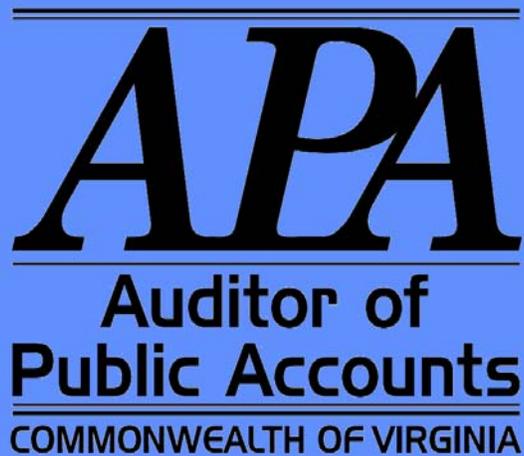


AGENCIES OF THE SECRETARY OF FINANCE

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2007**



AUDIT SUMMARY

This report summarizes our fiscal year 2007 audit results for the five agencies under the Secretary of Finance.

We have included four risk alerts, which discuss issues that require the action of either another agency, outside parties or a change in the method by which the Commonwealth of Virginia (Commonwealth) conducts its operations.

- Modernize Financial Systems and Processes

Although the Department of Accounts has primary responsibility for financial reporting, the State Comptroller depends heavily on the agencies and institutions to process and provide information to him in a timely manner. The systems that the State Comptroller uses and many of the key systems that supply information are antiquated and use programming and technologies, which are at least thirty years old.

Additionally, the Federal Government is seriously considering making changes to key reporting deadlines which could affect the Commonwealth's ability to receive grants and contracts and sell securities. At present, the changes may take several years to occur, however, the time and resources necessary to upgrade or replace these systems will also take a substantial amount of time. Therefore, the Commonwealth needs to develop a plan, process, and funding mechanism to address these systems.

- Improve Service Arrangements Between Agencies

The Auditor of Public Accounts has advocated that smaller agencies, which do not have the resources or staff, use larger agencies for business functions, such as accounting, budgeting, information security, or personnel resources. During our review of agreements between smaller agencies and their use of larger agencies for these services, we have found circumstances where these arrangements are not providing or improving internal controls. We believe Accounts holds an ideal position in taking a leadership role in developing a comprehensive back office operation for smaller agencies, which would assume total operations for administrative functions.

- Collect Information in the Commonwealth Portfolio

The Virginia Information Technologies Agency (VITA) has acquired a computer application to begin gathering the information necessary to properly manage its computer resources. To comply with changes in accounting standards, the Commonwealth must place a value on its computer application resources and reflect their value for financial reporting. Much of the information necessary to comply with the accounting standard will reside in the VITA application. To prevent the duplication of data gathering and improve the usefulness of the system, we are recommending that both VITA and the State Comptroller use the same system and work together to verify its accuracy.

- Security Risk Assurance for Infrastructure

The Departments of Accounts and Taxation must work with VITA to make sure that the Information Technology Partnership with Northrop Grumman addresses all their security needs.

The report also includes other internal control and compliance findings and recommendations.

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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 a change in the method by which the Commonwealth conducts its operations. The issues in this report arise from our work on the Comprehensive Annual Financial Report audit and at minimum will affect the Secretary of Finance, the State Comptroller, and the Department of Accounts.

The audit risk alerts Modernize Financial Systems and Processes, Improve Service Arrangements Between Agencies, and Collect Information in the Commonwealth Portfolio will affect the Virginia Information Technologies Agency and the rest of State Government depending on the method of implementation. The audit risk alert Security Risk Assurance for Infrastructure will affect both the Departments of Accounts and Taxation.

Modernize Financial Systems and Processes

Financial Systems

As we have indicated in previous reports, the Commonwealth's current accounting systems are all over twenty years old or older and have not had substantial upgrades since the Y2K concerns of the late 1990's. All of the systems, as the Y2K process disclosed, have passed their normal life cycle and are fundamentally at risk of a failure where either the vendor or expertise of keeping the system operating could become unsustainable.

While finding the resources to address these issues in the current economy may be difficult, the risk of system failure will continue to increase. Finally, the Commonwealth also needs to guard against the perceived economies that the systems do not cost substantial funds to maintain. There are clear examples within the Commonwealth of a system requiring replacement because vendors have abandoned the technologies, requiring the Commonwealth to upgrade the system with no improvements or efficiencies.

The current accounting systems limit Account's ability to expedite the financial reporting process since it is basically a general ledger and cash receipts and disbursement system. Therefore, the current system does not provide much of the information such as accounts receivable and long-term financial obligations that is necessary to prepare the annual report. This limitation has become more of a concern given the recent push for more timely financial reporting in the government sector, particularly in the areas of federal grants and contracts reporting and disclosures related to municipal securities.

Another concern as noted above is the need to modernize the Commonwealth's financial systems, since it has become more difficult to keep the Commonwealth's antiquated systems up to date to meet current user needs. Statewide systems such as the Commonwealth Accounting and Reporting System (CARS) along with the Commonwealth Integrated Payroll and Personnel System (CIPPS) use the Common Business Oriented Language (COBOL). While COBOL was one of the earliest high-level programming languages of its time, it has become outdated and is no longer part of modern day computer programming classes. In effect, this directly imposes a risk to owners of systems created under this programming language.

As individuals with the unique knowledge and skill sets in this language begin to retire, the Commonwealth may not be able to hire qualified replacements to maintain these systems. As user needs

change and system modifications become necessary, it is important to have skilled technicians that can make the proper changes. There are also many modern accounting systems used throughout the Commonwealth that are unable to interface with CARS efficiently due to its limitations. Therefore, some agencies are unable to take advantage of features that their systems may provide due to the restrictions of an out of date system.

In the prior year, we reported that the Commonwealth, through its Virginia Enterprise Application Project, had began the process for replacing its accounting, payroll, fixed asset and budgeting systems, with a planned initial implementation date for the first phase of July 1, 2008, for the budget module and July 1, 2009, for the remaining financial management modules. However, as we reported in our January 2008 report entitled "Progress Report on Selected Information Technology Projects in the Commonwealth" the specific timelines for implementation and the source of funding for the project remain uncertain.

We recommend the Secretary of Finance and State Comptroller continue to work with the Virginia Enterprise Application Program Office to develop solutions to the current issues facing this project to ensure the Commonwealth is able to move forward with the modernization of its financial systems.

Financial Processes

In our March 2005 report entitled "Review of Statewide Reporting Process", we recommended Accounts improve the process used to prepare the Commonwealth's Comprehensive Annual Financial Report. We recognize that the changes necessary to evaluate and implement our recommendations cannot occur in a short period of time and therefore we have continued to monitor and report on Accounts' efforts. Accounts has continued to make progress towards addressing our recommendations. In order to best utilize its available resources, Accounts has selected areas and agencies for review using a risk based approach.

