



**JOINT LEGISLATIVE AUDIT  
AND  
REVIEW COMMISSION**

**REPORT**

**FOR THE SECOND QUARTER**

**OCTOBER 1, 2013 THROUGH DECEMBER 31, 2013**



# APPA

AUDITOR OF PUBLIC ACCOUNTS  
COMMONWEALTH OF VIRGINIA  
**QUARTERLY REPORT**

*Quarterly Report Summary - - October 1, 2013, to December 31, 2013*

## *Audit Activities*

### **Review of the Management Agreement between CGI and the Department of Taxation**

Conducted pursuant to Chapter 806, 2013 Acts of Assembly, the [Review of the Management Agreement between CGI and the Department of Taxation](#) provides the results of a financial and operational review of CGI related to the Enterprise Applications Master Services Agreement Statements of Work Six and Seven. Our report includes background information, graphs of CGI debt collection activity, and three review recommendations.

### **Review of Retail Sales and Use Tax Collection and Distribution Processes**

The [Review of Retail Sales and Use Tax Collection and Distribution Processes](#) is our final report on our review of the retail sales and use tax collection and distribution process, with a focus on the collection and distribution of local sales and use taxes. This review was required by Section 30-133.2 of the Code of Virginia and we issued our initial report in November 2011. The retail sales and use tax distribution process requires a joint effort between the Department of Taxation, localities, and businesses. Over the last several years, Taxation has implemented controls to reduce the number of locality distribution errors and improve the process. While we found the overall process to be sound, we recommend that Taxation consider automating all or parts of the distribution transfer request process and the reconciliation process for localities. In addition, Taxation should continue efforts to reduce business registration errors and enhance communication and training opportunities for localities. As required, we are also recommending annual benchmarks Taxation should use to measure the effectiveness of the local sales and use tax distribution process.

### **2013 State of Information Security in the Commonwealth of Virginia**

The [State of Information Security in the Commonwealth of Virginia](#) is an annual report that accumulates and analyzes the information security recommendations issued by this office to agencies during audits conducted in the most recent fiscal year. The statewide analysis allows us to identify the most common information security categories whose controls are not implemented per the Commonwealth's information security standard or agencies' IT policies. We reviewed 235 controls in 20 information security categories, which covered 55 agencies in the executive and judicial branches and found 56 out of the 235 controls (24%) did not comply with standards as designed or did not work as required by policy.

### **Department of Game and Inland Fisheries**

The [Department of Game and Inland Fisheries](#) report includes a number of internal control and compliance recommendations, some of which we consider to be material weaknesses, from our audit of the Department's financial records and operations for the period July 1, 2011, through December 31, 2012.

## Virginia Employment Commission

The [Virginia Employment Commission](#) report includes a status of several system development initiatives, which will replace multiple outdated systems and significantly change the agency's current business processes, and a number of internal control and compliance recommendations from our audit of the Commission's financial records and operations for the fiscal year ended June 30, 2013.

## Other Reports

During the quarter, we issued the [2013 Annual Report of the Auditor of Public Accounts](#) . This report provides an overview of some of the more significant activities and results of audits from the past year.

We also issued our report on [Revenue Stabilization Fund Calculations for the year ended June 30, 2013](#), which includes calculations for the Revenue Stabilization Fund as required by Article X, Section 8 of the Virginia Constitution and Section 2.2-1829 of the [Code of Virginia](#). As of June 30, 2013, the balance in the Revenue Stabilization Fund was \$439.9 million. During fiscal year 2013, a deposit of \$132.7 million was made to the Revenue Stabilization Fund while no withdrawals from the fund occurred. Additionally, based on fiscal year 2013 certified tax revenues, the General Assembly must make a mandatory deposit of \$243.2 million in fiscal year 2015 to the Revenue Stabilization Fund.

Finally, during this quarter we completed our audit of the [Commonwealth's Comprehensive Annual Financial Report](#), issuing an unmodified opinion on the Commonwealth's financial statements.

We will be happy to provide you any reports in their entirety, or you can find all reports listed in this document at our website [http://www.apa.virginia.gov/APA\\_Reports/Reports.aspx](http://www.apa.virginia.gov/APA_Reports/Reports.aspx). We welcome any comments concerning this report or its contents.

