

VIRGINIA RETIREMENT SYSTEM

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2009**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Retirement System (Retirement System) for the year ended June 30, 2009, found:

- the financial statements are presented fairly, in all material respects;
- certain matters that we consider to be significant deficiencies in internal control; however, we do not consider them to be material weaknesses; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

We have audited the basic financial statements of the Virginia Retirement System as of and for the years then ended June 30, 2009, and issued our report thereon, dated December 2, 2009. Our report is included in the Virginia Retirement System's Comprehensive Annual Financial Report that it anticipates releasing on or after December 17, 2009.

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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Improve Sensitive Data Safeguards

The Retirement System needs to improve the safeguards that protect its sensitive data from unauthorized exposure or modification. The Retirement System needs to improve the following areas.

- Returned leased computers go to a vendor without following Commonwealth standards to ensure removal of sensitive data. While the Retirement System has the proper software and instructions detailing how to sanitize retired computers, it has no documentation that someone actually sanitized the computer and someone independent verified the computers' sanitization.
- Employers can send sensitive employee data on unencrypted disks, which places confidential information at risk of disclosure. We also found instances of staff sending sensitive data via unencrypted e-mail.
- An infrastructure server continues to support obsolete encryption methods.
- The incident response plan lacks some information that would allow management to handle information security incidents more efficiently and effectively.

The Retirement System should develop and implement policies and procedures to address all of the issues above. These policies and procedures should become part of the Retirement System's security awareness training so staff are fully aware of the data protection policies and procedures. These improvements will provide better protection of sensitive data from unauthorized exposure or modification.

Improve Check File Access

The Retirement System does not have adequate segregation of duties and supervisory review over their check files sent to the Department of Treasury and the bank. The check file resides on the IBM mainframe, which uses a security system that logs changes made to the check file. One of the individuals who regularly reviews the security logs also has the ability to alter information on the check file.

In addition, the supervisor is not regularly reviewing the security logs, but relies on the person previously mentioned. As a result, unwarranted changes could be made to the check file and go unnoticed by the Retirement System's management.

We recommend the Retirement System provide adequate segregation of duties over the check file and the supervisory review of the security logs. The Retirement System should ensure that someone other than a person with write access to the check file reviews the security logs. In addition, the designated reviewer should review the logs timely to ensure they detect any unwarranted changes to the check file.

Improve Written Policies and Procedures and Review Process for Financial Reporting

The Retirement System has documented some, but not all, of their policies and procedures for the preparation of its annual financial report. In addition, the Retirement System does not have an adequate review process for the entire preparation of their financial statements, footnotes, or attachments sent to the Department of Accounts. The Retirement System relies on a few individuals to prepare the financial

statements and, without more depth of knowledge and experience, the loss of one or more key individuals would make the preparation of financial statements difficult, if not impossible.

During fiscal year 2009, the Retirement System drafted two policies and procedures for the preparation of their financial statements and related notes. However, one of the drafts did not contain sufficient detail; the procedures did not always address the roles and responsibilities or the review processes. The lack of detailed written policies and procedures and a review process increases the risk of error in financial statement preparation and the modification of procedures to circumvent existing internal controls. Further, without well documented procedures, the transitioning of responsibilities when there is turnover in the positions responsible for preparing the financial statements is more difficult.

We recommend the Retirement System continue to develop and implement a formal review process for their financial statements, footnotes, and attachments sent to the Department of Accounts. The preparation and review process should provide for a proper segregation of duties and ensure that someone other than the preparer reviews all work. We recommend the Retirement System continue to improve the documentation of the financial reporting procedures to include detailed items such as specific reports and tables, analyses performed, roles and responsibilities, levels of reviews, and timing of events required for the creation of their annual financial report. In addition, these procedures should also address the preparation and timing of submissions to the Department of Accounts for reporting the Retirement System's financial information in the Commonwealth's annual financial statements.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

December 2, 2009

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
And Review Commission

Board of Trustees
Virginia Retirement System

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

We have audited the basic financial statements of the **Virginia Retirement System** as of and for the year ended June 30, 2009, and have issued our report thereon dated December 2, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Virginia Retirement System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Virginia Retirement System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Virginia Retirement System's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiencies entitled "Improve Sensitive Data

Safeguards”, “Improve Check File Access”, and “Improve Written Policies and Procedures and Review Process for Financial Reporting” which are described in the section titled “Internal Control Findings and Recommendations”, to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

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

The Virginia Retirement System’s response to the findings identified in our audit is included in the section titled “Agency Response.” We did not audit the Virginia Retirement System’s response and, accordingly, we express no opinion on it.

Status of Prior Findings

The Virginia Retirement System has not completed corrective action with respect to the previously reported finding “Improve Written Policies and Procedures over Financial Reporting.” Accordingly, we included this finding in the current year finding “Improve Written Policies and Procedures and Review Process for Financial Reporting” in the section entitled “Internal Control Findings and Recommendations.” The Virginia Retirement System has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Report Distribution and Exit Conference

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

We discussed this report with management at an exit conference held on December 4, 2009.

