

**DEPARTMENT OF TREASURY**

**RICHMOND, VIRGINIA**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2003**

---

---

***APA***

---

---

**Auditor of  
Public Accounts**

---

---

**COMMONWEALTH OF VIRGINIA**

## AUDIT SUMMARY

Our audit of the internal controls over transactions at the Department of Treasury, including the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority for the year ended June 30, 2003, found the Treasurer should include the following in her ongoing review of the Operations Division, Trust Accounting section:

- Continue having personnel document policies and procedures for financial statement preparation, statewide disclosures of state accounts in the State Non-Arbitrage Program, statewide cash and investment disclosures, statewide debt disclosures, and general accounting.
- Explore electronic reporting options for the Virginia College Building Authority to create time efficiencies for the staff. Complete the update of the current debt database to reduce manual efforts and provide efficiencies for preparing budget data, ad hoc reporting, and financial statement preparation at the Department of Treasury and other executive branch agencies.
- Perform a review of the management structure to allow for cross training, reduce overtime, and provide for a better allocation of work among staff.
- Devise a proactive method to monitor and improve the timeliness of transaction processing, track the number of errors during processing, and ensure compliance with reporting standards.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
INDEPENDENT AUDITOR'S REPORT	1-3
AUDIT FINDINGS	4-5
AGENCY RESPONSE	6-8



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

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

January 30, 2003

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

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

We have audited selected financial records and operations of the **Department of Treasury** including the Local Government Investment Pool, the Treasury Board, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority for the year ended June 30, 2003, in support of the Comprehensive Annual Financial Report for the Commonwealth of Virginia.

## Audit Objectives, Scope, and Methodology

Our audit's primary objective was to evaluate the accuracy of Treasury's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2003. In support of this objective, we evaluated the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in Treasury's accounting records, reviewed the adequacy of Treasury's internal controls, tested for compliance with applicable laws and regulations, and reviewed corrective actions of audit findings for prior year reports. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Cash and Cash Equivalents
- Investments
- Securities Lending Program Activity
- Receivables
- General Government Expenditures
- Long Term Liabilities
- Other Liabilities
- Interest, Dividends, Rents, and Other Investment Income
- Other Revenue
- Proceeds from Unclaimed Property
- Operating Appropriations from Primary Government
- Bond Proceeds
- Principal Retirement
- Capital Outlay

We reviewed and gained an understanding of the overall internal controls, both automated and manual, including controls for administering compliance with applicable laws and regulations, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the following operations:

- Financial Reporting
- Bond Issuance
- Debt Service Expenditures
- Investment Trading
- Investment Accounting
- Trust Accounting
- CD Database
- Bank Reconciliation System
- Check Processing System
- Investment Accounting System
- Unclaimed Property Management System
- Risk Management Claims System

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 tested transactions and controls and performed other audit tests we deemed necessary to determine whether Treasury's controls were adequate, had been placed in operation, and were being followed.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and go undetected. 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 conditions or that the effectiveness of the design and operation of controls may deteriorate.

#### Audit Results

We noted certain matters involving internal controls and its operations that we consider to be reportable conditions relative to the Comprehensive Annual Financial Report for the Commonwealth. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect Treasury's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions are in the audit section entitled "Audit Findings." We will include them in the Commonwealth of Virginia Statewide Single Audit Report for the year ended June 30, 2003. We believe that none of the reportable conditions are material weaknesses.

Treasury has taken adequate corrective action with respect to audit findings reported in the prior year.

We have included management's views concerning all of these findings and recommendations, as well as their planned corrective actions, at the end of this report.

AUDITOR OF PUBLIC ACCOUNTS

SHW:whb  
whb:54

## Audit Findings

The Operations Division, Trust Accounting section (Trust) handles and accounts for all bond issues within Treasury. Trust operations are critical to controlling and monitoring the Commonwealth's debt. Because of the importance of this section's functions, during the fiscal year the Treasurer began an internal review of Trust to identify redundant processes, find ways to automate processes, and assess the effectiveness of the management structure.

In connection with this review, the Treasurer sought the assistance of both this Office and Treasury's internal audit director. We commend the Treasurer for the actions taken to date and the items contained in this report are issues the Treasurer should consider in this on-going effort.

### Create Policies & Procedures

Treasury does not have adequate written policies and procedures for the following activities:

- 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.