## Other Activities

In this report we provide a summary of our other activities during the quarter. In addition to our audit activities, we participate in other activities to assist in our mission to improve accountability and financial management in the Commonwealth.

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## Audit Activities

### Review of the Management Agreement between CGI and the Department of Taxation

Pursuant to Chapter 806, 2013 Acts of Assembly, this report provides the results of a financial and operational review of CGI and its subcontractors related to the Enterprise Applications Master Services Agreement (PPEA). We have reviewed the management agreements between CGI and state agencies and institutions pursuant to the PPEA's Statements of Work Six and Seven and the performance of CGI and its subcontractors with regard to measured service levels.

Statements of Work Six and Seven (Statements) were designed to provide a funding mechanism to defray the cost of the implementing enterprise systems. CGI currently has no other revenue producing work under the PPEA other than the Department of Taxation's (Tax) use of the Statements to support CGI's performance of outside collection services, and this is not producing meaningful revenue to offset the Commonwealth's costs of enterprise systems. As such, the PPEA and Statements no longer serve the purpose for which they were intended.

Tax has not instituted effective performance monitoring techniques, nor are they completing annual documented contract evaluations over CGI, a best practice in contract management. Additionally, CGI's management of outside collection agencies, whose collections represent about seven percent of Tax's total annual delinquent account collections, carries higher fees than when Tax managed outside collections services themselves. We estimate the Commonwealth may save more than \$1 million annually by returning the management of the outside collection services to Tax, or competitively procuring these collection services independent from the PPEA.

While the Commonwealth expected to use the Statements as a means to pay for enterprise systems, as of June 30, 2013, only \$394,453 has been recouped since the Statements inception in 2008. A recent contract modification initiated by Tax in 2012 resulted in the deposit of those funds, but still the Commonwealth is paying fees well above the costs when Tax managed the collection agencies internally; resulting in a decrease in net revenue from outside collection activities when compared to net revenue achieved prior to CGI.

## Review of Retail Sales and Use Tax Collection and Distribution Processes – September 2013

In accordance with Section 30-133.2 of the Code of Virginia, we performed a review of the collection and distribution of the Retail Sales and Use Tax with a focus on the collection and distribution of local sales and use taxes. We conducted this review in multiple phases and we issued an interim report based on the initial phase of our review in November 2011.

In fiscal year 2012 the Commonwealth collected approximately \$4.9 billion in retail sales and use taxes. Over \$1 billion of these revenues were distributed to localities as a one percent local option tax. The Department of Taxation (Taxation) collects the tax and determines the local portion which is distributed to the locality where the sale or activity occurred.

Overall, the sales and use tax distribution process requires a joint effort between Taxation, localities, and businesses. There are a number of controls and processes in place to help ensure that locality distributions are accurate and made to the correct locality. When an error is detected, Taxation processes an adjustment to correct the distribution and transfer the funds to the correct locality.

Over the last several years, Taxation has implemented some new controls to reduce the number of locality distribution errors and improve the process. As a result, the error rate in the locality distributions has been steadily decreasing and was well below 1 percent in fiscal year 2012.

Error Rate for Local Sales Tax Distributions			
	2010	2011	2012
<b>Local Distribution Amount</b>	\$ 979,588,558	\$ 1,010,204,536	\$ 1,052,521,923
<b>Errors Identified and Corrected</b>	\$ 11,663,142	\$ 8,655,713	\$ 5,725,742
<b>Error Rate</b>	1.19%	0.86%	0.54%

Business registration errors continue to be the primary source of most locality distribution errors. Taxation has taken steps to reduce business registration errors; however, some may still occur. Any changes to the business registration process need to consider the impact on businesses, and changes that could increase costs for businesses or complicate the registration process may not be viable options.

Timely identification and correction of distribution errors is important to minimize the fiscal impacts on affected localities. The process for identifying distribution errors is highly dependent on localities reviewing information provided by Taxation. The level of effort and resources dedicated to this process varies and is directly related to the size and characteristics of the locality.

