. Major sources of revenue include hunting, fishing, and motorboat licensing; boat sales and use taxes; wildlife related sales taxes; and federal grants. Game's maximum employment level is 466 positions.

**Organization**

Game and Inland Fisheries Board - A supervisory board, appointed by the Governor to four-year terms, governs Game. The Board has 11 members, one from each congressional district. As a supervisory board, members have overall responsibility for Game's operations and also appoint Game's executive director, who serves as the principal administrative officer for Game. The Board elects one of its members as its chairman, who presides at all meetings of the Board, but who has no additional powers or authority other than those given to the other board members.

Game and Inland Fisheries Executive Director - The Board appoints Game's Director to act as the principal administrative officer and report directly to the Board. The Code of Virginia specifies that the Director is responsible for the following:

- enforce all laws for the protection, propagation, and preservation of game birds and game animals of the Commonwealth and all fish in the inland waters;

- initiate the prosecution of all persons who violate such laws, and seize and confiscate wild birds, wild animals, and fish that have been illegally killed, caught, transported, or shipped;

- employ persons necessary for the administrative requirements of the Board;

- conduct and establish cooperative fish and wildlife projects with the federal government;

- enter into all contracts and agreements necessary or incidental to the performance of his duties and the execution of his powers; and

- consult with, and keep informed, wildlife and boating constituent organizations so as to benefit Virginia's wildlife and natural resources and accomplish Game's mission.

Secretary of Natural Resources - The Secretary of Natural Resources, appointed by the Governor, has responsibility for Game, among other natural resource agencies.  The agencies assigned to the Secretary are required under the Code of Virginia to:

- exercise their respective powers and duties in accordance with the general policy established by the Governor or by the Secretary acting on behalf of the Governor;

- provide such assistance to the Governor or the Secretary as may be required; and

- forward all reports to the Governor through the Secretary.

The Secretary is granted administrative authority within his agencies by the Code of Virginia to do the following:

- resolve administrative, jurisdictional, operational, program, or policy conflicts between agencies or officials assigned;

- direct the formulation of a comprehensive program budget for the functional area, encompassing the services of agencies assigned for consideration by the Governor;

- hold agency heads accountable for their administrative, fiscal and program actions in the conduct of the respective powers and duties of the agencies;

- direct the development of goals, objectives, policies, and plans that are necessary to the effective and efficient operation of government;

- sign documents on behalf of the Governor that originate with agencies assigned to the Secretary; and

- employ such personnel and to contract for such consulting services as may be required to perform the powers and duties conferred upon the Secretary by law or executive order.

## Internal Control Findings and Recommendations

Game has been under review by the State Internal Auditor and the media due to the decisions of key administrative personnel related to travel, the acquisition of goods and services, and other personnel matters. While no organization can operate without criticism, much of the current controversy arises from a lack of uniform decision-making that results from the failure to develop and follow written policies and procedures. Also, it appears that the Board has not clearly defined the scope of their responsibilities in the active management of Game.

Internal controls are review checks on the processing of transactions against documented policies and procedures. Our audit found that in most cases Game's system of internal control has appropriate checks to review the processing of transactions. However, overall there is a significant lack of documented policies and procedures and their applicability to all levels of the organization, including senior management and the Board.

The sections below recommend processes that the Board and Game should follow to improve their operations and focus primarily on the development of written policies and procedures.

Clarify Duties and Responsibilities of the Board, Game Director, and Secretary for Following State Guidelines - Game's organizational structure may result in confusion since both the Board and Secretary have similar duties and responsibilities relative to Game. Questions arise such as who is responsible to the Governor for the operations of Game and who defines the policies they must follow. Since the Governor appoints both the Board and Secretary and both answer to him, they must agree on the division of their responsibilities and duties and determine how they can work together to ensure Game fulfills its mission and goals.

We reviewed the Board's governing policies. The Board adopted the majority of their policies in 1990 with two added in 1993 and one in 1995, and we found these policies generally vague and without clear definition of specific roles and responsibilities. Also, these policies did not address the Board's working relationship with the Secretary and how the Board would comply with responsibilities and duties for obtaining approvals or coordinating activities with and through the Secretary.

Underlying the Board's policies appears to be the assumption that staff will keep the Board informed of major state statutes, rules, and policies governing the conduct of state business. We believe that in addition to clarifying the roles and responsibilities, the Board should periodically receive an update on whether its policies comply with state statutes, rules, and policies and how they affect operations.