Over the last year, Accounts' Accounting and Internal Control Compliance Oversight Division began performing quality assurance reviews at select agencies primarily to review the accuracy of financial information agencies submit to Accounts for financial reporting purposes and determine whether agencies are complying with reconciliation requirements. Through this review, Accounts has identified issues and made recommendations for improving the process used by agencies in preparing financial information and reconciliations.

Accounts' Financial Reporting Division also continues to make progress towards evaluating and identifying areas that require improvement and implementing changes. During the year, the Financial Reporting Division focused their efforts on the capital assets area to address identified deficiencies. Accounts modified its policies and procedures to require quarterly reconciliations of capital asset information in the accounting and capital asset systems. In addition, Accounts has increased its analysis of capital asset data and inquiries of agencies regarding questionable activities. Through their increased efforts in this area, Accounts identified several reporting errors at the agency level and we have noted overall improvements in this area through our test work.

As we indicate above since the timeframe for implementing a new financial system remains uncertain and as the implementation of a new accounting system will not solve all of the inefficiencies in the current financial reporting process, Accounts' must continue to seek more efficient and effective methodologies for managing the current statewide systems and for accumulating and analyzing data. As part of this process, Accounts should continue to evaluate the guidelines in the Commonwealth Accounting Policies and Procedures manual to ensure the guidelines are up-to-date and appropriate. In addition, as Accounts performs review of agency processes, they should evaluate the efficiency and effectiveness of the processes and make recommendations for improvements.

Improve Service Arrangements Between Agencies

The Auditor of Public Accounts has advocated that smaller agencies, which do not have the resources or staff, use larger agencies for business functions, such as accounting, budgeting, information security, or personnel resources. These arrangements allow the smaller agencies to concentrate on providing program services and eliminate unnecessary personnel costs and resources dedicated to administrative functions.

During an audit, we review the arrangements between agencies and the internal controls surrounding financial transactions, payroll, fringe benefits, and information security. We have found circumstances where these arrangements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls.

Smaller agencies do not have the staff expertise or resources to process financial transactions, personnel and payroll, procurement, and other administrative processes, such as implementing an adequate information security program, and maintaining adequate separation of functions for basic internal controls. Loss of one person can, and does in many of these agencies, compromise the internal control structure and knowledge base needed to handle key transactions and duties. Therefore, the use of larger agencies with sufficient staff and resources provides needed internal controls and management oversight of public resources.

Further, change in agency leadership may result in having leaders without knowledge of state processes, standards, regulations, and laws. Agency leadership without an understanding of this essential information could enter into agreements or contracts that are not in the best interest of the agency or the Commonwealth.

In many cases, the service arrangements are ad hoc agreements to provide services where neither the service provider nor the agencies have a clear understanding of what they need. The intended purpose of these arrangements is to provide expertise, oversight, and direction, where small agency management may neither possess nor understand the importance of internal controls or have the necessary financial management expertise.

Our audits have indicated that in some circumstances these service arrangements are providing no oversight or internal controls for the smaller agency. The service providers are simply processing the paperwork without any managerial review of the transactions. This situation does not improve the Commonwealth's or the smaller agencies' handling of state funds and compliance with applicable state policies and procedures.

Since Accounts provides some of these services, we believe they hold an ideal position in taking a leadership role in developing a comprehensive back office operation for smaller agencies, which would assume total operations for administrative functions. This mechanism will also serve as a sound basis for the development of the needs for the Virginia Enterprise Application Program Office standards for the Commonwealth's Enterprise Application. In addition, Accounts has the Accounting and Internal Control Compliance Oversight Division, which through their quality assurance reviews can assist in identifying agencies that could benefit from a service arrangement. Finally, we believe the Governor's Cabinet could develop a model process for making sure that their agencies get needed services, without significant use of program resources to meet their performance measures.

In addition, our review of information security in the Commonwealth revealed that most small agencies, such as the Department of Planning and Budget, do not have the resources, expertise, or funding to develop and implement adequate information security programs that protect their critical and sensitive data.

We believe that the Secretaries of Administration, Finance, and Technology should work with the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency (VITA) to develop and implement an administrative agreement for all back office operations, including information security, managerial oversight and internal controls, for agencies requiring administrative assistance or establish a central back office operation to provide these functions. The current arrangements do not provide a cohesive process which addresses the true operations of an administrative unit. For example, purchasing depends on budget availability, understanding of state contracting practices, contract management, and ultimately the payment and recording of the purchase.

We believe that Secretaries need to address the needs of smaller agencies as an arrangement of outsourcing the entire administrative function rather than the paper processing of groups of transactions. We believe that this approach will improve the operational efficiency of these agencies. However, we do not believe that the Commonwealth will recognize any saving in either personnel or cost, since the smaller agencies are using marginal resources with marginal results.

We also recognize that leaders of the smaller agencies will resist this type of change, however, the Commonwealth will greatly improve its internal controls and gain risk management benefits.

Collect Information in the Commonwealth Portfolio

Accounting standards will require the Commonwealth to accumulate and capitalize the cost associated with both new and legacy computer systems similar to the accounting for buildings and other structures. VITA's Project Management Division (PMD) has a computerized tool, known as the Portfolio, which they use to track new systems development efforts. Fully implemented, the Portfolio has the capability to gather and analyze information on all of the Commonwealth's systems necessary to comply with these accounting standards. However, in order to achieve budget reduction targets for fiscal 2009-2010, VITA suspended implementation of these capabilities pending funding.

The State Comptroller should work with PMD to jointly implement the Portfolio cost accumulation capabilities to ensure it gathers accurate and complete cost information to comply with the accounting standard. Also, this joint effort should eliminate unnecessary duplicate data entry into two potential systems and should provide important management information, not currently found in our fixed asset accounting system.

To accomplish this, the Comptroller and PMD should develop data exchange standards so the Comptroller's accounting system can provide accurate and complete actual IT spending information for each agency in the Commonwealth's Portfolio system. For agencies that only submit summary data to the Comptroller, they must be required to provide the Portfolio with IT spending data consistent with the data standards developed by the Comptroller and PMD.

With the Portfolio fully implemented, the Commonwealth will have an official repository of its IT investment data and the Comptroller will have the information for the Commonwealth's annual financial report.

Security Risk Assurance for Infrastructure

The Departments have responsibility for the security and safeguarding of all of their Department's information technology systems and information. Over the past four years, the Commonwealth has moved the information technology infrastructure supporting these databases to VITA, who has an Information Technology Partnership (IT Partnership) with Northrop Grumman. In this environment, VITA and the Departments clearly share responsibility for the security of their Department's information technology assets, systems, and information and must provide mutual assurance of this safeguarding.

