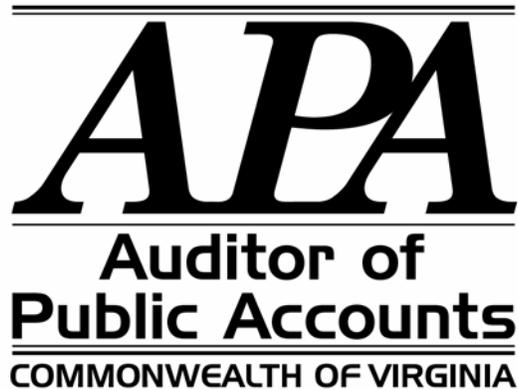


REVIEW OF STATEWIDE REPORTING PROCESS

MARCH 2005



AUDIT SUMMARY

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

We identified several areas as indicated below where Accounts and Treasury can achieve efficiencies in the CAFR and SEFA preparation processes and recommend they consider these as part of their on-going review of the process.

- *Automate Processes* - There are several areas where Accounts and Treasury either have the automation in place and have not taken full advantage of its capabilities or where the agencies can implement automation given their current resources.
- *Methods for Collecting Financial Information* - Accounts should consider alternative methods for gathering financial information to determine whether there are more efficient ways to accumulate and report the information.
- *Agency Guidance and Relationships* - Accounts and Treasury must enhance their relationships with the agencies that provide information for use in preparing statewide reports to ensure they have a full understanding of each agency's role in the report preparation process and continue to provide guidance to the agencies on how their information is used in statewide reporting.
- *Improve Statewide Federal Schedule Preparation* - Accounts should make better use of automation and enhance its review process to ensure the SEFA is complete and accurate.
- *Enhance Knowledge of Standards and Requirements* - Accounts' employees should receive additional training on federal guidelines and programs in order to provide sufficient guidance to state agencies and to perform an effective desk review of agency submissions.

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Department of Treasury

OFFICIALS



Commonwealth of Virginia

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March 7, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We are pleased to submit our audit report on the Commonwealth's statewide reporting process which includes the review of selected financial records and operations of the Department of Accounts and the Department of the Treasury for the year ended June 30, 2004. This review supported the audit of the Comprehensive Annual Financial Report for the Commonwealth of Virginia and the Single Audit Report of the Commonwealth of Virginia.

We have included our audit objectives, scope and methodology, and conclusions related to this review as Appendix A. Our report on internal control over financial reporting and on compliance and other matters related to the audit of the financial statements of the Virginia College Building Authority, Virginia Public Building Authority, Virginia Public School Authority, and the Local Government Investment Pool is included as Appendix B.

We discussed this report with management at an exit conference held on March 22, 2005, and have included their responses at the end of this report.

AUDITOR OF PUBLIC ACCOUNTS

SAH/kva
kva:

STATEWIDE REPORTING PROCESS

The Department of Accounts prepares several statewide reports including the Commonwealth's Comprehensive Annual Financial Report (CAFR) and the Statewide Schedule of Expenditures of Federal Awards (SEFA). The Trust Division at the Department of the Treasury provides a significant amount of information to Accounts for the CAFR preparation process. This report provides an overview of the process used to prepare each report and provides suggestion for enhancing these processes.

Comprehensive Annual Financial Report

The Code of Virginia sets forth the State Comptroller's responsibility to prepare an annual financial report on or before December 15. According to the Code of Virginia, the report shall include:

- financial statements that are prepared, insofar as practical, as determined by the Comptroller and the Auditor of Public Accounts, in accordance with generally accepted accounting principles;
- supplementary statements prepared on the budgetary basis of accounting;
- information provided by the State Treasurer on the status of bonded debt in the Commonwealth and the future general fund requirements for such debt; and
- other information deemed necessary by the State Treasurer.

The Comptroller complies with this requirement by preparing the CAFR in accordance with accounting standards issued by the Governmental Accounting Standards Board. In addition, when preparing the CAFR, Accounts adheres to the Government Finance Officers Association's (GFOA) requirements and deadline for its Certificate of Achievement for Excellence in Financial Reporting award program. To apply for the Certificate of Achievement, a government must submit its CAFR to the GFOA within six months of the government's fiscal year end. The GFOA has awarded the Commonwealth the Certificate of Achievement for its CAFR for the last 18 consecutive years. The CAFR informs the general public, Governor, and other state officials of the state's financial condition.

The Financial Reporting Division (Division) within Accounts prepares the CAFR using data from the Commonwealth Accounting and Reporting System (CARS), the Fixed Asset Accounting and Control System (FAACS), and financial information submitted by agencies and institutions. The Division annually issues a series of financial statement directives on behalf of the Comptroller that provide guidelines for agencies, higher education institutions, and authorities to follow to prepare and submit information to the Division for use in the CAFR preparation process. The Division primarily collects the submitted information in the form of templates, financial statements, and other standard report formats. As a result, entities use a variety of methods to account for and prepare information.

For instance, the Trust Division at Treasury provides a significant amount of information to Accounts for the CAFR preparation process including, but not limited to, long-term liabilities, cash, cash equivalents and investments, securities lending, risk management funds, unclaimed property schedules, the state Non-Arbitrage Program financial statements, Local Government Investment Pool financial statements, Virginia Public Building Authority financial statements, Virginia Public School Authority financial statements, and the Virginia College Building Authority financial statements. Treasury submits this information in the form of templates, financial statements, and a variety of nonstandard schedules.

