



Report of the Vermont State Auditor

September 8, 2008

INTERNAL CONTROLS

Results of Review at the
Agency of Administration

Thomas M. Salmon
Vermont State Auditor
Rpt. No. 08-10

Mission Statement

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**THOMAS M. SALMON
STATE AUDITOR**



**STATE OF VERMONT
OFFICE OF THE STATE AUDITOR**

September 8, 2008

The Honorable Gaye Symington
Speaker of the House of Representatives

The Honorable Peter D. Shumlin
President Pro Tempore of the Senate

The Honorable James Douglas
Governor

Neale Lunderville
Secretary of the Agency Of Administration

Dear Colleagues,

As part of our audit of the Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2007, we reviewed internal controls over financial reporting, and compliance with laws and regulations at several State organizations, including four departments within the Agency of Administration. Our work was performed for the limited purpose of planning and performing this audit and would not necessarily identify all deficiencies in internal control over financial reporting.

In general, we found that the Agency's Departments had appropriately designed controls in a number of areas. However, we also found internal control deficiencies in which improvements could be made. In particular, these areas relate to entity-level controls, financial reporting and payroll processing control activities.

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I would like to thank the management and staff of the Agency of Administration for their cooperation and professionalism. If you would like to discuss any of the issues raised by this audit, I can be reached at the phone number or email listed below.

Sincerely,

Thomas M. Salmon CPA

Thomas M. Salmon, CPA
State Auditor

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Abbreviations

AoA	Agency of Administration
BDS	Budget Development System
BGS	Department of Buildings & General Services
CAFR	Comprehensive Annual Financial Report
DHR	Department of Human Resources
DOT	Department of Taxes
F&M	Department of Finance & Management
IT	Information Technology
RAS	Revenue Accounting System
SAS	Statements on Auditing Standards
VISION	Vermont Integrated System for Information & Organizational Needs

Introduction

The mission of the Agency of Administration (AoA) is to provide centralized support services to all agencies and departments of state government as well to provide selected services to Vermont municipalities and Vermont citizens. The Agency also exists to ensure that the fiscal resources of the State are properly managed. The agency is comprised of the Office of the Secretary and six operating departments. The Office of the Secretary assists in the development and implementation of policies and programs throughout state government, coordinates and controls functions within state government, and manages the Agency of Administration. As part of our audit of the State's FY2007 CAFR, we reviewed the following departments within the AoA.

- *Department of Buildings and General Services (BGS)*. This department provides facilities management, risk management and other operational support services across state government. The total value of BGS revenues charged for sales, services, rental and other income in FY2007 was \$67.4 million.
- *Department of Finance and Management. (F&M)* The primary responsibility of the department is to manage the fiscal condition of state government. The department is responsible for the preparation of the State's Comprehensive Annual Financial Report (CAFR) and for ensuring that the State's overall internal control systems for financial accounting and reporting are sufficient. The department manages the State's centralized accounting system¹ (VISION) and oversees the preparation and execution of the annual state budget which was \$4.9 billion in FY2007.
- *Department of Human Resources (DHR)*. The department is responsible for the support of human resources within state government and works with other departments to support workforce needs. DHR provides centralized support to human resource managers in various state departments, including recruitment, employee compensation, labor relations and information technology. During FY2007, DHR was

¹ VISION is an acronym for "Vermont Integrated System for Information & Organizational Needs" The VISION Financials system is a PeopleSoft integrated financial management system. The system is managed by the Financial Operations Division of the Department of Finance & Management.

responsible for the State's payroll processing² which totaled \$446 million³.

- *Department of Taxes.* The Department of Taxes is responsible for the assessment and collection of certain tax revenue for the State. For FY2007, the department collected more than \$1.3 billion in tax receipts. In addition, the department provides support services to tax payers, local governments and the Legislature.

In consideration of the AoA's financial significance and in accordance with our internal control audit obligations⁴ related to the State's FY2007 Comprehensive Annual Financial Report (CAFR), our objectives were to assess the AoA's internal controls over financial reporting, and compliance with laws and regulations related to its (1) entity-level controls,⁵ and (2) control activities⁶ at BGS, F&M, DHR, and DOT.

Auditing standards define three types of control findings.⁷ First, a control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. According to auditing standards, the auditor must evaluate identified control deficiencies to determine whether these deficiencies, individually or in combination, are significant deficiencies or material weaknesses. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report

² Effective July 1, 2007 the management of the State's payroll function was assumed by the Department of Finance and Management.

³ Payroll expense includes gross wages and does not include fringe benefits.

⁴ *Generally Accepted Auditing Standards* AU Section 150.02 (American Institute of Certified Public Accountants, Inc.). These standards require that auditors obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.

⁵ Entity-level controls can have a pervasive effect on the overall system of control activities and pertain to the organization as a whole. They encompass the organization's control environment, risk assessment, information and communication, and monitoring activities.

⁶ Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives. Each of the AoA departments within our scope had varied responsibilities and functions and we reviewed the control activities that were most appropriate to each specific entity.

⁷ *Statement on Auditing Standards (SAS) 112, Communicating Internal Control Related Matters Identified in an Audit* (American Institute of Certified Public Accountants, Inc., May 2006).

financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote⁸ likelihood that a misstatement of the entity's financial statements that is more than inconsequential⁹ will not be prevented or detected. A material weakness is a significant deficiency, or a combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

⁸SAS 112 states that the likelihood of an event is "more than remote" when it is at least reasonably possible.

⁹The term "more than inconsequential" describes the magnitude of potential misstatement that could occur. A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements.

Highlights: Report of the Vermont State Auditor

Internal Controls: Results of Review at the Agency of Administration

(September 8, 2008, Rpt. No. 08-10)

Why We Did This Audit

As part of our audit of the State's fiscal year 2007 CAFR, we evaluated internal controls over financial reporting and compliance with laws and regulations at four departments within the Agency of Administration: 1) Buildings & General Services, 2) Finance & Management, 3) Human Resources and, 4) Taxes. As part of our evaluation, we reviewed the Agency's entity-level controls and specific control activities at each department. We did not perform tests of effectiveness.

What We Recommend

We made a variety of recommendations related to several entity-level controls and control activities areas. Specifically, we recommended that the Agency track employee performance reviews and ensure they are given on time, develop and implement a formal risk assessment and monitoring program, improve internal control evaluations and monitoring within its departments, refine the methodology for determining allowances for uncollectible accounts and perform bank

Summary of Findings

In general, the Agency and its departments provided evidence that it has established and utilized many key entity-level controls; however, we noted three deficiencies from our review of the AoA departments' entity-level controls.

- Employees' performance evaluations, an important element to managing human resources, had not been completed on time.
- The departments had not implemented a formal risk assessment and monitoring program nor was there a formal fraud prevention mechanism in place. The absence of a formal program makes it difficult to identify, analyze and mitigate risks to the organization.
- The departments do not have an ongoing mechanism to evaluate their internal controls. Monitoring the effectiveness of internal controls provides management the opportunity to identify and correct any control deficiencies or control overrides.

During our review of control activities within the Agency, we noted several control deficiencies.

- Controls over invoice approvals for accounts payable payments for were not always adhered to. (BGS)
- There was insufficient documentation on the rental rate development process and procedures for the Property Management Fund. (BGS)
- There continued to be too much reliance on the Director of Financial Reporting to prepare the CAFR. (F&M)
- A formal process had not been established to assist with the review of personnel action requests. (DHR)
- Payroll software tables were not secured after approved changes were made to records. (DHR)
- The payroll was approved, validated and posted to the general ledger after employees had been issued paychecks. (DHR)
- The quarterly federal payroll tax withholding reports were not reconciled to the general ledger in a timely manner. (DHR)
- There were various deficiencies related to IT general controls, such as lack of consistency of documentation of software testing processes and weaknesses in password requirements. (F&M and DHR)

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account and general ledger
account reconciliations on a
timely basis.

- The analysis to estimate the allowance for uncollectible accounts for taxes receivable was incomplete. (TAX)
- Bank accounts were not being reconciled on a timely basis. (TAX)

Background

Internal control can be broadly defined as a process, affected by an entity's governance structure, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal control is a major part of managing an organization. Such controls comprise the plans, methods, and procedures used to meet missions, goals, and objectives. In addition, internal controls serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

Scope and Methodology

As part of our audit of the State's FY2007 CAFR, we gained an understanding of the internal controls at the Agency of Administration. Our work was performed for the limited purpose of planning and performing this audit and would not necessarily identify all deficiencies in internal control over financial reporting. We considered the design of the Agency's controls and whether they were in place and operational. We did not test the effectiveness of the controls.

We assessed the entity-level and key control activities individually at the departmental level for the following departments within the Agency: Buildings & General Services, Finance & Management, Human Resources, and Tax. Each of these departments had varied responsibilities and functions and we reviewed the control activities that were significant to the financial accounting and reporting for each department. See Appendix I for a more detailed summary of the scope and methodology used at each department.

