

SECRETARY OF FINANCE

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2006**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

This report summarizes our fiscal year 2006 audit results for the five agencies under the Secretary of Finance.

Overall, our audits of finance agencies for the year ended June 30, 2006, found:

- one matter involving internal control and its operations at the Department of Taxation titled “Establish Procedures for Review of Router Policies and Procedures” included in the section entitled “Internal Control Findings and Recommendations”;
- one matter involving internal control and its operations at the Department of Planning and Budget titled “Provide Assurance of Infrastructure Security” included in the section entitled “Internal Control Findings and Recommendations”;
- matters involving internal control and its operations at the Department of Planning and Budget that we communicated to management in a separately issued report entitled “Review of the Budget and Appropriation Processing Control System”; and
- no instances of noncompliance or other matters with applicable laws and regulations tested that require reporting under Government Auditing Standards.

In addition, we included two risk alerts, which discuss issues that require the action of either another agency, outside party or the method by which the Commonwealth of Virginia (Commonwealth) conducts its operations. The following matter represents a risk to the Departments of Accounts, Taxation, and Treasury, but the Departments must rely on the Virginia Information Technologies Agency (VITA) to address the risk.

- Obtain Assurance for Infrastructure Security

The following matter represents a risk to the Commonwealth and may require the action of the Department of Accounts to address the risk.

- Meeting the Single Audit Deadline of March 31

Our report also includes a status of recommendations we made in prior audits to the Departments of Accounts and Treasury to improve the process used to prepare the Comprehensive Annual Financial Report (CAFR).

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COMMENTS TO MANAGEMENT

Risk Alerts

During the course of our audits, we encounter issues that are beyond the corrective action of management and require the action of either another agency, outside party, or the method by which the Commonwealth conducts its operations.

Obtain Assurance for Infrastructure Security

Applicable to: Department of Accounts, Department of Taxation, and Department of the Treasury

The following matter represents a risk to the Departments of Accounts, Taxation, and Treasury but the Departments must rely on the VITA to address the risk.

The Departments' Officials have responsibility for the security and safeguard of all of the Departments' information technology assets, systems, and information. Over the past three years, the Commonwealth has moved the information technology infrastructure supporting these databases to the VITA. In this environment, VITA and the Departments' Officials clearly share responsibility for the security of the Departments' information technology assets, systems, and information and must provide mutual assurance of this safeguarding.

The Departments' Officials have provided VITA with all the documentation required to make this assessment. However, VITA has not been able to provide the Departments with assurance that they can provide hardware and software configurations that satisfy these requirements and appropriate controls to secure information technology assets, systems and information.

Therefore, the Departments' Officials cannot fulfill their responsibilities stated in the state policy, which will put its information technology assets, systems, and information at risk. As such, VITA needs to provide assurance to the Departments that appropriate security is available to meet their information security requirements.

Meeting the Single Audit Deadline of March 31

Applicable to: Department of Accounts

During the course of completing agency audits for the statewide single audit of federal funds, we encountered an issue that represents a risk to the Commonwealth and may require the action of the Department of Accounts.

Federal Law requires the completion of single audits of federal funds and submission of the report by March 31. In order to meet this deadline requirement, the coordination and cooperation of both the auditor and all of the Commonwealth's agencies, institutions, and component units is essential.

The Auditor of Public Accounts and State Comptroller have developed a mutual time schedule, which would allow for the completion of the audit work within the required deadlines. In recent years, we have encountered several situations, in which the auditors complete the audit test work and draft the report in sufficient time to meet the deadline.

However, certain agencies have begun a process of requesting several meetings to discuss all findings and their implication to their operations. While we appreciate management's interest in the findings, the result of this extensive meeting schedule has affected our ability to complete and issue the single audit report by the March 31 deadline.

After our experience this year, we are informing the State Comptroller that without the agencies having to meet an accelerated timetable of resolving audit findings, we will not be able to issue the report by the deadline. Our other recommended alternative is having the State Comptroller coordinate directly the discussion of audit findings. We cannot satisfy the number of meetings requested by some agencies to discuss audit findings and at the same time issue the report within required timeframe.

The only alternative to not having the State Comptroller accelerate the reporting deadlines or coordinating the discussion of findings is to issue a qualified report indicating that not all work is complete. We believe that this action could have an adverse affect on the Commonwealth's federal funding and operation of those programs.

Internal Control Findings and Recommendations

Establish Procedures for Review of Router Policies and Procedures

Applicable to: Department of Taxation

The VITA does not regularly review configurations of routers that provide protection of mission critical information systems at Taxation. We found unnecessary Internet Protocol (IP) addresses in a router configuration file that have existed for three years.

Routers are important infrastructure equipment that allows for an extra layer of protection that any entity should take advantage of whenever possible. Inadequate security controls on such equipment weakens the overall infrastructure and may result in the compromising of sensitive data.

VITA should establish policies and procedures to review configuration files for network equipment at Taxation on a regular basis to ensure that Taxation's information has appropriate protection from security risks originating from outside the internal network.

Provide Assurance of Infrastructure Security

Applicable to: Department of Planning and Budget

The Department's management is responsible for the security and safeguarding of all of its databases, information, and information technology assets. Over the past three years, the Commonwealth has moved the information technology infrastructure supporting these databases and information to VITA. As part of this transfer, the agencies also transferred many of the staff who had the expertise to advise the agency heads on these matters.

