

**REVIEW OF THE
BUDGET AND APPROPRIATION
PROCESSING CONTROL SYSTEM**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2008**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our review of Statewide Budget and Appropriation Processing Controls for the year ended June 30, 2008 found:

- Planning and Budget is in compliance with requirements in the Act and the Code of Virginia that could materially affect the Commonwealth's annual financial statements;
- The budget approved by the General Assembly is properly recorded in CARS;
- Appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations; and
- Budget adjustments processed by Planning and Budget in the Form 27 Automated Transaction System (FATS) are properly approved, documented, and reconciled to CARS at the statewide level.

Our review also disclosed several budget transparency issues that affect the ability of the user to easily relate the budget to the actions of the Commonwealth. This report as well as our two previous reports discusses various budget transparency issues that make understanding the budget process difficult. Current accounting, budgeting, and procedural processes obscure the easy comparison of budgeted to actual activity. As the legislature and administration continue to explore making information on government activities more accessible to the public, they will need to address these issues.

The most significant budget transparency issue is the transfer of General Funds to various non-general funds that occurs after the budget's approval. These transfers affect programs such as Personal Property Tax Relief and higher education operations, and result in a loss of transparency of over \$3 billion in general funds. These transfers occur to comply with various requirements in the Appropriation Act which are intended to allow for separate monitoring and tracking of these funds; however, the current practice adopted by Planning and Budget and Accounts creates a disconnect between the budgeting and accounting for these programs.

Another budget transparency issue is an inadequate reporting process for administrative changes made to the budget after the General Assembly's approval. The current process does not provide adequate information to the General Assembly or the public of changes made to the budget during any fiscal year. Administrative adjustments can significantly alter the approved budget, and improved reporting of these changes to the General Assembly and public would enhance the transparency of the budgeting process.

We again offer the following recommendations for consideration to address some of the budget transparency issues caused by current practices.

- Accounts should consider adding a sub-fund of the General Fund in the Commonwealth Accounting and Reporting System to account for the Personal Property Tax Relief Program. The creation of a sub-fund for this program would improve the budget transparency of close to \$1 billion in General Funds. Another alternative would be making the payments from the General Fund.
- The Commonwealth should re-examine the practice of transferring General Funds budgeted for colleges and universities to higher education funds and similar transactions to other funds. This practice originated twenty years ago to

accommodate certain accounting system technology; however, this practice may no longer be necessary given the capabilities of modern financial systems at the higher education institutions and other funds. The elimination of this practice would improve the budget transparency of \$1.7 billion in General Funds.

- As part of the new performance budget system, Planning and Budget should consider an improved reporting mechanism for administrative adjustments processed during a year.

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FINDINGS AND RECOMMENDATIONS

Address Budget Transparency Issues

In our two previous reports, we reported significant budget transparency issues that affect the ability of citizens to understand the Commonwealth's budget and the use of resources. To date, neither Planning and Budget nor the Governor has taken action to address these issues. Given the emphasis, both in Virginia and nationwide, on greater accountability and transparency in government, we think the Commonwealth should consider these issues a priority.

Our original recommendation sought to have the Commonwealth address these issues as part of the enterprise application project; however, the status of this system development effort continues to be uncertain. In the interim period, we recommended that the Governor and Planning and Budget develop alternative solutions to address these issues. We again report this issue in our current report as the current budget process remains unchanged and the transparency issues continue to exist.

A transparent budget process allows any informed citizen sufficient ease in understanding and following the budget process without having any special training. This term describes a budget process which is clear, visible, and understandable to a citizen with an interest in the information. We discuss below two practices which affect the transparency of the Commonwealth's budget as well as recommendations for consideration.

Significant Transfers of General Funds to Other Funds

Significant transfers of general funds to various non-general funds occur after the budget's approval for certain programs making it difficult to identify the source of funds for these programs in the accounting records. The two largest transfers are the Personal Property Tax Relief Program and higher education operating funds. Together, these two programs result in almost a \$2.7 billion transfer of general funds to non-general funds after the approval of the budget.

In the case of the Personal Property Tax Relief program, these transfers occur to comply with various requirements in the Appropriation Act, which require setting aside and spending these funds in a separate fund. In an effort to satisfy the legislative requirements, the current practice moves these General Fund amounts to non-general fund accounts, in order to separate the monies to monitor and control the spending of the appropriation. The creation of these funds changes the nature of how both the accounting and budget systems show these funds.

While the current statewide accounting system, the Commonwealth Accounting and Reporting System (CARS), could accommodate creating separate sub-funds within the General Fund, the Department of Accounts (Accounts) has not attempted to do this. We recommend Accounts and Planning and Budget determine whether a separate sub-fund of the General Fund could be established to account for the Personal Property Tax Relief program. The creation of a sub-fund would improve the budget transparency of close to \$1 billion in general funds.

In the case of the transfer of general funds to higher education operating funds, this practice originated over twenty years ago to simplify accounting for these funds at each university.

Given that technology has advanced since then, we recommend that the Commonwealth re-examine this practice and determine whether or not this transfer is still necessary given the capabilities of current financial systems. Most of the Commonwealth's colleges and universities have financial management systems that can process transactions with multiple funding sources, making the current practice of transferring General Funds outdated. The elimination of this practice would improve the budget transparency of \$1.7 billion in general funds.