The Secretary of Natural Resources' response to the State Internal Auditor's report recommended that the Governor consider having legislation introduced to change the Board from supervisory to a policy board, therefore removing their hiring of the Executive Director and financial and daily operating responsibilities. In addition, the Secretary further recommend having the Governor select and appoint the Executive Director.

While we concur that action is necessary to clarify and delineate duties and responsibilities, we believe that there are several alternatives including the one recommended by the Secretary. In addition to the Secretary's recommendation, the following represent some of the alternatives.

- Make the Secretary of Natural Resources and the State Comptroller members of the Board, thereby providing increased supervision and insight into typical internal controls and state procedures;

- Change the Secretary's duties and responsibilities for Game to allow the Secretary to review and oversee the Board's actions similar to his oversight of other agency heads; and

- Clearly define the Board's consequences for failing to properly exercise control over the Executive Director, including in appropriate circumstances, the Secretary's ability to remove or suspend the Executive Director.

There is clearly a need to define the Board, Secretary and Executive Director's duties and responsibilities. Not addressing this issue will continue to result in periodic oversight problems. Any of these alternatives, including the Secretary's recommendation, will require statutory change in the Board duties and responsibilities. Both the Governor and General Assembly will need to address this relationship if they are going to improve Game's operations.

Define the Role of the Chairman - Under the Board's statutory authority, the Chairman has the same duties and responsibilities as any other board member, except to preside over meetings. However, our audit found several instances where the Chairman provided formal instructions to the Game Director, but there is no evidence that other Board members provided consultation or agreement with the instructions. These instances occurred under more than one chairman's leadership and it appears that both the Director and the individual appointed as Chairman assume this is a typical mode of operation.

While on many corporate and other supervisory boards, the Chairman may have additional duties and responsibilities; this is not the case in this circumstance. Since neither the Code of Virginia, nor the Board's governing policies sets out additional responsibilities and duties for the Chairman, all Board members should approve formal instructions to the Director, unless the Board agrees to a level of delegation. If the Board wishes to delegate certain responsibilities to the Chairman to act on their behalf relative to specific matters, the Board should describe and adopt this guidance as part of the Board's governing policies. Collectively, the Board should periodically review this delegation and relationship to ensure it stays within the Board's statutory mandate.

Establish Official Duty Guidance - The Board evaluates the Game Director's performance annually in five broad categories: Leadership; Government and Community Relations; Human Resource Management; Management Systems, Processes and Practices; and Relations with the Board. However, the categories provide no description of the Board's expectations. In addition, as mentioned in the section above, the Chairman has periodically issued formal instructions to the Game Director, but with no evidence that other Board members provided input.

While the evaluation is a personnel matter, all Board members should have a clear understanding of the Game Director's performance expectations. We recommend that the Board collectively develop and communicate clear performance expectations to the Director and any future formal instructions come from the collective Board or provided from a member and ratified at subsequent Board meetings.

Perform a top-down review of existing policies and procedures - Game lacks adequate policies and procedures governing its daily operations and decision-making, causing Game to address problems in a reactive stance. Instead, we believe Game and the Board should be proactive by identifying areas where policies and procedures do not address the standards and mode of operations that Game needs and the Board expects.

Game and the Board should perform a top-down review of existing policies and procedures to determine where they do not exist and those that are outdated or invalid. This review should include the Board's governing rules to ensure they clarify their responsibilities as a supervisory board and spell out whether the Chairman has any additional powers over regular members except to open and close Board meetings.

Game has had a reluctance to adopt and follow policies and procedures, which has contributed to criticism of management's operation of Game. This office has, over time, recommended adoption of policies and procedures and we again believe the Board should make this a management priority for all divisions, activities, processes, and procedures.

Without policies and procedures, Game management and Board members use their judgment when deciding what course of action is appropriate and whether their solution is in line with the Game's goals and mission. Often, this places Game and the Board in the position to later justify actions rather than citing public documents that demonstrate their decision was based on Game's established standards.

