State Auditor's Annual Report

Report on Compliance and Internal Control
Over Financial Reporting
&
State of Vermont Management Letter for the Fiscal Year
Ended June 30, 2002

Elizabeth M. Ready
Vermont State Auditor

Issue Date: November 21, 2003

Mission Statement

The mission of the State Auditor's Office is to be a catalyst for good government by promoting reliable and accurate financial reporting as well as promoting economy, efficiency and effectiveness in State government.

COVER IMAGE:

Detail of *View of Montpelier,* painted in 1891 by James Franklin Gilman (oil on canvas). This is one of the few images that shows the statehouse with its red dome and roof, which it had from the day it was constructed in 1859 until 1907 when it received the first gilding.

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Over Financial Reporting &
State of Vermont Management Letter

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ELIZABETH M. READY
STATE AUDITOR

STATE OF VERMONT

OFFICE OF THE STATE AUDITOR
132 STATE STREET
MONTPELIER, VT 05633-5101

State Auditor's Annual Report

Speaker of the House of Representatives, Walter E. Freed
President Pro-Tempore of the Senate, Peter F. Welch
Governor James H. Douglas

Gentlemen:

The Vermont General Assembly and the Dean Administration met Vermont's budget and revenue challenges for Fiscal Year 2002 with the same prudent fiscal policies that guided the State for the past decade, once again resulting in a balanced budget, well-fortified rainy day funds, and the highest bond rating of all New England states. This same financial stewardship continued in FY 2003 under the leadership of both the Dean Administration and the newly-elected Governor James H. Douglas.

In FY 2002, red ink was widespread and the fiscal problems of other states were severe, according to the National Conference of State Legislatures (NCSL). By June 30, 2002 there were 46 states reporting combined budget gaps of $37.2 billion. Since July 2001, Moody's has lowered the bond ratings of nine states and placed 13 others on a negative watch. Standard & Poor's lowered the bond rating of five states and put 11 others on a negative outlook – mainly due to long-term budget problems and growing deficits.

In FY 2003, the flow of red ink continued in other states with at least 33 states reporting a widening, combined budget gap of $50 billion, according to NCSL. By comparison, Vermont ended FY 2003 with a $10.7 million surplus, and increased stabilization reserves from $12.6 million in FY 2002 to $23.9 million in FY 2003. Again, Vermont largely averted major, painful budget recisions seen in other parts of the country thanks to the ongoing stewardship provided by the General Assembly, the Dean Administration, and the Douglas Administration.

In order to better track and report Vermont's trend of fiscal prudence to the financial markets and the general public, the State of Vermont, in FY 2000, made long overdue and substantial investments in information technology (I.T.) resources and staffing to bring State government's financial reporting systems into the 21st Century. This was an important first step that now must be followed up with strong oversight and management to ensure that this endeavor succeeds.

Improvements resulting from information management investments are slowly becoming evident in State government, although not without growing pains resulting from adopting a new enterprise-wide accounting system and new accounting standards - all in the same year.

This transition period has resulted in a number of material weaknesses and reportable conditions identified in Vermont's system of internal controls, first reported in FY 2001, that continued in FY 2002. These material weaknesses and reportable conditions include:

- *Poor controls over financial reporting;*
- *Problems with the timely reconciliation of accounts at the Treasurer's Office; and,*
- *A lack of adequate oversight, management, and security protocols for the State's I.T. resources.*

The Department of Finance and Management continued to experience numerous challenges, including staff training, in its attempt to implement the State's new VISION financial management and information system that went live on July 1, 2001. And, the State did not fully comply with GASB Statement No. 34 reporting requirements for FY 2002.

In addition, the Department of Finance and Management was not able to produce completed financial statements for audit until October 2003 despite a significant planning effort that began in June 2002. Therefore, the State of Vermont did not meet the March 31, 2003 State and Federal reporting deadline for completing its Comprehensive Annual Financial Report. In order to meet the deadline, completed financial statements should have been produced by December 31, 2002.

The failure of the Department of Finance and Management to produce timely financial statements for audit creates significant risks and tangible problems that affect the State's ability to offer its bonds in the public market on schedule, to refinance debt at favorable rates, and, in some cases, to receive Federal funds in a timely manner.

It is important to note that there appears to be real progress in addressing these weaknesses by both the Office of the State Treasurer and the Department of Finance and Management. These improvements will likely be reflected in this report for FY 2003.

Report on Compliance and Internal Control Overview

Our Office's *Report on Compliance and Internal Control Over Financial Reporting,* co-signed with KPMG, is related to our audit of the State's Basic Financial Statements for the fiscal year ending June 30, 2002, and follows this letter.

Management Letter Overview

The *Management Letter* is a result of our audit of the State's FY 2002 Basic Financial Statements and the federally required Single Audit of Federal Funds. This report is responsive to various duties of the State Auditor outlined in 32 V.S.A. § 163(1) and (7). The purpose of the *Management Letter* and the *Report on Compliance and Internal Control Over Financial Reporting* is to indicate specific ways for State managers to improve financial operations, reporting, and the efficient management of the State's resources.

During our audit of the State's Basic Financial Statements for FY 2002 we found a number of areas of financial management that could benefit from improved controls and greater accountability. *Management Letter* comments in these areas include the following:

- The Department of Finance and Management has not dedicated adequate resources to its Financial Reporting Division, which is responsible for the timely and accurate production of financial statements for the State of Vermont. During the audit period a number of instances of misstatements were noted by our Office, some of which were material to the fund financials and not identified and corrected before the statements were submitted for audit. This lack of review of the financial statements contributed significantly to the delay in the production of the statements for audit.

- The Department of Finance and Management did not exercise adequate oversight and control over the accounting and reporting of imprest/petty cash accounts totaling more than $900,000 for FY 2002 that were maintained by State departments and agencies. While the Department requested information regarding the imprest/petty cash accounts as part of the FY 2002 closing instructions, no follow-up was conducted on those departments/agencies that did not adhere to the reporting requirements, or on those departments that reported variances in the account balances. We also have *Management Letter* comments for each State department/agency that did not comply with the reporting requirements for imprest/petty cash accounts.