Aside from the two programs discussed above, the practice also affects several other programs including water quality improvement, some transportation programs, and the Governor's Opportunity Fund. The Governor and Planning and Budget should also consider examining the current practice for these programs.

Lack of Transparency for Some Economic Development Activities

The approved budget contains funding for economic development activities, such as the Governor's Opportunity Fund and various other specific actions. While some economic development activities are clearly set out in the budget, there is a significant amount of economic development funding that is budgeted as part of Central Appropriations, thereby losing some transparency. Central Appropriations is a section of the budget set up to implement budget actions which will affect multiple agencies and funds.

For fiscal year 2008, there was over \$38 million in economic development funding budgeted in Central Appropriations as part of the item "Payments for Special or Unanticipated Expenditures". The Governor and Planning and Budget should consider whether this is the most effective presentation for these funds given that these funds are for specific economic development activities in the budget. We have discussed similar budget transparency issues related to economic development activities in our "Governor's Cabinet Secretaries" reports for both fiscal years 2007 and 2008.

Inadequate Reporting Mechanism for Budget Adjustments

The current reporting mechanisms for administrative adjustments processed during the year need to be improved. While the Comptroller's year-end preliminary financial report does show some original and final budget information, it focuses primarily on the General Fund. Other than the Comptroller's report, our Data Point website, and FATS reports sent to Senate Finance and House Appropriations monthly, there is no comprehensive statewide budget information reported that includes the administrative budget adjustments. Without a formal reporting mechanism in place, legislators and the average citizen have no means to understand changes to the budget after its approval.

We continue to bring these issues to the attention of Planning and Budget as well as the Governor. The Joint Legislative Audit and Review Commission also reported some of these issues in their report entitled "The Potential for Improving Budget Review in Virginia" issued in December 2008. In addition, our office is in the process of working on a Budget Transparency project with the intent to issue a report by May 2009. This report will further discuss the budget transparency issues in the Commonwealth's budgeting process.

Update the FATS Manual

As we recommended in our prior report, Planning and Budget needs to review and update the Form 27 Automated Transaction System (FATS) Manual to reflect current practices and changes in authority. The Manual is the primary resource for policies, operational procedures and analytical criteria for budget analysts to follow when processing administrative budget adjustments. The last comprehensive revision to the FATS Manual was in 1998 and numerous changes have occurred since this time, including substantial changes in the authority delegated to Planning and Budget as provided in the Appropriation Act. As a result, the FATS Manual is out of date, incomplete, or irrelevant in the current environment.

We recommend Planning and Budget allocate resources to update the current Manual or implement an alternative solution for providing policies and procedures to Planning and Budget staff. Reliance by analysts on the existing Manual could cause errors in transaction processing due to outdated requirements.

Status of Prior Year Finding and Recommendation on Information Security

In our fiscal year 2006 report, we reported that Planning and Budget did not have a complete or current information security program; and thus, did not meet Virginia's information technology security standard. We were not able to secure the Planning and Budget staff resources necessary to follow up on the recommendation in our fiscal year 2007 audit.

In following up on the recommendation in our current audit, we found that Planning and Budget has made significant progress since our 2006 audit. They have developed an information security program with assistance from the Accounting and Internal Control Compliance Oversight unit at the Department of Accounts. This group is responsible for providing technical assistance to smaller agencies on their information security programs. The group is currently reviewing Planning and Budget's plan for compliance with Commonwealth information security standards. They expect to complete their review and make recommendations by March 17, 2009.

REVIEW OF THE BUDGET AND APPROPRIATION
PROCESSING CONTROL SYSTEM

Operating Budget Adjustments

The Governor and Planning and Budget have the authority to make changes to the budget after its approval. Planning and Budget refers to these budget changes as “administrative adjustments”, which resulted in a \$4 billion (11 percent) increase to the fiscal year 2008 budget. These adjustments are within the authority granted to Planning and Budget and the Governor by the General Assembly through the Appropriation Act.

There are a variety of reasons for administrative adjustments and the following table shows the amount of each type of adjustment and the effect on the General Fund and Non-General Fund operating budgets. For purposes of this analysis, we have divided the administrative adjustments into two categories in the table below: transfers, and adjustments and reappropriations. Transfers generally move appropriations between agencies and/or funds, while adjustments and reappropriations generally represent increases in appropriations. We provide more detail in the sections that follow the table on the most significant administrative adjustments processed in 2008.

Detailed Schedule of Fiscal Year 2008 Operating Budget Adjustments

	<u>General Fund</u>	<u>Non-General Fund</u>	<u>Total</u>
Original budget, Chapter 847 (2007 Act)	\$17,333,144,324	\$18,631,792,376	\$35,964,936,700
Subsequent legislative amendments	(859,227,412)	900,034,098	40,806,686
Administrative adjustments:			
Transfers:			
General fund to non general fund	(3,135,872,706)	3,128,485,614	(7,387,092)
General fund from capital budget	400,000,000	-	400,000,000
Other Transfers	(4,984,754)	(16,658)	(5,001,412)
Adjustments and reappropriations:			
Sum sufficient appropriations	9,827,196	1,764,228,606	1,774,055,802
Carry forward prior year cash balances	-	812,943,549	812,943,549
Additional revenues	295,839	677,775,018	678,070,857
Mandatory reappropriations	314,545,112	2,265,000	316,810,112
Discretionary reappropriations	50,263,053	-	50,263,053
Deficit appropriations	3,412,900	-	3,412,900
Other non-general fund appropriations	-	<u>1,901,502</u>	<u>1,901,502</u>
Adjusted budget as of June 30, 2008	<u>\$14,111,403,552</u>	<u>\$25,919,409,105</u>	<u>\$40,030,812,657</u>

Transfers

There are several types of transfer adjustments – transfers within general funds, transfers within non-general funds, and transfers between general funds and non-general funds. The first two types transfer appropriations within fund types and historically have had little net effect on the overall budget; however, this was not the case in fiscal year 2008.