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

The Department's management needs to evaluate its capabilities for determining the level of assurance needed from VITA. Since the agency retains ownership and maintains the application systems and databases that gather information, the Department's internal staff has full responsibility for access controls to these systems. If these systems operate in a shared environment, the provider of the shared services would need to assure the Department's management of the adequacy of those controls. This shared environment is the same as the mainframe, data center operation that VITA and its predecessors offered.

While the Department and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in this shared environment, the current MOU does not address the security levels required by the Department. For the secure transmission of information to and from the database, the Department's management must address whether it has the expertise to assess this issue. Inherent within this question is whether the Department has the resources to maintain the level of expertise capable of adapting to the changing infrastructure environment.

There are two potential approaches to this issue. The first assumes the Department has the expertise and the resources to understand the changing infrastructure and can therefore specifically address all of its security needs. The second approach requires that the Department explain to VITA, in detail, the security needs for each of its systems and databases along with what access controls they currently provide. VITA then must provide the Department assurance that the infrastructure provides the level and depth of security necessary to meet state policy.

The Department's management should continue developing an MOU with VITA to define the security levels required for the agencies' data and require that VITA provide, at least annually, written assurance so management can fulfill its responsibilities related to security requirements.

STATUS OF PRIOR YEAR RECOMMENDATIONS

Review of Statewide Reporting Process

In March 2005, we issued a report entitled 'Review of Statewide Reporting Process,' which included recommendations for Accounts and Treasury to improve the process used to prepare the Commonwealth's Comprehensive Annual Financial Report. In our March 2006 report entitled 'Agencies of the Secretary of Finance' we indicated that the new auditing standards would soon be effective that would place additional emphasis on internal controls over financial reporting, which made it even more imperative that Accounts and Treasury implement our recommendations related to improving the Commonwealth's financial reporting process.

We recognize that the changes necessary to evaluate and implement our recommendations cannot occur in a short period of time and therefore we continue to monitor and report on Accounts' and Treasury's efforts in addressing our recommendations. We commend the agencies on their efforts to address this issue thus far and anticipate continuing progress in response to our recommendations. In the prior year, Accounts and Treasury primarily focused on evaluating the recommendations included in our report and addressing those related to internal processes. Below we have provided an update on the agencies progress during the current year in responding to the issues noted in our previous reports.

Over the last year, Accounts has focused on evaluating and addressing our recommendations related to the area of improving agency guidance and relationships and as a result has made several changes within its organizational structure. The Comptroller created the Assistant Comptroller of Accounting and Reporting position to oversee the General Accounting and Financial Reporting Divisions. The Assistant Comptroller has since redirected some of the responsibilities of these Divisions to the newly created Accounting and Internal Control Compliance Oversight Division. The Accounting and Internal Control Compliance Oversight Division is responsible for performing quality assurance reviews at the agency level over the financial reporting process, internal control compliance, and general ledger reconciliation. In addition, this Division will be responsible for identifying and providing training opportunities for state agency fiscal personnel on accounting standards, new reporting requirements, and compliance issues. Finally, this Division is responsible for conducting quality control reviews to monitor agencies' compliance with delegated pre-audit policies and procedures associated with decentralization.

Another initiative of Accounts related to improving internal controls within the Commonwealth is the Agency Risk Management and Internal Control Standards (ARMICS), which it issued in November of 2006. These new standards provide guidance to agencies for establishing and assessing agency internal controls in order to more effectively manage risk and maintain accountability. The Accounting and Internal Control Compliance Oversight Division is responsible for reviewing agencies' compliance with these standards, identifying areas for improvement, and providing training to agency personnel responsible for implementing ARMICS.

Accounts and Treasury have continued to make progress in addressing the other recommendations included in our previous report. Accounts and Treasury created a work group during the year to better understand each other's role in the financial preparation process and to identify areas for improvement. Further, in its efforts to ensure the financial information in the Commonwealth Accounting and Reporting System (CARS) is accurate; Accounts updated its agency reconciliation guidelines and is performing additional review and analysis of CARS activity throughout the year.

Another major initiative of the Commonwealth that impacts the statewide reporting process is the replacement of CARS and other central systems. As we have indicated in previous reports, the Commonwealth's current accounting system limits Accounts' ability to expedite the financial reporting process since it is basically a general ledger and cash receipts and disbursement system, and therefore does not provide much of the information such as accounts receivable and long-term financial obligations that is necessary to prepare the annual report.

The Virginia Enterprise Application Project, which we discuss further in the Finance Secretarial Overview, has planned implementation dates of July 1, 2008, for the budget module and July 1, 2009, for the remaining financial management modules. The Comptroller, Assistant Comptroller, and Accounts' staff are actively participating in this project including assisting in defining the requirements related to recording and reporting the Commonwealth's financial activities. We encourage Accounts to continue to look for business process re-engineering opportunities relating to the financial reporting process in conjunction with the system development efforts. In addition, as the implementation of a new accounting system will not solve all of the inefficiencies in the current financial statement preparation process, we encourage Accounts to continue to look for more efficient and effective methodologies for accumulating and analyzing data that will not be available in the new system.