- The Office of the State Treasurer did not exercise adequate oversight of bank accounts that were maintained by State departments/agencies during FY 2002. During our test work we noted that the Treasurer's Office: could not produce documentation of a master list of all bank accounts that had been approved by the State Treasurer; did not conduct adequate follow-up to request required bank account information from State departments that did not comply with the reporting requirements; did not reconcile variances between information reported by the bank and by the departments; and could not provide documentation regarding its approval of reconciliation procedures, as required by law, for any of the bank accounts that are maintained by State agencies/departments. We also have *Management Letter* comments for each State department/agency that did not comply with the reporting requirements for bank accounts.

Management Letter comments resulting from our Federal Single Audit for FY 2002 identified several areas where internal controls related to subrecipient monitoring and the oversight and review of accounting practices need to be strengthened and improved. These areas include the need for: increased monitoring over the receipt, review and follow-up of subrecipient audit reports at the Office of Economic Opportunity; increased scrutiny of subrecipient expenditures at the Agency of Transportation to ensure they are allowable and in compliance with Federal regulations; and more timely reconciliations of bank accounts at the Agency of Natural Resources.

During our review of the internal controls over cash at the Courts for FY 2002 we noted similar issues at a number of county courts that resulted in *Management Letter* comments. These issues include: the lack of timely reconciliation and reporting of bank accounts and imprest/petty cash accounts; a 20 percent statewide increase over FY 2001 in the amount of total Fines and Fees Due to the State at all District and Family Courts; and, the need for an updated instructional accounting manual for the Courts' accounting staff.

Controls Over Information Technology Assets

A number of the reportable conditions and comments outlined in the *Report on Compliance and Internal Control Over Financial Reporting* and the *Management Letter* would benefit from improvements in the oversight and management of I.T. systems that support the fundamental and essential operations of State government. Problems with poor controls over financial reporting, the timely reconciliation of accounts and production of financial statements for audit, the lack of oversight, management, and security protocols for I.T. resources, numerous training and performance issues associated with the VISION accounting system, and the failure to fully comply with GASB 34 have their roots in poor functionality and oversight of the State's I.T. assets.

This Office has issued several special reports focusing on different components of the State's I.T. systems. Each of these reports includes recommendations, which if implemented, would lead to improved systems and efficiencies. These reports are available on the Office's website at **www.state.vt.us/sao** and include:

- *Turning VISION Into Action: A Follow-Up Review and Assessment of the Department of Finance and Management's Implementation of Project VISION*;

- *The Road Beyond Risk: Recommendations to Safeguard the Security of Vermont's Financial and Human Resources Information Systems*;

- *Securing the Enterprise: A High-Level Assessment of Vermont's Information Technology and Data Recovery Policies*;

- *Wiring Vermont's Future: Stronger Oversight & Project Management Needed to Develop and Protect Vermont's Information Technology Investments*; and,

- *A Review of the Department of Finance and Management's Implementation of Project VISION.*

The Office of the State Treasurer, the Department of Finance and Management, and other Departments and Agencies, have responded positively to the recommendations contained in these reports and have enacted changes as a result.

I am hopeful that the challenges encountered in producing the FY 2002 Basic Financial Statements will lead to greater emphasis being placed on VISION and financial management training across State government. This will enable the State to prepare complete financial statements, with all necessary back-up information as needed, in order to have audited financial statements by December 31 as outlined in 32 V.S.A. § 182(a)(8). In 1998 the General Assembly extended this date to March 31 until such time that the Commissioner of Finance and Management could utilize data generated by VISION to prepare financial reports. Returning to the December 31 deadline for producing audited financial statements will allow us to meet State and Federal audit deadlines, and will augment the usefulness of our report to managers in the overall effort to improve the effectiveness of the State's financial operations.

In summary, Vermont's budget remains balanced and its financial situation remains solid even amidst dramatic financial problems in other states. The State of Vermont is in an excellent position to meet future challenges.

FY 2002 brought with it all the challenges of a new accounting system, new accounting principles, and followed by significant changes in top executive positions. In spite of growing pains, there are signs that Vermont has recommitted itself to an environment of strong management and internal controls. Still, the reportable conditions and material weaknesses outlined in this report must be fully addressed. Additionally, I.T. resources must be made fully functional through training and proper testing, and new required accounting standards must be fully implemented as part of Vermont's plan to maintain and improve its already strong fiscal standing.

In closing, I wish to thank the Commissioner of Finance and Management and his staff, the State Treasurer and his staff and all of the staff here at the State Auditor's Office for their collective and cooperative efforts. Our Office will follow up on Department progress in implementing these recommendations as we work to complete the FY 2003 audit, with the hope of seeing substantial improvements as the year unfolds.

Sincerely,

Elizabeth M. Ready

State Auditor

November 21, 2003

State of Vermont
Office of the State Auditor
132 State Street
Montpelier, VT 05633-5101

KPMG
PO Box 164
Burlington, VT 05402

Report on Compliance and Internal Control Over Financial Reporting Based on An Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Speaker, House of Representatives, Walter Freed
President Pro-Tem of the Senate, Peter Welch
Governor James H. Douglas

Gentlemen:

The State Auditor has audited the basic financial statements of the State of Vermont, as of June 30, 2002 and for the year then ended, and issued a report thereon dated November 21, 2003. Our report refers to the adoption of Statement Nos. 34, 35, 37 and 38 and Interpretation No. 6 of the Governmental Accounting Standards Board. The State Auditor conducted the audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The State Auditor did not audit the financial statements of certain entities included in the reporting entity of the State of Vermont. Those financial statements were audited by other auditors who issued separate reports on compliance and internal control over financial reporting in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards.* The financial statements of the Special Environmental Revolving Fund (blended into the Federal Revenue Fund), the Vermont State Infrastructure Bank (blended into the Transportation Fund), and the Vermont Sustainable Jobs Fund (a discretely presented component unit), were not audited in accordance with *Government Auditing Standards* and accordingly this report does not extend to those funds.