Transfers within general funds resulted in a \$400 million increase in agency operating budgets as transfers occurred between the capital budgets to the operating budget. The Governor and the General Assembly replaced the general fund capital budget with bond funding.

The third type of transfer between general and non-general funds has a significant effect on the budget by creating significant budget transparency issues. These transfers usually occur so that Accounts can maintain separate bookkeeping for certain types of General Fund activities. Historically, both Accounts and Planning and Budget have agreed to move these General Fund amounts to Non-General Fund accounts, in order to separate the funds to monitor and control the spending of the appropriation. The creation of these funds changes the nature of how both the accounting and budget systems show these funds. While CARS could accommodate creating separate sub-funds within the General Fund, Accounts has not attempted to do this.

As the prior table shows, appropriation transfers from the General Fund to the Non-General Fund totaled \$3.6 billion in 2008. The following table lists the major types of General to Non-General Fund transfers. The two largest items, higher education operating funds and the Personal Property Tax Relief program, account for the majority of this type of transfer.

Transfers from General Fund to Non-General Funds for Fiscal Year 2008

Description of Transfer	Amount
To Higher Education Operating Funds (Chapter 847, 4-1.03)	\$1,742,922,217
To Personal Property Tax Relief (Chapter 847, Item 459)	950,000,000
To Revenue Stabilization Fund (Chapter 847, Item 260.10.A.2.)	114,845,430
To Priority Transportation Fund (Chapter 847, Item 447.F.3.)	109,800,000
To Virginia Water Quality Improvement Fund (Chapter 847, Item 364)	5,000,000
To Other Non-General Funds	<u>213,305,059</u>
Total Transfers from General Fund to Non-General Funds	<u>\$3,135,872,706</u>

Sum Sufficient Appropriations

A sum sufficient appropriation is a mechanism within the Act to allow the Governor and agencies to deal with unique programs. The Act uses this type of appropriation primarily in two situations. The first situation is a program where the amount of the program revenue or expenses requires some flexibility. An example is disaster related funding that is difficult to estimate from year to year.

The second situation where the Commonwealth uses a sum sufficient appropriation is in an internal service program to not double count expenses in the budget. Sum sufficient appropriations may have limits

set by a “not to exceed” amount within the language of the Act, or the Act provides no specific dollar spending limit but instead sets a limit of actual amounts collected. Planning and Budget has the authority to process adjustments to increase the budget to cover sum sufficient appropriations.

The Administration of Health Insurance, which is the Commonwealth’s self insured health benefit program for employees, accounts for most of the sum sufficient appropriation. The Department of Human Resource Management manages the Administration of Health Insurance program by collecting premiums from state agencies for employees to cover state employee health claims. The current budget process includes the cost of employee health insurance in the agency’s budget.

Therefore, the Commonwealth budgets the Administration of Health Insurance costs as a sum sufficient so as not to double count these amounts in the Budget Bill and the Appropriation Act. The adjustment is an increase in the state’s budget because there is an offset by the corresponding increase in revenues that the Department of Human Resources collects from agencies.

The following table shows the largest sum sufficient adjustments by agency and program processed by Planning and Budget in 2008. The table lists the item number in the Act that provides the authority for each sum sufficient amount shown.

Sum Sufficient Budget Adjustments for Fiscal Year 2008

<u>Act Item No.</u>	<u>Agency Name</u>	<u>Program</u>	<u>Total</u>
78	Administration of Health Insurance	Health Benefits Services	\$1,060,250,000
423 - 426	Virginia Information Technologies Agency	Computer, Telecommunications and Northrop Grumman Payments	298,543,716
469	State Lottery Department	Lottery Prize Payments	200,000,000
70-75	Department of General Services	Procurement, Plant Management and Other Services	109,440,012
470	Virginia College Savings Plan	Tuition Trust and Other Services	30,000,000
223	Virginia Tech	Auxiliary Enterprises	21,956,344
178	Old Dominion University	Auxiliary Enterprises	14,978,085
	Other Agencies	Various	<u>38,887,645</u>
		Total	<u>\$1,774,055,802</u>

Carry Forward of Prior Year Cash Balances

These administrative adjustments represent unspent cash in non-general funds at the end of a fiscal year, which agencies request to use in the next fiscal year. These adjustments are necessary when agencies wish to use the unspent balance that was not included as a funding source when the agencies developed their budget.