FINANCE SECRETARIAL OVERVIEW

The Departments of Accounts, Planning and Budget, Taxation, and Treasury and the Treasury Board report to the Secretary of Finance and primarily serve other agencies within the Commonwealth in a central support capacity. These agencies perform critical functions in the Commonwealth's statewide financial management system. Many of these functions crosscut agencies, requiring these agencies to work together and share information. Responsibilities include the following.

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

The agencies within the Finance Secretariat work closely together in the budgeting, management and reporting of the Commonwealth's resources. An overview of these activities and the interaction of the agencies within the Finance Secretariat in performing these activities are included below. Detailed information on each agency's operations is included in the individual agency section of this report.

Budget Development and Execution

Planning and Budget aids in the development and administration of the state budget. Planning and Budget relies on information from all agencies and universities in developing revenue estimates and expense budgets. Taxation also has a significant role in the budget development process in that it develops the General Fund revenue forecast for the Commonwealth and assists in revenue forecasting for certain non-general fund revenues, which are primarily transportation related revenues.

Once the General Assembly and the Governor have approved the budget, Planning and Budget provides an electronic copy of the budget to Accounts to upload into the Commonwealth Accounting and Reporting System (CARS), which the system uses to control agency spending. CARS contains automated edit controls to ensure agencies do not exceed the spending authority established in the budget. Planning and Budget also reviews and approves administrative budget adjustments. Planning and Budget and Accounts work together to ensure that CARS properly reflects these budget adjustments.

Financial Management

Agency Officials from Treasury, Accounts, and Taxation are all members of the Treasury Board and play a key role in the collection, investing and debt management activities of the Commonwealth.

Taxation is the largest collector of Commonwealth revenue, which it primarily deposits to the General Fund. It also collects a significant amount of tax revenue that is later distributed to localities by Accounts. Taxation and Accounts also collect money owed to the Commonwealth through a debt set-off program that they jointly administer. Treasury manages and invests the Commonwealth's funds throughout the year trying to achieve the highest level of returns based on the operational needs of the Commonwealth.

Treasury is responsible for the issuance and management of debt the Commonwealth and several of its boards and authorities. Through providing staff services to the Treasury Board, Treasury participates in developing the terms and structure of debt issued throughout the Commonwealth.

Financial Reporting

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

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

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

Central Systems

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

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

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

Enterprise Application Project

The Commonwealth, through its Virginia Enterprise Application Project, is implementing an enterprise system that will replace the accounting, payroll, fixed asset and budgeting systems maintained by Accounts and Planning and Budget. Both Accounts and Planning and Budget have been involved in developing the requirements for the new system and will continue to be involved throughout the implementation process.

The Project's implementation schedule will take place over the next seven years with the current focus on the financial management component, which consists of several modules. The Commonwealth plans to implement the budget development module by July 1, 2008, followed by the general ledger, accounts payable, revenue and accounts receivable, time and attendance, cost accounting, and purchasing modules by July 1, 2009. Agencies with their own financial system must interface to the enterprise system until they implement the financial management modules following a conversion strategy that will continue through 2011. Following the successful implementation of the financial management components, the Commonwealth will implement human resource, supply chain, and administrative components beginning in 2010.

Budgetary Highlights

General Funds are the primary resource for funding these finance agencies' operations and account for approximately 81 percent of the overall expenses. The original operating budget for agencies in the Finance Secretariat totaled approximately \$136 million. Agencies requested various budget adjustments that the Department of Planning and Budget approved, which resulted in a final operating budget of approximately \$154 million, an increase of \$18 million. Taxation increased its budget by \$8 million to support increased staff for tax reform, to improve its ability to recruit and retain full time compliance employees, and to cover a change in pay date from July to June, which crossed fiscal years. Treasury increased its budget by \$7 million primarily to cover increased costs of administering the Commonwealth's property insurance program, which paid several large deductibles for losses incurred during the year. The remaining increase of \$3 million is due to increases in salary and benefits and miscellaneous changes at the remaining agencies.

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

Summary of Budget and Expenses for 2006

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Secretary of Finance	\$ 580,969	\$ 654,567	\$ 617,262
Department of Accounts	8,558,452	9,771,147	9,706,073
Department of Planning and Budget	7,252,532	8,926,206	7,901,534
Department of Taxation	102,901,117	110,941,731	107,710,494
Department of the Treasury	<u>16,399,695</u>	<u>23,538,086</u>	<u>19,716,894</u>
 Total – finance agencies	 <u>\$135,692,765</u>	 <u>\$153,831,737</u>	 <u>\$145,652,257</u>

Source: Commonwealth Accounting and Reporting System

INDIVIDUAL AGENCIES

The following provides detailed information for each of the finance agencies, including an overview of the agencies' operations and the scope of the work we performed for the fiscal year ended June 30, 2006.

Secretary of Finance

Agency Overview

The Secretary of Finance assists the Governor in the management and direction of the finance agencies and performs program coordination, policy planning, and budget formulation activities.

Audit Scope

We performed an audit of the financial activity of the Secretary of Finance for the year ended June 30, 2006, and reported our audit results in a separate audit report entitled "The Governor's Cabinet Secretaries" issued in September 2006.