Accounts and Treasury have individually developed internal controls over their respective processes to accumulate the information reported in the CAFR. As a result of our testwork, these internal controls appear sufficient to provide assurance that the information is accurate. However, the significant amount of information and the Treasurer's mandated responsibility requires Accounts and Treasury to develop and maintain working relationships that strive to achieve the same accounting and reporting objectives. Staff at both agencies must consistently work to understand the nature, timing, and reporting requirements of the other agency's transactions and processes.

Suggested Process Enhancements

Recent trends in financial reporting emphasize the need for more timely financial information. Currently, Accounts is exploring ways it can produce more timely information and whether or not this is feasible given its current constraints. As a result of statewide budget reductions leading to layoffs and reorganizations, Accounts and Treasury face the challenge of retaining and developing experienced professional accounting staff. Individual agency budget reductions have also depleted a great deal of institutional knowledge at the agency level.

The Commonwealth's primary accounting system, CARS, also limits Accounts' ability to expedite the financial reporting process. The current system has existed since the mid 1980's after undergoing an upgrade from an earlier version and is basically a general ledger and cash receipts and disbursement system. CARS cannot perform revenue billing, tracking, or accounts receivable management and does not contain information regarding the Commonwealth's long-term financial obligations. Many agencies and higher education institutions have implemented their own independent accounting systems because they need features that CARS cannot provide, such as more account detail, encumbrance accounting, and analysis of real-time and historical data. These inherent system limitations make Accounts' ability to provide more timely financial information particularly challenging.

Given the existing constraints, Accounts faces a difficult task in preparing the CAFR in a significantly shorter timeframe. Therefore, it is crucial that Accounts and Treasury consider ways to increase the efficiency of the CAFR preparation process. Improved efficiency should consequently lead to more timely financial information. We have provided below several areas in which we believe the two departments could achieve efficiencies in the CAFR preparation process and recommend they consider these as part of their on-going review of the process.

Automate Processes

It is without question that automation can result in improved efficiency when applied to the appropriate processes. The issues documented in this section of the report demonstrate areas where Accounts and Treasury either already have the automation in place and have not taken full advantage of its capabilities, or where the agencies can implement automation given their current resources.

Financial Reporting for the State Non-Arbitrage Program - The Department of Treasury has contracted with a new administrator for the State Non-Arbitrage Program (SNAP). As a result of this transition, Treasury will receive the SNAP financial information for fiscal year 2005 in a different manner. Treasury and the Accounts need to ensure that they are proactive in working together with the new administrator to create an efficient automated process to receive, compile, and report SNAP financial information in the Commonwealth Comprehensive Annual Financial Report.

Debt Database - The Treasury Operations Division, Trust Accounting section completed its debt database project during fiscal year 2004 in response to our audit recommendation. The database includes the majority of Commonwealth debt, and its use can significantly reduce manual efforts and improve the efficiency of financial statement preparation, as well as budget preparation and ad hoc reporting. Since fiscal year 2004 was the first year the database was up-to-date, Accounts and Treasury still relied on hardcopy debt schedules to prepare the 2004 CAFR. However, going forward, both Accounts and Treasury should rely primarily on the debt database for financial statement preparation. Treasury should also use the database internally for budget preparation and ad hoc reporting.

Program Automation - Several of the trial balance programs Accounts and Treasury use in the financial statement preparation process lend themselves to increased automation, which would improve areas where hardcopy documentation, handwritten work, and numerous revisions create significant inefficiencies in both preparing and auditing the documentation. In general, both agencies use basic Microsoft Excel spreadsheets to enter financial data from CARS and from the agencies, prints the spreadsheets, makes any necessary adjustments to the spreadsheets in Excel, and then reprints them. Therefore, the financial statement preparation process is only somewhat more sophisticated than a manual process. While Accounts has increased its use of automation in some of the trial balance program areas, Excel provides a great deal of functionality that Accounts is not currently utilizing. Accounts and Treasury should consider dedicating staff, either existing or new, to explore ways to expand its use of automation in the financial statement preparation process.

As for financial information that agencies submit for the CAFR, Accounts should consider utilizing a web-based approach to accumulating this information as opposed to accumulating the information via electronic mail. For example, agencies could upload their information into a database and Accounts could import the data as necessary to the Excel workpapers.

Accounts and Treasury should, however, recognize that increased reliance on Microsoft Excel is an interim solution for truly automating the trial balance programs. True automation requires use of accounting software that enables the analysts to prepare trial balance workpapers and convert those trial balances into financial statements. Accounts and Treasury should consider this option to increase the efficiency of the financial statement preparation process. The cost of purchasing trial balance software is minimal in comparison to the benefits gained. For example, the software can automatically update the workpapers and financial statements when analysts post journal entries. The software may also provide an analysis tool, such as providing variances between current and prior period account balances, which will allow CAFR analysts more time and opportunity to perform such analytical procedures. There are numerous versions of software available to best suit the user's needs, including packages that are compatible with the agencies' existing hardware.

Recording Financial Transactions - Agencies should use CARS, the Commonwealth's primary accounting system, whenever practical to record financial transactions in lieu of Accounts preparing manual journal entries at year-end to properly reflect this activity. If an agency seeks Accounts' guidance in this area, Accounts should assist the agency in determining the most efficient method of recording the transactions.