The amount of these adjustments increased significantly over the prior year primarily due to changes in cash management policies as a result of the state's higher education restructuring efforts. Under the restructuring agreements, universities that receive certification from the State Council on Higher Education may draw down and manage certain Non-General fund cash balances. Planning and Budget processes these appropriation adjustments to facilitate the drawdown of the cash balances.

Carry-forward of Prior Year Non-General Fund Cash Balances for Fiscal Year 2008

University of Virginia Hospitals	\$201,621,407
Transportation Agencies	139,516,632
University of Virginia	131,226,257
Department of Environmental Quality	83,776,333
Virginia Tech	81,632,185
Secretary of Commerce and Trade	34,305,479
Tobacco Indemnification and Revitalization Commission	23,600,000
Smaller Amounts from Other Agencies	<u>117,265,256</u>
Total	<u>\$812,943,549</u>

Additional Revenue Appropriations

These types of adjustments occur when resources exceed the amount initially budgeted and appropriated. Agencies request these increases so they can spend the additional funds. For example, additional funds may become available under a federal grant that an agency did not anticipate during budget development. In this case, an agency would need to request an additional appropriation to spend these funds. In some cases, the additional resource may not represent solely revenue collections, but may also include bond proceeds or other sources of receipts not originally anticipated.

The following agencies made up the majority of these adjustments in fiscal year 2008.

Additional Revenue Adjustments for Fiscal Year 2008

<u>Fund Source</u>	<u>Agency Name</u>	<u>General Explanation for Adjustment</u>	<u>Amount</u>
Priority Transportation Fund	Transportation	Debt service payments for FRANS	\$109,800,000
Federal	Department Aid to Special Education	Funding for reimbursement for Title 1 and Special Education grants.	100,000,000
Higher Ed - Federal	Virginia Community College System	Funding for enrollment increases and additional financial aid	65,594,325
Health Insurance Fund - Local	Admin of Health Insurance	Funding to cover increased enrollment in healthcare costs in the local choice health benefits program	60,000,000
Trust and Agency	Virginia Employment Commission	Funding of unemployment insurance benefits	35,000,000
Federal	Department of Emergency Management	Funding of disaster related expenses	27,000,000
Dulles Toll Road Facilities	Transportation	Funding to cover operating expenses for the Dulles Toll Road and transfer payment to DRPT	22,800,000
Federal	Department of Medical Assistance Services	Funding for the reimbursement to the Department of Mental Health for the settlement of 2007 Medicaid costs.	21,332,413
Tobacco Indemnification	Tobacco Settlement	Increase Master Settlement agreement bond proceeds	35,000,000
Dedicated Special Revenue	Department of Health	Funding from the USDA to cover the WIC program	13,194,745
	Other Agencies		<u>188,349,374</u>
	Total		<u>\$678,070,857</u>

Mandatory and Discretionary Reappropriations

Reappropriations represent adjustments for unspent cash balances as of June 30, 2007, that an agency could carry forward into the next fiscal year. As a general rule, unspent general fund balances as of the end of a fiscal year revert to the Commonwealth's General Fund. The Appropriation Act does include some exceptions to this policy, which include legislative, judicial, and independent agencies that automatically carry forward unspent general funds. The Commonwealth shows these adjustments as mandatory reappropriations which totaled \$316 million in fiscal year 2008. This was a significant increase from the prior year due to reappropriation of \$157 million from the 2007 Transportation Initiative.

The Governor also has the authority to approve reappropriation of unspent general fund cash balances at the end of a year, and the Commonwealth refers to these items as discretionary reappropriations. These general fund reappropriations totaled \$50 million in fiscal year 2008. This represents an increase over the prior year when the Governor approved \$22 million in discretionary reappropriations.

Central Appropriations

Planning and Budget also has responsibility for executing items within the Central Appropriations section of the Act. The Act uses a section known as Central Appropriations to implement budget actions, which will affect multiple agencies and funds. Central Appropriations also serve to deal with budgetary decisions, which do not require the action of an individual agency, but may require multiple agencies to execute the action. Central Appropriations includes the funding for the Personal Property Tax Relief Act, which requires the segregation of the funding and the joint cooperation of the Departments of Motor Vehicles and Accounts.

Planning and Budget and Accounts establish an agency on their systems to control the budgetary transactions arising from the Central Appropriation actions in the Act. Planning and Budget relies on information from other agencies to determine the amount and allocation of the Central Appropriations to individual agencies. For example, Planning and Budget uses payroll information from Accounts and agencies to distribute increases in salary and fringe benefit amounts. The Appropriation Act also uses the Central Appropriations to control and process budget reduction from various agencies as in fiscal year 2008.

The following sections below discuss the largest appropriations for fiscal year 2008 from Central Appropriations by purpose, program description, and item number in Chapter 847. The tables show the amount appropriated for each program, any adjustments, the amount transferred out, and any remaining balance at fiscal year-end 2008. For comparison, the 2009 budget approved by the 2008 General Assembly in Acts of the Assembly, Chapter 847 is included in each table.

Higher Education – Interest Earned on Educational and General Programs Revenue (Item 455.20)

This item provides funding to institutions of Higher Education for interest earned on small purchase charge cards and interest earned on tuition and fees.