Compliance

As part of obtaining reasonable assurance about whether the State of Vermont's basic financial statements referred to above are free of material misstatement, the State Auditor and KPMG LLP performed tests of the State's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of the audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

Internal Control Over Financial Reporting

In planning and performing the audit, the State Auditor and KPMG LLP considered the State of Vermont's internal control over financial reporting in order to determine auditing procedures for the purpose of expressing the opinion on the basic financial statements referred to above and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Vermont's ability to record, process, summarize and report financial data consistent with the assertions of management in the basic financial statements. The reportable conditions noted are described below:

(1) *The Department of Finance and Management's controls over financial reporting are not sufficient to provide for the timely and accurate production of the State's financial statements. The Department did not produce complete financial statements to be audited for the year ending June 30, 2002 until October 2003. This was despite a significant planning effort on the part of the Department and the Auditor's Office that began in June 2002.*

With the implementation of the new VISION financial management system, the timeliness of the month-end closings was considerably later than expected, resulting in a severe delay in the annual closing of the books. This has resulted in a severe delay in the production of the State's annual financial reports and required audit. The following issues contributed to the delay in completing the financial reports:

- *The final audited financial statement for the last component unit was not received until May 2003. Most component unit statements were received in the fall of 2002;*

- *Additions and deletions to the State's inventory of capital assets were not compiled until July 2003;*

- *General ledgers associated with all business units for the State were not fully closed for FY 2002 until February 2003;*

- *Compilation and reconciliation of the Schedule of Expenditures of Federal Awards for FY 2002 was not fully completed until November 2003;*

- *The restating of the June 30, 2001 financial statements to comply with GASB Statement No. 34 was not completed until December 31, 2002;*

- *The final reconciliation of the FMIS balance sheet ending amounts to the beginning VISION balance sheet amounts was not completed until December 2002; and,*

- *A substantial amount of data needed to prepare the State's financial statements is still compiled manually, as reported in prior years' management letters. Most notably, the compilation of accounts receivable and the Schedule of Expenditures of Federal Awards is a long manual process subject to errors.*

The State of Vermont did not meet the March 31, 2003 State and Federal reporting deadline for submitting its Comprehensive Annual Financial Report or Federal Single Audit Report for the fiscal year ending June 30, 2002.

***(2)** During Fiscal Year 2002 the Treasurer's Office continued to experience delays in completing monthly and year-end reconciliations of the State's cash accounts. The lack of complete and timely bank reconciliations continued to be a challenge to the Treasurer's Office for FY 2002 and exposed the State to risk that intentional or unintentional errors could occur and not be detected by the Treasurer's Office. The fraudulent cashing of $5,600 in checks against the vendor account and the $2.88 million overstatement of general funds due to a duplicate entry made during FY 2002 are examples of the risks associated with not conducting timely reconciliations.*

In February 2002 the State contracted with outside accountants to assist with the backlog of monthly reconciliations for FY 2002, however the procedures did not include making necessary adjustments for all reconciling items to fully complete the reconciliation process. The accounts listed below show the annual transactions for FY 2002 and the outstanding unidentified items as of June 30, 2002:

Account	**Annual Transactions**	**Amount of Unidentified Items**
Child Support – EFT	$2,326,538	$1,384,616
Federal Funds	$986,019,425	$2,948,038
Depository	$1,427,793,085	$6,740,294

As of March 2003, nine months after the close of the fiscal year, the outstanding reconciling items had not been identified, necessary adjusting entries had not been recorded and the accounts had not been fully reconciled. The lack of timely reconciliations is a significant control weakness that was noted in prior years' management letters and continued to go uncorrected in FY 2002.

***(3)** The State of Vermont's financial statements have never included a general fixed asset account group as required by generally accepted accounting principles. The effect of the omission of the general fixed asset account group was an annual auditor's opinion qualification on the fixed asset portion of the financial statements. For FY 2002, Government Accounting Standards Board Statement No. 34 requires the State to present fixed assets, including infrastructure assets, in the governmental activities column of the government-wide statements.*

For FY 2002 we found that the State of Vermont did not have adequate controls in place to properly classify and ensure accountability over the State's assets in accordance with generally accepted accounting principles, accordingly the State was unable to produce fixed asset records for audit. As part of our audit we reviewed the internal control over fixed assets and tested the *completeness and accuracy of the fixed assets listing through a sample of the construction in progress at the Department of Buildings and General Services. We found that seven of the ten items selected for testing in our initial sample were improperly classified and included items that did not meet the definition of an asset or of construction in progress. Following the reporting of our results of our initial test work the totals for construction in progress decreased by $8.1 million, or by 33 percent. Of the $8.1 million decrease, 77 percent was expensed and the remaining 23 percent was classified as fixed assets. Upon further review we determined that adequate documentation to support the fixed asset and construction in progress on the financial statements was not available for audit.*

For FY 2002 we have issued a qualified opinion on the governmental activities column of the entity-wide statements due to the lack of a detailed accounting record of general fixed assets and construction in progress at the Department of Buildings and General Services.

***(4)** The Agency of Transportation uses an internal accounting system, STARS, to track and monitor expenditures on a project basis. The expense information is interfaced with the State of Vermont's centralized accounting system, VISION, on a daily basis. During FY 2002 the STARS system was not reconciled to the VISION system to ensure that the data interface was working properly and that revenues and expenditures were properly and accurately recorded. The FY 2002 reconciliation of the STARS to VISION system was not completed until October 2003, nearly 16 months following the close of FY 2002. This significant delay in reconciling STARS to VISION contributed to the delay in the timely and accurate production of the State's financial statements for FY 2002.*

***(5)** During our audit of the Vermont Economic Advancement Tax Incentives Program we determined that the Department of Taxes did not have an adequate system of internal control and procedures in place to fully verify the credits being claimed on tax returns. As of December 2002, 94 businesses and 19 municipalities had active authorizations for $80,162,048 in tax credits, with $8,727,876 of tax credits having been applied against tax liabilities. The tax credits claimed are allowed by the Department of Taxes at the time the returns are filed and follow-up, if any, is done at a later date. The lack of review undermines the performance-based principle of the program and represents a material risk and potential cost of millions of dollars to the State.*

The tax credits, which are authorized by the Vermont Economic Progress Council, require certain economic goals be met in order for the credit to be taken. These goals may include such measures as creation of new jobs, plant expansion, or investments in machinery and equipment. The ability of the Department of Taxes to verify data relative to these goals and validate the data to support attaining the goals is limited. Tax credits are being taken on returns based on the authorized amounts without any validation of the required performance and corresponding economic data.