CARS is not the only system involved where Accounts can improve its CAFR preparation process. One example of this type of inefficiency noted not only during fiscal year 2004 audit work but also in previous years is capital assets recording in the Fixed Asset Accounting and Control System (FAACS). Accounts has made manual CAFR adjustments for certain agencies for items that Accounts knows are incorrect, because the agencies have not made the necessary adjustments in FAACS. Each year, Accounts reviews FAACS, determines that the items are incorrect, and makes the manual entry.

Rather than requiring the agencies to correct the problem in FAACS, Accounts spends the time and resources preparing and reviewing CAFR adjustments, which in turn creates additional audit work. This demonstrates one area where Accounts should work with the agencies to determine the most efficient means by which to record these transactions in FAACS. Another example is the redundant and inefficient way the Department of Transportation is required to account for debt issues in CARS, “grossing up” revenues and expenses transactions using cash as the offsetting account when there is actually no cash involved. As a result, Accounts must create a manual entry to correct the balance at year end instead of working with Transportation to properly account for their transaction needs in CARS.

Methods for Collecting Financial Information

Accounts should consider alternative methods for gathering financial information used during the financial statement preparation process. Currently, some agencies do use estimation processes to develop the information submitted to Accounts. However, many rely heavily on actual activity in determining balances. For example, Accounts uses actual July and August data to report accounts payable on the modified accrual basis. Accounts could instead use a reliable estimate to report accounts payable based on information already available to them at fiscal year-end, such as receiving reports. Accounts receivable is another area where they should consider alternative methods of collecting the data. For instance, Accounts could use a dollar threshold approach for recording receivables. Accounts should also identify the reasons why it is difficult for certain agencies to submit acceptable receivables data in a timely manner and adjust the method for gathering such information accordingly. The above mentioned accruals serve only as examples of balances that Accounts should analyze to determine more efficient ways to accumulate and subsequently report the information. Accounts should review its financial statement directives to fully determine areas where alternative methods of gathering data for preparation of the financial statements would prove efficient.

Agency Guidance and Relationships

To improve efficiency of the CAFR preparation process, Accounts and Treasury must enhance their relationships with other agencies, as well as with each other, to ensure they have a full understanding of each agency’s role in the CAFR preparation process. Accounts has taken some corrective action in this area. For example, the Financial Reporting Division added a position in fiscal year 2004 to perform quality assurance reviews on the financial reporting process within various agencies, which was in response to a recommendation in the fiscal year 2003 audit report (further discussed in section entitled “Status of Prior Year Audit Recommendations”). Accounts is working with agencies that provide material financial information to the CAFR to the extent that its resources allow. However, this is a work-in-progress and Accounts cannot fully accomplish this goal in a short timeframe. Accounts is still evaluating the most effective use of its additional resources. We suggest that Accounts more formally define its current process to ensure it meets this objective.

During the last year, Accounts did meet with the agencies that provided significant data for the CAFR to communicate directive submission requirements and answer questions about these requirements. Accounts should continue this process and focus on ensuring agencies understand and review how they report their information for the CAFR. In addition, Accounts should continue to gain an understanding of how agencies utilize CARS and prepare attachments per the financial statement directives. Further, Accounts should consider expanding on this concept by forming work groups to explore ways to improve the process and get feedback from the various agencies.

It is also critical that Accounts and Treasury continue to develop a working relationship with each other that ensures maximum efficiency in the CAFR preparation process. There are noted examples where Accounts and Treasury have duplicated efforts in large part due to a lack of understanding of the other's role in the process. Going forward, Accounts and Treasury should take advantage of opportunities presented to them, such as the recent change in administrator, that allow for both agencies to be involved in and aware of how financial information is accumulated.

Finally, the Commonwealth will be required to implement a new accounting standard beginning in fiscal year 2008 related to post employment benefits other than pensions which are provided by the Commonwealth to its employees after separation. The new accounting standard requires the Commonwealth to recognize the costs related to the post employment benefits over the years of active employment rather than after employment when the individual receives the benefits. Funding is not required, but standards require segregation and restriction of plan assets. The accounting and reporting for other post employment benefits is similar to that for pensions. Several agencies administer programs that will be considered post employment benefits under the new standard including Accounts, the Department of Human Resource Management, and the Virginia Retirement System. As Accounts is ultimately responsible for the presentation of this activity in the CAFR, communication with these agencies will be the key to successful implementation of the standard. Accounts should lead a centralized effort to evaluate all the Commonwealth's "other post employment benefits", to determine the most efficient way to identify, value, and uniformly report them in the CAFR. By dedicating resources to advance research, planning and oversight the Commonwealth can successfully structure financial reporting in compliance with the new accounting standards.

Statewide Schedule of Expenditures of Federal Awards

The Federal Single Audit Act established uniform requirements for audits of Federal grants and contracts administered by governments and other groups to promote sound financial management, including effective internal controls. The U.S. Office of Management and Budget (OMB) issued Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (A-133) pursuant to the Single Audit Act, which sets forth the standards for obtaining consistency and uniformity among Federal agencies for the audits of governments and other groups.