While we found the overall process to be sound, we recommend that Taxation consider automating all or parts of the distribution transfer request process and the reconciliation process

for localities. In addition, Taxation should continue efforts to reduce business registration errors and enhance communication and training opportunities for localities.

As required, we are also recommending annual benchmarks Taxation should use to measure the effectiveness of the local sales and use tax distribution process. We recommend Taxation continue to calculate an annual error rate for local retail sales and use tax distributions. Based on our analysis of the error rates, we recommend 1 percent as a reasonable threshold, meaning if the error rate exceeds 1 percent in any given year, Taxation should perform additional analysis to determine the causes of the errors and if further actions are required.

## 2013 State of Information Security in the Commonwealth of Virginia

The *State of Information Security in the Commonwealth of Virginia* is an annual report that accumulates and analyzes the information security recommendations issued by this office to agencies during audits conducted in the most recent fiscal year. The statewide analysis allows us to identify the most common information security categories whose controls are not implemented per the Commonwealth's information security standard or agencies' information technology (IT) policies.

The focus of this statewide review is slightly different from previous statewide reviews. Instead of identifying the number of agencies with inadequate controls in each category across the state, this review focuses on ranking the categories and identifying the most problematic areas.

We reviewed 235 controls in 20 information security categories, which covered 55 agencies in the executive and judicial branches and found the following top-5 inadequate control categories:

- |  |                  |
|--|------------------|
| 1. IT System Data Backup and Restoration | (50% inadequate) |
| 2. Database Security                     | (44% inadequate) |
| 3. IT Disaster Recovery Plans            | (43% inadequate) |
| 4. IT Risk Assessments                   | (38% inadequate) |
| 5. IT Systems and Data Security (tie)    | (33% inadequate) |
| 5. IT Asset Management (tie)             | (33% inadequate) |

In total across all categories, 56 out of the 235 controls (24%) did not comply with standards as designed or did not work as required by policy. We also found that there were no agencies with undocumented information security programs for this review period. This is down from 17 agencies with undocumented programs in our 2006 statewide review. However, while we found documented programs, the quality of these programs vary greatly, which is a contributing factor to the inadequate controls.

## Department of Game and Inland Fisheries

Our audit of the financial records and operations of the Department of Game and Inland Fisheries (DGIF) for the period July 1, 2011, through December 31, 2012 includes a number of internal control and compliance recommendations. Below is a summary of the internal control and compliance findings that we consider to be material weaknesses and a risk alert related to the impact of position vacancies in its Finance Division. The report also includes findings recommending DGIF improve its performance of reconciliations, database security, and internal controls over system access.

### Vacancy Impacts (Risk Alert):

*DGIF continues to experience the negative effects of significant employee turnover in the Finance area that occurred in fiscal year 2011 as seen through the findings noted in the report. DGIF lost numerous individuals from the Finance area due to resignations and retirements and has not been able to fill many of the positions timely due to the Commonwealth's hiring freeze. Several positions in Finance and the Information Technology area over the financial systems remained vacant for four to 23 months, with an average vacancy of 11 months. DGIF management identified the risk the vacancies caused but have been unable to completely eliminate the risk and effects without the ability to fill the positions timely. DGIF management should continue its efforts to obtain approval to fill vacant positions and to cross train individuals to compensate for vacancies when possible.*

### Improve Timeliness and Accuracy of Revenue Redistribution (Material Weakness):

*DGIF did not properly record license revenues at the end of fiscal year 2012 or through the first six months of fiscal year 2013. DGIF records license revenues collected internally in its' Boat Registration and Titling System (BRTS). BRTS does not automatically code these license sales or related refunds to the appropriate account code. Instead, DGIF records the revenues from these sales and any refunds in a holding account. Because refunds often occur after DGIF redistributes the related revenue, the recording of refunds causes the holding accounts to have negative balances. At the end of each month, before monthly close, DGIF should process a transaction to transfer the funds to the correct revenue account. For all eighteen months of the audit period, DGIF never performed the redistribution prior to month end close. This prevents DGIF from having an accurate picture of the types of revenues collected and affects its ability to determine the amount of revenue to transfer to other agencies. DGIF should develop and implement policies and procedures to redistribute all revenues prior to CARS month end close to allow for timely and accurate revenue reporting.*