The Departments have provided VITA with all the documentation required to make this assessment and VITA should provide assurance that the IT Partnership will practice proper policies and procedures as outlined by the Departments. The annual review and audit of the IT Partnership infrastructure has concluded and VITA will communicate any findings and corrective action to the Departments.

The annual review and audit has identified that the IT Partnership staff did not have formal, documented policies and procedures for backup media, system monitoring, help desk functions, or job operation scheduling. In addition, IT Partnership staff does not perform periodic review of user accounts; comply with CIS standards surrounding password parameters; maintain evidence of system monitoring; or document offsite tape rotation. A documented and implemented system administration process and system monitoring process is critical in order to minimize the security risks relating to the confidentiality, integrity, and availability of their Department's information stored on the IT Partnership's hardware and infrastructure.

Although the Departments are not responsible for correcting these findings, they should receive regular status reports from VITA on the progress the IT Partnership is making to correct the issues. As part of the progress reporting, VITA should provide the Departments with any interim steps they should take if the IT Partnership must delay addressing this issue. We bring this matter to the attention of the Departments so that they can properly manage their risk and monitor corrective action.

Internal Control and Compliance Findings and Recommendations

Enhance Validation of Lease Reporting

Applicable to: Department of Accounts

Accounts had material errors in its operating lease disclosure for the Comprehensive Annual Financial Report for fiscal year 2007 resulting in an understatement of future rental payments of \$31 million. In fiscal year 2006, Accounts created a new web-based version of the Lease Accounting System (LAS). The new system allowed Accounts to shift responsibility for recording leases from Accounts to the individual agencies. When the data entry responsibilities resided with Accounts, there were some basic controls to ensure the accuracy of the data recorded. However, by transferring responsibility to the agencies, Accounts has lost this control. Agencies do not have personnel skilled in this area to reliably record accurate data in the LAS. Therefore, Accounts must develop and implement additional methods and controls to validate data in the system.

We found similar issues during the fiscal year 2006 audit and understood that since the system and process were new, that Accounts would implement changes. However, Accounts did not take action to improve controls or detect errors in the system. Accounts has not updated the lease policies and procedures in the Commonwealth's Accounting Policies and Procedures Manual to reflect the requirements and capabilities of the new system or processes necessary for agencies to use the new system correctly.

The Department of General Services negotiates contracts for all leased real property and statewide contracts for equipment leases. General Services' Division of Real Estate Services negotiates all real property leases, with General Services as the lessee and individual agencies as the occupants. Under these leases, the individual agencies are responsible for recording their part of the lease in LAS. This process increases the risk that agencies do not record their part of the lease. We could not find one lease involving six agencies recorded in LAS resulting in an understatement of future payments of \$27 million. General Services' Division of Purchases and Supply negotiates statewide contracts for frequently leased equipment, such as copiers. Agencies receive some, but not all, of the required information for lease recording in LAS from General Services' Divisions. There is currently no standardized lease document that provides the data necessary for agencies to properly enter required data in LAS.

We recommend that Accounts implement additional methods and controls to validate data in the lease system and provide the agencies with applicable policies and procedures for using the system. In addition, Accounts should coordinate efforts with General Services to standardize real property and equipment leases to ensure that they include the information necessary so that agencies can properly record the leases in LAS. Further, Accounts should re-examine its decision not to have General Services enter LAS information for all centrally negotiated leases involving multiple agencies.

Properly Complete Employment Eligibility Verification Forms

Applicable to: Department of Accounts and Department of the Treasury

The Departments are is not properly completing Employment Eligibility Verification forms (I-9) in accordance with guidance issued by the US Citizenship and Immigration Services of the US Department of Homeland Security in its Handbook for Employers. This guidance requires the employee to complete, sign, and date Section 1 of the I-9 form on the first day of employment. Additionally, the employer or designated representative must complete, sign, and date Section 2 of the I-9 form within three days of employment to show that they verified the employee's identity and employment eligibility at the point of hiring.

We found the following exceptions during our review of I-9 forms completed by the Departments.

- New employees did not complete Section 1 on or before the first date of employment.
- The Departments did not properly complete documentation of employee verification in Section 2.
- The Departments did not complete the employer section of the I-9 form within three days of the employee's first day of work.

The exceptions noted represent noncompliance with the guidelines issued by the US Citizenship and Immigration Services of the US Department of Homeland Security in its Handbook for Employers. Failure to comply with these guidelines can result in significant penalties to both the employee and employer. Because of the potential sanctions, we recommend that the Departments ensure their employees receive adequate training on the guidelines for completing I-9 forms. In addition, we recommend the Departments develop and follow policies and procedures for complying with these guidelines. The lack of documented policies and procedures increases the risk of non compliance and the likelihood that errors will occur.

Improve Controls over Leases

Applicable to: Department of Taxation

Prior to fiscal year 2006, the Department of Accounts (Accounts) entered all agencies' lease information into the Lease Accounting System (LAS). When LAS became web-based in 2006, each agency began entering and updating its own information in LAS. Although Accounts has not updated the Commonwealth's statewide policies and procedures for the newest version of LAS, all LAS users at Taxation have attended adequate LAS training and received resource materials from Accounts.

The Taxation LAS users have not followed these instructions and Accounts did not review any submissions to determine if agencies were meeting the reporting requirements. As a result, Taxation staff have inaccurately recorded its real property leases in LAS causing misstated lease commitments for disclosure in the Commonwealth's Comprehensive Annual Financial Report. We found the following issues with Taxation's methods for recording lease information in LAS.

- All of Taxation's real property leases have improper data entered in LAS, such as beginning payment dates, payment timing, number of payments, payment amounts, executory costs, and economic life of the leased property.
- Taxation does not consider the portion of their monthly rental payments attributed to executory costs. Executory costs are payments for items such as insurance, maintenance, and taxes, which the property owner pays, and are not included in the agency's minimum payments reported on the Commonwealth's financial statement footnotes.

Accounts should update the LAS statewide policies and procedures, and Taxation should adopt this guidance and adapt it to meet its internal policies and procedures for entering lease information in LAS. Accounts should periodically review during the year the information entered in LAS to determine its accuracy and work with agencies, such as Taxation, to ensure personnel have an adequate understanding and can follow the standards and principles of lease accounting.

We recommend that Taxation adopt the statewide guidance and adapt it to implement agency specific policies and procedures to cover all aspects of entering and modifying leases into LAS. Taxation should ask for assistance from Accounts on any area Taxation does not fully understand. We also recommend that Taxation correct all real property leases, active in fiscal year 2007 and beyond, in LAS to reflect actual lease agreement information.