We performed this audit in accordance with generally accepted government auditing standards between August and December 2007 in Montpelier.

Agency Entity-level Controls

AoA's entity-level controls encompass its control environment, risk assessment, information and communication, and monitoring activities. In general, we found that AoA has implemented many controls at the entity level¹⁰. However, we identified three entity-level control deficiencies.

Control Environment

The control environment sets the tone of an organization. It is the foundation for all other components of internal control. Among the factors that influence an evaluation of an organization's control environment are ethical values and integrity, management philosophy and operating style, commitment to competence, and structure. The AoA provided evidence that it has implemented important controls in this area. For example, the AoA submits strategic plan documents with its annual budget request.

- The first entity-level control deficiency is that many agency employees had not received performance evaluations or that they had not been completed in a timely manner. Candid and constructive performance evaluations are an important element in demonstrating a commitment to competence. The State's personnel policies and procedures manual notes that annual performance evaluations are to be completed for all classified employees on the anniversary date of the employee's completion of original probation. Completing timely performance evaluations is not only required under the State's personnel policy, but provides employees the necessary feedback to enable them to perform their duties satisfactorily and meet their annual objectives in support of the Agency's overall goals.

Risk Assessment

Risk assessment is the identification and analysis of relevant risks to the achievement of the objectives of organizations, which forms the basis of determining how these risks should be managed. The AoA demonstrated some elements of an effective risk assessment process. For example, BGS has been concerned about risks associated with employee turnover and has proactively

¹⁰ Any issues and recommendations related to the statewide oversight role of the Agency that were material weaknesses or significant deficiencies have been reported in the required report on internal controls and compliance with laws and regulations that pertain to the Agency of Administration entitled: *Fiscal Year 2007: Report on Internal Control Over Financial Reporting and on Compliance with Laws and Regulations*.

sought to mitigate these risks by monitoring its workforce. BGS is actively planning to address the impact of employee turnover through supervisory training, utilizing career ladders¹¹ and increased recruitment and use of internships.

All entities, regardless of size, structure, nature, or industry, encounter risks at all levels within their organizations. Through the risk assessment process, management determines how much risk is to be prudently accepted and strives to maintain risk within these levels. Such a process is important because, according to the State's internal control guidance, managers can use risk assessments to determine the relative potential for loss in programs and functions and to design the most cost effective and productive internal controls.

- The second entity-level control deficiency is that the Agency had not implemented an agency-wide formal risk measurement and monitoring program. The Agency has some formal and informal risk assessment processes in place. For example, Building and General Services has a Risk Management Division, which is primarily responsible for mitigating the insurance costs associated with risk and promoting workplace safety. Finance and Management maintains an internal project list that also serves as an informal list of potential risks. However, these are only a part of risk management. In consideration of the extreme importance of the role the Agency of Administration has in overseeing the financial operations of state government, the Agency's departments should use a uniform methodology and develop a common set of criteria to rate both the likelihood and potential magnitude of the impact of an unwanted event. Using a uniform methodology and common criteria allows the AoA to better understand and then manage the results of the risk assessment process.

Information and Communication

For an entity to manage and control its operations, it must have relevant, reliable information, financial and non-financial, related to internal and external events. Effective communication must occur in a broad sense, flowing down, across, and up the organization. In general, we found expected controls in place in this area. For example, the Agency issues policy statements known as "Administrative Bulletins" and requires all departments to adhere to these policies or to formally request waivers for any exceptions. Another example is Finance & Management's quarterly newsletter to all business units and staff throughout State government

¹¹ Career ladder is a common term used to describe vertical job promotion opportunities.

which provides information on internal controls, best practices, and current and upcoming events.

Monitoring

Internal control environments need to be monitored. Ongoing monitoring occurs in the course of operations, including regular management and supervisory activities. The AoA provided evidence that it has many individual monitoring controls. For example, Finance & Management performs periodic reconciliations between the Budget Development System (BDS) and VISION to ensure that financial and budgetary data is accurate and appropriation budgetary control is maintained. Any significant reconciling items or exceptions that could indicate internal control problems are brought to the attention of management.

- The third entity-level control deficiency is the lack of an ongoing formal mechanism to evaluate AoA's internal controls. According to the State's own internal control guide, management should establish procedures that monitor the effectiveness of control activities and the use of control overrides. Such monitoring gives management the opportunity to identify and correct any control activities or problems and to minimize the impact of unfavorable events. The Department of Finance & Management participates in the state-wide annual self assessment of internal controls. While the internal control self assessment questionnaire is a good tool, it does have weaknesses in that it is a checklist and as such cannot address all of the many varied business activities conducted by departments. For example, it does not address the controls in place over the CAFR compilation process, a major responsibility of the department.

Control Activities at BGS

BGS' Administrative Services is a centralized finance organization and provides accounting and financial support to all divisions of BGS. Due to the large volume of transactional activity that occurs in this organization, Administrative Services has many of its internal procedures and processes documented. It also maintains a "BGS Internal Control Manual" for staff to use and update as processes change. Our review of business processes and related control activities at BGS found that the department generally had the expected controls in place. However, there were two control deficiencies in the accounts payable process and in the property rental rate development process.

Accounts Payable Control Activities

During our review of the accounts payable procedures and testing of disbursements, we noted that controls were not operating as designed to ensure that actual invoices are reviewed and signed by the applicable authorizer prior to payment. BGS Administrative Services' standard procedure is to have the actual invoice signed as approved. We found four accounts payable invoices in our sample totaling approximately \$138,000 that did not have approved for payment indicated on the invoices. A claim adjuster, processing invoices related to Workers Compensation, did not indicate approval on the actual invoice or source document itself. These invoices were processed and paid by Administrative Services staff who believed that having an "RMD Payment Request" form attached to the invoice indicated sufficient approval for payment. The payment request form is similar to a checklist in that it ensures complete and accurate financial information is summarized and available during the processing of a payment, but it was not intended to replace signing and approving the actual invoice.

Authorization is a control activity designed to ensure events or transactions are initiated and executed by those designated to do so. Departments should ensure that the conditions and terms of authorizations are clearly documented and communicated to financial accounting staff, and that significant transactions, such as payment of insurance claims, are marked as approved and executed only by persons acting within the scope of their authority.

Revenue Control Activities

The rental rate charged to departments and other renters of State of Vermont owned and leased property is calculated by accumulating/estimating the costs for the operating and maintenance of each facility. Due to the timing of the State's appropriation cycle (which authorizes the departmental funds to pay for these charges), this estimation process can occur as much as two years in advance of the charges. During our review of the rental rate development process for the Property Management Fund, we noted that there were no formal written policies and procedures in place for descriptively supporting this extensive process. Written documentation of how rental rates are determined is critical to ensure that rental rate calculations are complete, accurate and consistently developed. According to the State's internal control guide, written documentation is the vehicle to clearly communicate the what, why, how, who and when(s) of operations. It is instrumental in training new staff, retaining institutional knowledge as staff members leave/retire, ensuring consistency and accuracy, and enabling the department to monitor and review its internal control system.

Purchasing Control Activities

The department is responsible for the oversight of the State's purchasing activities. The purchasing control activities we examined included 1) VISION budget checking¹² 2) approval of the invoice within VISION prior to processing invoices and 3) the approval of all warrants by the Commissioner of F&M prior to payment of invoices. These control activities were included in the scope of our review; however, they do not represent all the control activities of this process. Generally, we found the internal controls over the purchasing controls we reviewed to be properly designed.

Control activities at the Department of Finance & Management

During our review of the Department of Finance & Management, we examined the control activities over budgeting and financial reporting. We found that the department had many controls in place over the budgeting process; however, we noted deficiencies in our review of the financial reporting process related to 1) the use of spreadsheets for financial reporting, 2) the statewide reporting group and 3) agency and department accounting.

Financial Reporting Control Activities

- *Reliance on key individual.* There are five members of the Department of Finance and Management's Statewide Reporting group, which is principally responsible for the activities related to the compilation and analysis activities related to the CAFR. In particular, the Director of Statewide Reporting is actively involved in the day-to-day operations and in the preparation of the CAFR and other reports. Likewise, much institutional knowledge, strategic oversight, and responsibility for critical day-to-day operations are vested with this Director.

Our concern with this condition is that with such a heavy reliance on a single individual to perform key functions, if she were unavailable, the operations of this group and the financial reporting of the State as a whole could be adversely affected. Other staff members may be able to provide some additional coverage with respect to daily departmental operations in the short-term absence of the Director, but the department needs to ensure an appropriate distribution of financial review and analysis and critical areas of

¹² VISION requires all purchase orders and invoices to be budget checked to ensure that sufficient appropriations are available prior to a department approving an expenditure for payment.

knowledge such that the absence of this individual would not create undue risk.