Department of Accounts

Agency Overview

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

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

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

Administrative Services

The Administrative Services Division provides support services such as accounting, human resources, and payroll and benefits administration for Accounts as well as several other agencies. The other agencies receiving services include the Department of the Treasury, the Department of Planning and Budget, the State Council on Higher Education of Virginia, the Commonwealth Health Research Board, the Virginia Racing Commission and Virginia College Savings Plan. The Division stores and manages public records and publishes and maintains several publications on Accounts’ website.

Administrative Services also processes Line of Duty Act payments to beneficiaries of certain public safety officers who die or become disabled from work related causes. Under this Act, the death of certain public safety officers entitles their beneficiaries to receive a lump sum payment. The Division also makes monthly payments for health insurance for surviving spouses, disabled officers and their spouses, and dependents.

State Payroll Operations and Charge Card Administration

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

General Accounting

The General Accounting Division’ operates and maintains CARS as required by the Code of Virginia. General Accounting activities include developing and issuing policies and procedures for entering transactions in CARS and offering periodic training courses. This Division also monitors CARS activity, provides assistance to agencies, performs daily cash reconciliations, and resolves errors as necessary. They also process certain transactions in CARS including reoccurring or correcting journal entries, transfers as required by the Appropriation Act, and the quarterly calculation and allocation among the various funds of interest earned by the Department of the Treasury on the Commonwealth’s cash and investments as required by the Code of Virginia and Appropriation Act.

General Accounting also calculates and distributes certain revenue collections to local governments as required by the Code of Virginia. The Appropriation Act budgets and Accounts records these transfer payments under a separate agency number. Accounts distributed the following amount of revenue during the year.

Sales and use tax for education	\$1,087,960,903
Recordation taxes	19,175,185
ABC profits	4,150,000
Wine taxes	4,350,000
Rolling stock taxes	4,968,612
Public facilities rebate tax	863,747
Other	<u>120,847</u>
Total	<u>\$1,121,589,294</u>

Source: Commonwealth Accounting and Reporting System

Accounts also made recordation tax transfers to the Department of Transportation for the Northern Virginia Transportation District Fund and the Transportation Improvement Set-Aside Fund in the amounts of \$19,782,684 and \$1,042,127, respectively.

Financial Reporting

The Financial Reporting Division prepares various financial reports and schedules related to the Commonwealth's financial activity including the following.

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

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

Audit Scope

We performed an audit of Accounts' financial reporting process primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2006. We also reviewed the controls surrounding the central systems administered by Accounts.

Department of Planning and Budget

Agency Overview

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

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

During fiscal year 2006, Planning and Budget processed administrative adjustments, which resulted in a \$3.7 billion increase to the Commonwealth's operating budget and a \$4.5 billion increase to the capital budget. These adjustments result for a variety of reasons, some of which are necessary to process General Assembly actions, and we provide more detail on the adjustments in another report. The adjustments are within the authority granted to Planning and Budget and the Governor by the General Assembly through the Act. These increases were primarily reappropriations of prior year's balances, increases for additional revenues collected not included in the original budget, and increases for items not estimated in the original budget.

New Performance Management Structure

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

Informational Websites

Planning and Budget maintains two websites that provide information to the public on the Commonwealth's regulations and performance.

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

Planning and Budget also administers the Virginia Performs website in accordance with requirements of the Code of Virginia Section 2.2-1501. Planning and Budget released this website in fall 2006 and it replaces the Virginia Results website. Virginia Performs reports information by agency on two primary processes - strategic planning and performance measurement. These processes are intended to work together to better manage the performance of state government.

Audit Scope

We performed a review of the budget and appropriation processing control system administered by Planning and Budget for the fiscal year ended June 30, 2006, primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2006. We issued a separate report on the results of this review in April 2007, in a report entitled "Review of Budget and Appropriation Processing Control System."

Department of Taxation

Agency Overview

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

Overview of the Revenue Forecast and Collections

Revenue Forecast

Taxation develops the General Fund revenue forecast for the Governor, so that he may provide the General Assembly with the six-year revenue forecast. General Fund revenues come primarily from five major revenue sources; the two largest are the individual income tax and sales and use tax. Other major revenue sources are corporate income taxes, recordation taxes, insurance premiums, and miscellaneous taxes. Below is a summary of the forecast and actual revenues collected for fiscal year 2006:

Summary of Fiscal Year 2006 General Fund Revenue: Actual and Forecast (in millions)

	<u>2006 Forecast</u>	<u>2006 Actual Revenue</u>	<u>Dollar Variance</u>	<u>Percent Variance</u>
Source:				
Withholding	\$ 7,978.8	\$ 8,061.0	\$ 82.2	1.0%
Nonwithholding	2,431.3	2,530.2	98.9	4.1%
Refunds	<u>(1,239.7)</u>	<u>(1,282.6)</u>	<u>(42.9)</u>	<u>3.5%</u>
Net	9,170.4	9,308.6	138.3	1.5%
Sales and use tax	2,803.8	2,812.7	8.9	0.3%
Corporate income tax	851.5	871.6	20.1	2.4%
Insurance premiums	392.5	373.8	(18.7)	(4.8)%
Wills, suits, and deeds	723.0	694.7	(28.3)	(3.9)%
All other taxes and revenue	<u>746.1</u>	<u>772.9</u>	<u>26.8</u>	<u>3.6%</u>
Total	<u>\$14,687.3</u>	<u>\$14,834.3</u>	<u>\$147.0</u>	<u>1.0%</u>

Source: Actual General Fund Revenues for Fiscal Year 2006 and the State of the Virginia Economy as presented by Jody M. Wagner, Secretary of Finance August 28, 2006.