Establish Criteria for Official Duties - Many of Game's staff and management are actively involved in activities that the Game oversees, controls, or provides services to, both in their official capacity, as well as on a personal level. In some cases, staff and management are providing services to organizations and groups and at the same time are members of those organizations and groups. While constituent outreach is an important part of Game's goals and mission, this overlap of official duties and responsibilities with membership participation creates confusion and misunderstanding as to the staff and management's participation in activities.

As an example, Game has responsibility for providing instruction in hunting and weapon safety. Many of staff that provide this training also have an active personal interest in hunting and weapon's

proficiency. As they develop these skills and participate in various group or organization events, it may become difficult to differentiate whether the staff are there as participants or official representatives of Game. Without some guidance in this area, Game staff and management will continue to receive criticism for purchases, travel, and participation in certain activities since it is unclear why an individual may be participating in an event.


## Department Of Veterans Services and The Veterans Services Foundation

**Internal Control Findings and Recommendations**

Generally, we found that Veterans Services' system of internal controls did not achieve the objectives for such a system. Although some of the problems arose from not understanding the Commonwealth's process, we are of the opinion that many of the managers and supervisors do not fully understand their responsibilities and what they contribute to the organization. Finally, the managers and supervisors do not appear to understand how to use these tools to improve internal controls and the knowledge of the staff.

Develop and Enforce Internal Controls over Financial Transactions - The Department of Veterans Services is the result of the merger of several functions of government previously performed by the Department of Veterans' Affairs and the Veterans Care Center. The former Department of Veterans' Affairs had the most expertise in dealing with the Commonwealth's accounting, payroll, personnel, procurement, and other administrative system, policies and procedures. However, Veterans' Affairs was a small agency with limited support staff. The creation of Veterans Services and the assumption of all the employees and responsibilities of operating the new agency, especially the Veterans Care Center, has fully taxed the knowledge, experience, and abilities of the original support staff.

As part of the merger, Veterans Services assumed the operation of the Commonwealth's Veterans Care Center, which is a nursing home facility, and as such bills insurance companies, Medicare, and Medicaid for services. Prior to the merger, a contractor operated the Veterans Care Center; therefore, there was little or no need to deal with the Commonwealth's processes. There was limited time to plan for the merger and the staff, although knowledgeable, was not able to properly support the core administrative staff from Veterans' Affairs.

Inherent in any system of internal controls is a dependence on supervisory review and timely and accurate reconciliations. Supervisors, who question and understand the process they oversee, are any organization's first line of defense in maintaining accountability regardless of system or process.

Reconciliations and supervisory reviews provide both a check on how well staff are doing their jobs, but they also provide assurance that management is getting timely and reliable information to make decisions. Without timely and accurate reconciliations coupled with their use to correct information, management faces the prospect of having inaccurate and unreliable information.

Reconciliations and supervisory reviews provide two additional controls fundamental to any well-running system of internal controls and accountability. Both of these functions provide checks

against outside sources as to the processing of financial transactions by providing information on the timely receipt, payment, and accuracy of transactions processed by vendors, customers and others, such as the bank. Finally, these two processes also provide information on the performance of the staff processing the transactions. Errors, miscoding, duplicate transactions, and untimely processing can all indicate whether whole sections or individuals either do not understand their duties and require additional training or are just failing to perform their job.

Reconciliations and supervisory reviews are also an organization's first line of defense against fraud and other errors. All of these factors contribute to the need to do timely, accurate, and thorough supervisory reviews and reconciliations.

Generally, we found that the supervisory reviews and reconciliations at Veterans Services did not achieve the objectives above and the lack of them contributed to many of the following problems. Although some of the problems arose from not understanding the Commonwealth's process, we are of the opinion that many of the managers and supervisors do not fully understand their responsibilities and what they contribute to the organization. Finally, the managers and supervisors do not appear to understand how to use these tools to improve internal controls and the knowledge of the staff.

Develop Adequate Administrative Resources to Operate the Agency - Veterans Services was formed by merging several entities with small administrative staffs. In the case of the Veterans Care Center, except for nursing home billings, the administrative staff primarily processed transactions and relied on the contractor's corporate staff to provide administrative guidance. Generally, the Veterans Services' staff has the experience and with some training, the knowledge to effectively process financial transactions. However, there is clearly an absence of experienced, knowledgeable individuals to provide the on-going and daily oversight of the accounting and administrative function.