As we recommended in our 2006 internal control report,¹³ the Department recently hired a new Assistant Director of Statewide Reporting, who in time, should help alleviate this condition. Nevertheless, at this point, the breadth of the responsibilities placed on the Director of Statewide Reporting and her central role in compiling, preparing, analyzing and reviewing the year-end financials statements continues to be a risk that can threaten the achievement of the department's objectives.

Budgeting Control Activities

Preparation of the Governor's annual budget for the State of Vermont is the responsibility of the Commissioner of F&M, the staff of the Budget and Management Division, and agency and departmental budget staff. The development and implementation of the budget is an on-going annual cycle. F&M is responsible for 1) the compilation of the statewide preliminary budget, 2) ensuring the accuracy of budget information in the Budget Development System (BDS)¹⁴ and VISION and 3) tracking excess receipts¹⁵ from departments.

We reviewed the design of the controls related to compiling the statewide budget, populating BDS and VISION with authorized appropriations, and approving excess receipts. F&M utilizes many internal controls over these processes including 1) restricted access to BDS, 2) Commissioner of F&M approval of agency preliminary budget requests, 3) reconciliation of the approved legislative budget information to BDS and VISION, 4) required approval for spending excess receipts and unexpended appropriations and 5) VISION budget checking. We found no deficiencies during our review of the budget control activities.

¹³*Fiscal Year 2006: Report on Internal Control Over Financial Reporting and on Compliance with Laws and Regulations* (Vermont State Auditor's Office, Report No. 07-07, February 16, 2007), page 5.

¹⁴The Budget Development System is used by the State to prepare and approve preliminary budget information as well as to track and report budgets approved by the legislature and other budget changes.

¹⁵Upon approval by F&M, the departments may carry forward unspent receipts, known as excess receipts, into the next fiscal year.

IT Control Activities

As part of our review of IT general controls¹⁶ at several departments, we reviewed controls related to the VISION applications environment. Because of the potentially sensitive nature of some of the findings related to IT security, we are providing the detailed results to the Department of Finance and Management in a confidential appendix (Appendix II). Table 1 is a high-level summary of the areas reviewed and the extent to which there was reasonable assurance of the controls' existence or exceptions found. Taken together, these control deficiencies are considered to be significant. In early April 2008, the Department of Finance and Management's Technical Services Director reported that some of the detailed recommendations previously provided had been implemented¹⁷ and that the remainder were expected to be implemented by June 30, 2008.

Table 1: VISION IT General Control Summary

Control Objective Description	Number of Controls Reviewed	Number of Exceptions
ACCESS TO PROGRAMS AND DATA: Access controls should provide reasonable assurance that computer resources are protected against unauthorized modification, disclosure, loss, or impairment.		
Information security is managed to promote consistent implementation of security practices, and users are aware of Finance and Management's position with regard to information security, as it pertains to VISION financial reporting applications and data.	2	0
Physical access to IT computing resources, particularly those used to process and report on financial activity, is restricted by the implementation of appropriate identification, authentication and authorization procedures that reduce the risk of unauthorized and/or inappropriate access.	5	0
Logical access to IT computing resources, particularly those used to process and report on financial activity, is restricted by the implementation of appropriate identification, authentication and authorization procedures that reduce the risk of unauthorized and/or inappropriate access.	9	1
Procedures have been established that ensure user accounts are added, modified and deleted in a timely manner reducing the risk of unauthorized access and/or inappropriate use of the VISION financial application and data.	3	0
Controls are in place to monitor the management and maintenance of access rights to Finance and Management's financial applications and data.	2	2
Appropriate segregation of duties within the VISION financial applications and system processes have been identified and have been put into operation.	2	2

¹⁶General controls are the structure, policies, and procedures that apply to an entity's overall computer operations. They create the environment in which application systems and controls operate.

¹⁷We did not audit this assertion and express no opinion as to whether actions that were taken address previous recommendations.

Control Objective Description	Number of Controls Reviewed	Number of Exceptions
Security violations including unauthorized access attempts to the VISION financial system and application are monitored and reported.	2	0
PROGRAM CHANGES: A disciplined process for testing and approving modified programs prior to their implementation is essential to make sure programs operate as intended and that no unauthorized changes are introduced.		
Changes to the VISION financial application have been authorized by an appropriate level of management prior to development and migration into production.	2	2
System software and configuration changes to the computer systems that run the VISION financial application have been authorized by an appropriate level of management.	1	1
Changes to the VISION financial application have been tested, validated, and the results approved prior to being moved into production.	3	2
Operating system software and configuration changes that affect Finance and Management's financial computer systems have been tested, validated, and the results approved prior to being moved into production.	4	3
The ability to migrate VISION financial application changes into production is restricted to authorized staff.	2	2
The ability to migrate system software and configuration changes that affect Finance and Management's financial computer systems is restricted to authorized staff.	1	1
Emergency changes made to the VISION financial application, system and infrastructure configurations are appropriately managed and approved.	3	3
VISION financial application documentation is maintained in a timely fashion and access to the documentation restricted to authorized staff.	2	2
COMPUTER OPERATIONS: Controls in this area address a wide variety of issues, such as controls over job processing, backup and recovery procedures, and problem management procedures.		
The VISION financial application job runs including batch jobs, interface runs and system backups are accurate, complete, and timely.	4	0
Backup and recovery procedures have been implemented that permit databases, transactions, feeds and application programs that are necessary for VISION financial reporting to be recovered.	5	1
Periodic testing of the VISION financial system and data file restoration process is conducted and the quality of backup media used to store Finance's financial applications and data is monitored.	2	1
The backup media for systems and applications used by the VISION financial application is safeguarded, and only authorized staff have access to the backup media.	2	0
The VISION financial application hardware, software, and media inventory is tracked and kept current.	2	1
Operations documentation is maintained and access restricted to authorized staff.	1	0
Incidents, problems and errors arising from the VISION financial application are analyzed and underlying causes resolved.	2	0

Some of these general control deficiencies, particularly those related to software changes, were evident in weaknesses that we found in a major upgrade project undertaken by the Department of Finance and Management. This project, which

was completed in March 2007, was a significant upgrade of the VISION system. The Department of Finance and Management had a test plan and cutover plan for this upgrade, but it did not always follow the processes and procedures outlined in these plans, as follows:

- *Test Documentation.* In order to test the upgrade process, multiple practice upgrades called “passes” were executed prior to the cutover to the new system. The test plan called for tests to be executed in accordance with test scripts¹⁸ in each pass. According to the plan, these test scripts were to be used as part of interface programs¹⁹ and functional testing. Completed test scripts were supposed to indicate the tester name, the date of the test, and the results (e.g., pass or fail). Our review of the documentation files for seven interface tests found (1) two did not have test scripts, (2) three had test scripts with a “passed” notation, but did not indicate who performed the test and when it was performed, and (3) two indicated that there was a test failure, but did not indicate that a retest was performed once the failure was fixed (in three other cases, a conclusion could not be drawn because there was no test script or it was not dated). According to two of the testers, the lack of consistency in the documentation showing the results of interface testing occurred because each tester was allowed to decide on his or her own what should be tested and how to document the tests and results. In addition, of the 75 functional test scripts of various VISION modules that we reviewed, (1) 2 were not tested, (2) 25 had no supporting documentation that the test was performed, and (3) 22 had incomplete supporting documentation (e.g., documentation of the most recent test was not available or test results were not dated). As a result, we could not substantiate the testing performed for over half of the functional test scripts reviewed.
- *Cutover Decision.* As the decision was being made to “go live” with the VISION upgrade, there remained a wide variety of issues that were outstanding. According to the test plan, test incidents were to be assigned priority levels as follows, (1) critical—the upgrade cannot continue until the issue is resolved, (2) urgent—upgrade can continue now, but will come to a stop in the near future if it is not resolved, (3) standard—upgrade can continue, but issue should be resolved before “go live”, and (4) low—upgrade can continue and issue does not effect “go live”. Nevertheless, there were

¹⁸These test scripts defined, for a particular test scenario, the procedures and data to be used as well as the expected results of the test.

¹⁹Interface programs are used to import data from another system into VISION and/or export data from VISION to another system.

several outstanding issues labeled critical, urgent, or standard that remained outstanding at the time of the decision to cutover to the new system. The staff member in charge of functional testing explained how the Department of Finance and Management's strategy for prioritizing and resolving issues evolved. She stated that at the time of the "go live" decision, an issue was not considered critical if a work-around could be implemented or if the applicable functionality or report would not be used on the first day that the system was live. Another issue was that the final "go live" decision was not documented. According to the Production Cutover Plan, the cutover to "go live" with the VISION upgrade was supposed to be formally approved through a signature document. However, there is no formal sign off on the decision to "go live." According to the staff member in charge of functional testing, the decision to go live "was inherent, based on the success of the upgrade steps and testing."