A-133 defines an *auditee* as "any non-federal entity that expends Federal awards which must be audited...." For the Commonwealth of Virginia, Accounts prepares the Statewide Schedule of Expenditures of Federal Awards (SEFA) and is the auditee. A-133 includes the auditee responsibilities listed below.

- Identify all Federal awards received and expended by program. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

- Maintain a system of internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with applicable laws, regulations, provisions of contracts, or grant agreements.
- Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with A-133.
- Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan.
- Complete the auditee section of the data collection form required by A-133. A senior level representative of the auditee (e.g. State comptroller, director of finance) must sign a statement as part of the data collection form certifying the auditee has met the requirements of A-133, prepared the form following A-133, and the information included in the form, in its entirety is accurate and complete.

To comply with the federal requirements, the Financial Reporting Division (Division) of Accounts prepares the Commonwealth's statewide SEFA. In preparing the SEFA, Accounts relies on information provided to them from state agencies, colleges and universities, and other component units and authorities receiving federal awards.

Through the annual financial statement directive process, Division provides instructions and guidelines for preparation of the federal schedules. Once the state agencies and institutions complete these schedules, they send them electronically to Accounts. Division uploads the electronic information into a database and prepares one statewide schedule. Division has one individual who prepares the SEFA and two supervisors who review the completed schedule.

Accounts' process for the compilation of the individual federal schedules into one statewide SEFA was highly manual. In recent years, they have begun using an MS Access database to upload the schedules, collate them, and produce a completed SEFA. Auditor of Public Accounts staff originally created the database in 2002 and Division personnel have indicated that it has enhanced their data collation process.

Suggested Process Enhancements

To assist Accounts in enhancing the SEFA preparation process we have identified some areas for improvement, which we discuss below.

Improve Statewide Federal Schedule Preparation

Each year, the schedule provided to the auditors requires substantial adjustments to properly present and categorize federal expenditures. Accounts should recognize that the Statewide Single Audit Report that contains the SEFA is just as important as the Comprehensive Annual Financial Report and this information must have the same level of correctness and accuracy as the CAFR. The SEFA contained in the Statewide Single Audit Report is the Commonwealth's report to the federal government on its use of almost \$8 billion in federal awards, grants, and contracts. Accounts, in its function as auditee under A-133, must prepare a complete and accurate schedule.

Improve Automated Processes

During fiscal year 2004, Accounts changed its computer network system, resulting in a reconfiguration of the staff's computers. This reconfiguration caused problems with Accounts' SEFA database, resulting in numerous problems and manual adjustments to the Schedule. Accounts should have staff capable of maintaining the database and ensuring its functionality. Additionally, the individuals using the database should completely understand its use and the processes underlying the database. Knowledge of and comfort with the SEFA preparation process is essential in the preparation of an accurate SEFA.

Although Accounts has been using the MS Access database to prepare the SEFA since 2002, they still print all agency submitted federal schedules and all database tables and excel files. Accounts' staff reviews these hard copy schedules and add changes and notes to the hard copy files, which they then copy again to provide the auditors; however, they do not make the adjustments in the database.

This process creates duplication of effort and is inefficient and time and space consuming. In addition, in order to audit the SEFA, we must review both the electronic files and the hard copy files because there is no one source with all information. Accounts should work with their information technology staff to improve the functional processes, and identify and correct any deficiencies in the database. Accounts should thereafter fully utilize the database's capabilities and cease to rely on extensive printed workpapers.

Enhance Knowledge of Standards and Requirements

Familiarity with the federal regulations contained in the Single Audit Act and Circular A-133 is necessary in order to properly prepare the SEFA. A-133 provides very specific requirements and guidance for federal award presentation. The individuals preparing the schedules should have extensive knowledge of A-133, as well as other resources for federal regulations and guidance. Additionally, Accounts' personnel should act as a resource for the other state institutions, providing guidance and feedback. Therefore, the individual having these responsibilities should be familiar with the federal regulations in order to perform an effective desk review of agency submissions and identify obvious errors and lack of adherence to the directive instructions.

Agency Guidance and Relationships

Accounts provides instructions annually to the agencies using the financial statement directives. From the schedules we have reviewed, it is clear that the agencies either do not understand the instructions, or are not properly following the instructions. The instructions for the federal schedules are extremely long and deal primarily with the process. Accounts should simplify the directions and provide more background information and federal requirements versus explaining how to input data. What to input is more important than describing how to input.

During the last two audits, the auditors have documented numerous instances where agencies submitted incorrect or incomplete federal information to Accounts. However, Accounts has not used the information to question or return the information to the submitting agency for correction. This year we again found material errors in data coming from the same agencies who have made the same error in the past.

Additionally, Accounts should ensure that the upcoming financial statement directive training previously discussed includes specific training focused on the federal schedules. The training should provide an overview of federal requirements and federal resources the agencies can use to meet those requirements. Accounts should also include a discussion of the importance of the federal schedules and how Accounts use the information in preparing the statewide report.

STATUS OF PRIOR YEAR AUDIT RECOMMENDATIONS

This section reports the status of prior year recommendations included in the fiscal year 2003 Department of Accounts and Department of Treasury audit reports. The fiscal year 2003 Treasury findings are recommendations to improve efficiency and not internal control issues. Therefore, the status update will address the prior year Treasury recommendations as such.

Department of Accounts

During the fiscal year 2003 audit of the CAFR, we noted the need for the State Comptroller to improve several areas in the internal controls over the report preparation process. The prior year internal control improvements suggested in the audit report resulted from our auditors having to propose several material adjustments.