Actual General Fund revenue collections for fiscal year 2006 exceeded the General Fund forecast by \$147 million or 1.0 percent. Non-withholding payments, corporate income taxes, and recordation taxes are the three most volatile revenue sources and depend on economic and non-economic conditions.

Total individual non-withholding payments exceeded the forecast by \$98.9 million or 4.1 percent. These payments consist of both estimated and final payment. Estimated payments meet the forecast; however, final payments exceeded the forecast. Non-withholding increases are largely due to growth in non-wage income, which appear to result from the capital gains tax reduction that appears to have caused an increase in capital gains realizations. Due to the unavailability of federal tax return data, a precise explanation of why the increases occurred in non-wage income is not available.

Corporate income tax receipts exceeded the forecast by \$20.1 million or 2.4 percent. Fiscal year 2006 was the fourth consecutive year of double digit growth. Growth in corporate income tax receipts reflects a strong economy centered around defense-related firms and housing-related firms.

Despite the implementation of the new accounting system, Taxation issued 2.5 million refunds in fiscal year 2006 versus 2.6 million in fiscal year 2005. Refunds increased \$42.9 million or 3.5 percent. The increase in refunds is most likely due to increases in tax credit programs that a taxpayer can claim on their final return in addition to tax reform that increased the filing threshold, allowing more individuals to file for a refund.

Recordation taxes fell short of the forecast by \$28.3 million or 3.9 percent. Home sales, refinancing, and price appreciation all drive recordation tax revenues. Price appreciation has begun to fall. The economy saw double digit increases in the average sale prices while there was a decline in the volume of home sales.

Revenue Collections

Taxation is the largest collector of Commonwealth revenue. During fiscal year 2006, Taxation collected \$15.9 billion in revenue, depositing \$14.6 billion into the General Fund. The remaining revenues went to taxpayers as refunds or as transfers to other state agencies or to localities for taxes collected on their behalf. The largest sources of General Fund revenues are individual and fiduciary income taxes and state sales and use taxes. Individual and fiduciary income taxes include taxes from employer withholdings, estimated taxes paid, and individual income tax returns. Below is a summary of revenue collections for fiscal year 2005 and 2006.

Fiscal Year 2005-2006 General Fund Revenue Collections
(in millions)

Source:	2006 Actual Revenue	2005 Actual Revenue	Actual Variance	Percent Variance
Withholding	\$ 8,061.0	\$ 7,513.0	\$548.0	7.29%
Non-withholding	2,530.2	2,073.5	456.7	22.03%
Refunds	<u>(1,282.6)</u>	<u>(1,234.2)</u>	<u>(48.4)</u>	<u>3.92%</u>
Net Individual	<u>9,308.6</u>	<u>8,352.4</u>	<u>956.3</u>	<u>11.45%</u>
Sales and use tax	2,812.7	2,946.1	(133.4)	(4.53%)
Corporate income tax	871.6	616.7	254.9	41.33%
Insurance premiums	373.8	373.6	0.20	0.05%
Public service	90.0	88.3	1.7	1.93%
Wills, suits, deeds	694.7	596.1	98.6	16.54%
All other taxes and revenue	<u>682.9</u>	<u>714.2</u>	<u>(31.3)</u>	<u>(4.38%)</u>
Total	<u>\$14,834.3</u>	<u>\$13,687.3</u>	<u>\$1,147.0</u>	<u>8.38%</u>

Source: Actual General Fund Revenues for Fiscal Year 2006 and the State of the Virginia Economy as presented by Jody M. Wagner, Secretary of Finance August 28, 2006.

Collections increased \$1,147 million or 8.38 percent in fiscal year 2006. Increases in the general fund tax collections are mainly due to favorable economic conditions discussed above. The Commonwealth recognized a decrease of \$133.4 million (or 4.53%) in Sales and Use taxes. This decrease is due to the early repeal of the Accelerated Sales Tax program, which caused fiscal year 2006 to only have 11 monthly payments.

Status of the Public Private Partnership Project

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

Although implementation has taken place and the critical system applications and most of the reports are currently functional, all applications and reports are not fully functional. Taxation has developed some alternatives for those applications and reports that are not functional. Some reports and applications have gone thorough an initial design, testing and approval phase, however in some cases the end users have requested changes to the reports and/or applications. Taxation anticipates all remaining reports will be functional by August 2007 and applications by December 2007.

Audit Scope

We performed an audit of Taxation's financial transactions related to tax collections including accounts receivable, deferred revenues and taxes, accounts payable and other liabilities, and tax and interest revenue as reported in CARS and the Integrated Revenue Management System for the fiscal year ended June 30, 2006. We also reviewed Taxation's financial reporting activities primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2006.