Properly Document Application and Operating System Options

Applicable to: Department of Taxation

Taxation has not applied vendor supplied patches to application software or allowed the VITA to update operating system software on four servers that support critical web applications since December 2005. The vendor has released three patches for the application software during this period. Further, the vendor no longer supports the operating system software running on two of these servers. Taxation's policies require its Information Technology personnel to apply patches and update operating system software at least quarterly, unless management provides an alternative direction for sound business reasons.

While Taxation has provided verbal assurance over the business decisions made concerning the environments discussed above, management could not provide formal documentation of the assessment and

decision process. Without updated operating system and application software, Taxation risks system failure and data destruction, among others. Without documented justification for decisions made not to apply patches or upgrades, the knowledge of these decisions could be lost and patches or upgrades erroneously applied causing similar risks to those mentioned above.

While Taxation has worked to minimize the risks to these specific servers through various compensating controls, Taxation should document their risk assessment of vendor supplied patches and upgrades for applications and operating systems through their change management or other formal decision process. If Taxation elects not to apply a particular patch or upgrade a particular system, Information Technology personnel should document the justification for this decision as well as the planned risk mitigation activities.

Establish Sufficient Controls over the Wire Transfer Process

Applicable to: Department of the Treasury

As part of their responsibility for statewide financial services, Treasury executes wire transfers to pay vendors and transfer funds among bank accounts. Treasury performs these transactions for internally managed Commonwealth funds, as well as for other state agencies.

In addition, Treasury also allows other state agencies, including the Virginia Employment Commission and the Department of Housing and Community Development, to directly execute their own wire transfers. Currently, Treasury has limited or no involvement in agency-initiated wires and only grants, deletes, and changes access to the online banking systems as the agencies request this access. Treasury provides no oversight and review to individual transactions or even wire transfer account access.

We have concerns that Treasury allows individual agencies to perform their own wire transfers. By allowing individual agencies to perform wire transfers, Treasury has created a lack of segregation of duties and has not ensured that adequate controls over the process exist at the individual agencies. Treasury has not provided wire transfer guidance to individual agencies, including best practices and access information. This practice places Commonwealth funds at a significant risk for misappropriation.

Treasury should evaluate the wire transfer process and initiate all wire transfers for the Commonwealth. Treasury should not allow individual agencies to execute their own wire transfers, unless there are external or other mandated requirements. Under those circumstances, Treasury should provide the agencies guidance, and at least annually conduct a detailed review of the agency's internal controls and transactions.

Establish, Maintain, and Review Centralized Cash, Investment, and Application Access Account Listings

Applicable to: Department of the Treasury

Treasury does not have a centralized automated record of employees' access, including those with signature authority for cash and investment accounts, and those with access to their information systems. This lack of central information hinders their ability to safeguard Commonwealth assets because management cannot determine in a timely manner who has access to what assets and information systems. In addition, without a centralized listing, management cannot easily review access for separated employees to ensure that they no longer have access to Treasury's accounts. During our review, we found that a terminated employee still had access to a trustee account for more than two years after separation.

Treasury should develop and continually update a centralized listing of employees and their access to accounts and information systems. Management should then periodically review this listing to ensure that access is still appropriate for current employees and that terminated employees no longer have access to Treasury accounts or information systems.

Strengthen Controls over Information Systems

Applicable to: Department of the Treasury

In support of their responsibility for statewide financial services, Treasury owns or has access to a number of key systems and applications for managing, transferring, and recording cash, investments, debt, and unclaimed property funds and other assets. Different divisions within Treasury, as well as other state agencies and external parties use these systems and applications. We have some concerns that Treasury does not have adequate controls and sufficient policies and procedures over these systems and applications.

Establish Sufficient Controls over Online Banking Systems

Currently, select Treasury employees have access to the four concentration banks' online banking systems. Treasury also controls access to these systems for other state agency employees. During our review, we noted a lack of controls surrounding access to these systems. Specifically, we have concerns about the following areas having a lack of detailed established processes governing online banking access, as well as written policies and procedures.

- How Treasury personnel physically grant, delete, and change access and review an employee's duties in relationship to the associated responsibilities and restrictions for each level of access;
- Ensuring that Treasury has a secure method for itself and external agencies to request access additions, modifications, and deletions;
- Treasury's process for determining that agencies are tracking accounts, conducting periodic reviews and reconciliations; and
- Providing guidance to individual agencies, including best practices and access information.

During our review, we also noticed generic agency access accounts and terminated employees with access to the online banking systems. Treasury does not have a list of individuals who are associated with or have access to these generic agency accounts.

By not having sufficient controls over online banking systems, Treasury increases the risk of inappropriate access to Commonwealth data and assets. We recommend that Treasury evaluate their current processes governing online banking system access and establish detailed, written policies, procedures, and processes. Management should communicate these policies to the appropriate individuals and agencies, and monitor the processes to ensure compliance. Treasury should also evaluate current online banking system access and modify as necessary.

Segregate System Access Responsibilities

Treasury data owners serve as their own system administrators for some systems by granting, changing, or deleting access for system users. However, for other Treasury systems, the information security unit grants, changes, or deletes access based upon a request by the data owner. Management does not have a consistent policy to ensure that data owners do not serve as system administrators.

By not consistently separating the responsibilities of data owner from system administrator, Treasury has not complied with Commonwealth information security standards and has created a lack of segregation of duties. We recommend information security handle all access requests and data owners should formally request that the system administrator grant, modify, or delete user accounts.

Enable Audit Trails and Transaction History on Information Systems

Treasury does not enable audit trails or transaction history features on all of their information technology systems. As a result, individuals could inappropriately change data, either mistakenly or intentionally, and Treasury would not have a readily available mechanism to determine who accessed the data and what activity occurred. For example, during our review, we found one individual with access to change tables within a critical database; this individual was unfamiliar with the tables and lacked the training on how to change the data. Without enabling logging features, Treasury could not easily identify and correct accidentally changed data.

Due to the sensitivity and critical nature of data on the systems, Treasury must have proper controls in place to manage access and log activity. We recommend that Treasury enable audit trail and transaction history features on its information systems and implement a process to periodically review these logs.

Strengthen Internal Controls over Disbursement Processing

Applicable to: Department of the Treasury

Currently, Treasury reconciles check payment totals to the Commonwealth's Accounting and Reporting System or another originating system to ensure accuracy of processing. Treasury uses "payee match positive pay" processing with certain accounts where the amount and volume of checks is large; which makes the banks responsible for verifying data before clearing the disbursements. However, Treasury personnel have internal access to make certain check alterations before disbursement. In order to decrease this risk, Treasury should evaluate viable options to mitigate this risk. These options can include payee match positive pay for all disbursements or an internal reconciliation process.