In addition to the known issues that remained outstanding at the time of the implementation of the upgrade, there were a variety of problems that occurred subsequent to the cutover date. Indeed, it is not unusual for major system upgrades to experience some degree of problems once implemented (e.g., due to user unfamiliarity with the new software or because of oversights in the upgrade/testing process). The Department of Finance and Management uses a tool called "Footprints" to record reported issues with VISION. Between the "go live" date on March 19, 2007 and August 1, 2007,²⁰ 552 issues were recorded in Footprints.²¹ These issues spanned a wide variety of problems reported by users; from the need to reset passwords to the slow performance of the system, to errors that needed to be corrected via software changes. Although issues were assigned a priority level when entered into Footprints, according to a staff member with the VISION help desk, there is no written documentation defining what type of issue should be assigned a particular priority level. As a result, priority levels have not been consistently assigned and it is difficult to assess the significance of the problems that were reported. In addition, information in Footprints did not always support why an issue was closed or include relevant information about software changes.

²⁰We chose August 1, 2007 as the cutoff date to obtain Footprints data in order to include any issues that may have been reported during the year-end closing cycle or at the beginning of a new fiscal year.

²¹We could not tell how many of these issues were due to the upgrade or were issues that occurred during the normal course of operations.

Control Activities at the Department of Human Resources

The state government's payroll, managed by DHR during FY2007, totaled approximately \$446 million. DHR processed the bi-weekly payroll for all Agencies and Departments within Vermont State Government for approximately 12,000 employees. Payroll processing occurs in a very limited timeframe, requiring a statewide coordination of effort among departments and DHR. Many of the payroll and related IT system control activities were properly designed. However, during our review we noted a number of deficiencies. For example, we noted deficiencies related to the review and approval process for personnel action requests, payroll tax reconciliations, employee access to electronic records and tables, and logical access to IT computing resources.

Payroll Control Activities

DHR uses Paradox time reporting²² and Human Capital Management (HCM)²³ systems to process payroll. The payroll process encompasses a variety of activities, many of which we were able to determine had adequately designed controls. Examples of control activities include the following:

- Employee time sheets are reviewed and approved by supervisors.
- Edit checks are performed on time reports to validate time codes, leave balances and time totals.
- Changes to employee deductions are reviewed and approved by the payroll administrator.
- The Director of Payroll reconciles the total net payroll on the Warrant Report²⁴ to the payroll system control totals.
- A VISION Financial Analyst reconciles the total gross payroll posted to the general ledger to the payroll system control totals.

²² The Paradox time reporting is a stand-alone system used to process and review employees' time sheets and expense reports.

²³ The HCM is a module of the State's PeopleSoft management information system used to maintain employee human resources information and process payroll. The time and expense information from Paradox is uploaded into HCM every pay cycle to facilitate payroll processing.

²⁴ The Warrant Report identifies all State employees' payroll disbursement information to be processed by the Office of the State Treasurer.

Notwithstanding the controls that were in place, we found several control deficiencies in fiscal year 2007 that warrant attention.

- *Review of Personnel Action Requests (PAR).* The State's individual department's Personnel Officers are responsible for initiating changes to employees' employment status, including actions to hire, terminate, promote or change pay rates.²⁵ For most State employees, these changes are initiated electronically in the HCM system by the Personnel Officers and generally take effect the following day unless the Classification and Compensation Division (C&C Division) intervene. Two employees in the C&C Division are responsible for reviewing a high volume of PAR (approx. 500 per week) generated on the daily Turnaround Report.²⁶ The C&C Division reviews the PAR primarily for reasonableness and consistency but may not be able to determine the appropriateness of the request. In addition, the C&C Division does not have any documented criteria to ensure a consistent, thorough review. The volume of personnel action requests processed, coupled with the absence of a formal review process, could increase the risk that an error will not be detected.
- *Vulnerable Employee Records and Payroll Tables.* At least 16 individuals from the Payroll, C&C and IT Divisions can change employee record information, such as pay rates, in the Human Capital Management (HCM) system. Many of these employees are not responsible for making changes to employee records but nevertheless have access to them. In addition, the Payroll Division maintains a large number of payroll tables within HCM that contain information related to earnings, taxes and deductions. There were eight Payroll Division employees who can access and edit these tables. Audit reports are not generated after table maintenance is performed and dual authorization is not required for changes to the tables to become effective. Failing to restrict access to the employee records and payroll tables or to have a review of changes increases the likelihood they will be inadvertently or inappropriately accessed, causing losses to the State.
- *Untimely Payroll Validation.* The payroll is budget checked, validated and posted to the State's general ledger after payments are made to employees. The budget checking process is designed to control spending. Without the

²⁵ The Personnel Officers can initiate actions to hire, terminate, promote and change pay rates, but do not have access to the employees' step or cost of living adjustment tables. These tables are maintained by the DHR Payroll division.

²⁶ The Turnaround Report identifies PAR and other changes to electronic employee records.

budget checking process preceding the payment of payroll, the State risks making payments which have not been appropriated or approved.

- *Time Sheets Reported in Advance of Hours Worked.* The time sheets of some employees working at remote locations were reported in advance of the actual hours worked. Reporting timesheets in advance may lead to employees being incorrectly compensated and cause subsequent payroll adjustments.
- *Payroll Tax Reconciliations.* The required quarterly Federal payroll tax withholding reports (IRS Form #941) were not reconciled to the general ledger in a timely manner.²⁷ These reports were reconciled only at our request as part of the financial statement audit. Without reconciling the quarterly Federal payroll tax withholding reports, the Payroll Division may not detect an error reported on the IRS Form #941 or general ledger.
- *Manual Adjustments to checks.* Payroll Division employees can make manual adjustments to employee pay amounts without additional authorizations required. In addition, there are no reports generated to monitor the appropriateness of manual adjustments to employees' pay amounts.

In addition to the deficiencies, we noted process redundancies. State employees' time and expenses are entered by both individual employees and payroll data entry personnel. Time and expenses are first prepared by individual State employees using Excel spreadsheets. The time and expense reports are entered a second time by either the department personnel or DHR Payroll Division's data entry personnel into the State's Paradox payroll system. The Agency is evaluating the need for a new statewide time and labor payroll system with additional software modules being considered for expense reimbursement and accrued compensated time reporting. The system would allow employees to enter their time and expense data directly into the PeopleSoft system, avoiding duplicative entry.

IT Control Activities

As part of our review of IT general controls at several departments, we reviewed controls related to the Human Capital Management (HCM) applications environment. Because of the potentially sensitive nature of some of the findings related to IT security, we are providing the detailed results to the Department of Human Resources in a confidential appendix (Appendix III). Table 1 is a high-

²⁷As of December 2007, the Payroll Division stated that it had not initiated reconciliations of the quarterly Federal payroll tax withholding reports to the general ledger.

level summary of the areas reviewed and the extent to which there was reasonable assurance of the controls' existence or exceptions found. In general, the HCM IT control environment was designed such that there was reasonable assurance that expected controls were in place. The exceptions that were found are considered control deficiencies.

Table 2: HCM IT General Control Summary

Control Objective Description	Number of Controls Reviewed	Number of Exceptions
ACCESS TO PROGRAMS AND DATA: Access controls should provide reasonable assurance that computer resources are protected against unauthorized modification, disclosure, loss, or impairment.		
Information security is managed to promote consistent implementation of security practices, and users are aware of HR's position with regard to information security as it pertains to VISION HCM reporting applications and data.	2	0
Physical access to IT computing resources, particularly those used to process and report on financial activity, is restricted by the implementation of appropriate identification, authentication and authorization procedures that reduce the risk of unauthorized and/or inappropriate access.	5	0
Logical access to IT computing resources, particularly those used to process and report on financial activity, is restricted by the implementation of appropriate identification, authentication and authorization procedures that reduce the risk of unauthorized and/or inappropriate access.	9	1
Procedures have been established that ensure user accounts are added, modified and deleted in a timely manner and which reduce the risk of unauthorized access and/or inappropriate use of the VISION HCM application and data.	3	0
Controls are in place to monitor the management and maintenance of access rights to HR's financial applications and data.	2	2
Appropriate segregation of duties within the VISION HCM application and system processes have been identified and have been put into operation.	2	0
Security violations including unauthorized access attempts to the VISION HCM system and application are monitored and reported.	2	0
PROGRAM CHANGES: A disciplined process for testing and approving modified programs prior to their implementation is essential to make sure programs operate as intended and that no unauthorized changes are introduced.		
Changes to the VISION HCM application have been authorized by an appropriate level of management prior to development and migration into production.	2	0
System software and configuration changes to the computer systems that run the VISION HCM application have been authorized by an appropriate level of management.	1	0
Changes to the VISION HCM application have been tested, validated, and the results approved prior to being moved into production.	3	0
Operating system software and configuration changes that affect HR's financial computer systems have been tested, validated, and the results approved prior to being moved into production.	4	0
The ability to migrate VISION HCM application changes into production is restricted to authorized staff.	2	0