With the lack of adequate written policies and procedures, Treasury has a significant risk to operations since the department depends on key personnel to understand and remember their duties and provide staff with only verbal instructions. If key personnel leave or become unable to perform their duties there are inadequate procedures to ensure that operations can continue. Verbal policies and procedures are extremely susceptible to misunderstandings and increase the risk that the operations will not occur if a key personnel leaves or cannot perform the duties.

The Treasurer had the Trust personnel begin documenting their policies and procedures with the internal auditor. The Treasurer should have Trust personnel complete the written policies and procedures. The internal auditor should ensure that these policies include a schedule for year-end close and documented procedures for preparing timely financial statements and other financial information. Finally, the Treasurer should have the internal auditor use this document as a basis to begin a review of how, what, and why personnel do their work within Trust. We believe that there are a number of procedures and tasks performed which debt agreements no longer require and that can be automated, reducing extensive manual efforts, and in several cases, could reduce the staff's workload.

### Provide Adequate Accounting Systems

#### *Virginia College Building Authority*

Trust does not operate an accounting system for the Virginia College Building Authority and to compile monthly financial statements, personnel must enter information manually from approximately 183 hard copy bank statements into Excel spreadsheets. Most of these accounts have little or no activity, and

therefore, Trust should examine alternatives for reporting and summarizing information, before considering an accounting system. Trust staff should analyze the VCBA bank accounts and close inactive accounts. In addition, they should explore electronic reporting options with the VCBA banks. By only keeping active bank accounts open and automating accounting and financial reporting, Treasury can create time efficiencies for staff and potentially avoid the need for an accounting system.

#### *Eliminate Redundant Accounting Systems*

Trust operates redundant accounting systems for the LGIP and the Commonwealth's General Account Investments. Trust staff manually enter and maintain investment records in a system known as Series II. These investment records are already available through Treasury's Master Custodian JPMorganChase. Treasury should analyze Series II to determine if it provides any additional benefits other than what is provided by the Master Custodian.

#### *Debt Database*

Trust began a project to create an automated database of debt schedules, which it never completed. Staff currently rely on this partial database and additional manual processes to bill state agencies, institutions of higher education, and local governments for principal and interest payments due for debt service on bonds which is a time consuming process. This partial database and manual information are the same sources Trust staff rely on for reporting debt information in the Commonwealth's Annual Financial Report, while other Treasury staff rely on different sources of debt data to prepare the budget and ad hoc reporting.

Treasury should update their current database to include all Commonwealth debt, institute controls and written procedures for data security and input, and define users and their needs from the database to create effective user reports. While the existing database, when completed, may not fully handle variable rate debt, it would greatly reduce manual efforts and improve the efficiency for receiving data for budget preparation, ad hoc reporting, and financial statement preparation. We believe a properly maintained central information source has the potential to significantly reduce staff time, not only at the Department of Treasury but also at other executive branch agencies.

#### Management Structure

The current management structure in Trust coupled with a lack of inadequate written policies and procedures creates a considerable risk to the operations of the agency. Managers must review and approve all work output before release, and this structure's inflexibility does not allow for adequate cross training or delegation of responsibilities for performance and review of work. Loss of one or more key personnel could significantly disrupt daily operations and could affect the Commonwealth's ability to produce its annual financial report. Additionally, the current structure results in a few people working excessive overtime to avoid missing deadlines. The Treasurer should review this structure and create a structure where multiple individuals receive cross training. There can be delegation of who can perform and review work assignment which indirectly may reduce overtime and more evenly allocate work among staff.

#### Performance Management

Trust does not have a mechanism to monitor the performance effectiveness and efficiency of staff and transaction processing. A performance management mechanism will allow Trust to continually evaluate processes, determine what changes it can make to improve internal controls, ensure compliance with accounting standards, cut costs, and save time. Management should devise a proactive method to monitor and improve the timeliness of transaction processing, track the number of errors during processing, and ensure compliance with reporting standards.