Department of the Treasury

Agency Overview

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

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

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

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

Cash Management and Investments Division

The General Account of the Commonwealth, a pool of investments representing assets of the General Fund of the Commonwealth, higher education (operating), highway maintenance, and transportation trust funds, is the largest portfolio managed by the Cash Management and Investments Division. The General Account has two pools: the primary liquidity pool and the total return pool. The Cash Management and Investments Division internally manages the primary liquidity pool, which provides the major source of liquidity for the disbursement requirements and operational needs of the Commonwealth. The externally managed total return pool seeks to generate higher total returns over time, as compared to the liquidity pool. Treasury's target allocation for the overall general account asset mix is 75 percent for the primary liquidity pool and 25 percent for the total return pool. Treasury's monthly average invested balance for fiscal year 2006 was \$5.8 billion. The average yield for fiscal year 2006 was 3.4 percent, which is higher than the 2.9 percent return for fiscal year 2005, but still low by historical comparisons.

The Cash Management and Investments Division also manages the Local Government Investment Pool (LGIP). LGIP is a short-term investment pool offered to counties, towns, cities, state agencies, departments, and authorities of the Commonwealth of Virginia. It is an open-ended money market type fund that offers public funds investors daily liquidity, diversification, and professional management. Treasury manages the pool in compliance with SEC regulations for money market funds. Standard & Poors Corporation has assigned the pool its highest rating, which is “AAA.”

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

Debt Management Division

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

Division of Risk Management

The Division of Risk Management administers insurance programs on behalf of the Commonwealth that cover state government, other public entities, and certain individuals serving in the public interest. Administered insurance programs are either self-insured or commercially insured.

Risk Management administers the following programs under Treasury.

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

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

Unclaimed Property Division

The Unclaimed Property Division administers two major types of abandoned property programs.

- Personal property
- Real property

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

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

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

Operations Division

Check Processing

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

Trust Accounting

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

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

Bank Reconciliation

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

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

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

Audit Scope

We performed an audit of Treasury's financial transactions related to cash and cash equivalents, investments, debt, risk management and unclaimed property activity which is controlled by Treasury as reported in the CARS and Treasury's accounting records (including the activity of the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority) primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2006.

Treasury Board

The Code of Virginia sets forth the appointments to the Treasury Board, which includes the State Treasurer, the State Comptroller, the State Tax Commissioner, and four members appointed by the Governor. The Treasury Board has the following responsibilities.

- Exercise general supervision over the investment of state funds
- Administer the Virginia Security for the Public Deposits Act
- Control and manage sinking and other funds that the Commonwealth holds as fiduciary
- Contract with an outside manager for the administration of the State Non-Arbitrage Program
- Provide advice and supervision in the financing of state buildings
- Approve the terms and structure of proposed state educational institution bond issues and other financing arrangements
- Approve the terms and structure of proposed bond issues secured by state appropriations
- Administer the regional jail financing reimbursement program
- Issue all general obligation debt of the Commonwealth
- Manage its bond issues in compliance with federal taxation and arbitrage laws

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

The Treasury Board operates a tax-exempt commercial paper program to provide start-up funding for several of the Commonwealth's capital borrowing programs. As of June 30, 2006, there was no tax-exempt commercial paper for general obligation bond projects outstanding.

The following schedule provides information on the Treasury Board's original and final budgets and expenses for fiscal year 2006:

Analysis of Budgeted and Actual Expenses by Program

Program:	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Financial assistance for confinement in local facilities	\$ 3,100,000	\$ 3,100,000	\$ 2,760,529
Financial assistance for cultural and artistic affairs	2,636,727	2,636,727	2,636,726
Industrial development services	5,322,190	5,322,190	5,311,431
Bond and loan retirement and redemption	<u>327,324,242</u>	<u>306,095,525</u>	<u>297,285,186</u>
Total uses	<u>\$338,383,159</u>	<u>\$317,154,442</u>	<u>\$307,993,872</u>

The Treasury Board's budget decreased by approximately \$21 million, which is the result of a change in the draw schedules for previously authorized capital projects and the refinancing of outstanding debt in order to capitalize on lower interest rates.



Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

March 14, 2007

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

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the agencies under the **Secretary of Finance** for the year ended June 30, 2006. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit objectives for the audit of the Departments of Accounts, Planning and Budget, Taxation, and Treasury for the fiscal year ended June 30, 2006, include the following:

- to determine whether management has established and maintained internal controls over the Commonwealth's financial reporting and other central processes and the centralized services provided to agencies and institutions in support of the preparation of the financial statements as indicated in the scope section of this report;
- to determine whether management has established and maintained adequate operating and application system controls over CARS, CIPPS, FAACS, the Integrated Revenue Management System, the Form 27 Automated Transaction System and other central systems;
- to evaluate the accuracy of financial transactions related to tax collections including accounts receivable, deferred revenues and taxes, accounts payable and other liabilities, and tax and interest revenue as reported in CARS and the Integrated Revenue Management System and in supplemental information prepared by Taxation;
- to evaluate the accuracy of financial transactions related to cash and cash equivalents, investments, debt, risk management and unclaimed property activity which is controlled by Treasury as reported in CARS and Treasury's accounting records (including the activity of the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority);

- to evaluate whether appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
- to evaluate the proper approval and documentation of budget adjustments; and
- to determine whether the agencies have complied with applicable laws and regulations.