Update Risk Assessment and Test Business Continuity Plan

Applicable to: Department of the Treasury

Treasury last updated their risk assessment in July 2003 and has not consistently tested the business continuity plan and updated it to reflect any concerns noted during testing. Treasury also did not document the required annual review of the business impact analysis and the continuity of operations plan.

Without a current risk assessment, Treasury does not have a documented record of present risks to their information systems and the measures taken to minimize those risks. A formal risk assessment process identifies threats, determines the likelihood of such threats, identifies and evaluates vulnerabilities, and determines the impact of an exploited vulnerability. Additionally, the risk assessment provides information to help develop a thorough business continuity plan and disaster recovery plan. By not testing their business continuity plan on an annual basis, Treasury cannot evaluate the adequacy and effectiveness of the plan.

Treasury should update their risk assessment and document management's review of the business impact analysis and the continuity of operations plan. In addition, Treasury should test the continuity of operations plan at least annually and determine whether any concerns exist. As part of this process, Treasury management should review and revise the plan to reflect any concerns noted during testing.

FINANCE SECRETARIAL OVERVIEW

The Departments of Accounts, Planning and Budget, Taxation, the 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 of 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.

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.

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, 2007.

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.

Financial Summary

The following schedules provide information on the Secretary of Finances’ operating budget and expenses for fiscal year 2007 at the program level.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

	Program Expenses			Funding Source
	Original Budget	Final Budget	Actual Expenses	General Fund
Program: Administrative and Support Services	\$626,392	\$1,091,869	\$1,038,982	\$1,038,982

Source: Commonwealth Accounting and Reporting System

The Secretary’s budget increased by approximately \$465,000 due to additions for grant payments to assist localities with funding needs, reappropriation of prior year balance, salary, benefits, and mileage reimbursements, and other adjustments.

Audit Scope

We performed an audit of the financial activity of the Secretary of Finance for the year ended June 30, 2007, and reported our audit results in a separate audit report entitled “The Governor’s Cabinet Secretaries” issued in October 2007.

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 the Payroll Service Bureau, State Internal Audit, Information Resource Management, Finance and Administration, State Payroll Operations and Charge Card Administration, Financial Reporting, Accounting and Internal Control Oversight, and General Accounting. 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 upon request, provides independent and objective general, technical, and audit assistance. Information Resource Management supports the operations over Accounts' systems and provide "check and balance" controls over Accounts' systems. Below is a discussion of Accounts' remaining divisions.

Finance and Administration

The Finance and Administration 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. In addition, the Division provides services to the Enterprise Applications Public-Private Partnership Project Office. 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. In addition, the Division makes monthly payments for health insurance for surviving spouses, and disabled officers, 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.

Accounting and Internal Control Oversight

The Accounting and Internal Control Oversight Division evaluates and reports on agency financial accountability, compliance, and internal controls. The Divisions activities include reviewing state agencies implementation of Agency Risk Management and Internal Control Standards, performing quality assurance reviews of agency submitted data for inclusion in the CAFR, and recommending improvements in agency reconciliation processes. In addition, the Division monitors, reconciles, and reports on the Cost Recovery Audit process and results. The cost recovery audits examine state expenditures for all state agencies and institutions to identify and recover any duplicate or erroneous payments.

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	\$1,027,006,261
Recordation taxes	20,880,627
ABC profits	4,150,000
Wine taxes	4,350,000
Rolling stock taxes	5,284,183
Public facilities rebate tax	1,037,260
Other	<u>128,470</u>
Total	<u>\$1,062,836,801</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 \$18,003,562 and \$1,115,808, 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 is responsible for providing guidance to agencies concerning the recording and reporting of capital assets and leases.

Audit Scope

We performed an audit of Accounts' financial operations and financial reporting process primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2007. We also reviewed controls surrounding the central systems administered by Accounts.

Financial Summary

The following schedules provide information on Accounts' operating budget and expenses for fiscal year 2007 at the program level.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

Program:	Program Expenses			Funding Sources	
	Original Budget	Final Budget	Actual Expenses	General Fund	Special Revenue Funds
Administrative and Support Services	\$1,274,903	\$ 2,172,683	\$ 2,147,658	\$ 2,147,658	\$ -
Financial Systems Development and Management	3,439,514	3,409,432	3,384,432	3,384,432	-
Accounting Services	4,443,316	4,686,226	4,526,555	4,077,336	449,219
Service Center Administration	509,633	470,536	470,536	470,536	-
Total Uses	\$9,667,366	\$10,738,877	\$10,529,181	\$10,079,962	\$449,219

Source: Commonwealth Accounting and Reporting System

During the fiscal year, Accounts' original budget increased by approximately \$1 million. Approximately, \$600,000 of the increase is attributable to payments to the federal government for internal service fund over-recoveries. The Appropriation Act contains the authority for Accounts to make these payments, but does not include a budget amount since the payments can vary significantly from year to year.

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 2007, Planning and Budget processed administrative adjustments, which resulted in a \$2.4 billion increase to the Commonwealth's operating budget and a \$3.9 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 re-appropriations 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 July 1, 2006, 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 used activities for 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.

School Efficiency Reviews

Planning and Budget operates the school efficiency review program since 2003. Under the program, Department staff, combined with consultants, review operations in local school districts to identify opportunities for saving and application of best practices. Planning and Budget performed eight school efficiency reviews in 2007 and schools now pay a portion of the cost of the review. Planning and Budget collected approximately \$93,000 and deposited the funds directly into the General Fund to reimburse the state for the review cost.

Commonwealth Competition Council

Planning and Budget must provide staffing and operational support to the Commonwealth Competition Council (Council). The Commonwealth Competition Council was part of the Virginia Government Competition Act of 1995 and is an outgrowth of the Commission on Government Reform. The Council is an independent advisory body within the executive branch of Virginia's state government. The Council has 15 members appointed by the Governor, the Speaker of the House of Delegates, and/or the Senate Committee on Rules. The Council focuses on reducing the size and scope of government activity, especially in areas where the private sector can provide services or products.

Financial Summary

Planning and Budget receives primarily General Fund appropriations, and personnel costs make up the majority of the expenses. Planning and Budget's budget includes \$250,000 in anticipated non-general funds, which represents savings identified by the Commonwealth Competition Council. These funds would have defrayed the costs of providing support to the Council, but the Council did not identify any savings in fiscal year 2007. The following table shows budget and actual activity for fiscal year 2007.