The size and scope of current operations and the expected expansion of the agency with additional veterans care centers makes it important that the agency establish proficient administrative resources. Part of this development should include having personnel that can not only supervise and manage their sections, but also have the resources to oversee the entire operations. Whether this resource exists centrally, at each facility, or comes from a contractor, Veterans Services' management must address this need.

**Other Matters**

This report addressed several other issues, below is a listing of these findings.

- Improve Payment Documentation and Ensure Compliance with Policies
- Improve Small Purchase Charge Card Documentation and Ensure Compliance with Policies
- Improve Internal Controls over the Fund Receipting and Posting Process
- Establish Policies for Allowance for Doubtful Accounts and Write-offs

**Conclusion**

All of these deficiencies collectively represent a material weakness in the agency's internal control structure. A material internal control weakness means that the possibility exists that a fraud or other error could occur and go undetected. Although, we have not found a fraud or other material error, the lack of internal control hampers the discovery during an audit.

Effective internal control over financial transactions is vital to the proper recording and preparation of reliable financial information. An effective internal control process is comprehensive and involves people at all levels throughout an agency, including those who keep accounting records, prepare and disseminate policies, and monitor systems, as well as people in a variety of operating roles.

The responsibility for the establishment and maintenance of internal control in an agency resides with management. Such controls must take into consideration the requirements promulgated by central agencies in the form of policies and procedures, as well as adherence to the controls built into central, statewide systems. Agencies must develop a formal program to evaluate the operating environment and ensure they maintain adequate internal controls over financial assets.

Although the individuals at Veterans Services have received some training in how to use the Commonwealth's central administrative systems, policies, and procedures, these employees have limited knowledge of state rules and regulations. Further, consider that the Commonwealth is planning the opening of additional veterans care centers.

We recommend that the Secretary of Administration work with the Commissioner of Veterans Services to consider alternatives to current and future operations, which will provide the necessary controls to operate these facilities. Alternatives include setting minimum administrative staff levels for each facility and the agency; consolidating some functions, either in one central location or have some of the functions such as payroll and procurement functions performed by a larger agency; or employing an outside contractor to do some or all of these functions. Considering the expected growth of the agency, the decisions need to occur quickly.

# Fraud

During the course of the year, in accordance with the above statute we receive reports of circumstances indicating a reasonable possibility of fraudulent transactions. This Office conducts an initial review of all reports and depending on the nature and circumstance determines how best to proceed. The majority of reports and related situations result in this office and State Police coordinating our activities with agency, institution and locality officials, primarily internal auditor and local law enforcement. The tables below outline the volume of activity we had reported during the fiscal year 2005.

### Fraud Reports

|  | Fiscal Year | | |
| --- | --- | --- | --- |
|  | 2005 | 2004 | 2003 |
| Outstanding cases at beginning of fiscal year | 45 | 44 | 34 |
| New reports | 49 | 59 | 46 |
| Closed reports | (66) | (58) | (36) |
| Active or pending cases at end of fiscal year | 28 | 45 | 44 |

The following table provides a breakdown of the new reports received during fiscal year 2005 by type of entity.

### New Reports

| | Fiscal Year | | |
| --- | --- | --- | --- |
| Entity | 2005 | 2004 | 2003 |
| Courts | 2 | 4 | 1 |
| Local Governments | 7 | 2 | 4 |
| Institutions of Higher Education | 14 | 18 | 17 |
| State Agencies | 26 | 35 | 24 |
| Total | 49 | 59 | 46 |

During the year, we were able to resolve and close a number of reports.  The breakdown of this resolution follows.

| Disposition | Fiscal Year | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Conviction | 2 | 3 | 2 |
| Conviction and restitution | 9 | 5 | 6 |
| Suspension | 0 | 3 | 1 |
| Termination | 18 | 13 | 16 |
| Termination and restitution | 0 | 1 | 0 |
| No administrative action | 2 | 5 | 0 |
| No fraud | 10 | 14 | 6 |
| No suspect | 17 | 12 | 4 |
| No conviction | 8 | 2 | 1 |
| Total | 66 | 58 | 36 |

Each of the Specialty Teams contributes members to a special fraud task group which coordinates and conducts our reviews.  Many of the group members have received special training and a number of them have become Certified Fraud Examiners.  Obtaining this designation require the individual to take a national administrated test and pass an examination.  The organization that provides this certification is recognized nationally for its training and skills taught for the investigation of white collar crime.