Appropriation per Chapter 847, 2007 Acts of Assembly	\$ 12,700,000
Subsequent Legislative Amendment	3,978,402
Appropriation of Interest Earned and Charge Card Rebates:	
Virginia Community College System	(3,204,007)
University of Virginia – Academic Division	(2,266,439)
Virginia Commonwealth University	(2,254,396)
George Mason University	(2,031,820)
Virginia Tech	(2,017,638)
Old Dominion University	(1,595,093)
James Madison University	(1,291,219)
The College of William and Mary in Virginia	(466,498)
All Other Public Institutions	<u>(1,551,292)</u>
Unexpended Balance	<u>\$ -</u>
Proposed appropriation for 2009	\$ 16,678,402

Miscellaneous Reversion Clearing Account (Item 455.30)

This item provides a reversion account to accomplish General Fund savings in the second year of the biennium as directed by the Governor’s 2008 reduction plan. These savings totals \$285 million across various state agencies in fiscal year 2008.

Tobacco Settlement Funds (Item 458)

This item provides spending authority for the Tobacco Indemnification and Community Revitalization Fund and the Virginia Tobacco Settlement Fund from amounts awarded to the Commonwealth under the Master Settlement Agreement with tobacco manufacturers.

Appropriation per Chapter 847, 2007 Acts of Assembly	\$46,313,093
Transfer NGF appropriation from central accounts to Tobacco Indemnification and Community Revitalization Fund and VA Tobacco Settlement Fund	<u>(46,313,093)</u>
Unexpended balance	<u>\$ -</u>
Proposed appropriation for 2009	\$91,431,429

Personal Property Tax Relief (Item 459)

This item includes the Commonwealth's portion of the Personal Property Tax Relief amounts paid to localities for registered vehicles assessed at \$20,000 or less and limited to personal use. The General Assembly capped the total amount for the tax year 2006 at \$950 million. In fiscal year 2008, Planning and Budget made quarterly transfers from this account to Agency 850-Personal Property Tax Relief (PPTR) so that Accounts could distribute the amount to localities.

Appropriation per Chapter 847, 2007 Acts of Assembly	\$ 950,000,000
Transfers to Agency 850 Personal Property Relief Act	<u>(950,000,000)</u>
Unexpended balance	<u>\$ _____ -</u>
Proposed appropriation for 2009	\$ 950,000,000

Compensation Supplements (Item 461)

This item provides a mechanism for funding for increases in state employee salaries and benefits.

Appropriation per Chapter 847, 2007 Acts of Assembly	\$297,175,861
Discretionary Reappropriation of FY 2007 General Fund Balance	9,584
Transfer of mileage reimbursement funding and increased VITA Geospatial rates between programs	1,958,815
Transfer to agencies for compensation and benefit supplements	<u>(298,984,675)</u>
Unexpended balance	<u>\$ 159,585</u>
Proposed appropriation for 2009	\$ 53,256,863

Payments for Special or Unanticipated Expenditures (Item 462)

This item provides general funds to address emergency or other unbudgeted costs to state agencies for essential commodities and services, which agencies cannot absorb in their existing appropriations. This item also includes funding for various economic development activities. Most of these funds are transferred to various agencies, who in turn spend the funds. The following table shows budget and actual activity in this item, broken down by individual service areas.

Analysis of Budgeted and Actual Activity for Fiscal Year 2008

<u>Service Areas</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amount Transferred/Spent</u>
Miscellaneous Contingency Reserve	\$ 3,472,069	\$ 23,652,561	\$ 17,045,033
Governor's Opportunity Fund	-	750,000	750,000
Economic Development Assistance	38,473,815	38,472,815	38,334,781
Base Realignment and Closure	<u>12,500,000</u>	<u>24,570,651</u>	<u>6,418,599</u>
Total	<u>\$ 54,445,884</u>	<u>\$87,447,027</u>	<u>\$ 62,548,413</u>

There were some significant budget changes in two of these services areas. The Miscellaneous Contingency Reserve covers various unbudgeted costs. The increase from the original to the final budget is \$8 million in unspent funds from fiscal year 2007, which carried forward into 2008, as well as additional funds approved by the 2008 General Assembly. The Assembly approved an additional \$12 million to cover increased VITA costs as well as the costs of the presidential primary.

The original budget for Base Realignment and Closure (BRAC) also increased significantly due to unspent funds from fiscal year 2007 requiring re-appropriation in 2008. The budget includes BRAC funds in Central Appropriations, since multiple agencies administer these funds. To address and coordinate BRAC implementation, the 2005 General Assembly appropriated \$25 million for BRAC payments and established the Virginia National Defense Industrial Authority (VNDIA). VNDIA assists Virginia installations and communities in meeting the requirement of BRAC. Planning and Budget transferred BRAC funds from Central Appropriations to the Secretary of Finance, who processes the payments to affected localities based on VNDIA approval. These payments reimbursed localities for incurred expenses, and the amount shown is for committed, but unspent funds.

Higher Education Tuition Incentive Fund (Item 463.10)

This item provides funding to institutions of Higher Education as incentives to limit increases in tuition and fees for in-state undergraduate students to not more than six percent for the 2007-2008 academic years.