Control Objective Description	Number of Controls Reviewed	Number of Exceptions
The ability to migrate system software and configuration changes that affect HR's financial computer systems is restricted to authorized staff.	1	0
Emergency changes made to the VISION HCM application, system and infrastructure configurations are appropriately managed and approved.	3	0
VISION HCM application documentation is maintained in a timely fashion and access to the documentation restricted to authorized staff.	2	0
COMPUTER OPERATIONS: Controls in this area address a wide variety of issues, such as controls over job processing, backup and recovery procedures, and problem management procedures.		
The VISION HCM application job runs including batch jobs, interface runs and system backups are accurate, complete, and timely.	4	0
Backup and recovery procedures have been implemented that permit databases, transactions, feeds and application programs are necessary for VISION HCM reporting to be recovered.	5	0
Periodic testing of the VISION HCM system and data file restoration process is conducted and the quality of backup media used to store HR's financial applications and data is monitored.	2	1
Back up media for systems and applications used by VISION HCM application is safeguarded, and only authorized staff have access to the backup media.	2	0
The VISION HCM application hardware, software, and media inventory is tracked and kept current.	2	2
Operations documentation is maintained and access restricted to authorized staff.	1	0
Incidents, problems and errors arising from the VISION HCM application are analyzed and underlying causes resolved.	2	0

DHR reported that it has already implemented some of the detailed recommendations that were provided. For example, DHR reported that it strengthened its password requirements and reduced the number of unsuccessful log in attempts that a user could make before being automatically locked out of the system. In addition, DHR agreed to implement the remaining detailed recommendations that were provided and expected to complete this work by June 30, 2008. For example, in some cases the DHR stated that it would draft policies or procedures.

Control Activities at the Department of Taxes

During our review of the Department of Taxes, we examined the control activities for revenues, accounts receivables and cash control activities. We found that the Department had many controls in place over these processes; however the analysis of the allowance for uncollectible accounts was incomplete and preparation of bank account reconciliations was not performed on a timely basis.

Revenue Control Activities

In FY2007, the Department of Taxes collected approximately \$1.3 billion in taxes from taxpayers. The major sources of these collections consisted of personal income, sales and use, meals and room and corporate income taxes. The Department uses a stand-alone system known as the Revenue Accounting System (RAS) to record cash receipts received by the department. The Department also records the summarized cash receipts into VISION daily. The cash receipts recorded in the RAS system are reconciled to the amounts deposited into the State's bank accounts and recorded in VISION.

Among the controls utilized by the Department were the (1) establishment of an "enter and verify" process which validates the accuracy of the cash receipts entered into RAS, (2) a review of the daily deposits posted to VISION and (3) a monthly reconciliation of the RAS tax receipts reports to VISION. These control activities were included in the scope of our review; however, they do not represent all of the control activities of this process. We found no deficiencies in the Department's revenue control activities that we reviewed.

Accounts Receivable Control Activities

At fiscal year end, the Department of Taxes reported taxes receivable of approximately \$223 million. At the end of each fiscal year the Department is responsible for reporting taxes receivable to the Department of Finance & Management. These balances are compiled and reviewed by the Department from information generated from the Department's collections and cash receipts systems.

We reviewed the design of the controls related to generating taxes receivable information. Among the controls utilized by the Department was a reconciliation of the summarized accounts receivable balances to underlying support control totals. In addition, the accounts receivable summary is reviewed by the Director of Statewide reporting for reasonableness.

Among the practices associated with properly accounting for receivables are realistic estimates of uncollectible accounts based on a documented estimation methodology.

The Department of Taxes in conjunction with a Tax Research and Statistics Analyst developed an allowance for uncollectible accounts by analyzing historical collection information. This analysis tracked the aging of the Department's accounts receivable balances over the course of 4 years from fiscal years 2004 through 2007. The Department utilized the percentages of remaining accounts receivable balances by aging category from year to year to project the accounts

receivable balance at June 30, 2007 that would be uncollectible. Based on this analysis the Department determined that approximately 36.5% of the total billed accounts receivable would not be collectible and should be recorded as the allowance for uncollectible accounts at June 30, 2007. However, the allowance for uncollectible accounts calculation at June 30, 2007 excluded a reserve for the estimated meals and rooms and sales and use tax balances billed that would not be subsequently realized²⁸ and will be written off. This resulted in an audit adjustment in the amount of \$15.7 million to increase the allowance for uncollectible accounts. We applaud the Department for seeking to refine its approach to estimating the allowance for uncollectible accounts and feel the Department has improved its allowance methodology from the prior year, but believe that a more multi-dimensional, integrated approach to the analysis will result in a reasonable estimate of the allowance at year end and would avoid material audit adjustments.

Cash Control Activities

The Department of Taxes is responsible for reconciling five bank accounts. These bank accounts are used to process manual and electronic tax payer receipts and disbursements. The department uses standard bank reconciliations which are prepared by an accountant and reviewed by the Director of Revenue Accounting and Returns Processing. All reconciliations are submitted to the Office of State Treasurer for final oversight.

We reviewed the design of the controls related to (1) preparation and review of the bank reconciliations, (2) segregation of duties over the cash accounts and (3) the authorization of certain cash transactions. Generally, we found the Department has many internal controls over its cash accounts. For example, the Department's preparation and review process is segregated and standard bank reconciliations are used to reconcile the Department cash accounts. In addition, the department has limited the type of transactions that can be processed using the bank's online banking system.²⁹

Notwithstanding the controls that were in place, we found that the bank statements for one of the bank accounts managed by the Department for February,

²⁸ The Department bills tax payers by estimating their tax liability which can create instances whereby tax payer liabilities are billed at amounts which are more than the actual tax liability collected. Significant estimates are made for non-filing meals & room and sales & use tax payers.

²⁹ Several Department employees responsible for the Department's cash accounts have access to the State's online banking system. The bank, under the direction of the Department and the office of the State Treasurer, has placed restrictions over the use of the online banking system.

March, April, May and June were not reconciled until the beginning of July 2007. The delay in reconciling the bank accounts was primarily the result of unreconciled automated clearinghouse payments. In order to maintain effective internal controls over the Department's cash accounts and report general ledger cash balances accurately and timely, the Department should reconcile and review all bank accounts on a timely basis.

Conclusions

The agency has implemented numerous internal controls related to its entity-level controls and control activities. Such controls improve the likelihood that the agency is positioned to achieve reliability in its financial operations. Nevertheless, there were a number of areas for potential improvements, such as:

- Performing timely employee performance evaluations.
- Establishing formal risk assessment and monitoring programs.
- Evaluating and monitoring the effectiveness of the Agency's specific internal controls.
- Seeking enhancements in the compilation of the State's CAFR and the statewide underlying accounting and financial reporting processes.
- Improving the controls over payroll processing.
- Continuing to refine the uncollectible accounts estimates for tax revenues.
- Implementing applicable IT controls.

These improvements would further enhance and improve the agency's internal controls and ensure the reliability of its financial reporting.

Recommendations

Agency Entity-Level Controls

We recommend that the Secretary of the Agency of Administration direct the Commissioners of its departments to:

- Track the completion of employee performance evaluations to ensure that they are accomplished in a timely manner.
- Develop and maintain a risk assessment process, which utilizes a uniform methodology and common set of criteria to identify potential areas of risk and considers both the likelihood and magnitude of potential unwanted events and occurrences that may affect the Agency and its departments.
- Implement internal control evaluation processes that are more comprehensive than the annual statewide internal control self-assessment and designed to consider controls and activities unique to the Agency's departments.

Buildings & General Services

We recommend that the Secretary of Administration direct the Department of Buildings and General Services to:

- Periodically review and assess the existing internal controls specifically related to invoice approvals. This could be coordinated with the Department's annual self-assessment of internal controls.
- Create formal documentation for the rental rate development process within the Property Management fund including process flows, a narrative supporting process documentation and procedural documentation. This documentation should be reviewed and updated on a regular basis.

Department of Finance and Management

We recommend that the Secretary of Administration direct the Department of Finance & Management to:

- Continue to assess the risks and impacts associated with the level of reliance placed on the Director of Financial Reporting to compile and prepare the State's CAFR.

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- Implement the IT general control recommendations related to the VISION application environment contained in the confidential appendix.
 - Establish written criteria for determining priority levels in the Footprints issues tracking system.

Department of Human Resources

We recommend that the Secretary of the Agency of Administration direct the Department of Human Resources to:

- Develop and document a formal process for reviewing personnel action requests. The use of checklists should be considered and the review documented. The Department should determine if additional review is needed by the initiating department personnel.
- Restrict access to payroll tables and electronic employee records to only those payroll personnel that need such access to perform their duties.
- Validate and budget check payroll prior to disbursing funds.
- Prohibit the practice of reporting time in advance. Require actual hours worked reported on time sheets.
- Reconcile the Federal payroll tax withholding reports to the general ledger quarterly.
- Develop a process to monitor and review Payroll's manual adjustments to employee pay amounts.
- As part of its evaluation of a new payroll system, F&M should ensure that the new system eliminate the duplicative data entry and reviews.
- Implement the IT general control recommendations related to the HCM application environment contained in the confidential appendix.