### Improve Timeliness and Accuracy of Revenue Transfers to Other Agencies (Material Weakness):

*DGIF did not correctly or timely transfer license revenues collected on behalf of other agencies and watercraft sales tax collected on behalf of the Department of Taxation (Taxation). DGIF collects various types of revenue for multiple agencies and transfers these revenues either monthly or daily. DGIF does not have formal agreements with most of these agencies that establish how and when transfers will occur.*

*DGIF uses data from several different systems to determine what they should transfer to agencies. One of those systems, BRTS, does not automatically record license revenues in the correct account codes, but instead puts all revenues into a holding account. DGIF should manually redistribute those revenues monthly so that they are included in the amount transferred to the applicable agency. DGIF Accounting staff do not have an established procedure to ensure they redistribute these revenues timely and consistently.*

*In addition, DGIF is recording and transferring sales revenue rather than cash. With the Commonwealth Accounting and Reporting System (CARS) being on a cash basis, this is inappropriate. In a cash basis system, revenue should be recorded when the cash is received. However, license agents sell licenses to the public and then transfer the cash to DGIF monthly. Therefore, DGIF does not receive the cash to support the sale until possibly a month after the sale. By recording revenues in CARS based on when the revenue is earned rather than when the cash is received, DGIF has caused the revenue in CARS to be unreliable.*

*Finally, when the transfers do take place, DGIF Accounting staff do not properly review amounts prior to transfer, resulting in overpayments. DGIF also does not reconcile revenues at the end of each month or in total at the end of the year to determine that total collections on behalf of other agencies agree to total transfers to those agencies.*

*DGIF should enter into agreements with all of the agencies for which they collect revenues to determine how and when transfers will occur. DGIF should begin recording revenues in CARS based on the receipt of cash, not the earning of revenue. DGIF should track the sale of licenses for purposes of enforcing the license separate from the receipt of cash. DGIF should develop policies and procedures to reconcile revenues, properly review and approve transfers, and process transfers timely. DGIF needs to ensure the procedures provide for multiple trained staff that are competent to review and approve transfers.*

## Virginia Employment Commission

### *Internal Control and Compliance Recommendations*

During the course of our audit of the financial record and operations of the Virginia Employment Commission (Commission) for fiscal year 2013 we reported a number of internal control and compliance findings. We found that the Commission needs to continue to improve their employer wage reconciliation process to ensure information used in unemployment benefit calculations is accurate. We also found some issues with benefit adjustment payments and recommend the Commission consider reviewing this process for larger adjustment payments. These adjustment payments occur when wage information is modified resulting in an additional amount owed for unemployment benefit payments. We also recommend the Commission strengthen their financial reporting process over year end accounts receivable information and improve controls over the small purchase charge card program.

We also reported that the Commission has made progress, but has not completed its corrective action for our prior audit finding titled “Follow Timekeeping and Payroll Procedures” by reviewing and modifying their policies and procedures for overtime. We will continue to follow up on the issue to ensure that the Commission properly implements the new procedures.

### *Status of Systems Development Projects*

The Commission is currently involved in several system development initiatives, which will replace multiple outdated systems and significantly change the agency’s current business processes. We summarize these projects and their status below.

#### Unemployment Insurance Modernization (UI Mod) Project

The Unemployment Insurance Modernization Project (UI Mod) will replace multiple existing mainframe-based software systems with a web-based platform, changing the way employers interact with the Commission. UI Mod will support payment of benefits to unemployed workers, collection of taxes from employers, and the accumulation of wage data. The total budget for UI Mod is \$58.5 million with \$49.1 million coming from Reed Act funds and the remaining \$9.4 million coming from the Commission’s penalty and interest fund. The Commission has spent approximately \$34 million as of August 2013.