Prior Year Finding: Improve Controls over Financial Reporting Process – Inform Auditor of Material Journal Entries

The State Comptroller's staff recorded several material journal entries before discussing the nature of or the process used to prepare the entries with the Auditor. Failure to notify the Auditor in a timely manner of material adjustments to the financial statements and the process used to develop the adjustments could result in a scope limitation on the audit. During fiscal year 2004, the Comptroller's staff disclosed such entries to the Auditor to ensure there was sufficient time to perform an audit to review the internal control process surrounding the development of these entries. Therefore, Accounts has taken adequate corrective action with regard to this prior year finding.

Prior Year Finding: Improve Controls over Financial Reporting Process – Update Procedures in a Timely Manner

Accounts often updated its procedures that document the financial statement preparation process as they were preparing or after they had completed the financial statements. The procedures used to prepare the financial statements are an important internal control over the financial reporting process and should serve as a tool to ensure the proper recording of all necessary journal entries and balances and use of the appropriate sources of the financial data. In planning for the fiscal year 2004 CAFR, Accounts updated its procedures approximately two months before fiscal year-end and provided the auditors with the procedures for review. Any changes Accounts made to the procedures during the CAFR preparation process were the result of unforeseen events. Accounts included in its procedures for staff to document any changes to the procedures in the workpapers and prepare a separate document to keep track of procedure revisions and any suggested changes for the next year. While we recognize that Accounts cannot be aware of all potential changes from one year to the next, we believe they could further improve the process by soliciting input from the agencies that provide significant data for the CAFR as to any changes either in the nature of the activity for their agency or the method in which they will accumulate and provide information to Accounts.

Prior Year Finding: Improve Controls over Financial Reporting Process – Educate Agency Staff on the Financial Reporting Process

The auditors documented several instances where an agency submitted incorrect or incomplete financial information to Accounts for the CAFR. Since Accounts has ultimate responsibility for the financial information included in the CAFR, it must ensure that the information submitted by agencies is accurate. In response to this finding, Accounts noted that when budget reductions and staff layoffs necessitated elimination of Accounts' Financial Management Training Program, Accounts financial reporting staff continued their efforts to provide targeted agency assistance. Past Accounts' budget reductions also resulted

in the elimination of its Disbursements Review unit and the Agency Review and Assistance unit, all of which affected Accounts' agency monitoring, oversight, and training capabilities. Accounts chose to target its scarce training resources to those agencies that provide material financial information to the CAFR and to provide additional training and assistance to those agencies.

During fiscal year 2004, Accounts added a position to the Division to perform quality assurance reviews on the financial reporting process within the various state agencies. Looking forward, the Division plans to further evaluate this quality assurance function and determine the most efficient and effective use of this function given that only one resource is currently dedicated to this endeavor. For preparation of the fiscal year 2004 CAFR, Accounts primarily focused on the ten largest agencies in terms of the agencies' financial impact on the CAFR. Accounts held individual meetings with each of these agencies to discuss the financial reporting process and address the agencies' concerns. However, Accounts is refining this process and will likely focus on other agencies as issues arise and in areas where there have been concerns in the past.

As a result of this prior year finding and the recent trend in providing more timely financial information, the Division plans on issuing its fiscal year 2005 financial statement directives approximately one month earlier than in past years. The Division will also provide mandatory directive training prior to fiscal year-end for all agencies submitting financial information for the CAFR. This training should provide an opportunity for Accounts to again communicate the financial reporting requirements and expectations of the agencies and provide a forum for feedback and questions from the agencies. Only agency staff responsible for preparing and submitting financial information for the CAFR will attend the directive training. This training should help ensure that agencies submitting financial information understand how their information fits into the financial reporting process and the CAFR.

Accounts also added a position to the General Accounting Division in fiscal year 2004 to perform quality assurance reviews on the accounting operations within the various state agencies. Additionally, the Division reinstated a position that is responsible for decentralized agency reviews, which it had eliminated during fiscal year 2003 due to agency budget reductions. During fiscal year 2005, the Division created an Assistant Director position to assist in the agency review area. The Assistant Director is to have no operational duties in order to focus solely on this area. To alleviate some of the daily operational duties of senior General Accounting staff, the Division has also created two new accounting analyst positions to take on these duties, which will consequently allow more time for agency reviews. Further, Accounts recently created a position in the Division of State Internal Audit to assist in the review of statewide internal controls and procedures beginning in fiscal year 2005.

In addition to the abovementioned actions to address this prior year finding, Accounts plans to provide mandatory fiscal officer training during spring 2005 in order to enhance agency fiscal officers' understanding of the financial environment of the Commonwealth, covering such broad topics as internal control, general accounting, financial reporting, and payroll. The objective of the training is to provide fiscal officers a comprehensive list of areas in which they should be knowledgeable. Among other outcomes, the training should result in agencies submitting more timely and accurate financial information for the CAFR preparation process.

In conclusion, we recognize that the prior year finding was the culmination of several years' events, most of which were out of Accounts' direct control, and remedying the situation is an on-going process. We commend Accounts' efforts to address this issue thus far and anticipate continuing progress in response to the finding.