(6) *The Department of Finance and Management continues to present its budgetary results on a cash received and modified cash paid basis. (In addition to cash paid, the State accrues certain expenditures on a budgetary basis.) The compilation of the budget numbers continues to be a manual process and the relationship between the budget in VISION and the authorizations passed by the Legislature is not clearly delineated. There continues to be little accountability within the State to match services provided to the proper fiscal year. While some invoices that have been entered into the VISION system have been accrued for, the State does not fully use the encumbrance process to restrict budgetary spending. This can lead to manipulation of the budgetary process by either: 1) holding invoices at year end and paying them out of the next year's budget thereby causing a mismatch between when a service is budgeted and when it is actually paid for; or 2) accelerating the payment of invoices to an earlier fiscal year to expend any remaining appropriation before a year closes. Both situations, if left unattended, can result in budgetary manipulation that will not be detected by personnel within the State.*

When expenditures for goods or services received during one fiscal year are paid in the subsequent fiscal year without the corresponding carry forward authority, departments are unable to properly match annual budgets and spending against those budgets. As of the end of October 2002, $76.6 million of bills for goods and services received during FY 2002 were paid for in FY 2003. While the State may have sufficient carry forward authority to cover these expenses in total, there is not always a relationship between the amount of a department's carry forward expenditures and the amount of its appropriated spending authority. Management of departmental budgets could be adversely affected if the appropriate amounts of carry forward expenditure authority are not authorized to cover prior year expenditures.

(7) *In February 2002 our Office reported that the State had inadequate protocols regarding the issuance, changing and revocation of user names and passwords for access to the VISION financial management information system and placed the State at risk of cyber-sabotage. In May 2002 staff from this Office found that by replicating initial passwords assigned to users it could easily gain access to key VISION user accounts in almost all business units tested, including the Executive Office. Anyone with basic knowledge of VISION could have entered, changed, approved, and budget checked vouchers to generate fraudulent payments. Neither the Human Resource Management System (HRMS) nor VISION system is currently configured to mandate password changes on a regular basis and further test work revealed that the applications could not track or monitor when or how often passwords are changed.*

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

However, of the reportable conditions described above, we consider the Department of Finance and Management's inability to generate timely and accurate financial statements, the lack of timely reconciliations by the Treasurer's Office, the lack of adequate documentation to support the State's capital assets, the Agency of Transportation's delay in reconciling STARS to VISION, and the Department of Taxes' lack of internal controls to fully verify tax credit claims to be material weaknesses.

We also noted other matters involving the design and operation of the internal control over financial reporting, which we have reported to management of the State in the accompanying Management Letter dated November 21, 2003.

This report is intended solely for the information and use of management, the cognizant Federal agency, the Office of Inspector General and Federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Elizabeth M. Ready

Elizabeth M. Ready
State Auditor

KPMG LLP

KPMG LLP

November 21, 2003

Administration's and Treasurer's Response to Auditor's
Report on Compliance and Internal Control Over Financial Reporting

Listed below are the responses by the Douglas Administration and the State Treasurer to the reportable conditions contained in the *Report on Compliance and Internal Control Over Financial Reporting.*

Reportable Condition

The Department of Finance and Management's controls over financial reporting are not sufficient to provide for the timely and accurate production of the State's financial statements. The Department did not produce complete financial statements to be audited for the year ending June 30, 2002 until October 2003. This was despite a significant planning effort on the part of the Department and the Auditor's Office that began in June 2002.

With the implementation of the new VISION financial management system, the timeliness of the month-end closings was considerably later than expected, resulting in a severe delay in the annual closing of the books. This has resulted in a severe delay in the production of the State's annual financial reports and required audit. The following issues contributed to the delay in completing the financial reports:

- The final audited financial statement for the last component unit was not received until May 2003. Most component unit statements were received in the fall of 2002;
- Additions and deletions to the State's inventory of capital assets were not compiled until July 2003;
- General ledgers associated with all business units for the State were not fully closed for FY 2002 until February 2003;
- Compilation and reconciliation of the Schedule of Expenditures of Federal Awards for FY 2002 was not fully completed until November 2003;
- The restating of the June 30, 2001 financial statements to comply with GASB Statement No. 34 was not completed until December 31, 2002; and,
- The final reconciliation of the FMIS balance sheet ending amounts to the beginning VISION balance sheet amounts was not completed until December 2002.

A substantial amount of data needed to prepare the State's financial statements is still compiled manually, as reported in prior years' management letters. Most notably, the compilation of accounts receivables and the Schedule of Expenditures of Federal Awards is a long manual process subject to errors.

The State of Vermont did not meet the March 31, 2003 State and Federal reporting deadline for submitting its Comprehensive Annual Financial Report or Federal Single Audit Report for the fiscal year ending June 30, 2002.

Administration Response

The delay in production of this financial report was caused primarily due to the confluence of two major events in Fiscal Year (FY) 2002:

Problems from the implementation of the VISION accounting system

The State of Vermont's new financial reporting system went live on July 1, 2001, the first day of FY 2002. As has been widely reported, the introduction of the VISION system was exceedingly challenging due to:

- *Technical glitches prevented certain transactions from properly processing. These glitches created significant complications during the year-end close that required subsequent corrective action.*

- *The learning curve associated with the implementation of VISION on a statewide basis was very steep. Financial Operations and Technical Services staff struggled, operating entirely reactively to address only the most urgent operational problems.*

- *Due to a lack of the necessary accounting knowledge, many users in individual departments struggled with the new system, generating hundreds of mistakes that eventually had to be identified, researched and corrected after year-end, greatly delaying the financial closing and reporting process.*

- *Poor system performance had a significant detrimental impact on the first year-end close and reporting process.*

- *Year-end closing instructions for FY 2002 were too accommodating and delayed the process, and thus the eventual resolution of the mountain of problems.*

Implementation of GASB 34 accounting standards

- *Complying with the new Governmental Accounting Standards Board (GASB) Regulations, most notably Number 34 (GASB 34), entailed more work than was originally projected. While GASB 34 also proved problematic for many other States, Vermont had the misfortune to undertake the GASB 34 adoption while dealing with the repercussions of the new computer system (VISION)**.***

For FY 2003 and beyond, Finance and Management has made and will continue making changes that will improve performance both in the short as well as the long-term. These changes include but are not limited to:

- *Adding additional people in both the accounting and financial reporting areas of financial operations. These additions will allow us to take proactive steps to monitor and reconcile data prior to year-end closing.*

- *Obtaining assistance from the Director of Financial Reporting from a northeastern state to review our closing and financial statement preparation procedures and to develop a closing time line, work plan and CAFR Preparation Guide. This will help us expedite and control our year-end closings as well as prepare our CAFR in a more efficient manner.*

- *Establishing departmental month-end closing procedures - these closing procedures will minimize the amount of review that will be necessary at year-end (11 months will have already been reviewed).*

- *Additional changes will be implemented as needed.*

Reportable Condition

During FY 2002 the Treasurer's Office continued to experience delays in completing monthly and year-end reconciliations of the State's cash accounts. The lack of complete and timely bank reconciliations continues to be a challenge to the Treasurer's Office and exposes the State to risk that intentional or unintentional errors will occur and not be detected by the Treasurer's Office. The fraudulent cashing of $5,600 in checks against the vendor account and the $2.88 million overstatement of general funds due to a duplicate entry made during FY 2002 are examples of the risks associated with not conducting timely reconciliations.