Appropriation per Chapter 847, 2007 Acts of Assembly	\$ 7,175,000
Appropriations to Institutions	
Virginia Tech	(1,295,297)
Virginia Commonwealth University	(1,041,949)
Virginia Community College System	(1,003,804)
James Madison University	(784,186)
Radford University	(670,333)
George Mason University	(614,746)
University of Virginia	(409,113)
The College of William and Mary in Virginia	(185,879)
All Other Public Institutions	<u>(1,169,693)</u>
Unexpended Balance	<u>\$ -</u>
Proposed appropriation for 2009	\$ -

Capital Budget Adjustments

In fiscal year 2008, administrative adjustments to the capital budget resulted in a net increase of approximately \$5.7 billion. Most of the adjustments represent unspent appropriations at the end of a fiscal year that automatically carry forward into the next fiscal year. Unexpended appropriations from completed or closed capital projects revert to their funding source and are the reversions in the table below.

Detailed Schedule of Fiscal Year 2008 Capital Budget Adjustments

	<u>General Fund</u>	<u>Non General Fund</u>	<u>Total</u>
Original budget, Chapter 847, 2007 Acts of the Assembly	\$308,140,972	\$ 473,656,500	\$ 781,797,472
Subsequent legislative amendments	44,558,000	998,641,683	1,043,199,683
Transfers:			
General Fund to Non General Fund	(92,455,061)	96,451,099	3,996,038
General funds moved from capital to operating budget	(400,000,000)	-	(400,000,000)
Administrative adjustments:			
Carry forward of prior year balances	842,742,039	4,083,953,416	4,926,695,455
Other Non-General fund appropriations and additional revenues	<u>-</u>	<u>130,963,312</u>	<u>130,963,312</u>
Adjusted budget as of June 30, 2008	<u>\$702,985,950</u>	<u>\$5,783,666,010</u>	<u>\$6,486,651,960</u>

Background Information on the Commonwealth's Budget Process

Virginia has a biennial budget system, which means it adopts a two-year budget. The budget development process involves many participants and spans several months. The Act is a special piece of legislation to authorize the spending of the projected revenues approved by the General Assembly and the Governor. The Virginia Constitution limits appropriation acts to a life of two years and six months, unless shortened by the Act and requires balancing the total biennial budget.

The Commonwealth budgets expenses based on projected state revenues. State statutes differentiate revenues into two broad categories: general and non-general funds. Non-general funds are revenues that, by law or external authorities, support specific programs, activities, or purposes.

General funds consist primarily of taxes paid by Virginia citizens and businesses, including fees and other revenues that support basic governmental programs. The Governor and General Assembly have more discretion in allocating general funds to programs than non-general funds. The Commonwealth budgets separately for operating expenses and capital projects due to the long-term and non-recurring nature of capital expenses.

The Governor and Planning and Budget have certain statutory authority to increase, decrease, or transfer funds and positions during the implementation of the budget. This authority is primarily set forth in Section 4-1.00 of the Act, but there are also other requirements throughout the Act.

Section 4-1.00 establishes the overall criteria by which an agency can request appropriation adjustments. The Director of Planning and Budget has further delegated his authority over certain types of adjustments to Planning and Budget staff, and documented this delegation of authority in a memorandum, effective October 18, 2006. Under this delegation, for example, Planning and Budget analysts have the authority to transfer appropriations between programs within an agency; however, appropriations transfers between agencies require authorization by a Planning and Budget Associate Director or the Director.

Upon approval of the Act, the Division of Legislative Services sends an electronic file with the appropriation data to Planning and Budget. Planning and Budget performs various control procedures to ensure the file's completeness and accuracy and then creates the budget development master (BDM) file on the mainframe. Planning and Budget then creates an execution master (EXM) file from the BDM file along with a copy for Accounts. Planning and Budget procedures vary depending on whether the file contains a new biennial budget or amendments to an existing budget. Accounts accesses its appropriation file copy and uploads the data to CARS.

The appropriations set forth in the Act set annual legal spending limits by secretarial area, agency, program, and project. Automated edit controls within CARS ensure agencies do not exceed their spending authority at each of these levels. CARS edit controls analyze expenses to determine if appropriations and allotments are sufficient before paying an expense transaction. However, there are instances where Accounts can override transactions that do not meet appropriation edit controls. Although Accounts may override the controls, Accounts implements additional manual control procedures to ensure that agencies do not exceed their authorized appropriation levels.

Planning and Budget operates several information systems that support the budget process. FATS process most administrative changes to the budget. Planning and Budget maintains FATS and controls the granting and deleting of access for individual users. Agency personnel initiate most budget adjustments and staff of Planning and Budget approves and processes these adjustments through FATS. During fiscal year 2008, Planning and Budget processed over 4,000 budget adjustments through FATS.

The level of supervisory review within Planning and Budget depends on the type of transaction. FATS transactions are subject to a series of edits that verify the accuracy of the information. These edit controls include verifying funding availability, validity of program codes, agency and project codes, fund and subobject detail, and the completion of transaction briefs. Planning and Budget staff complete transaction briefs in FATS and maintain additional documents that explain details of certain FATS transactions.

After Planning and Budget approval of FATS transactions, staff uploads FATS transactions into an EXM file on the mainframe, which updates CARS on a nightly basis. Planning and Budget and Accounts staff review a daily listing to verify the proper processing of FATS transactions in CARS. Amendments to the Act approved by the General Assembly do not go through FATS, but go directly to Accounts for loading to CARS. Within FATS, Planning and Budget uses alpha codes to differentiate types of budget adjustments. The FATS adjustment type code initiates the proper program budgeting adjustment and when uploaded to CARS identifies the correct transaction codes for recording in CARS.