Prior Year Finding: Comply with the Virginia Truth in Revenue Source Reporting Act

This point served as an internal control finding that the State Comptroller should work with the Department of Planning and Budget to identify those items in the Appropriation Act that transfer or redirect funds for any purpose other than that originally established by law. In accordance with Section 2.2-813.1 of the Code of Virginia, the “Virginia Truth in Revenue Source Reporting Act,” the State Comptroller had posted to Accounts’ Internet site the listing of revenue by source of collection and all of the transfers in Part 3 of the Appropriation act that do not represent payments for services.

However, our office advised that the State Comptroller should also indicate on his Internet site the source of the revenue stream from which the transfer occurred in order to fully comply with the Act. As a result of this finding, the State Comptroller posted additional CARS reports to his Internet site identifying the revenue sources associated with each fund. Accounts has taken adequate corrective action with regard to this prior year finding.

Department of the Treasury

In the fiscal year 2003 audit report, we noted issues that the Treasurer should consider as part of her on-going effort to perform an internal review of the Trust Accounting section in order to identify redundant processes, find ways to automate processes, and assess the effectiveness of the management structure. The following provides an update on this effort:

Prior Year Finding: Create Policies and Procedures

The auditors found the majority of Treasury policies and procedures for the Operating Division, Trust Accounting Section to be inadequate or non-existent. The Trust Section improved on and created procedures for the following:

- Financial statement preparation for Virginia College Building Authority (VCBA), Virginia Public Building Authority (VPBA), Virginia Public School Authority (VPSA), Local Government Investment Pool (LGIP), and Treasury’s Division of Risk Management;
- Statewide disclosures of state accounts in the State Non-Arbitrage Program (SNAP);
- Statewide cash and investment disclosures;
- Statewide debt disclosures; and
- General accounting for VCBA, VPBA, VPSA, LGIP, and Treasury’s Division of Risk Management.

Treasury should maintain these procedures, making them working documents to support the continual operations of the Trust Section and eliminating the risk of non-performance due to illnesses, vacations, staffing shortages etc.

Prior Year Finding: Provide Adequate Accounting Systems

Treasury is currently exploring other options to account for the investments of the Local Government Investment Pool and the Treasurers General Account in a more cost effective manner. Once obtained, the new accounting process and or system will provide consistent and automated accounting and financial reporting functions for the Treasurer's General Account, the Virginia College Building Authority, Virginia Public School Authority, Virginia Public Building Authority, and Local Government Investment Pool.

Treasury did update the Debt Database, however, neither Treasury nor Accounts used the information for financial reporting purposes, but instead created manual spreadsheet information. In the future, Treasury should maintain the database and use it as the primary source for reporting long term debt information for Virginia College Building Authority, Virginia Public School Authority, Virginia Public Building Authority, institutions of higher education, other authorities and agencies, and for the CAFR.

Prior Year Finding: Management Structure

Treasury has created a cross-training plan that when fully implemented will have a trained backup person for every task. Treasury should ensure that backup staff perform the task at a minimum of once every six months.

Prior Year Finding: Performance Management

As Treasury continues to automate their accounting and reporting processes, management should also ensure management monitoring of performance is efficient.

Audit Objectives

Our objectives for the audit of Accounts and Treasury include the following:

- to determine whether management has established and maintained internal controls over the Commonwealth’s financial reporting and other central processes, the central accounting and reporting systems, 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;
- to determine whether the agencies have complied with applicable laws and regulations; and
- to evaluate the accuracy of financial transactions related to cash and investments, debt, risk management and unclaimed property activity which is controlled by Treasury as reported in the Commonwealth’s central accounting and reporting systems and in 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).

We conducted our overall review in accordance with the standards for performance audits set forth in Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Scope and Methodology

We reviewed and gained an understanding of the overall internal controls sufficient to plan the audit. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the agencies’ operations. We considered materiality and control risk in determining the nature and extent of our audit procedures. We tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal controls, including controls for administering compliance with applicable laws, regulations, contracts, and grant agreements over the following processes and systems.

Financial Reporting *	Investment Accounting
Commonwealth Accounting and Reporting System	Trust Accounting
Commonwealth Integrated Payroll/Personnel System	Certificate of Deposit Database
Fixed Asset Accounting and Control System	Bank Reconciliation System
State Indirect Cost Allocation Plan	Check Processing System
Bond Issuance	Investment Accounting System
Debt Service Expenditures	Unclaimed Property Management System
Investment Trading	Risk Management Claim System

* including preparation of the CAFR and SEFA by Accounts and the preparation of financial statements of the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority by Treasury

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. Our audits were more limited than would be necessary to provide assurance on internal control or to provide an audit opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in condition or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We noted no matters involving internal control that require management's attention related to the Commonwealth's financial reporting and other central processes, the central accounting and reporting systems, and centralized services provided to the agencies and institutions in support of the preparation of financial statements as indicated in the scope section of this report. However, we identified several areas where Accounts and Treasury could improve the efficiency of the statewide reporting processes, and include them in the section entitled "Statewide Reporting Processes."

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

We found the agencies 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 the CAFR 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.

Exit Conference and Report Distribution

We discussed this letter with management at an exit conference held on March 22, 2005.

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.