Department of Taxes

We recommend that the Secretary of Administration direct the Department of Taxes to:

- Continue to refine the process for estimating the allowance for uncollectible accounts by considering and integrating all pertinent information prepared

and available, including estimated tax balances from meals and rooms and sales and use taxes which will not be subsequently realized.

- Reconcile and review all bank accounts in a timely manner.

Management's Comments and Our Evaluation

The Agency's departments provided comments individually on the draft of this report (reprinted in Appendices IV, V, VI & VII). In general, the departments' comments address the actions that they plan to take in response to our findings on control activities. However, the departments did not fully agree with some of our comments. The following summarizes the departments' comments and our evaluation.

Agency of Administration

On September 3, 2008, the Office of the State Auditor received a verbal response from the Commissioner of Finance and Management in which he stated that the Agency of Administration was taking the entity-level control findings under advisement.

Department of Buildings & General Services

Invoice approvals for accounts payable. The Department responded by implementing a formal process to reinforce their policy of requiring the indication of approval on the actual claim invoices.

Insufficient documentation on the rental rate development for the Property Management Fund. The Department stated that the rental rate development process has been documented and is now included as a part of the Department's internal control manual.

Department of Finance & Management

Financial Reporting Control Activities. The Department disagreed with our comment and stated that the hiring of an Assistant Director of Financial Reporting mitigated the overall reliance on a single individual to compile the State's CAFR³⁰. Additionally, the Department believes that the current staff is well-

³⁰ Subsequent to the Agency's response, the Assistant Director of Financial Reporting resigned and the position is vacant.

trained and the level of review and oversight of the compilation process is sufficient. We believe the department needs to ensure an appropriate distribution of financial review and analysis and assess the critical areas of knowledge required in the compilation and timely completion of the CAFR.

Information Technology Control Activities. In its response to IT control activities, the Department explained the process it used to reach the decision to “go live” with the VISION upgrade. In addition, the Department discussed changes that it has made, or planned to make, regarding its organizational structure and project and issue resolution process.

Payroll Control Activities. Due to the management of the State’s payroll function being assumed by the Department of Finance and Management, the Department chose to respond to the payroll control activity findings. In its responses to payroll controls activities, the Department brought forth issues related to key staff vacancies and the realignment of the payroll function moving to the Department of Finance and Management from the Department of Human Resources. Additionally, it stated that payroll reconciliations are now current and documentation of payroll processes is under way. The Department also elaborated its plans for upgrading and expanding its PeopleSoft Human Capital Management system stating that all areas of concern will be addressed at the completion of that process.

Department of Human Resources

Personal Action Requests (PARs). The Department responded to our recommendation by citing the personal action request process, but did not specifically address what actions, if any, were to be taken to address our recommendations. We recognize that the Classification & Compensation division and individual departments are reviewing the PARs, but given the nature and volume of the requests, we feel a critical element to maintaining strong internal controls over this process would be to develop and document a formal process for reviewing PARs. Although the Department has stated that the recent addition of critical data to the turnaround reports can be considered a checklist, we believe the development of a formal checklist guiding the entire PAR review process would help to eliminate human error, be an effective training tool and strengthen the Department’s internal controls.

Department of Taxes

Allowance for Uncollectible Accounts. The Department reported that it further refined the process for estimating its allowance for uncollectible accounts to address our concern but noted that there will always be volatility in the estimate.

We agree that some degree of volatility is inherent to the allowance for doubtful accounts but feel this can be minimized by considering all pertinent information, including tax balances from meals and rooms and sales and use taxes which will not be subsequently realized.

Bank Account Reconciliations. The Department stated it reconciles and reviews all bank accounts in a timely manner.

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In accordance with 32 V.S.A. §163, we are also providing copies of this report to the Secretary of the Agency of Administration, Commissioner of the Department of Finance and Management, and the Department of Libraries. In addition, the report will be made available at no charge on the State Auditor's web site, <http://auditor.vermont.gov/>.

Appendix I: Scope and Methodology

Entity-Level Controls

As part of reviewing entity-level controls we used guidance developed by the U.S. Government Accountability Office to develop a set of questions that addressed the control environment, risk assessment, information and communication, and monitoring. We discussed these questions with various Departmental personnel and assessed the responses provided to us by the Agency's departments. To corroborate management's responses we reviewed and assessed applicable documentation such as annual budgets, key financial reports and internal control self-assessments.

BGS

As part of our assessment of control activities at the Department of Buildings and General Services, we reviewed three internal service funds managed by the Department.

1.) The resources available through the Property Management Fund are used to manage and maintain property owned by the state and leased property used by the State. The costs of managing and maintaining state-owned property is billed to other state agencies and departments. Property owned by the state may be rented to the private sector. 2.) The State Liability Fund is used to record the activity of providing financial coverage for general and employment practices liability, discrimination and auto liability risk for the State of Vermont. 3.) The Workers' Compensation Fund is used to record the activity of providing financial coverage for workers' compensation claims made against the State. The Workers' Compensation Fund covers all state employees. Our review included entity-level controls for each fund or for the divisions which manage these processes as well as the controls over BGS's centralized Administrative Services Division, which performs the accounting for these funds.

We reviewed and performed testing on claims processing and payments, reviewed the costing and allocation of premiums to participants, and reviewed the methodology for developing the State Liability and Workers' Compensation Fund's loss estimates. For the Property Management Fund, we reviewed the monthly rental billing to the departments, validated the associated rental revenues and performed testing on the accounts payable payments made to vendors and private property owners leasing space to the State of Vermont.

Appendix I: Scope and Methodology

F&M

Our work at the Department of Finance & Management included reviewing control activities relating to budgeting and financial reporting. For budgeting, we reviewed the design of the control activities related to compilation and approval of the State's preliminary budget, the reconciliation of the approved budget to VISION and the approval of excess receipts. For financial reporting, we reviewed the design of control activities related to F&M preparation and review of the CAFR.

As part of assessing the Department of Finance and Management's IT controls, we gained an understanding of general controls for the VISION IT environment. In particular, we assessed whether there were weaknesses in the design of controls in the areas of (1) access to programs and data, (2) application and system software changes, and (3) computer operations. To make this assessment, inquiries were made of applicable IT management and staff and applicable documentation obtained. We also reviewed the documentation associated with the VISION upgrade project. This included the planning documentation, such as the test plan and the cutover plan, as well as supporting documentation for the test results. In addition, we reviewed open and closed entries in the Footprint issues tracking system that were entered before and after the upgrade was implemented. We also discussed issues related to the upgrade with the co-project managers and testers.

DHR

Our work at the Department of Human Resources included review of payroll processes, the Medical Insurance Fund, an internal service fund managed by the Department, and DHR's IT controls. The Medical Insurance Fund is used to record activity related to health coverage for current state employees, retirees, legislators and other eligible groups. There are four separate plans within the fund and the State employs a third party administrator to provide administrative services such as claims payments. The State self-insures for health insurance and purchases stop-loss insurance to limit any potential large claims exposure.

As a part of reviewing the Department controls over payroll and the Medical Insurance Fund, we performed walkthroughs of functions with Department staff. The walkthroughs consisted generally of a review of the business processes and related control activities with Department staff and a corroboration of key control activities by observation, inspection or re-performance. For payroll, we reviewed the processes to enter, change and

Appendix I: Scope and Methodology

approve individuals' personal information such as pay rates, withholdings and benefits. In addition, we reviewed the processes utilized to review employee time sheets and expense reports and the processes used to generate payroll checks, approve check warrants and post payroll expense to the general ledger. For the Medical Insurance Fund, we reviewed and performed testing on claims processing and payments and reviewed the methodology for developing the loss estimates.

As part of assessing DHR's IT controls, we gained an understanding of general controls for the Human Capital Management IT environment. In particular, we assessed whether there were weaknesses in the design of controls in the areas of (1) access to programs and data, (2) application and system software changes, and (3) computer operations. To make this assessment, inquiries were made of applicable IT management and staff. In addition, documents, such as the security and change management policies and other applicable procedures and reports were reviewed.

DOT

Our work at the DOT included a review of DOT design of the controls activities related to the (1) taxes accounts receivable and revenue and (2) bank accounts maintained by the Department.

As a part of reviewing the Department controls, we performed walkthroughs of functions with Department staff. The walkthroughs consisted generally of a review of the business processes and related control activities with department staff and a corroboration of selected control activities by observation, inspection or reperformance. For taxes accounts receivable and revenue, we reviewed the design of control activities related to 1) the preparation and review of the accounts receivable schedule submitted to F&M, 2) the methodology for estimating the allowance for doubtful accounts and 3) the process for recording and reviewing tax receipts. For the bank accounts, we reviewed the design of controls related to 1) the preparation and review of the bank accounts 2) the segregation of duties and 3) the authorization of certain cash transactions.