Program:	Program Expenses			Funding Source
	Original Budget	Final Budget	Actual Expenses	General Fund
Planning, Budgeting and Evaluation Services	\$ 8,450,057	\$9,161,436	\$7,387,182	\$ 7,387,182

Source: Commonwealth Accounting and Reporting System

The budget increased during the year for statewide salary and related fringe benefit increases, funding to support the Council on Virginia's Future, and re-appropriation of the prior year's unexpended balance.

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, 2007, primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2007. We issued a separate report on the results of this review in March 2007, 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.

Taxation is the largest collector of Commonwealth revenue. During fiscal year 2007, Taxation collected \$17.3 billion in revenue, depositing \$15.6 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 2006 and 2007.

Fiscal Year 2006-2007 General Fund Revenue Collections
(in millions)

Source:	2006 Actual Revenue	2007 Actual Revenue	Actual Variance	Percent Variance
Withholding	\$ 8,061.0	\$ 8,576.8	\$515.8	6.40%
Non-withholding	2,530.2	2,840.1	309.9	12.25%
Refunds	<u>(1,282.6)</u>	<u>(1,559.8)</u>	<u>(277.2)</u>	<u>(21.61)%</u>
Net Individual	<u>9,308.6</u>	<u>9,857.1</u>	<u>548.5</u>	<u>5.89%</u>
Sales and use tax	2,812.7	3,049.1	236.4	8.40%
Corporate income tax	871.6	889.9	18.3	2.10%
Insurance premiums	373.8	384.9	11.1	2.97%
Public service	90.0	88.0	(2.0)	(2.22)%
Wills, suits, deeds	694.7	582.9	(111.8)	(16.09)%
All other taxes and revenue	<u>682.9</u>	<u>713.9</u>	<u>31.0</u>	<u>4.54%</u>
Total	<u>\$14,834.3</u>	<u>\$15,565.8</u>	<u>\$731.5</u>	<u>4.93%</u>

Source: Actual General Fund Revenues for Fiscal Year 2007 and the State of the Virginia Economy as presented by Jody M. Wagner, Secretary of Finance August 20, 2007.

Despite the overall increase in general fund revenue collections, revenues finished below the fiscal year 2007 forecast by \$234.4 million or 1.5 percent. The Commonwealth experienced an increase in tax refunds and a decrease in the recordation tax, which negatively impacted overall revenue collections. Increases in refunds were due to a combination of overpayment of estimated income taxes and increased tax credits claimed on returns. The decrease in recordation taxes was due to the decline in the housing market.

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, 2007. 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, 2007.

Financial Summary

The following schedules provide information on Taxations' operating budget and expenses for fiscal year 2007 at the program level.

Analysis of Budgeted and Actual Expenses by Program and Funding Source

Program:	Program Expenses			Funding Sources	
	Original Budget	Final Budget	Actual Expenses	General Fund	Special Revenue Funds
Planning, Budgeting, and Evaluation Services	\$ 2,940,607	\$ 2,916,724	\$ 2,916,724	\$ 2,916,724	\$ -
Revenue Administration Services	56,121,296	55,793,054	53,465,893	45,850,705	7,615,188
Tax Value Assistance to Localities	1,115,115	1,356,652	1,321,377	983,123	338,254
Public/Private Partnership Administrative and Support Services	2,500,000	4,130,000	3,653,983	-	3,653,983
	36,016,917	35,805,428	34,876,011	34,843,757	32,254
Total Uses	<u>\$98,683,935</u>	<u>\$100,001,858</u>	<u>\$96,233,988</u>	<u>\$84,594,309</u>	<u>\$11,639,679</u>

Source: Commonwealth Accounting and Reporting System

During the fiscal year, Taxation's original budget increased by approximately \$2 million. The increase covered salary and health insurance premium increases, in addition to changes in retirement and disability contribution rates.

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 2007 was \$7.2 billion. The average yield for fiscal year 2007 was 5.3 percent, which is higher than the 3.4 percent return for fiscal year 2006. The difference between each year is a result of an increase in market rates during those years. This yield is a composite yield from both internally managed primary liquidity portfolio and from externally managed extended duration portfolio.

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 & Poor's 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 seven states with a "AAA" bond rating for general obligation debt from three rating services: Moody's Investors Service, Standard & Poor's 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, 2007.

Financial Summary

The following schedules provide information on the Treasury's operating budget and expenses for fiscal year 2007 at the program level.

Analysis of Budgeted and Actual Expenses by Program

Program:	Original Budget	Final Budget	Actual Expenses
Investment, Trust and Insurance Services	\$ 8,221,351	\$ 9,054,311	\$ 7,155,467
Revenue Administration Services	9,751,008	10,758,271	9,481,556
Total Uses	\$17,972,359	\$19,812,582	\$16,637,023

Source: Commonwealth Accounting and Reporting System

Analysis of Expenses by Program and Funding Source

Program:	General Fund	Special Funds	Highway Maintenance and Construction Funds	Trust and Agency Funds	Dedicated Special Revenue Funds
Investment, Trust and Insurance Services	\$5,063,268	\$ -	\$163,619	\$1,928,580	\$ -
Revenue Administration Services	3,893,669	613,327	-	544,977	4,429,583
Total Uses	\$8,956,937	\$613,327	\$163,619	\$2,473,557	\$4,429,583

Source: Commonwealth Accounting and Reporting System

During the year, Treasury's budget increased by approximately \$1 million primarily to fund VITA rate increases and increases in compliance fees.

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 following schedule provides information on the Treasury Board's original and final budgets and expenses for fiscal year 2007:

Analysis of Budgeted and Actual Expenses by Program

Program:	Program Expenses		
	Original Budget	Final Budget	Actual Expenses
Financial Assistance for Educational, Cultural, Community, and Artistic Affairs	\$ 3,100,000	\$ 3,100,000	\$ 2,902,811
Financial Assistance for the Confinement of Inmates In Local and Regional Facilities	2,633,490	2,633,490	2,633,490
Economic Development Services	5,319,403	5,319,403	5,297,039
Bond and Loan Retirement and Redemption	355,851,460	345,909,757	342,550,761
 Total Uses	 \$366,904,353	 \$356,962,650	 \$353,384,101

Source: Commonwealth Accounting and Reporting System

Analysis of Expenses by Program and Funding Source

Program:	Funding Sources		
	General Fund	Special Revenue Fund	Higher Education Fund
Financial Assistance for Educational, Cultural, Community, and Artistic Affairs	\$ 2,902,811	\$ -	\$ -
Financial Assistance for the Confinement of Inmates In Local and Regional Facilities	2,633,490	-	-
Economic Development Services	5,297,039	-	-
Bond and Loan Retirement and Redemption	333,280,884	2,427,276	6,842,602
Total Uses	<u>\$344,114,224</u>	<u>\$2,427,276</u>	<u>\$6,842,602</u>

Source: Commonwealth Accounting and Reporting System

The Treasury Board's budget decreased by approximately \$9.9 million, which is the result of actual spending trends for capital projects, interest rate changes, new debt authorizations, and refinancing of certain refunding issues.



Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

February 26, 2008

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, 2007. 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, 2007, 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, LAS, the Integrated Revenue Management System, the Form 27 Automated Transaction System and other central systems;
- to evaluate the accuracy of financial and budgetary transactions of the administrative activities as reported in the CARS for the agencies included in the Secretary of Finance;
- to evaluate the accuracy of financial transactions related to tax collections including accounts receivable, deferred revenues and taxes, accounts payable and other liabilities, 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, Treasury's accounting records, and in supplemental information prepared by Treasury (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)
 Lease Accounting System (LAS)

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 certain matters involving internal control at Accounts, Taxation, and Treasury 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. These matters are described in the section entitled "Internal Control and Compliance Findings and Recommendations".

We noted certain matters involving operating and application system controls over central systems at Planning and Budget, Taxation and Treasury that we consider necessary to be reported to management. The Taxation and Treasury matters are described in the section entitled "Internal Control and Compliance Findings and Recommendations". We reported the matter at Planning and Budget, which indicates the need to the update the Form 27 Automated Transaction manual, in the separately issued report entitled "Report on Budget and Appropriation Processing Control System, For the Fiscal Year Ended June 30, 2007."

We found that agencies included in the Secretary of Finance properly stated, in all material respects, the financial and budgetary transactions related to their administrative activities recorded and reported in CARS. The financial information presented in this report related to the administrative activities of the agencies came directly from CARS and is recorded on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

We found that Taxation properly stated, in all material respects, the financial records reviewed in support of the tax collections activity detailed in the audit objectives as reported in CARS, 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, Treasury's accounting records, and supplemental information.

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

We found that budget adjustments were properly approved and documented.

We noted certain matters involving compliance with applicable laws and regulations at Accounts and Treasury that are required to be reported under Government Auditing Standards. These matters are described in the section entitled “Internal Control and Compliance Findings and Recommendations”.

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



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

April 2, 2008

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

Dear Mr. Kucharski:

The Department of Accounts (Accounts) appreciates the opportunity to respond to the risk alerts and recommendations contained in your 2007 Secretary of Finance Audit Report. Your comments and recommendations are appreciated and are given the highest level of importance and consideration by the Administration and Accounts as we continue to review and improve our current practices. Accounts appreciates your acknowledgement of the progress made on prior recommendations and the recognition that some issues take time to resolve.

Secretary of Finance Risk Alerts

Modernize Financial Systems and Processes

Accounts understands the risks associated with older computer systems and ramifications of potential system failures. Accounts continues to place high emphasis on legacy financial systems replacement. Accounts was directly involved in the Virginia Enterprise Application Project over the past several years and plans have been made for Accounts' staff to be permanently assigned to the Enterprise "go-forward" implementation team at the Virginia Department of Transportation. In addition, the Assistant Comptroller of Accounting and Reporting is a voting member of the Enterprise Steering Committee. Other high level governance involvement in this project is planned.

Financial Processes

Accounts appreciates the acknowledgment of the progress we have made since you first reported on the statewide reporting process in March 2005. We will continue to use a risk-based approach in our evaluation of agency CAFR submissions. The Accounting and Internal Control Compliance Oversight Division will evaluate the efficiency and effectiveness of agency processes when performing agency reviews. Further, we will ensure the Commonwealth Accounting Policies and Procedures (CAPP) Manual is up-to-date and provides appropriate guidance. Lastly, Accounts will ensure that the Comprehensive Annual Financial Report (CAFR) reporting needs are considered during the Enterprise Financial System replacement "go-forward" project.

Improve Service Arrangements Between Agencies

Accounts agrees with these concerns, and policies have been drafted to govern the service arrangements between agencies. These policies, while still in draft form, are intended to standardize the services provided and the responsibilities assumed by service provider agencies with an emphasis on ensuring the customer agency benefits from the internal control environment of the service provider agency. We also plan to examine the feasibility of establishing the full-service administrative operation within State government you describe.

Collect Information in the Commonwealth Portfolio

Currently, Accounts requires agencies to capture all appropriate costs associated with the purchase and/or development of computer systems to comply with financial reporting requirements. We will increase our efforts to emphasize the need to capture comprehensive systems development costs through our Financial Reporting Directives and associated training. We will also open a dialog with the Virginia Information Technologies Agency to explore the possibilities of capturing system development data in a manner that supports the needs of the VITA PMD while preventing duplication of efforts and increasing automation across the Commonwealth's agencies.

Security Risk Assurance for Infrastructure

The IT Partnership staff informs Accounts that they have documented or complied with the backup media, offsite tape rotation, system monitoring, help desk functions, job operation scheduling and CIS password parameters audit findings. The partnership staff is currently working on documenting the process for reviewing user accounts, domain administration and the requirements for network security with a targeted completion date of June 1, 2008. Accounts will continue to work with the Virginia Information Technologies Agency to address Accounts' information security needs.

Secretary of Finance Internal Control and Compliance Findings

Enhance Validation of Lease Reporting

We agree that the lease area requires additional attention, and we are finalizing the system modification requests (SMR) to enhance the reporting options. Once the SMR process is complete, the Lease Accounting System (LAS) team will test and approve the output. The CAPP Manual topic will be finalized this spring and will include various enhancements. Financial Reporting will also provide various procedural enhancements to assist fiscal officers focus some much needed attention on LAS. One such enhancement will provide a checklist of items to consider regarding leases and require periodic certification by the fiscal officers. In addition, we will meet with the Department of General Services and investigate opportunities to standardize the lease documentation and improve accuracy of data recorded in LAS. Further, we agree that LAS controls should be strengthened. Currently, the LAS system includes a significant systemic control in that the user id, the date a change was made, and the type of change that occurred is captured. This functionality was not available in the previous system. We are exploring additional controls such as flagging transactions that fall outside expected parameters for internal rate of return, acquisition date, and variances in payment streams.

As noted above, we will update the CAPP Manual topic this spring. Due to staffing resource issues, management was required to evaluate the process and identify the critical needs. Given the time

Walter J. Kucharski
April 2, 2008
Page 3

requirements associated with CAPP updates and competing priorities with Fixed Asset Accounting System (FAACS) and the CAFR, management decided that the FAACS area posed a greater threat to the CAFR. As such, significant efforts were made to address previous deficiencies identified with capital assets. While further improvements are needed, our efforts have resulted in better capital asset reporting. Even though most of our limited resources were focused on FAACS, we did provide LAS information to users. Prior to receiving a LAS user identification number, individuals are required to attend Accounts training. This training session combines a lecture and hands-on format. In addition, the training participants receive a bound reference book that encompasses power point slides and user instructions pertinent to the system. We believe that this mandated training session and resource material provides a stronger control environment than merely posting updated procedures in the CAPP Manual on the Accounts website.