AUDITOR OF PUBLIC ACCOUNTS


MSM/alh



Robert P. Schultze
Director

MEMORANDUM

TO: Walter J. Kucharski
Auditor of Public Accounts

FROM: Robert P. Schultze
Director 

DATE: December 1, 2009

SUBJECT: Response to APA's - VRS Report on Audit for the Year Ended June 30, 2009

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

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- Employers can send sensitive employee data on unencrypted disks, which places confidential information at risk of disclosure. We also found instances of staff sending sensitive data via unencrypted e-mail.
- An infrastructure server continues to support obsolete encryption methods.
- The incident response plan lacks some information that would allow management to handle information security incidents more efficiently and effectively.

The Retirement System should develop and implement policies and procedures to address all of the issues above. These policies and procedures should become part of the Retirement System's security awareness training so staff are fully aware of the data protection policies and

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procedures. These improvements will provide better protection of sensitive data from unauthorized exposure or modification.

VRS Response:

With regard to Improve Sensitive Data Safeguards, the VRS places considerable priority on maintaining an effective information systems security program, but we acknowledge that improvements can be made in the areas you reported. We are committed to ensuring the security, integrity and availability of our systems and safeguarding the information that is in our custody, and have already implemented most of your recommendations. In particular,

- The procedures for removing sensitive data were enhanced to include additional documentation and an independent sample review of the computer's sanitization as soon as these concerns were mentioned by the Auditor in July.
- We are in the process of notifying employers that we will no longer accept diskette submissions of employer data. Implementation is planned for January 2010. Additional training and awareness activities are already underway to remind VRS staff that sensitive data must not be included in unencrypted emails and to monitor their compliance with our policy.
- The obsolete encryption method was removed from the server as soon as the concern was mentioned by the Auditor.
- Additional documentation will be added to the VRS incident response plan.

Improve Check File Access

The Retirement System does not have adequate segregation of duties and supervisory review over their check files sent to the Department of Treasury and the bank. The check file resides on the IBM mainframe, which uses a security system that logs changes made to the check file. One of the individuals who regularly reviews the security logs also has the ability to alter information on the check file.

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We recommend the Retirement System provide adequate segregation of duties over the check file and the supervisory review of the security logs. The Retirement System should ensure that someone other than a person with write access to the check file reviews the security logs. In addition, the designated reviewer should review the logs timely to ensure they detect any unwarranted changes to the check file.

VRS Response:

Responsibility for review of the ACF2 Security logs will be moved away from Computer Operations to ensure appropriate segregation of duties over the check file. The VRS Security Team will provide oversight of the ACF2 Security log reviews to ensure the reviews occur in a timely manner and that any issues identified during the review are appropriately addressed.

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We recommend the Retirement System continue to develop and implement a formal review process for their financial statements, footnotes, and attachments sent to the Department of Accounts. The preparation and review process should provide for a proper segregation of duties and ensure that someone other than the preparer reviews all work. We recommend the Retirement System continue to improve the documentation of the financial reporting procedures to include detailed items such as specific reports and tables, analyses performed, roles and responsibilities, levels of reviews, and timing of events required for the creation of their annual financial report. In addition, these procedures should also address the preparation and timing of submissions to the Department of Accounts for reporting the Retirement System's financial information in the Commonwealth's annual financial statements.

VRS Response:

For FY 2009, the VRS Finance Division staff did use a number of features of the new accounting system to capture the year-end accruals and adjustments within the accounting system. These accruals and adjustments were recorded in manual workpapers prepared as part of the year-end processes for the financial statements and development of the assets by

employer for the annual actuarial valuation. Use of the automated system provided a more structured approach to statement preparation, reduced the opportunity for errors, and provided a means of ensuring consistency between the financial data in the System's annual financial statements and the asset information provided to the VRS actuary. These procedures will be enhanced to include expected dates for the various items, the individual(s) responsible for preparing them, and the individual(s) responsible for reviewing the results.

As noted by APA, the Virginia Retirement System's Finance Division staff has documented some but not all of the policies and procedures for the preparation of the System's annual financial report. The documentation update was initiated following the FY 2008 audit and was expected to be completed following the FY 2009 audit. As part of the CAFR preparation documentation, we will be addressing the System's annual submissions to the Department of Accounts. The documentation will include the processes surrounding preparation of the various sections of the CAFR. Particular emphasis will be placed on the processes used for the preparation of the financial, actuarial, and statistical sections of the report. These procedures will be enhanced to include expected dates for the various items, the individual(s) responsible for preparing them, and the individual(s) responsible for reviewing the results. As noted by APA, this documentation will improve our internal controls and reduce the risks associated with turnover of key staff and the impact such turnover might have on the timely preparation of the System's financial information and annual financial report.

We appreciate the thoroughness and competence of the review of our technology security and CAFR information. We are confident that your suggestions will assist us in continuing to maintain a security approach and financial reporting process that complies with Commonwealth policies and standards and reflects best practices.

If you have any questions concerning the above items, please call me at 344-3120.

c: VRS Board of Trustees

VIRGINIA RETIREMENT SYSTEM

BOARD MEMBERS
As of June 30, 2009

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Chairman

John M. Albertine
Vice Chairman

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Director