**Independent Auditor's Report On Internal Control Over
Financial Reporting And On Compliance And Other Matters**

We have audited the following financial statements as of and for the year ended June 30, 2004, and have issued our reports dated as indicated below:

- Local Government Investment Pool dated October 29, 2004;
- Virginia Public School Authority dated November 15, 2004;
- Virginia College Building Authority dated November 23, 2004; and
- Virginia Public Building Authority dated November 24, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authorities' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

Status of Prior Findings

The Authorities have taken adequate corrective action with respect to audit findings reported in the prior year.

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



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

March 22, 2005

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 appreciates the opportunity to respond to the recommendations contained in your review of the statewide reporting process for the year-ended June 30, 2004. Thank you in advance for publishing our response with your report.

Comprehensive Annual Financial Report Suggested Process Enhancements

Automate Processes

Financial Reporting for the State Non-Arbitrage Program – DOA plans to work closely with both Treasury and the new State Non-Arbitrage Program (SNAP) administrator to ensure that we obtain the SNAP financial information in the most efficient manner possible.

Debt Database – Although the debt database was not completed in time to use during preparation of the 2004 CAFR, DOA has already scheduled meetings with Treasury to determine the most efficient method to obtain the CAFR debt information from the newly completed debt database.

Program Automation – DOA will explore the use of additional advanced Excel functions in the preparation of the CAFR. DOA will also increase our use of comment boxes or typed notes on electronic work-papers to further reduce reliance on handwritten workpaper notes during the preparation process. DOA will also explore the possibility of expanding use of linking or macros to further automate journal entry postings. Additionally, DOA will explore the benefits, cost and funding feasibility of automated trial balance software.

The database has some ad hoc reporting capabilities. Currently data is extracted from the database to prepare the debt schedules for the CAFR. The main purpose of the database in the past and currently, however, has been to bill institutions of higher education and localities for their upcoming 9(c), 9(d), and Virginia Public School Authority debt payments.

Program Automation – Trust Accounting does use Excel extensively for financial statement preparation. We have been able to streamline the financial statement preparation process through the use of Excel by linking trial balances to produce “camera-ready” financial statements for publishing both electronically and by hard copy.

Agency Guidance and Relationships

Treasury has an excellent working relationship with Accounts with regard to the CAFR preparation process. As in past years, Treasury will continue to work with Accounts to enhance reporting capabilities for the benefit of both agencies, with an emphasis on developing a better understanding of the CAFR process. Treasury and Accounts have already had meetings to discuss changes for the upcoming CAFR cycle. These discussions have addressed the new reporting requirements for the Unclaimed Property Division, implementation of Governmental Accounting Standards Board Statement No. 40, and additional information needed in other reporting areas.

Status of Prior Year Audit Recommendations

Create Policies and Procedures – Prior to FY 2004, Trust Accounting had written procedures for all the accounting processes listed in the Report and continues to maintain them.

Provide Adequate Accounting Systems – At this time, Treasury will continue to use its current subsidiary investment accounting system, while researching alternative investment systems. Treasury is researching the ability to download data from outside trustees for use in the preparation of annual financial statements for the VCBA and VPBA. Treasury did update its debt database to include debt of the VCBA, VPBA, and other Treasury Board related debt. As in past years, information in the debt database was used to compile debt information for the CAFR.

Management Structure – Trust Accounting will continue to use its cross-training plan to ensure that each accounting process can be performed by at least two Trust Accounting staff members.

Performance Management – Trust Accounting continues to monitor employee performance on an ongoing basis.

Improve Statewide Federal Schedule Preparation

For the 2005 reporting cycle, DOA will take full responsibility for preparing and publishing the SEFA. Any adjustments to the schedule following submission to APA for audit, whether suggested by APA or DOA, will be posted only with proper supporting documentation by the DOA federal analyst.

***Background** – Although DOA took over preparation of the SEFA in 1998 from APA, the preparation process has been a joint effort between our respective agencies. As such, the process was largely collaborative and iterative, routinely requiring adjustments but ultimately resulting in the schedule APA publishes in the Single Audit Report. Our respective responsibilities have been documented since 1998 through a Memorandum of Understanding (MOU), as updated annually. In accordance with our understanding of the MOU, DOA did not make changes to the SEFA after October 1, but rather notified APA of any changes identified following the initial compilation of the schedule. Based on exit conferences held from 1998-2001, APA involvement was limited to addressing changes made subsequent to October 1 or those resulting specifically from field audits. During the 2002 and 2003 SEFA reporting cycles, the single audit director elected not to have an exit conference because there was nothing of significance to discuss. Accordingly, DOA was not aware of problems or adjustments APA encountered or process enhancements APA recommended during that timeframe.*

Improve Automated Processes

For the 2005 reporting cycle, DOA will take full responsibility for the maintenance of the SEFA database and update the federal SEFA attachment procedures. Financial Reporting will work with our systems staff to improve the system functionality and identify and correct any deficiencies in the database. As part of this process DOA will implement the most efficient use of the database. DOA will need APA to provide the documentation of any programming associated with the MS access SEFA database and will need your staff to be available to answer questions from our systems and programming staff.

***Background** – It was our understanding that from 2001 (when the database project started) through 2004, APA agreed to develop and maintain the MS Access database supporting SEFA reporting. We were not aware that APA wanted DOA to take responsibility for the maintenance of the SEFA database.*

Mr. Walter J. Kucharski
March 22, 2005
Page 4

Enhance Knowledge of Standards and Requirements

DOA staff is knowledgeable on federal regulations pertaining to SEFA preparation and have served as a resource for agencies making inquiries related to preparation of the federal schedules. However, DOA will obtain additional training for the federal analyst and other individuals involved in the SEFA preparation process and inquire with the APA only when all other information sources are exhausted.