# Follow-up on Findings

Included throughout this report are references to individual reports issued by this Office over the past year, which had findings or brought matters to the attention of the General Assembly and agency management. Some of these findings and issues required further follow-up and if not specifically covered in elsewhere in this report. Below are those findings, followed by their current status. If you have any question or other concerns about the status of any report, please contact this office.

## Virginia Election and Registration Information System (VERIS)

In August 2005, Elections made the decision to postpone their implementation of VERIS from September to December as a result of continued missed deliverables. Elections activated their contingency plan as a result of this schedule change and will use their existing system to manage the November 2005 election. The move to a December implementation dramatically increases the project risk, as the time available to implement VERIS by the January 1, 2006 HAVA deadline is limited. As before, Elections must continue to move forward to ensure HAVA compliance; however, some if not all of their federal funding may be lost if the deadline is not met. We continue to monitor project activities for progress against the project schedule.

## Virginia Information Technologies Agency

VITA has started updating their strategic plan and expect to have it complete by April 2006. To date they have identified stakeholders and other workgroup members to participate in a workgroup retreat sometime this fall. They plan to use the Council on Virginia's Future Long-Term Objectives, business and customer requirements, and feedback from stakeholder groups as input to the strategic planning effort.

VITA continues to operate without sufficient security policies and procedures and without defining their roles and responsibilities with agencies. In addition, they have not finalized a process to identify databases, their risks, and an audit schedule; although they have drafted procedures. The APA's Information Systems Security specialty team issued a separate report in September 2005 stating continued concerns with the lack of security policies.

VITA's Project Management Division still needs to improve their oversight and monitoring of projects. Their focus has been primarily on refining the project approval process, coordinating project manager training, and assisting the Information Technologies Investment Board through the preparation of the annual Recommended Technology Investment Projects (RTIP) report.

## eVA Auditability and Security Review

General Services substantively agreed with our findings and implemented several corrective actions in response to this report including central daily monitoring of key exception reports and a focus on bringing executive branch agencies in compliance with reporting requirements of the current eVA security manual.

General Services plans on providing the monitoring reports developed jointly by APA and General Services staff to key eVA security individuals for review and comment by the end of September. They will then assemble a training guide and publish the reports to be used by agency security officers. General Services is also working on a delegation strategy which will focus on agencies with the largest eVA user populations.

General Services has hired an additional resource that has revised General Services security program and standards. Next, this resource will rewrite the eVA security manual and develop a best practice guide. Formal training on the new security manual will be provided early in 2006 and quarterly meetings will be established for security officers and administrators.

Finally, General Services has established a procedure to have all eVA enhancements reviewed by the DPS Policy Committee. In addition, General Services has begun notifying agencies of changes to eVA that may impact compliance with existing state policies.

## Review of the Statewide Reporting Process

The Departments of Accounts and Treasury have implemented some of the recommendations included in our report and generally have indicated that they will review the benefits, cost and funding feasibility of the remaining recommendations. We have carried forward many of the recommendations in the final draft of our Review of the Financial Accounting and Control Operations of the State Comptroller, which is discussed further below. We will also continue to follow up on the status of these recommendations during our fiscal year 2005 audits of these agencies, which are currently in progress.

## Review of the Financial Accounting and Control Operations of the State Comptroller

The Appropriation Act Chapter 4 of the 2004 Acts of the Assembly included language requiring this Office to conduct a two-year study of the duties and responsibilities of the State Comptroller. This Office made an interim report to the Committees of House Appropriation and Finance and Senate Finance on November 18, 2004, which contained several preliminary proposals. We will issue our final report by November 15, 2005, and will address the status of the preliminary proposals and our final recommendations.

## Department of Mental Health, Mental Retardation and Substance Abuse Services

Before the end of fiscal 2005 the Mental Health paid their $30 million Treasury Loan in full. As of the end of September 2005 the Mental Health has drawn $8 million from its $20 million line of credit and is not expecting to draw anymore on its line of credit during fiscal 2006 because the agency ended fiscal 2005 with $11 million in their cash accounts. The Mental Health is working with the Department of Planning and Budgeting (DPB) to ensure they have the information needed to include salary increases into their projection of expenditures for Medicaid reimbursement.