Appendix II: IT General Controls—Department of Finance and Management

This appendix was provided solely to the Department of Finance and Management due to the potentially sensitive nature of the information.

Appendix III: IT General Controls—Department of Human Resources

This appendix was provided solely to the Department of Human Resources due to the potentially sensitive nature of the information.

Appendix IV: Response from the Department of Buildings and General Services, August 1, 2008



Department of Buildings and General Services
BGS Financial Operations Division
Office of Finance & Budget
6 Baldwin Street
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Agency of
Administration

Date: August 01, 2008
To: Gerry Myers, Commissioner
Tom Sandretto, Deputy Commissioner
From: Paul Rousseau CPA ^(u)
Chief Financial Officer
Subject: Response to the State Auditor Report on Internal Controls

The State Auditor issued his draft of the 2007 Report on Internal Controls in which BGS was cited for two items under the Control Environment section. Below is our official response.

Finding #1: Controls over invoice approval for accounts payable payments were not always adhered to.

Issue:

What is being referenced in this case is the way Workers Compensation claims payments are processed. A request for payment form from Workers Comp is faxed over with the invoices to be paid and any supporting documentation. Workers Comp uses the request form to code and allocate the payment request and is initialed or signed by the claims adjuster. They did not sign the actual invoice approving payment. It was our contention that the request for payment form was sufficient for the requisite approvals. The Auditor's office disagrees.

Action:

Since the issue was raised this past spring with the BGS accounting staff, we have instituted a more formal procedure whereby the invoice must be stamped "Approved" and signed/dated by the claims adjuster requesting payment before payment will be made. BGS Finance will no longer accept a signed or initialed request for payment coversheet as evidence of approval.

Finding #2: There was insufficient documentation on the rental rate development process and procedure for the Property Management Fund.

Response to the State Auditor

Appendix IV: Response from the Department of Buildings and General Services, August 1, 2008

August 1, 2008
Page 2.

Issue:

The issue here is that no written policy and procedure existed to document how BGS Finance develops the annual billing for the three PM-Treasurer buildings in the Property Management program. The three buildings (Asa Bloomer in Rutland, 108 Cherry Street in Burlington, and 20 Houghton Street in St. Albans) have a unique rate which is developed differently from the way the rates for Fee for Space is calculated. In this case, the cost of each building, including debt service, is determined annually and billed 100% to the occupants. The expectation is that 100% of the cost of the building will be recovered in any given year. This process was not documented, which is the Auditor's issue in this case.

Action:

The process has now been documented by Jason Pinard, BGS Financial Manager II and has been placed in each staff members Internal Control Manual.

Appendix V: Response by the Department of Finance & Management, June 25, 2008



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Department of Finance & Management
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Agency of Administration

MEMORANDUM

TO: Thomas M. Salmon, Auditor of Accounts
CC: Jim Reardon, Commissioner
FROM: Susan A. Zeller, Deputy Commissioner
RE: FY 2007 Internal Control Response
DATE: June 25, 2008

Attached please find the Department of Finance & Management's response to the findings concerning this department contained in the FY 2007 Agency of Administration Report on Internal Controls.

Should you require additional information, please do not hesitate to contact me.



Appendix V: Response by the Department of Finance & Management, June 25, 2008

FY 2007 Agency of Administration Internal Controls Review Finance & Management Comments

Control Activities at the Department Finance & Management

Financial Reporting Control Activities

Management Comments:

Our response to the concerns in this area is the same as it was to Finding 2007-6 of the FY 2007 Statewide Internal Control Audit. While over reliance on the Director of Statewide Reporting was the case in the past; we disagree with the current comments. A fully competent Assistant Director was hired, who is an experienced government CPA. Also, the staff is now very well trained. In fact, for the preparation of the 2007 Financial Statements, the Director provided primarily oversight, review and approval of staff work. It was the staff that performed almost all of the necessary analysis, reconciliation and adjusting entries this past year. The Statewide Reporting group has used a Microsoft Access database to track assignments and reviewer sign-off of the major components of the CAFR for the past four years.

Information Technology Control Activities

Management Comments:

In addition to the detailed responses from our Manager of IT that is shown in the far right hand column of the IT Control Appendix we have additional comments relating to the PeopleSoft 8.8 technical upgrade and issue tracking:

CUTOVER DECISION: While the cutover decision may not have been documented to the extent the auditors would have liked, the go-live decision was properly discussed and authorized by and through the daily involvement of the Deputy Commissioner of Finance & Management. We encountered numerous issues and delays with the implementation vendor which necessitated calling a 6 month hiatus in order to close year-end, prepare the CARF and conclude the audits. The original upgrade timeline was to be April 2005 to late November 2006. A late start pushed the start back 2 months. Then, after the vendor failed completely on the commitment control aspects of the first pass we were "up against it" by the end of April 2006. A hiatus was negotiated starting May of 2006. During hiatus we requested different team members from the implementation vendor; the project, with new team members resumed in October 2006, with go-live scheduled for Town Meeting weekend in March 2007. By April 2007 we were again looking at the very real possibility of running into year-end again without go-live. Many meetings later, we had assembled a list of all outstanding issues and categorized them as to their criticality. The project team worked closely with the vendor and Oracle and in fact delayed go-live twice more. In the final analysis, we determined that we had 20 top "critical" issues; the lesser issues would be addressed over time. After resolving or developing viable "work arounds" for the 20 top critical issues, go-live could proceed.

Appendix V: Response by the Department of Finance & Management, June 25, 2008

FY 2007 Agency of Administration Internal Controls Review Finance & Management Comments

What we could not afford to do was experience another 6-month hiatus. The go-live decision was properly made and necessitated by the business demands. Further, we negotiated a contract price reduction with the vendor for poor performance and cancelled the second part of the contract with that vendor because we did not have confidence in the vendor's ability or in our ability to self-manage another major project.

PROJECT AND FUNCTIONAL MANAGEMENT: Our experiences with self-managing the 8.8 upgrade and the conflicting priorities experienced by our key staff members during the upgrade taught us a great deal. It was apparent that we could not effectively self-manage projects and that an organizational restructure of our department was necessary. We needed to develop a dedicated unit of people who would "own" the system functionally. Our original organizational structure resulted in the same key accounting staff members ("super users") also being the "functional system experts".

As a result, we have since acquired via a Memorandum of Understanding, a full time Project Manager from the Department of Information and Innovation who is managing the current PeopleSoft Enterprise Expansion Project (PET) using established Project Management protocols and methodologies. Further, we proposed a new organizational structure; creating a "configuration group" which is similar to Oracle's recommended "ERP Competency Centers". Staffing this group is currently in the planning stage with a goal of having this group in place prior to the beginning of implementation.

DOCUMENTATION – ISSUES AND PROJECT: We have made progress in the areas of project and issue documentation. In concert with DII, F&M installed a new version of Footprints for our Help Desk, which has expanded capabilities for issue tracking and prioritization. Priorities are set by consensus between the division managers and reviewed with the Department's Commissioner and Deputy Commissioner in the weekly staff meeting.

We have also established a SharePoint site for the PET project. Core Team members and Key Sponsors have password protected access with varying levels of functionality and approval authority. The site contains all project documentation including Project Charter, Communication Plan, Agendas, Meeting Minutes, Decision Logs, Risk Assessment, RFPs, Contracts and other project documentation.

Payroll Control Activities

Management Comments:

While the Payroll software is part of the Department of Human Resources Oracle/PeopleSoft Human Capital Management System, the Payroll Division was transferred to the Department of Finance & Management on July 1, 2007 in accordance with Act 7 of the 2007 legislative session. Payroll was essentially without an experienced Payroll Manager for about 18 months prior to the transfer; the result was a

Appendix V: Response by the Department of Finance & Management, June 25, 2008

FY 2007 Agency of Administration Internal Controls Review Finance & Management Comments

backlog of reconciliations for VISION to payroll, agency funds and quarterly taxes. Finally in April 2007, a very experienced payroll manager was hired. Reconciliations are now current and a new 941 system generated report has been developed to aid in the reconciliation process. Several business processes have been changed improving internal controls, and documentation of the payroll process is well underway. We are almost complete with cross-training the payroll staff.

As part of the PET project, we have already contracted for and received the deliverable for the Business Needs Assessment and the Paradox Risk Assessment. We are currently at the contracting stage of the RFP process for creating the Project Business Logic Documentation and for overall Program Management Services for Phase 1. We are now beginning the development of the RFP for Phase 1 Implementation, which includes: the upgrade of HCM to version 9.X; the removal of all (or as close to all as we can get) customizations in the HCM and payroll software; synchronizing the HCM chart of accounts with VISION, full roll-out of employee self-serve functionality, the implementation of new modules and new functionality (Time & Labor, Benefits Admin, Absence Management). Almost every area of concern referenced in the Agency Internal Control Review will be resolved with the PeopleSoft upgrade and expansion, and the elimination of Paradox. The upgrade and new modules will: change table structure; database architecture; screen shots; and allow for stricter security tree(s); on-line edit capabilities; auditable payroll adjustments; and real-time time-sheet and expense submission eliminating the need for timesheet reporting in advance of hours worked and dual entry of expenses.