Audit Scope and Methodology

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

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

Department of Accounts

Financial Reporting*
 Commonwealth Accounting and Reporting System (CARS)
 Commonwealth Integrated Payroll/Personnel System (CIPPS)
 Fixed Asset Accounting and Control System (FAACS)

Department of Planning and Budget

Form 27 Automated Transaction System
 Budget Execution
 Budget Adjustment Process

Department of Taxation

Financial Reporting	Lifeworks System
Tax Return Processing	Computer Assisted and Data Capture System
Tax Revenue Collection	Total Automated Capture System
Virginia Tax On-line	Joint Electronic Filing System
Integrated Revenue Management System	

Department of the Treasury (including Treasury Board operations)

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

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

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

Audit Conclusions

We noted no matters involving internal control that we consider necessary to be reported to management related to the Commonwealth's financial reporting and other central processes and the centralized services provided to agencies and institutions in support of the preparation of financial statements as indicated in the scope section of this report.

We noted no matters involving operating controls over CARS, the Integrated Revenue Management System, and other central systems. However, we noted certain matters related to the security and safeguarding of all databases, information, and information technology assets maintained by the Department of Planning and Budget and the review of router policies and procedures at the Department of Taxation that we consider necessary to be reported to management that require management's attention and corrective action. These matters are described in the section entitled "Comments to Management – Internal Control Findings and Recommendations."

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

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

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

We noted matters involving internal control and its operation at Planning and Budget related to its information security program and documentation of budget adjustments that we reported to management in the separately issued report entitled “Report on Budget and Appropriation Processing Control System, For the Fiscal Year Ended June 30, 2006.”

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

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

EXIT CONFERENCE AND REPORT DISTRIBUTION

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

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

AUDITOR OF PUBLIC ACCOUNTS

SAH:sks

sks: 61



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

April 13, 2007

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

Dear Mr. Kucharski,

Thank you for the opportunity to respond to the Risk Alerts contained in the Fiscal Year 2006 Agencies of the Secretary of Finance Audit Report. We will continue to work with the Virginia Information Technologies Agency to address the Department of Accounts' (DOA) information security needs.

DOA welcomes the opportunity to facilitate the completion of the statewide single audit and will incorporate the following steps to accomplish this goal.

- Revise the Commonwealth Accounting Policies and Procedures Manual Section 10205, Financial Management-Agency Response to APA Audit, to include a section for statewide single audit comments.
- Notify agencies receiving potential single audit comments that the agency is required to participate in any required meetings with APA personnel to resolve outstanding questions and provide a written response to APA and DOA within the specified time frame.
- Closely monitor responses to the potential single audit comments to ensure a timely response to the APA.

These steps provide a general approach that DOA will take to ensure your office receives a timely response from applicable agencies. DOA staff will coordinate the development of specific procedures with the APA staff to help ensure this process operates as effectively and efficiently as possible.

Sincerely,

A handwritten signature in cursive script, appearing to read "David A. Von Moll".

David A. Von Moll



COMMONWEALTH of VIRGINIA
Department of Planning and Budget

Richard D. Brown
Director

1111 E. Broad St., Room 5040
Richmond, VA. 23219

April 17, 2007

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski:

Thank you for the opportunity to address the finding applicable to the Department of Planning and Budget in the FY 2006 audit results for the five agencies under the Secretary of Finance.

Finding: Provide Assurance of Infrastructure Security

The Department's management is responsible for the security and safeguarding of all of its databases, information, and information technology assets. Over the past three years, the Commonwealth has moved the information technology infrastructure supporting these databases and information to the Virginia Information Technology Agency (VITA). As part of this transfer, the agencies also transferred many of the staff who had the expertise to advise the agency heads on these matters.

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

The Department's management needs to evaluate its capabilities for determining the level of assurance needed from VITA. Since the agency retains ownership and maintains the application systems and databases that gather information, the Department's internal staff has full responsibility for access controls to these systems. If these systems operate in a shared environment, the provider of the shared services would need to assure the Department's management of the adequacy of those controls. This shared environment is the same as the mainframe, data center operation that VITA and its predecessors offered.

While the Department and VITA have entered into a detailed memorandum of understanding (MOU) that defines service level responsibilities in this shared environment, the current MOU does not address the security levels required by the Department. For the secure transmission of information to and from the database, the Department's management must address whether it has the expertise to assess this issue. Inherent within this question is whether the Department has the resources to maintain the level of expertise capable of adapting to the changing infrastructure environment.

Walter J. Kucharski
April 16, 2007
Page Two

There are two potential approaches to this issue. The first assumes the Department has the expertise and the resources to understand the changing infrastructure and can therefore specifically address all of its security needs. The second approach requires that the Department explain to VITA, in detail, the security needs for each of its systems and databases along with what access controls they currently provide. VITA then must provide the Department assurance that the infrastructure provides the level and depth of security necessary to meet state policy.

The Department's management should continue developing an MOU with VITA to define the security levels required for the agencies' data and require that VITA provide, at least annually, written assurance so management can fulfill its responsibilities related to security requirements.

Agency's Response:

The Department of Planning and Budget (DPB) believes that it has a shared responsibility with the Virginia Information Technologies Agency (VITA) for safeguarding DPB databases and other information housed on VITA owned and managed computers. DPB also believes that it can work with VITA to develop an agreement to provide a level of security that will meet appropriate standards.