To improve the management of resources the Mental Health submitted technical adjustments to the DPB to align facility budgets with actual funding sources for the 2007-2008 biennium.  Additionally, the Mental Health on July 1, 2005 reorganized their aftercare pharmacy at Hiram Davis Medical Center to be under the Assistant Commissioner for Community Services to facilitate the recovery of these pharmacy costs.

## Review of Performance Measures

The Department of Planning and Budget, in conjunction with the Governor's Office and the Council on Virginia's Future, is working on implementation of a more integrated performance and budgeting structure.  With this effort, Planning and Budget will be replacing Virginia Results with a new performance reporting system. It is our understanding that issues that we have raised regarding the information presented on Virginia Results will be addressed in the new system.

## Office of the Governor

The Governor's Office, as well as Cabinet Secretaries', budgets in the Appropriation Act for the 2006-2008 biennium reflects the actual costs of operations.

## Virginia Department of Social Services (VDSS)

Central Office has begun notifying local social service agencies when a Temporary Assistance to Needy Families (TANF) client refuses to cooperate with the Division of Child Support Enforcement (DCSE).  The VDSS intends to automate this notification process between the TANF and DCSE systems.  In order to address case documentation issues, the VDSS informed local social service agencies of the issue and has created an evaluation checklist for eligibility workers to utilize.  We will evaluate the effectiveness of these actions during the fiscal year 2005 audit.

To address information system security issues, the VDSS has further emphasized the local security officers' roles and responsibilities through the annual memorandum of agreement and security officer training.  The VDSS has also created automated access listings for four of its systems.  While performing the fiscal year 2005 audit, we have found little indication that the VDSS' changes have adequately addressed their systems security issues.

## Secretary of Natural Resources Agencies
## including the Department of Game and Inland Fisheries

Since issuing our report the Board has implemented several significant changes to the organization.  In May 2005 the Board accepted the Game Director's resignation and hired the former State Police Superintendent, Colonel Gerald Massengill, as Interim Director.  Under the Interim Director's leadership they have started a review of existing policies and procedures, official duties guidance, and the search for a new Director.  In addition, both the Board and Interim Director have supported an official State Police investigation into allegations contained in the Department of the State Internal Auditor's report.

The Board has acknowledged the need for a review of their governing policies and definition of their roles and responsibilities. Part of this process will involve defining their relationship with the Secretary of Natural Resources. Currently it is uncertain whether the Governor or a legislator will propose any Code of Virginia changes during the upcoming General Assembly session to clarify this relationship.

# APPENDIX A
## Fiscal Year 2005 Budgetary Analysis

### Analysis of Budgeted and Actual Revenue by Funding Source

| Funding Source | Original Budget | Adjusted Budget | Actual Revenue |
|---|---|---|---|
| General Fund appropriations | $9,164,102 | $ 9,579,192 | $ - |
| Special revenue | 732,169 | 725,954 | 942,832 |
| Total revenues | $9,896,271 | $10,305,146 | $942,832 |

### Appropriation Adjustments

| | |
|---|---|
| General Fund | $ 9,164,102 |
| Required adjustments | 415,090 |
| Adjusted General Fund appropriation | 9,579,192 |
| Special Fund | 732,169 |
| Required adjustments | (6,215) |
| Adjusted Special Fund appropriation | 725,954 |
| Total appropriations | $10,305,146 |

### Revenues

| | |
|---|---|
| Circuit Courts | $300,955 |
| Center for Innovative Technology | 29,095 |
| Total General Fund | $330,050 |

### Analysis of Budget versus Actual Expenses by Funding Source

| | | | |
|---|---|---|---|
| General Fund appropriations | $ 9,579,192 | $7,777,316 | $1,801,876 |
| Special revenue | 725,954 | 732,169 | (6,215) |
| Total | $10,305,146 | $8,509,485 | $1,795,661 |

# APPENDIX B
## Audited Courts

This Appendix is a listing of those Circuit, General District, Juvenile and Domestic Relations, and Combined General District courts that were audited during our fiscal 2004 work plan for the period ended June 30, 2004.