In February 2002 the State contracted with outside accountants to assist with the back log of monthly reconciliations for FY 2002, however the procedures did not include making necessary adjustments for all reconciling items to fully complete the reconciliation process. The accounts listed below show the annual transactions for FY 2002 and the outstanding unidentified items as of June 30, 2002:

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Child Support – EFT	$2,326,538	$1,384,616
Federal Funds	$986,019,425	$2,948,038
Depository	$1,427,793,085	$6,740,294

As of March 2003, nine months after the close of the fiscal year, the outstanding reconciling items had not been identified, necessary adjusting entries had not been recorded and the accounts had not been fully reconciled. The lack of timely reconciliations is a significant control weakness that was noted in prior years' management letters and continues to go uncorrected.

Treasurer Response

The Office of the State Treasurer agrees with the Office of the Auditor of Accounts that reconciliation provides a key internal control to detect posting errors or fraudulent activity. The Office of the State Treasurer has made concerted efforts to bring the reconciliations current, improving cash control and check fraud procedures. The engagement of a consulting CPA firm, Mudgett Jennett & Krogh-Wisner, P.C., to review our procedures and recommend improvements was a significant initial step. A series of joint reviews of the reconciliation process with the Department of Finance and Management assisted the Office of the State Treasurer in resolving important procedural and system issues. A more formal tracking system to review reconciliation progress is now in place. Tracking of bank accounts has indicated that by March 2003, many of the accounts were reconciled within thirty (30) days of the monthly accounting close. Reconciliation timeliness has continued to improve, and as of the issuance of this report, all Treasury bank accounts are current; we plan to maintain a target of completion within thirty (30) days from the close of the accounting period.

With respect to the $5,600 of fraudulent checks, this activity was detected by the Office of the State Treasurer in concert with the consulting CPA firm's review. The fraud was then reported to the appropriate regulatory and law enforcement agencies. The individual perpetrating the fraud was prosecuted, and the State has been fully reimbursed. The Office of the State Treasurer has taken additional steps to protect the cash assets. For example, "positive pay" systems (where the bank only pays those checks that match specific instructions from the Treasurer's Office regarding check number & dollar amount) have been introduced for almost all the State's checking accounts. That change has significantly reduced the likelihood of fraud taking place. In the few remaining accounts where positive pay is still in transition, a daily match of the check warrant data to the bank presentment data is conducted. We expect full implementation of positive pay in the next two months.

As noted in the audit finding, there were significant reconciling items, on the book side of the systems, as of June 30, 2002. The efforts of all relevant departments working cooperatively reduced these to $40,319 (child support), $153,230 (federal funds), and $3,195,005 (depository), by March 30, 2003, three months' time from the issuance of the consulting CPA firm's recommendations. The reconciling items for the one remaining significant concern, the depository account, have since been reduced to $170,186. These items relate primarily to a specific department, and the Office of the State Treasurer, in cooperation with the Department of Finance and Management, has taken appropriate steps to work with the department to resolve these items. Our review identifies these reconciling items to be on the book side (VISION), not related to *cash in bank or check errors or fraud. Ongoing reconciliation is likely to identify future reconciling items that will require investigation by various agencies. We are currently implementing additional improvements to our "aging" procedure and department follow-up procedures to expedite resolution.*

The Office of the State Treasurer is responsible for monthly reconciliations of the State's bank account balances to the VISION book balances. The combination of the transition to the VISION system and, at the same time, the movement of the State's primary bank accounts to a new bank resulted in a number of procedural changes for the Office of the State Treasurer and the various user departments/agencies. The book balance, as recorded by VISION, had numerous problems that required resolution. The accounting system in place prior to VISION was centralized in the Department of Finance and Management. VISION is a decentralized system that transfers much of the responsibility for entry of revenues and expenditures to the user departments/agencies. As noted in the report by Mudgett Jennett & Krogh-Wisner, Upon installation of any new accounting system there is an expected period of errors and corrections while accounting staff learn to use the new software. When VISION was implemented, errors were introduced by the decentralization of the general ledger posting function.

Thus, hundreds of mistakes, generated by individual units of State government, went unresolved and had to be identified, researched and corrected after year-end, greatly delaying the financial closing and reporting process. Activity posted to the general ledger system was, at the outset, prone to error and poorly documented, making reconciliation difficult. In addition, there were initial problems with the system's transaction management software requiring additional programming assistance. At the same time, when the State changed its bank of record for its primary depository and checking accounts, difficulties were encountered with the use of various interfaces between the Treasury based cash systems, VISION, and the bank software. While these difficulties produced an unusual number of erroneous entries that needed to be reconciled, reporting shortcomings in the VISION system delayed the actual identification and resolution of these errors.

The offices of the State Treasurer and Finance and Management have taken pro-active steps to reduce the risks and improve the integrity of the data, timeliness, and reporting tools in the various systems. While we have clearly experienced a painful transition period, we also have made significant progress in resolving these issues. The Department of Finance and Management has put additional resources into place for training user department staff and establishing internal controls. Finance is also mandating a more rigorous month-end closing schedule. With faster finalization of data by departments and Financial Operations, the Treasurer's Office will be able to conduct faster reconcilliations.

The Office of the State Treasurer benefited from the advice and past recommendations of the Office of the Auditor of Accounts. The recommendations of Mudgett Jennett & Krogh-Wisner have been substantially implemented and we will continue to evaluate our processes to identify any additional improvements in our internal controls.