The Commission initiated the UI Mod project in 2009 and the first phase, Imaging and Workflow, went into production successfully and under budget in December of 2011. The remaining phases of the project, Tax and Benefits, were originally scheduled to go live in December 2012 and May 2013; however, the Commission and HCLA, the UI Mod project vendor, have extended the implementation dates for remaining portions of the system multiple times. The most recent contract modification executed in September 2013 adjusted the go live dates for both remaining phases to December 2013. The project team has been testing the system and working to achieve the aggressive December go live date; however, discussion has begun again to move the go live date into 2014 due to recently enacted law changes as well as necessary changes to core system functionality. Currently, the Commission has not incurred any additional contractual costs but anticipate the most recent changes will cost approximately \$775 thousand.

#### Financial Management System

The Commission is implementing the Oracle Financial Management System to replace an outdated mainframe batch system and databases. In May 2012, the Commission signed a contract with Strategic Information Solutions (SIS) for implementation services. The total project cost is \$4.9 million with funding coming primarily from Reed Act funds and the Commission has spent approximately \$2.8 million as of August 2013. The original implementation schedule for the new system was October 2013; however, during the summer of 2013, the Commission and SIS realized that this schedule was unattainable and they are currently reworking the implementation schedule with no additional contractual costs. Currently, the project team’s focus is on testing the system and using the results to determine the most appropriate go live schedule.

## Other Activities

### *Participation with state, local and other groups*

During the quarter we participated in the activities of various groups including presenting information on a variety of topics and attending events as highlighted below.

SCHEV* Board of Vistors New Member Orientation	<ul style="list-style-type: none"><li>• Presented information on the role of the Auditor of Public Accounts and our interacation with the Boards</li></ul>
Department of Planning and Budget	<ul style="list-style-type: none"><li>• Presented information to new analysts on the APA's role in state government and Commonwealth Datapoint</li></ul>
Fiscal Officers of College and Universities State Supported	<ul style="list-style-type: none"><li>• Presented information on new accounting and auditing standards</li></ul>
Virginia Sheriff's Institute	<ul style="list-style-type: none"><li>• Provided overview to newly elected sheriffs on APA requirements for sheriffs and CPA firms, focus of APA audits of sheriffs, and common audit findings</li></ul>
Virginia Association of Counties and Virginia Municipal League	<ul style="list-style-type: none"><li>• Presented information on new Governmental Accounting Standards Board pension accounting standards at joint meeting to discuss pension liabilities for teachers</li></ul>
Virginia Society of Certified Public Accountants Leadership Academy	<ul style="list-style-type: none"><li>• A member of the APA management team was a co-facilitator of the Academy and two other members of the management team attended the Academy</li></ul>

*\*State Council of Higher Education for Virginia*

## SUMMARY OF REPORTS ISSUED

The following reports on audit were released by this Office during the period October 1, 2013, to December 31, 2013. Those reports which included findings in the area of internal controls or compliance are indicated by an (\*) asterisk.

### Judicial Branch

Virginia Board of Bar Examiners for the year ended June 30, 2013

### Independent Agencies

State Corporation Commission for the year ended June 30, 2013

Virginia Retirement System for the year ended June 30, 2013\*

### Executive Departments

Division of Selected Agency Support Services for the year ended June 30, 2013

Governor's Cabinet Secretaries for the year ended June 30, 2013

Office of the Attorney General and the Department of Law for the year ended June 30, 2013\*

Office of the Governor for the year ended June 30, 2013

Office of the Lieutenant Governor for the year ended June 30, 2013

### Commerce and Trade

Virginia Biotechnology Research Partnership Authority for the year ended June 30, 2013\*

Virginia Economic Development Partnership for the year ended June 30, 2013

Virginia Employment Commission for the year ended June 30, 2013\*

Virginia Tourism Authority for the year ended June 30, 2013

### Education

Department of Education and Direct Aid to Public Education for the year ended  
June 30, 2013

Virginia College Savings Plan for the year ended June 30, 2013

### Colleges and Universities

Old Dominion University Intercollegiate Athletics Programs for the year ended June 30, 2013

Virginia Polytechnic Institute and State University for the year ended June 30, 2013

Virginia Commonwealth University for the year ended June 30, 2013\*

## Natural Resources

Department of Environmental Quality for the years ended June 30, 2012 and 2013  
Department of Game and Inland Fisheries for the period July 1, 2011 through  
December 31, 2012\*