### Circuit Courts

| | | |
|---|---|---|
| Accomack County* | Halifax County | City of Portsmouth |
| City of Alexandria | City of Hampton | Powhatan County* |
| Amelia County | Hanover County | Prince Edward County |
| Bath County | Henrico County | Prince George County |
| Bedford County | Henry County* | Prince William County* |
| Bland County | Highland County | Pulaski County* |
| Botetourt County | City of Hopewell | City of Radford |
| City of Bristol | Isle of Wight County | City of Richmond |
| Brunswick County | James City County/ | Richmond County |
| Buchanan County* | Williamsburg | City of Roanoke |
| City of Buena Vista | King & Queen County | Roanoke County |
| Caroline County* | King George County* | Rockbridge County* |
| Carroll County | King William County | Rockingham County* |
| Charles City County* | Lancaster County | Russell County |
| Charlotte County | Lee County | City of Salem* |
| City of Charlottesville | Loudoun County* | Scott County* |
| City of Chesapeake | Louisa County* | Shenandoah County |
| Clarke County | Madison County* | Smyth County* |
| City of Colonial Heights | City of Martinsville | Stafford County* |
| Craig County | Mathews County | City of Suffolk |
| Culpeper County | Mecklenburg County | Surry County |
| City of Danville | Middlesex County | Sussex County* |
| Dickenson County | Montgomery County* | Tazewell County |
| Dinwiddie County | New Kent County | City of Virginia Beach |
| Essex County | City of Newport News | Warren County |
| Fauquier County | City of Norfolk | Washington County* |
| Floyd County | Northampton County* | City of Waynesboro |
| Fluvanna County | Northumberland County* | Westmoreland County |
| Franklin County* | Nottoway County* | City of Winchester* |
| City of Fredericksburg | Orange County | Wise County & Norton |
| Giles County* | Patrick County | Wythe County* |
| Gloucester County | City of Petersburg* | York County |
| Grayson County* | Pittsylvania County | |

  * Denotes audit with one or more findings

# APPENDIX B
## Audited Courts

### General District Courts

| | | |
|---|---|---|
| Accomack County | James City County/ | Patrick County |
| Albemarle County |    Williamsburg | City of Petersburg |
| Augusta County | King & Queen County | Pittsylvania County |
| City of Bristol | King William County | City of Portsmouth |
| Caroline County | City of Martinsville | Prince William County |
| City of Charlottesville | Mathews County * | Pulaski County * |
| City of Chesapeake | Mecklenburg County | City of Richmond |
| Chesterfield County * | Montgomery County |    Manchester * |
| Clarke County |    Blacksburg * | City of Richmond |
| City of Danville | Montgomery County |    Traffic Division |
| Fairfax County |    Christiansburg | City of Roanoke |
| Fauquier County | New Kent County | Roanoke County |
| Franklin County | City of Newport News | Rockingham County |
| City of Fredericksburg |    Civil Division | Spotsylvania County |
| Frederick County | City of Newport News | Stafford County * |
| Gloucester County |    Criminal Division | Suffolk County |
| Halifax County | City of Norfolk Civil Division | City of Virginia Beach |
| City of Hampton | City of Norfolk Criminal Division | Washington County |
| Hanover County | City of Norfolk Traffic Division | City of Waynesboro |
| Henrico County | Northampton County | City of Winchester |
| Henry County | Northumberland County | Wise/Norton City |
| Isle of Wight County | Page County | York County |

### Juvenile and Domestic Relations Courts

| | | |
|---|---|---|
| Accomack County | James City County/ | City of Galax |
| Albemarle County |    Williamsburg | Giles County |
| City of Alexandria | King & Queen County | Goochland County |
| City of Bristol | King William County | City of Portsmouth |
| Caroline County | Mathews County | Prince William County |
| City of Charlottesville | Mecklenburg County | City of Richmond |
| City of Chesapeake | City of Newport News | City of Roanoke |
| City of Danville | City of Norfolk | Roanoke County |
| Fairfax County * | Northampton County | Rockingham County |
| Fauquier County | Northumberland County | Spotsylvania County |
| Franklin County | Patrick County | Stafford County * |
| City of Fredericksburg | City of Petersburg | Suffolk County |
| Halifax County | Pittsylvania County Combined | Tazewell County |
| City of Hampton |    General District Courts | City of Virginia Beach |
| Hanover County | City of Falls Church | Washington County |
| Henrico County | Floyd County | City of Waynesboro |
| Henry County | Fluvanna County | Wythe County |
| Isle of Wight | City of Franklin | York County |

 * Denotes audit with one or more findings