Reportable Condition

The State of Vermont's financial statements have never included a general fixed asset account group as required by generally accepted accounting principles. The effect of the omission of the general fixed asset account group was an annual auditor's opinion qualification on the fixed asset portion of the financial statements. For FY 2002, Government Accounting Standards Board Statement No. 34 requires the State to present fixed assets, including infrastructure assets, in the governmental activities column of the government-wide statements.

For FY 2002 we found that the State of Vermont did not have adequate controls in place to properly classify and ensure accountability over the State's assets in accordance with generally accepted accounting principles, accordingly the State was unable to produce fixed asset records for audit. As part of our audit we reviewed the internal control over fixed assets and tested the completeness and accuracy of the fixed assets listing through a sample of the construction in progress at the Department of Buildings and General Services. We found that seven of the ten items selected for testing in our initial sample were improperly classified and included items that did not meet the definition of an asset or of construction in progress. Following the reporting of our results of our initial test work the totals for construction in progress decreased by $8.1 million, or by 33 percent. Of the $8.1 million decrease, 77 percent was expensed and the remaining 23 percent was classified as fixed assets. Upon further review we determined that adequate documentation to support the fixed asset and construction in progress on the financial statements was not available for audit.

For FY 2002 we have issued a qualified opinion on the governmental activities column of the entity-wide statements due to the lack of a detailed accounting record of general fixed assets and construction in progress at the Department of Buildings and General Services.

Administration Response

The State of Vermont does need to have more adequate controls in place to assure the completeness and accuracy of fixed asset information. The Department of Finance and Management is currently developing changes to the State of Vermont's Asset Management Policy. We also agree that a percentage of the Department of Buildings and General Services (BGS) capital expenditures selected for testing had been incorrectly booked to Construction in Progress. The Department of Finance and Management has been working with BGS to improve that the accuracy of this information for the FY 2003 audit.

We appreciate the commitment by the Auditor's Office to, in the coming weeks, review the previously provided information on fixed asset infrastructure held by the Agency of Transportation to help identify any additional revisions or corrections required to the State of Vermont Asset Management Policy.

Reportable Condition

The Agency of Transportation uses an internal accounting system, STARS, to track and monitor expenditures on a project basis. The expense information is interfaced with the State of Vermont's centralized accounting system, VISION, on a daily basis. During FY 2002 the STARS system was not reconciled to the VISION system to ensure that the data interface was working properly and that revenues and expenditures were properly and accurately recorded. The FY 2002 reconciliation of the STARS to VISION system was not completed until October 2003, nearly 16 months following the close of FY 2002. This significant delay in reconciling STARS to VISION contributed to the delay in the timely and accurate production of the State's financial statements for FY 2002.

Administration Response

STARS' activity for FY2002 has now been reconciled to VISION and AOT is proceeding to reconcile FY2003 STARS activity to VISION. Adjusting entries required because of these reconciliations will actually be booked in FY2004, but material amounts will be accrued in the respective year's financial statements. AOT's ultimate goal is to reconcile each month's activities on a timely basis.

Reportable Condition

During our audit of the Vermont Economic Advancement Tax Incentives Program we determined that the Department of Taxes did not have an adequate system of internal control and procedures in place to fully verify the credits being claimed on tax returns. As of December 2002, 94 businesses and 19 municipalities had active authorizations for $80,162,048 in tax credits, with $8,727,876 of tax credits having been applied against tax liabilities. The tax credits claimed are allowed by the Department of Taxes at the time the returns are filed and follow-up, if any, is done at a later date. The lack of review undermines the performance-based principle of the program and represents a material risk and potential cost of millions of dollars to the State.

The tax credits, which are authorized by the Vermont Economic Progress Council, require certain economic goals be met in order for the credit to be taken. These goals may include such measures as creation of new jobs, plant expansion, or investments in machinery and equipment. The ability of the Department of Taxes to verify data relative to these goals and validate the data to support attaining the goals is limited. Tax credits are being taken on returns based on the authorized amounts without any validation of the required performance and corresponding economic data.

Administration Response

In January 2003, the Tax Commissioner developed the following plan to address the issues raised by the EATI audit report dated February 4, 2003:

(1) The Tax Department would assign additional staff to reduce the backlog of tax returns containing EATI credits.

(2) The Tax Department would request detailed performance expectations from VEPC for all credits awarded prior to July 1, 2000. These performance expectations, or benchmarks, would be similar to the performance expectations VEPC is required to specify on all awards authorized after June 2000, pursuant to 32 VSA §5930a(k).

(3) The Tax Department would review all future requests for utilization of EATI credits based on these benchmarks and allow or disallow credit requests on that basis. The Auditor indicated that this plan was acceptable and implementation is underway.

NOTE: Since January 2003, the Tax Department also lent its support to Legislative initiatives requiring "clear and quantifiable benchmarks" for the performance expectations required in 32 VSA §5930a(k), which was subsequently enacted in Act 67 of 2003.

Reportable Condition

The Department of Finance and Management continues to present its budgetary results on a cash received and modified cash paid basis. (In addition to cash paid, the State accrues certain expenditures on a budgetary basis.) The compilation of the budget numbers continues to be a manual process and the relationship between the budget in VISION and the authorizations passed by the Legislature is not clearly delineated. There continues to be little accountability within the State to match services provided to the proper fiscal year. While some invoices that have been entered into the VISION system have been accrued for, the State does not fully use the encumbrance process to restrict budgetary spending. This can lead to manipulation of the budgetary process by either: 1) holding invoices at year end and paying them out of the next year's budget thereby causing a mismatch between when a service is budgeted and when it is actually paid for; or 2) accelerating the payment of invoices to an earlier fiscal year to expend any remaining appropriation before a year closes. Both situations, if left unattended, can result in budgetary manipulation that will not be detected by personnel within the State.

When expenditures for goods or services received during one fiscal year are paid in the subsequent fiscal year without the corresponding carry forward authority, departments are unable to properly match annual budgets and spending against those budgets. As of the end of October 2002, $76.6 million of bills for goods and services received during FY 2002 were paid for in FY 2003. While the State may have sufficient carry forward authority to cover these expenses in total, there is not always a relationship between the amount of a department's carry forward expenditures and the amount of its appropriated spending authority. Management of departmental budgets could be adversely affected if the appropriate amounts of carry forward expenditure authority are not authorized to cover prior year expenditures.