There are a few types of routine appropriation adjustments that do not flow through FATS that are loaded directly to the EXM file and recorded directly in CARS. An example is the transfer of the initial higher education general funds appropriations to non-general funds and the transfer of transportation general funds to non-general funds.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

February 13, 2009

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

The Honorable Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have completed a **Review of the Budget and Appropriation Processing Control System** administered by the Department of Planning and Budget for the year ended June 30, 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

The overall purpose of our audit was to evaluate the adequacy of statewide budget and appropriation processing controls. The following objectives satisfy the audit's purpose by determining whether policies and procedures were adequate to ensure:

1. Planning and Budget is in compliance with requirements in the Appropriations Act and the Code of Virginia that could materially affect the Commonwealth's annual financial statements;
2. The budget approved by the General Assembly is properly recorded in the Commonwealth Accounting and Reporting System (CARS);
3. Appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
4. Budget adjustments processed by Planning and Budget in the Form 27 Automated Transaction System (FATS) are properly approved, documented, and reconciled to CARS at the statewide level.

We also reviewed corrective actions of audit findings from the prior year audit report.

Audit Scope and Methodology

Planning and Budget's 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 gained an understanding of the overall internal controls, 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 Planning and Budget's budgetary process.

We performed audit tests to determine whether Planning and Budget's controls over the budgetary process 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 and records, and observation of Planning and Budget's operations.

We tested transactions and performed analytical procedures, as we considered necessary to achieve audit objectives. Our review included research of relevant sections of the Code of Virginia, the Appropriation Act, and applicable policies and procedures at Planning and Budget and the Department of Accounts. It included gaining an understanding of the budget process, including reconciling, and monitoring the budget approved by the General Assembly. In addition, we reviewed and analyzed adjustments made to the budget, appropriation controls in CARS, and access to budget systems.

Conclusions

We found that Planning and Budget's policies and procedures for the budget and appropriation process control system were adequate to ensure that:

1. Planning and Budget is in compliance with requirements in the Act and the Code of Virginia that could materially affect the Commonwealth's annual financial statements;
2. The budget approved by the General Assembly is properly recorded in CARS;
3. Appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
4. Budget adjustments processed by Planning and Budget in the Form 27 Automated Transaction System (FATS) are properly approved, documented, and reconciled to CARS at the statewide level.

We noted certain matters involving internal control and its operation and compliance that require management's attention and corrective action. These matters are described in the section entitled "Findings and Recommendations."

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

Planning and Budget has taken adequate corrective action with respect to those audit findings reported in the prior year that are not repeated in this letter.

Exit Conference and Report Distribution

We discussed this report with Planning and Budget management on March 17, 2009. Management's response has been included at the end of this report.

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

AUDITOR OF PUBLIC ACCOUNTS

lcw/alh



COMMONWEALTH of VIRGINIA

Department of Planning and Budget

DANIEL S. TIMBERLAKE
Director

1111 E. Broad Street
Room 5040
Richmond, VA 23219-1922

April 7, 2009

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

Dear Mr. Kucharski:

Thank you for the opportunity to review and comment on the Auditor of Public Accounts (APA) report – the Review of the Budget and Appropriation Control System. We have reviewed this report and have discussed the findings with the APA staff.

Generally, the Department of Planning and Budget (DPB) notes that there are several areas in which there is agreement regarding the need for improvement described in the report. While there may be differences of opinion relative to the steps that should be taken to reach certain objectives and the specific role of DPB, the objectives themselves are worthwhile.

DPB understands the premise on which the recommendations are based. There is growing pressure and expectation for transparency in the way government operates generally and that extends directly to how taxpayer funds are used to deliver services.

APA Recommendation

Address Budget Transparency Issues

In our two previous reports, we reported significant budget transparency issues that affect the ability of citizens to understand the Commonwealth's budget and the use of resources. To date, neither Planning and Budget nor the Governor has taken action to address these issues. Given the emphasis, both in Virginia and nationwide, on greater accountability and transparency in government, we think the Commonwealth should consider these issues a priority.

Our original recommendation sought to have the Commonwealth address these issues as part of the enterprise application project; however, the status of this system development effort continues to be uncertain. In the interim period, we recommended that the Governor and Planning and Budget develop alternative solutions to address these issues. We again report this issue in our current report as the current budget process remains unchanged and the transparency issues continue to exist.

APA Recommendation – continued

A transparent budget process allows any informed citizen sufficient ease in understanding and following the budget process without having any special training. This term describes a budget process which is clear, visible, and understandable to a citizen with an interest in the information. We discuss below two practices which affect the transparency of the Commonwealth's budget as well as recommendations for consideration.

DPB notes that the challenge to improve transparency cannot be accomplished without agreement by the legislative and executive branches on what is meant or expected by transparency. Second to achieving this agreement is the dedication of resources to implement many of the procedural and system changes that may be required. As with the linkage of expenditure data to performance measures, the Commonwealth's current financial systems have inherent technological shortcomings that significantly hinder measurable progress in this area. Until these issues are addressed, DPB is limited to taking small steps each year toward improving the presentation of budget data and information.