Properly Complete Employment Eligibility Verification Forms

DOA's administrative unit has reviewed the federal regulations related to I-9 forms and has implemented procedures to ensure compliance. Procedures include a thorough review of these forms for new hires on a monthly basis in conjunction with our monthly reconciliation procedures.

Sincerely,



David A. Von Moll

Copy: The Honorable Jody M. Wagner, Secretary of Finance
Lewis R. McCabe, Assistant Comptroller



COMMONWEALTH of VIRGINIA
Department of Taxation

January 3, 2008

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

Dear Mr. Kucharski:

The Department of Taxation (TAX) appreciates the time and effort you and your staff devoted reviewing the department's financial records and operations for the year ended June 30, 2007. Thank you for the opportunity to provide TAX's comments and action plans to address the audit findings identified.

A recap of TAX's plan in response to the audit follows:

Properly Document Application and Operating System Options

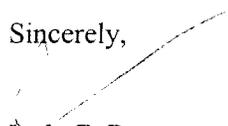
Taxation agrees that we should better document our options related to vendor supplied patches and upgrades for applications and operating systems. All decisions of significance will be discussed during TAX's Leadership Team meetings and the results will be documented in the minutes of these meetings.

Improve Controls Over Leases

Taxation agrees that we should improve controls over lease accounting. As of today, all corrections necessary to account for real property leases have been made. We will adopt statewide guidance for lease accounting when it is published and develop agency specific policies and procedures. Agency lease accounting personnel will also ask for assistance from Accounts when they are unsure how to accurately process a lease accounting transaction. In addition, lease accounting personnel will attend LAS training again to ensure that they better understand the technical subject matter

Again, I appreciate the opportunity to provide the Department of Taxation's comments as part of your office's report.

Sincerely,


Janie E. Bowen
Tax Commissioner

c: The Honorable Jody Wagner
Secretary of Finance



COMMONWEALTH of VIRGINIA

Department of the Treasury

J. BRAXTON POWELL
TREASURER OF VIRGINIA

April 1, 2008

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

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, 2007. 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.

Internal Control and Compliance Findings and Recommendations

Recommendation: Properly Complete Employment Eligibility Verification Forms

Internal controls involving the completion of Employment Eligibility Verification Forms (I-9) will be improved and strengthened to ensure I-9s are completed correctly and in their entirety. Treasury will follow the guidelines for completing such forms and ensure that employees receive adequate training.

Recommendation: Establish Sufficient Controls over the Wire Transfer Process

While Treasury has established certain controls, policies and procedures over its wire transfer process; such internal controls will be improved and strengthened to ensure adequate protection over the process. Treasury will not allow individual agencies to execute their own wire transfers unless there are external or other mandated requirements. Agencies that are granted access to initiate wire transfers are only granted such access after considerable planning and discussion with all affected parties. While several agencies granted access to initiate wire transfers must be allowed to continue this practice, Treasury will review all agencies granted such access to determine if such access can be limited to only repetitive wire transfers with dollar amount restrictions or be removed altogether. Under those circumstances, Treasury will provide the agencies guidance, including best practices and access information, and annually conduct a detailed review of the agency's internal controls and transactions.

Recommendation: Establish, Maintain, and Review Centralized Cash, Investment, and Application Access Account Listings

Treasury has policies and procedures in place for granting and deleting employees' access rights to accounts and information systems; however, we do not have a centralized automated record of employees' access rights, including those with signature authority for cash and investment accounts, and those with access to information systems. Treasury will study the relative merits of a centralized account access management system. The system development costs of an integrated system are estimated to be

outside of current budget restraints. If an integrated system cannot be implemented, Treasury will develop a manual, though somewhat more limited system, to manage such account access and periodically review to ensure such access is appropriate.

Recommendation: Strengthen Controls over Information Systems

Establish Sufficient Controls over Online Banking System. While Treasury has established certain controls, policies and procedures over its online banking process, Treasury will evaluate current processes governing online banking system access and establish detailed, written policies, procedures, and processes. We will then communicate these policies to the appropriate individuals and agencies and monitor the processes to ensure compliance.

Segregate System Access Responsibilities. Systems used by Treasury staff should be administered by our Information Systems staff. Treasury will review our application systems to determine if any allow users system administration rights and take corrective action for any exceptions to ensure that data owners do not also serve as system administrators.

Enable Audit Trails and Transaction History on Information Systems. By design, application systems are intended to have transaction logs to manage access and log activity. Treasury has reviewed the applications cited and found that all have transaction logs. However, we believe improvements can be made in the monitoring of security logs. Treasury will review all other system applications to ensure that such logs are enabled to provide an audit trail and transaction history. Any exceptions will be addressed with corrective actions to enable such logs and provide for their periodic review.

Recommendation: Strengthen Internal Controls over Disbursement Processing

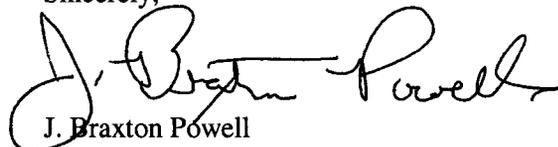
Although we have investigated several options to mitigate the risk of altered data in our disbursement processing function, expansion of payee match positive pay process to all disbursement accounts is the most practical and cost-effective means for Treasury to address the possibility of check alteration. Such expansion requires some reformatting of the check, possible modifications to the file layout of the issue file transmitted to the bank, and testing. We anticipate implementation of those accounts not already converted could take as much as a year. Treasury will convert each check type based on the risk that we associate with each type of account, converting the more risky accounts first.

Recommendation: Update Risk Assessment and Test Business Continuity Plan

Treasury will update its risk assessment and business impact analysis immediately. The business impact analysis will be updated annually and documented, including management's review. We will initiate controls to update our risk assessment on a three-year cycle. The risk assessment will be used to further identify risks and to strengthen the agency's internal control environment. The business impact analysis will be incorporated in the next update of Treasury's Continuity of Operations Plan. Treasury will test the Continuity of Operations Plan by July 1, 2008 and management will review and revise the plan to reflect any concerns noted during testing.

Again, thank you for the opportunity to respond to your report.

Sincerely,



J. Braxton Powell

c: The Honorable Jody M. Wagner
Secretary of Finance

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2007

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