## Public Safety

Department of Alcoholic Beverage Control for the year ended June 30, 2013\*

## Technology

Innovation and Entrepreneurship Investment Authority and Center for Innovative Technology  
for the year ended June 30, 2013

## Special Reports

2013 Annual Report of the Auditor of Public Accounts  
2013 State of Information Security in the Commonwealth of Virginia\*  
Department of Assistance Services Vulnerability Assessment and Network Penetration Test  
as of October 2013\*  
General Assembly, Legislative Agencies, and Commissions of the Commonwealth of Virginia  
Financial Report for the year ended June 30, 2013  
Report to the Joint Legislative Audit and Review Commission for the quarter July 1, 2013  
through September 30, 2013\*  
Revenue Stabilization Fund Calculations for the year ended June 30, 2013  
Review of Retail Sales and Use Tax Collection and Distribution Processes – September 2013\*  
Review of the Management Agreement between CGI and the Department of Taxation –  
November 2013\*

## Clerks of the Circuit Courts

### Counties:

County of Alleghany – April 1, 2012 through September 30, 2013  
County of Chesterfield for the year ended June 30, 2013  
County of Clarke – April 1, 2012 through September 30, 2013  
County of Dickenson – July 1, 2012 through September 30, 2013  
County of Greensville – April 1, 2012 through September 30, 2013  
County of King William – October 1, 2012 through September 30, 2013\*  
County of Northampton – April 1, 2011 through March 31, 2013\*  
County of Powhatan – January 1, 2011 through June 30, 2013\*  
County of Powhatan (Turnover) – July 1, 2013 through September 30, 2013

## State Accounts (as of June 30, 2013)

### Cities:

City of Alexandria\*  
City of Bristol  
City of Buena Vista  
City of Charlottesville  
City of Chesapeake  
City of Colonial Heights  
City of Danville  
City of Fairfax  
City of Falls Church\*  
City of Fredericksburg  
City of Hampton  
City of Harrisonburg  
City of Lynchburg  
City of Martinsville\*  
City of Newport News  
City of Petersburg  
City of Radford for  
City of Richmond  
City of Roanoke\*  
City of Salem\*  
City of Staunton\*  
City of Suffolk\*  
City of Williamsburg

### Counties:

County of Accomack  
County of Albemarle  
County of Amelia  
County of Appomattox  
County of Appomattox (Turnover)  
County of Arlington  
County of Botetourt  
County of Brunswick  
County of Buckingham\*  
County of Campbell  
County of Caroline  
County of Charles City  
County of Charlotte  
County of Craig\*  
County of Dickenson  
County of Dinwiddie \*

County of Essex  
County of Fauquier\*  
County of Fluvanna \*  
County of Franklin (Turnover) as of November 15, 2013  
County of Franklin\*  
County of Giles  
County of Goochland  
County of Grayson \*  
County of Halifax\*  
County of Henrico\*  
County of Isle of Wight  
County of King & Queen  
County of King George  
County of King William  
County of Louisa  
County of Lunenburg  
County of Madison  
County of Mathews  
County of Mecklenburg  
County of Montgomery  
County of New Kent\*  
County of Northampton  
County of Northumberland  
County of Nottoway  
County of Orange\*  
County of Page  
County of Patrick  
County of Pittsylvania (Turnover) as of November 30, 2013  
County of Powhatan  
County of Prince Edward  
County of Prince George  
County of Rappahannock\*  
County of Roanoke\*  
County of Rockingham  
County of Russell  
County of Scott\*  
County of Shenandoah  
County of Southampton\*  
County of Spotsylvania  
County of Surry  
County of Tazewell  
County of Warren  
County of Westmoreland \*

## General Receivers

### Cities:

City of Alexandria for the year ended June 30, 2013

City of Lynchburg for the year ended June 30, 2013

### Counties:

County of Arlington for the year ended June 30, 2013

County of Buchanan (Turnover) – July 1, 2012 through June 30, 2013

County of Lee for the year ended June 30, 2013

County of Wise/City of Norton for the year ended June 30, 2013

\*Denotes management control finding