To further define the issues related to transparency, this recommendation has three areas of focus. These areas include:

- 1. Significant transfers of General Funds to Other Funds*
- 2. Lack of Transparency for Some Economic Development Activities*
- 3. Inadequate Reporting Mechanism for Budget Adjustments*

DPB's response to these components follows:

Significant transfers of General Funds to Other Funds

DPB generally agrees that the transfer of general fund appropriations to various nongeneral fund accounts hinders transparency in tracking expenditures versus appropriations. However, this is a long-standing practice that has been endorsed by the General Assembly. Moreover, the implementation of the APA's recommended changes involves numerous state agencies (mostly institutions of higher education) and would require them to make significant system changes.

Accordingly, DPB cannot unilaterally dictate any change to the current practice. As stated earlier, change will require the collaborative effort of the executive and legislative branches. Once everyone is in agreement about a direction or path for addressing these transfers, decisions about the required system and/or program changes that are necessary to accommodate the tracking of expenditures and other relevant data can be made in a more informed manner. This action could require fairly extensive modifications to CARS which means that DOA also must be involved.

The report asks DPB to consider, as part of the new performance budget system, an improved reporting mechanism for administrative adjustments processed during a year. The specifications for the solution include several requirements to improve the capability to report on each agency appropriation adjustment request. DPB will look to include recommendations to address these issues as the financial management and performance budgeting systems are developed.

Lack of Transparency for Some Economic Development Activities

In Chapter 847, 2007 Virginia Acts of Assembly, the appropriation act for FY 2007 and FY 2008, contained many economic development programs in the Central Appropriations item of the budget, Item 462, "Payments for Special or Unanticipated Expenditures." At the time the item included such economic development funds for the Governor's Development Opportunity Fund, the Motion Picture Opportunity Fund, Semiconductor Memory or Logic Wafer Manufacturing Performance Grant Fund, Semiconductor Memory or Logic Wafer Manufacturing Performance Grant Fund II, and Virginia Investment Performance Grant Fund. In the development of the budget for FY 2009 and FY 2010, in an attempt to follow the recommendation of the Auditor of Public Accounts, the Governor proposed to move ongoing economic development programs from Central Appropriations to the Office of the Secretary of Commerce and Trade. The 2008 General Assembly adopted the Governor's budget recommendation; the budget recommendations were enacted as part of Chapter 879, 2008 Virginia Acts of Assembly.

The Chapter 879 budget established a new service area under the Secretary of Commerce and Trade, "Financial Assistance for Economic Development." This new service area includes such ongoing programs as the Governor's Development Opportunity Fund, the Motion Picture Opportunity Fund, Semiconductor Memory or Logic Wafer Manufacturing Performance Grant Fund, and the Semiconductor Memory or Logic Wafer Manufacturing Performance Grant Fund II, Virginia Investment Performance Grant Fund.

Chapter 879 includes new economic development programs proposed by the Governor for the General Assembly to consider and existing programs with a defined duration under the Central Appropriations Item 473, "Payments for Special or Unanticipated Expenditures" and the service area "Economic Development Assistance." The treatment of funds pursuant to this Item is consistent with any enabling legislation and is currently endorsed by the General Assembly.

The above actions were taken in response to transparency issues raised by the APA. Consequently, it may be somewhat misleading to say that, "To date, neither Planning and Budget nor the Governor has taken action to address these issues."

APA Recommendation

Update the FATS Manual

As we recommended in our prior report, Planning and Budget needs to review and update the Form 27 Automated Transaction System (FATS) Manual to reflect current practices and changes in authority. The Manual is the primary resource for policies, operational procedures and analytical criteria for budget analysts to follow when processing administrative budget adjustments. The last comprehensive revision to the FATS Manual was in 1998 and numerous changes have occurred since this time, including substantial changes in the authority delegated to Planning and Budget as provided in the Appropriation Act. As a result, the FATS Manual is out of date, incomplete, or irrelevant in the current environment.

We recommend Planning and Budget allocate resources to update the current Manual or implement an alternative solution for providing policies and procedures to Planning and Budget staff. Reliance by analysts on the existing Manual could cause errors in transaction processing due to outdated requirements.

Walter J. Kucharski

April 7, 2009

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We acknowledge that planned revisions to the Form 27 Automated Transaction System (FATS) manual did not occur in FY 2008. However, we remain committed to updating the budget execution process and will do so by October 2009. Staff in DPB's Best Management Practices division have been charged with leading the FATS manual update initiative. They are looking closely at our budget execution processes and practices to find more efficient and effective ways to do business.

Please be advised that we are also developing an in-house, low-cost, Web-based application that is showing considerable promise as a FATS replacement. This evolving system, once fully tested and accepted, could be ready for statewide use by late summer. The accompanying manual may have some minimal policy changes, but the technical user's portion will be much different from what is currently in place for budget execution transactions.

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

Sincerely,

A handwritten signature in black ink, appearing to read 'D. S. Timberlake', with a stylized flourish at the end.

Daniel S. Timberlake

OFFICIALS PAGE

As of June 30, 2008

Jody Wagner
Secretary of Finance

Richard D. Brown
Director, Department of Planning and Budget

David A. Von Moll
State Comptroller, Department of Accounts