Because Payroll is not integrated with VISION and uses a different "chart of accounts" than VISION, payroll is not recorded directly into VISION. The processed Payroll must first go through a general ledger crosswalk and then runs through a custom interface into VISION. Once again, the PET project will enable processed payroll to be budget checked and recorded directly into VISION without the interface processing delay currently required. In the meanwhile, we are investigating ways to accelerate the process allowing Payroll to be budget checked at least overnight the night before pay day.

Appendix VI: Response by the Department of Human Resources, August 20, 2008



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Agency of Administration

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MEMORANDUM

To: Thomas Salmon, Auditor
From: David K. Herlihy, Commissioner 
Date: August 20, 2008
Subject: Department of Human Resources Response to Internal Control Report Draft Findings

This Department's response to the draft findings of your office regarding internal controls is attached. Please do not hesitate to contact me if there are questions about any of these matters.



Appendix VI: Response by the Department of Human Resources, August 20, 2008

DEPARTMENT OF HUMAN RESOURCES RESPONSES TO STATE AUDITOR INTERNAL CONTROLS DRAFT FINDINGS

State Auditor's Office IT General Controls in Support of 2007 Financials Statement Audit- AoA- VISION-HCM

The TSD division reports that each of the recommendations have been adopted. (1 C 2, 1 E1 &2, IV C 1, IV E 1&2)

Draft Report of the Vermont State Auditor, Internal Controls, Results of Review at the Agency of Administration – Rpt. No. 08-10

Draft Finding: Page 19: Vulnerable Employee Records and Payroll Tables- At least fifteen individuals from the Payroll, C&C and IT Divisions can change employee record information., such as pay rates, in the HCM system. Many of these employees are not responsible for making changes to employee records but nevertheless have access to them. In addition, the Payroll Division maintains a large number of payroll tables within HCM that contain information related to earnings, taxes and deductions. There were eight Payroll Division employees who can access and edit these tables. Audit reports are not generated after table maintenance is performed a dual authorization is not required for changes to the tables to become effective. Failing to restrict access to the employee records and payroll tables or to have a review of changes increases the likelihood they will be inadvertently or inappropriately accessed, causing losses to the State.

Draft Recommendation: Restrict access to payroll tables and electronic employee records to only those payroll personnel that need such access to perform their duties.

Response: The ability to change employee record information/job data (i.e. individual pay rate, vacation accrual rate, step dates, etc.) is now limited to eight employees within the Department of Human Resources. Six employees within the Classification & Compensation Division and two PeopleSoft administrators (i.e. "super users") within the IT department can now change job data at the employee level.

The ability to access and edit payroll set up tables is now limited to seven Payroll division employees and the two PeopleSoft administrators from IT. The Payroll division is responsible for maintaining these tables and updating as appropriate. These tables focus at a much higher level than the employee record/job data tables described above and do not affect individual employee records. Two examples of what information these tables affect are the creation of a new earnings code, a new or a change to an existing deduction. Specific employee changes (i.e. pay rate) cannot be changed in these tables.

Appendix VI: Response by the Department of Human Resources, August 20, 2008

We do not view the above actions that limit the number of individuals who have access to the records or tables to be a complete solution to the identified vulnerabilities. In addition, we are considering additional suggestions found in the audit findings that, in conjunction with limiting the number of individuals with access, would further enhance the integrity of the system. We are in strong agreement with the recommendations in the report for dual authorization requirements and an audit trail report in order to be able to track any changes made to these tables. Enhancement of audit trail reporting is the first priority, and we are studying how best to add to our ability to get reports for all the change actions identified. Dual authorization is also a highly desired feature, but is not considered a short term priority because it will be obtained when we complete the process to upgrade the HCM system. That process is already underway and will include work flow control features that will give us the ability to impose dual approval requirements, without making a substantial investment in making changes to the current version that is to be replaced. We are also considering additional use of different payroll employee access levels to further limit access to only those employees who have been trained and authorized to have the ability to access and edit these critical tables.

Draft Finding: Page 19: Review of Personnel Action Requests (PAR): The State's individual department's Personnel Officers are responsible for initiating changes to employee's employment status, including actions to hire, terminate, promote, or change pay rates. 25 For most State employees, these changes are initiated electronically in the HCM system by the Personnel Officers and generally take effect the following day unless the Classification and Compensation Division (C&C Division) intervene. Two employees in the C&C Division are responsible for reviewing a high volume of PAR (approx. 100 per week) generated on the daily Turnaround Report. 26 The C&C Division reviews the PAR primarily for reasonableness and consistency but may not be able to determine the appropriateness of the request. In addition, the C&C Division does not have any documented criteria to assist with review to ensure a consistent thorough review. Given the volume of personnel action requests processes coupled with the absence of a formal review process, may increase the risk that an error will not be detected.

Recommendation: Page 22: Develop and document a formal process for reviewing PARs. The use of checklists should be considered and the review documented. The department should determine if additional review is needed by the initiating department personnel.

HRIS response is as follows:

The following is the formal review process used by the C&C Division.

The Classification, Compensation and HRIS Division (C & C Division) of the Department of Human Resources verifies, enters, and reviews Personnel Action Request Forms (PARs) and reports generated when records are entered into an employee's Job Data (turnaround reports). Excluding system-generated step progression reports, the C&C Division receives an average of 97 reports per day (not 100 per week as stated in the above

Appendix VI: Response by the Department of Human Resources, August 20, 2008

draft finding) over the seven business days that define the HCM record entry deadline cycle. The number remains relatively low until the end of what is referred to as the deadline period – at which time the reports increase to sometimes hundreds in a day. These reports are generated by the addition of or correction to a record in an employee's Job Data in HCM by the entering party. C&C Division personnel review all turnaround reports including changes in bargaining codes, effective dates, next step dates, and overtime categories, for compliance with state policy and procedures. The criteria they use are provisions in the labor contract, published policies and procedures, state statute, work rules and other written sources. Also, the C & C Division reviews and enters records for any agency or department when the effective date predates the top record (inserted record) in addition to entering records for several centralized agencies and departments after verifying the signature appearing on the form or that the email account is an individual designated to make such requests.

The Department of Human Resources devoted months of review & testing to update the data located on the turnaround reports. From December 2006 to March 2007, HRIS & Technical Services staff members worked to ensure critical data was included on the reports. The updated reports provide a formalized framework to ensure a thorough audit can occur with each record entered.

Those updated turnaround reports were moved from the test database to production Friday, March 16, 2007. The addition of critical data on these reports resulted in what can and should be considered a checklist. Each piece of data and/or combinations of data (e.g., bargaining unit and management level) are reviewed for compliance with statute, bargaining agreements, policies and procedures & work rules associated with all aspects of human resource management.

During review of the turnaround reports, and based on the above stated references, data in the specific employee's Job Data is either corrected, the record is rejected (removed from the system), or the report passes quality assurance and the record is allowed to remain in the system for processing. When corrections to data occur, specific comments pertaining to the correction, the date the of correction, and the initials of the staff member making the correction are added to the turnaround report. The report with notations is then used to verify both the receipt of an updated turnaround report and that the expected change to data in the employee's record occurred. Both the noted correction and the receipt of the new report are initialed by the HRIS staff member conducting the review.

The updated turnaround reports are located on the DHR Intranet in a restricted-content location by department. The reports are updated each business day, at which time the previous reports move to an archive folder. The purpose of the intranet posting is for review by the originating department personnel. They are trained on how to locate and use these reports, as DHR communicates the fact that it is the originating personnel's responsibility to review the turnaround reports (as the final check), in addition to printing and filing the reports.

Appendix VII: Response by the Department Taxes, July 21, 2008



State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration



July 21, 2008

Thomas M. Salmon
Vermont State Auditor
132 State Street
Montpelier, VT 05633-5101

Dear Tom:

I am writing on behalf of Tax to respond to your draft report on Internal Controls within the Agency of Administration.

Two recommendations on Tax were made in your report.

Recommendation 1: That the Department continue to refine the process for estimating the allowance for uncollectible accounts by considering and integrating all pertinent information prepared and available, including tax balances from meals and rooms and sales and use taxes which will subsequently not be realized.

Response: The Department has further refined the process for estimating the allowance for uncollectible accounts to address your concern. The Department wishes to note that there is always going to be volatility in the projection of this value given the range of activities in this area. However, over time, as our data history becomes more seasoned, we expect the margin of error to decrease.

Recommendation 2: Reconcile and review all bank accounts in a timely manner.

Response: The Department reconciles and reviews all bank accounts in a timely manner.

Sincerely,


Tom Pelham
Commissioner

cc: Jim Reardon, Commissioner
Department of Finance
Sue Zeller, Deputy Commissioner
Department of Finance