Administration Response

The Department of Finance and Management reports its Budget to Actual schedules on the same basis as the budget is prepared (budgetary basis) as required by the Governmental Accounting Standards Board (GASB). The budget is compiled using Legacy, the state's automated budgeting system. The original budget figures are the figures contained in the initial budget (Big Bill) as passed by the Vermont legislature while the final budget figures contain all changes to these original budget figures (e.g. legislated budget adjustments and excess receipts).

We do not agree that there is little accountability to match the cost of services to the proper fiscal year. The financial statements, which report these costs along with their associated sources of revenue, are prepared on an accrual basis of accounting which assigns expenses to the year in which their liability was incurred, not the year in which the liability was actually paid (cash out the door). In the case where an expense is prepaid, its cost will be expensed in the year in which it is actually consumed utilizing accrual based accounting. As most operations are ongoing and liabilities are carried over from month to month and year to year, the accrual based financial statements report this on-going process while the budgetary- based schedules present the actual budgetary-based expenditures against their respective budgets for a specific time period (fiscal year).

Auditor's Note

We have reviewed the response and continue to believe that the failure to assign costs to the appropriate fiscal year is a reportable condition and needs to be corrected.

Reportable Condition

In February 2002 our Office reported that the State had inadequate protocols regarding the issuance, changing and revocation of user names and passwords for access to the VISION financial management information system and placed the State at risk of cyber-sabotage. In May 2002 staff from this Office found that by replicating initial passwords assigned to users it could easily gain access to key VISION user accounts in almost all business units tested, including the Executive Office. Anyone with basic knowledge of VISION could have entered, changed, approved, and budget checked vouchers to generate fraudulent payments. Neither the HRMS nor VISION system is currently configured to mandate password changes on a regular basis and further test work revealed that the applications could not track or monitor when or how often passwords are changed.

Administration Response

We would like to reinforce the fact that most state systems require regular password changes to gain connection to the network. At the application (VISION/HRMS) level, we have a complex security matrix that has levels of access to each module in the system that corresponds with the function performed by the employee. In addition to the functional restrictions, Finance restricts user accounts to access data related only to their organizational area, so that they cannot change or enter transactions outside their purview. Requests for additions, changes and deletions are sent from department business managers to the VISION application security officer. The Director of Financial Operations reviews the requests and authorizes the changes. HRMS requires Commissioner approval for all requests to access data, whether add/update or view only.

As an internal control, at each payroll cycle names of individuals who have left state service are forwarded to the VISION application security officer to confirm that all activity has been reported by departments to VISION. A similar process is followed for HRMS. Password changes for these accounts are required and the employee is required to sign an authorization form where they agree to change their password at a minimum of 90-day intervals. VISION also sends a reminder to all users through our listserv facility every 90 days. In addition to the reminder, password changes are monitored at the database level with reports prepared that include accounts and the dates recorded for when the password last changed. These reports are run approximately every 90 days as well and there is follow-up with business managers for those accounts where the password has not been changed.

HRMS is currently being upgraded and a VISION upgrade is planned as well to the 8.x versions of the financial and human resource PeopleSoft applications that support enhanced password security features including mandated password changes.

Section I

Management Letter Comments
Source: Basic Financial Statements

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-01-FS**

Agency/Department: **Department of Finance and Management**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations. The SAS further provides for the assurance of completeness and accuracy.

Observation:

During our audit work on the fund financial statements we noted a number of instances of misstatements, some of which were material to the fund financials that were not identified and corrected before the statements were submitted by the Department of Finance and Management for audit. Examples of these misstatements include:

Agency Fund – Revised on six different occasions because of numerous reporting errors including: the netting of reported "addition and deduction activity" for the Retirement System Contributions and Withholding Fund, the Employees Deferred Income Withholding Fund and the Employee Insurance Contributions and Withholding Fund; an unsubstantiated $295,874 of reported taxes receivable in the Vendor and Other Deposits Fund; an internal cash adjustment of $783,082 in the Unidentified Receipts Fund; and changes to the Child Support Collections Agency Fund beginning cash balance which contained erroneous postings from FY 2001.

Federal Revenue Fund – Encumbrances totaling $13,046,730 originally appeared as a portion of the Undesignated Fund Balance rather than as an encumbrance.

Highway Garage Fund – Expenses were originally combined into one line item labeled "Cost of Sales and Services" rather than broken down into discrete expense categories as they were in prior fiscal years.

General Fund – The General Fund financial statement balance sheet was out of balance by approximately $6,000 and an adjusting entry was incorrectly posted.

Transportation Fund – The original Transportation Fund financial statements overstated accounts receivable and revenue by approximately $16,000,000. This overstatement is primarily attributable to incurring costs that exceeded the project agreement amounts and not having executed agreements with federal funding sources for the anticipated revenues. Similar observations regarding the overstatement of accounts receivable have been noted in prior audits.

The Department's failure to adequately review the financial statements for accuracy and completeness contributed to the delay in the timely issuance of the statements and subsequent audit.

Recommendation:

We recommend that the Department of Finance and Management dedicate adequate resources to help ensure the accuracy and completeness of all financial statements before they are submitted for audit.

Agency/Department Response:

In fiscal years 2003 and 2004, the Department of Finance & Management has added additional resources to both the accounting operations and financial reporting areas of the Financial Operations Division. We are currently reviewing our closing and financial statement preparation procedures, with the assistance of a Director of Financial Reporting from another northeastern state, to develop a closing timeline, work plan and CAFR preparation manual. Additionally we are finalizing departmental month-end closing procedures that we expect to publish in the coming weeks. These procedures will require all departments to review their financial data for accuracy and completeness. This will minimize the number of corrections to financial data during the financial statement preparation process. We will also more thoroughly review the financial statements prior to submitting to the Auditor. The goal of these changes is to enhance internal controls and procedures to assure the accuracy and completeness of financial statements prior to submission for audit.

Management Letter Comments
Financial Statements
Internal Controls Over Cash
For the Fiscal Year ended June 30, 2002 **Comment #2002-02-FS**

Agency/Department: Department of Finance and Management

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Finance and Management exercised no oversight and control over imprest/petty cash accounts that are maintained by agencies/departments across state government.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $901,311.39 was advanced to agencies/departments across State government to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003 a total of $326,554.82 in imprest/petty cash account balances had been reported to the Department on the required Imprest/Petty Cash Verification forms. This means a total of $524,834.29 in imprest/petty cash accounts has not been properly reported to and accounted for by the Department.