In February 2007, DPB requested and received a six-month extension from VITA to address security matters under ITRM Policy SEC500-2 and ITRM Standard SEC501-1. In the request, DPB stated that it did not have the resources to fully implement the requirements under the policy and standard. That statement remains true today; however, DPB will continue to pursue solutions that will help it reach security expectations and will seek VITA's guidance and assistance for developing a joint approach to ensure proper protection of database information.

Sincerely,



Richard D. Brown

cc: Don Darr
Paul Bender



COMMONWEALTH of VIRGINIA

Department of Taxation

February 26, 2007

Mr. Walter J. Kuckarski
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Dear Mr. Kucharski:

Thank you for the opportunity to provide the Department of Taxation's (TAX) comments to address the findings identified as part of your office's audit of TAX's financial records and operations for the year ended June 30, 2006.

Since my appointment as Commissioner in May 2006, I have strived to maintain TAX's strong record of ensuring that internal controls and business processes reflect standards of highest integrity without sacrificing critical operating efficiencies. Based upon the record of this year's audit findings, it appears that the excellent record over the last several years continued in fiscal year 2006 despite the massive effort involved with the implementation of our new TAX system.

I understand the Internal Control Finding and Recommendation on establishing Procedures for Review of Router Policies and Procedures and the joint requirement I have with VITA for the security and safeguarding of all information technology assets, systems and information. TAX has had several conversations with VITA concerning this lack of performance and TAX will continue to do all it can to remind, strongly encourage, and otherwise persuade VITA to fulfill its responsibilities to meet these information security requirements.

I appreciate the opportunity to provide the Department of Taxation's comments as part of your office's report of TAX's financial records and operations for the year ended June 30, 2006.

Sincerely,

A handwritten signature in black ink, appearing to read "Janie E. Bowen".

Janie E. Bowen

c: The Honorable Jody Wagner
Secretary of Finance



COMMONWEALTH of VIRGINIA

Department of the Treasury

J. BRAXTON POWELL
TREASURER OF VIRGINIA

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

April 13, 2007

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

Dear Mr. Kucharski:

The Department of the Treasury (Treasury) appreciates the opportunity to respond to the comments and recommendations in your draft Report on Audit of Agencies of the Secretary of Finance for the fiscal year ended June 30, 2006. Your comments and recommendations are appreciated and are given the highest level of importance and consideration by the Administration and Treasury as we continue to review and improve our financial reporting practices and procedures. Treasury appreciates your acknowledgement of the progress being made in several prior recommendations and the recognition that some of these issues take time to resolve.

SECRETARY OF FINANCE AUDIT RECOMMENDATIONS

Risk Alert - Obtain Assurance for Infrastructure Security

Treasury is well aware that the Department's Officials have responsibility for the security and safeguarding of all information technology assets, systems and information. As you noted, over the past three years the Commonwealth has moved the information technology infrastructure supporting these databases to the Virginia Information Technology Agency (VITA). In this environment, VITA and the Department Officials clearly share responsibility for the security of such assets, systems and information. Since VITA has assumed responsibility for the information technology infrastructure, the Department's Officials must evaluate the agency's capabilities for determining the level of assurance needed from VITA and have VITA provide assurance that their infrastructure provides the safeguards and controls needed to protect information and databases as required by state policy.

Treasury has provided VITA with all the documentation required to make this assessment of safeguards and controls needed for VITA to provide such assurance. However, as noted in your report, VITA has not been able to provide the agency with assurance that they can provide hardware and software configurations that satisfy these requirements and appropriate controls to secure information technology assets, systems and information. As a result, Treasury is continuing to work diligently with VITA to provide any further information needed for VITA to provide assurance that appropriate security is available to meet information security requirements.

STATUS OF PRIOR YEAR RECOMMENDATIONS

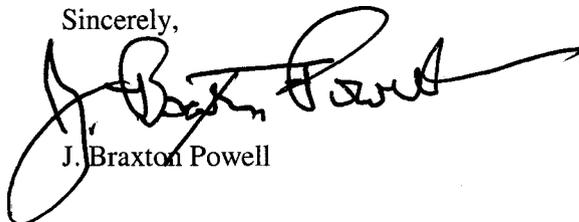
Review of Statewide Reporting Process

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

In this regard, Treasury has hired a senior level accounting position to work in concert with Accounts to coordinate the agency's extensive year-end financial reporting responsibilities, which take place under extremely tight deadlines. This position will coordinate researching and implementing new financial reporting standards affecting accounting operations, coordinate year-end financial reporting with Accounts and APA, review the agency's financial reporting system capabilities and coordinate the agency's compliance with the Agency Risk Management and Internal Control Standards initiative by Accounts related to improving internal controls. Additionally, Treasury will continue to work with Accounts in an inter-agency working group that meets periodically to improve inter-agency communication and the financial reporting processes, including the Virginia Enterprise Application Project to replace the Commonwealth Accounting and Reporting System and other central systems.

Again, thank you for the opportunity to respond to your report and for publishing this response with your report.

Sincerely,



J. Braxton Powell

c: The Honorable Jody M. Wagner
Secretary of Finance
Robert S. Young
Deputy State Treasurer

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2006

Jody M. Wagner
Secretary of Finance

David A. Von Moll
Comptroller

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

Janie E. Bowen
Tax Commissioner

J. Braxton Powell
Treasurer