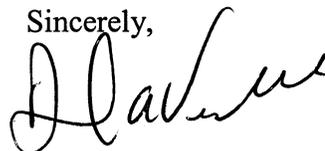
Background – DOA acknowledges that our federal analyst contacted APA frequently during SEFA preparation. However, these contacts were understood to be within the provisions of the MOU.

Agency Guidance and Relationships

DOA will clarify and enhance the SEFA instructions and the upcoming financial statement directive training will include specific training focused on the federal schedules. DOA will emphasize the importance of the federal schedules, how DOA uses the information in preparing the statewide report, and the federal requirements and federal resources the agencies can use to meet those requirements.

Background – The federal SEFA attachment instructions were written and have been updated for the last two years by APA. DOA did not change the instructions prior to incorporating them in the Comptroller's Directives. The APA single audit director elected not to have an exit conference during the prior two years because according to APA there was nothing of significance to discuss. As a result, DOA has no knowledge of problems or adjustments that the APA encountered during that time. Prior to 2002, there were annual exit conferences and any issues brought to our attention were promptly corrected.

Thank you for your staff's hard work and professionalism in conducting the audit.

Sincerely,

David A. Von Moll

DAV/bml

Copy: The Honorable John M. Bennett
Secretary of Finance



COMMONWEALTH of VIRGINIA

Department of the Treasury

JODY M. WAGNER
TREASURER OF VIRGINIA

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RICHMOND, VIRGINIA 23218-1879
(804) 225-2142
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March 23, 2005

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

Dear Mr. Kucharski:

Thank you for the opportunity to respond to the suggestions and efficiency recommendations contained in the Audit Report on the Statewide Reporting Process for year ending June 30, 2004 (Report). We welcome your comments and suggestions for improvement and will take them under consideration as we continue to evaluate our reporting processes. Our comments on specific enhancements recommended in the Report are outlined below:

Automate Processes

Financial Reporting for the State Non-Arbitrage Program – Treasury has already begun working with the new administrator for the State Non-Arbitrage Program (SNAP) and the Department of Accounts (Accounts) on year-end financial reporting requirements. Treasury addressed the need for receiving electronic SNAP account transaction information in our RFP for the new program administrator. Treasury has received and approved test files from the program administrator. The information will be sent to Treasury in Excel format and will include all necessary information needed for the Virginia Comprehensive Annual Financial Report (CAFR).

Debt Database – The Trust Accounting debt database has been used for many years to compile debt information for year-end reporting purposes. At the request of your Office, the database was expanded to include debt of the Virginia College Building Authority (VCBA), the Virginia Public Building Authority (VPBA), and other Treasury Board related debt issues in fiscal year 2004. The Trust Accounting debt database has always been up-to-date and the Treasury's source of debt information for the CAFR. Trust Accounting does rely primarily on the debt database for financial statement preparation.

The database has some ad hoc reporting capabilities. Currently data is extracted from the database to prepare the debt schedules for the CAFR. The main purpose of the database in the past and currently, however, has been to bill institutions of higher education and localities for their upcoming 9(c), 9(d), and Virginia Public School Authority debt payments.

Program Automation – Trust Accounting does use Excel extensively for financial statement preparation. We have been able to streamline the financial statement preparation process through the use of Excel by linking trial balances to produce “camera-ready” financial statements for publishing both electronically and by hard copy.

Agency Guidance and Relationships

Treasury has an excellent working relationship with Accounts with regard to the CAFR preparation process. As in past years, Treasury will continue to work with Accounts to enhance reporting capabilities for the benefit of both agencies, with an emphasis on developing a better understanding of the CAFR process. Treasury and Accounts have already had meetings to discuss changes for the upcoming CAFR cycle. These discussions have addressed the new reporting requirements for the Unclaimed Property Division, implementation of Governmental Accounting Standards Board Statement No. 40, and additional information needed in other reporting areas.

Status of Prior Year Audit Recommendations

Create Policies and Procedures – Prior to FY 2004, Trust Accounting had written procedures for all the accounting processes listed in the Report and continues to maintain them.

Provide Adequate Accounting Systems – At this time, Treasury will continue to use its current subsidiary investment accounting system, while researching alternative investment systems. Treasury is researching the ability to download data from outside trustees for use in the preparation of annual financial statements for the VCBA and VPBA. Treasury did update its debt database to include debt of the VCBA, VPBA, and other Treasury Board related debt. As in past years, information in the debt database was used to compile debt information for the CAFR.

Management Structure – Trust Accounting will continue to use its cross-training plan to ensure that each accounting process can be performed by at least two Trust Accounting staff members.

Performance Management – Trust Accounting continues to monitor employee performance on an ongoing basis.

Response to APA Report on Statewide Report Preparation
March 23, 2005
Page 3

Please contact me if you have any questions or comments related to our response.

Sincerely,

A handwritten signature in black ink that reads "Jody M. Wagner". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Jody M. Wagner

JMW:kar

c: The Honorable John M. Bennett
Secretary of Finance

OFFICIALS

Comptroller
David A. VonMoll

Treasurer
Jody M. Wagner