# COMMONWEALTH of VIRGINIA

*Department of the Treasury*

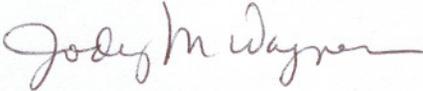
JODY M. WAGNER  
TREASURER OF VIRGINIA

March 3, 2004

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

## MEMORANDUM

TO: Walter J. Kucharski  
Auditor of Public Accounts

FROM: Jody M. Wagner 

SUBJECT: Response to 2003 APA Audit Findings

Thank you for the opportunity to respond to the audit findings contained in the Auditor of Public Accounts 2003 audit of the Department of the Treasury and its related authorities and investment pools. Your suggestions and guidance related to our on-going evaluation of the Trust Accounting function are both beneficial and timely. Our internal review will be expanded to include open issues you have raised. Our comments on specific findings follow:

### Create Policies and Procedures

Trust Accounting has policies and procedures covering most of its activities. A few GASB tasks have been newly documented this year. As indicated by you, Treasury is in the process of updating its Trust Accounting policies and procedures and the documentation thereof. Our Internal Auditor and Trust Accounting's management will continue to work towards completing this project by June 30, 2004, which will include documented procedures for preparing financial statement and other financial information.

The Internal Auditor will pay particular attention to how, what, and why personnel do their work within Trust to determine if there are procedures and tasks performed which debt agreements no longer require and/or that can be automated to reduce manual efforts and streamline the staff's workload.

### Provide Adequate Accounting Systems

- a. Virginia College Building Authority

We recognize that there may be a better alternative to the current spreadsheet process for compiling data. An accounting system will change the fashion in which the data is input, but unless we are able to obtain information electronically, it will not significantly reduce the manual entry. We are exploring with The Bank of New York the possibility of downloading data from its system. If that option is viable, we will seek to improve the process by which we compile our financial statement data.

The Bank of New York is the Trustee on VCBA bond issues. Accordingly, we must defer to it on the appropriateness of combining and/or closing bank accounts. We have submitted a listing of possible accounts to close and will work with The Bank of New York to close as many accounts as possible before June 30, 2004. We will continue to research whether there is a more efficient structure to manage the various funds required in the VCBA bond indentures.

b. Eliminate Redundant Accounting Systems

We devoted significant time to evaluating the possibility of eliminating our internal investment system (APS2 2002 – formerly known as Series 2) for maintaining investment data and concluded that it would be imprudent to do so. We use our internal system to verify the accuracy of the data provided by the Master Custodian. We believe that verification is the industry standard.

c. Debt Database

The existing debt database was designed and implemented to track and bill locality debt, higher education debt, and other debt for which the Treasurer serves as paying agent. The system has effectively served that purpose for years.

A few years ago, we converted the database to an Access database. We designed the new database to permit incorporation of other Commonwealth debt. We are working to add other Commonwealth debt issues to the system prior to June 30, 2004.

In addition, we are exploring moving the existing database to a Microsoft SQL server environment, which would enable us to add security features and allow broader access to users outside of Trust Accounting. This is a longer-range project that may require additional funds, and we do not anticipate completion for the FY 04 reporting cycle.

### Management Structure

We agree that there is a need for more cross training within Trust Accounting and have begun implementation of cross training activities. We are working on, and will establish, a plan to ensure that at least two people are trained on all functions so that all tasks can be accomplished in the event that key personnel discontinue service to Treasury.

We will do an evaluation of our year-end work assignments and the assignment of ongoing operations at year-end to determine the most effective distribution of tasks. Internal review prior to distribution outside of the Department is necessary to maintain quality control.

Each year end, our workflow priorities are established to conform to the deadlines established by the Department of Accounts for preparation of the CAFR. We successfully meet DOA's deadlines each year. We are willing to discuss with both DOA and APA any mutually beneficial modifications to the schedule.

#### Performance Management

We monitor operational performance through our monthly reconciliations. If there are significant problems, the volume and nature of the reconciling items will reflect such problems. Transaction review is also accomplished prior to release to the accounting system, as required by the Comptroller, allowing us to monitor and rectify staff performance prior to posting transactions. As a result of both processes, we continually look for ways to improve what we do and implement appropriate changes as needed.

We would welcome APA's suggestion of performance mechanisms that could improve our current process in this high volume task-diverse Trust Accounting operational environment.

Our internal review of the Trust Accounting function should be completed in the current fiscal year; however, full implementation of all recommendations related to that review may not be completed by June 30, 2004. Our Internal Auditor will keep your office informed of both the findings and recommendations associated with his review.

Our Department appreciates the efforts of your staff on the 2003 audit. Please contact me if you have any questions or comments related to our response.

JMW:jbp/kar

C: John M. Bennett  
Secretary of Finance  
J. Braxton Powell  
Deputy State Treasurer  
Gary P. Crispens  
Internal Audit Director