For those agencies/departments that did complete the required Imprest/Petty Cash Verification form, there were many cases where the account information did not reconcile to the account information maintained by the Department of Finance and Management. The Department performed no follow-up to request the required information from those agencies/departments that did not comply with the reporting requirements and did not make any attempt to reconcile the discrepancies on the Imprest/Petty Cash Verification forms that were submitted.

Recommendation:

We recommend that the Department of Finance and Management implement the necessary policies and procedures to ensure timely compliance with its imprest/petty cash account reporting requirements.

We further recommend that the Department develop and implement adequate policies and procedures to ensure that all imprest/petty cash accounts controlled by agencies/departments are properly managed and accounted for on an annual basis to help ensure the accurate accounting and safeguarding of funds in the accounts. These policies and procedures should include:

- Following-up with those agencies/departments that do not report the required information;
- Following up with those agencies/departments that have reported account information that does not agree with the Department's records; and,
- Conducting spot checks of a sample of accounts to confirm that the information reported on the Verification forms is correct and to determine if the use of the account continues to meet the definition of an imprest/petty cash account.

Agency/Department Response:

The Department of Finance and Management agrees with this finding, appropriate oversight and control of Imprest and Petty Cash was not exercised on a timely basis for FY 2002. For FY 2003, all Imprest and Petty Cash verification forms have been received from departments and reconciled. Additionally, the Operations Section of Financial Operations will begin performing spot checks with those departments that have been advanced cash.

__Management Letter Comments__
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-03-FS**

Agency/Department: **Department of Finance and Management**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

The Department of Finance and Management employs a labor-intensive manual system for reconciling the original appropriated budget to the final appropriated amount for each governmental fund. The State did not purchase the budgeting module for the PeopleSoft based financial management information VISION system and the current Legacy Budget Development system is not being utilized as an off-system tool to help in reconciling the budget to actual statements.

Recommendation:

We recommend that the Department of Finance and Management explore different options for automating the tracking and reconciliation of the original appropriated budget to the final appropriated budget as well as the expenditures associated with the appropriations. These options include revisiting the strengths and weakness of the budgeting module for the PeopleSoft financial management software, the Legacy Budgeting Development System that is currently used to develop the Governor's Recommended Budget, or any other software application that can be easily integrated into the current financial management information system.

Agency/Department Response:

We agree that the current reconciliation process is manual and labor intensive and should be automated. The Department of Finance and Management will continue to explore options to streamline this reconciliation process.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-04-FS**

Agency/Department: Department of Finance and Management

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over investment income we noted that the Department of Finance and Management did not properly post investment income allocations provided by the Office of the State Treasurer as outlined below.

Liability Insurance Fund – The Office of the State Treasurer provides investment income allocation information to the Department of Finance and Management for posting in the VISION system. Our audit work on the State Liability Insurance Fund found that the Department posted one entry with the wrong amount and one entry was not posted at all for a combined total of $69,799.04. These errors resulted in an understatement of investment income in the State Liability Insurance Fund and required an audit adjustment. Additionally, the Department could not locate the supporting documentation for the June 2002 VISION entries. We also noted that the Office of the State Treasurer provided investment allocation information for this fund to the Department on February 11, 2002 for the first six months of FY 2002, however the Department did not post this information until April 11, 2002.

Workers Compensation Fund – The Office of the State Treasurer provides investment income allocation information to the Department of Finance and Management for posting in the VISION system. Our audit work on the Workers Compensation Fund found that the Department posted two entries with the wrong amounts for a combined total of $103,426.49. These errors resulted in an overstatement of investment income in the Workers Compensation Fund and required an audit adjustment. Additionally, the Department could not locate the supporting documentation for the June 2002 VISION entries. We also noted that the Office of the State Treasurer provided investment allocation information for this fund to the Department on February 11, 2002 for the first six months of FY 2002, however the Department did not post this information until April 11, 2002.

Recommendation:

We recommend that the Department of Finance and Management implement adequate policies and procedures to ensure that all investment income entries into the VISION system are:

- Reviewed by a supervisor for accuracy;
- Posted in a timely manner;
- Reconciled to the source information provided by the Office of the State Treasurer; and,
- Supported with appropriate documentation.

Agency/Department Response:

The Department of Finance and Management agrees with this finding. Financial Operations has developed a more comprehensive process that will assure the timely and accurate posting of interest earnings and provide for a more complete audit trail.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-05-FS**

Agency/Department: **Department of Finance and Management**
Agency of Human Services

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work on the General and Special Fund Financial Statements we identified the following audit adjustments to the fund financial statements.

General Fund and Special Fund - The General Fund Financial Statements included erroneous accruals for Medicaid Payables totaling $21,618,137 and for Medicaid Receivables totaling $2,701,098. These accruals should have been included in the Special Fund Financial Statements. These amounts represent material audit adjustments to the General Fund and Special Fund Financial Statements.

Recommendation:

We recommend that the Department of Finance and Management and the Agency of Human Services implement adequate internal controls and procedures to ensure all Medicaid accrual entries are properly recorded in the financial statements and reviewed for accuracy and completeness.

Agency/Department Response:

As noted earlier, in fiscal years 2003 and 2004, the Department of Finance & Management added additional resources to both the accounting operations and financial reporting areas of the Financial Operations Division. We are currently reviewing our closing and financial statement preparation procedures with the assistance of a Director of Financial Reporting from another northeastern state. One of the goals of this review is to enhance internal controls and procedures to assure the accuracy and completeness of financial statements prior to submission for audit.

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-06-FS**

Agency/Department: **Office of the State Treasurer**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our test work over cash we noted that the Treasurer's Office did not exercise adequate oversight of bank accounts maintained by State agencies/departments. This lack of adequate oversight was evidenced by the following:

1. The Treasurer's Office could not produce documentation of a master list of all bank accounts that had been approved by the State Treasurer;

2. The Treasurer's Office did not conduct adequate follow-up to request the required bank account information from those State agencies/departments that did not comply with the annual reporting requirements;

3. The Treasurer's Office did not adequately review and require reconciliation of variances between the information provided by the bank and information provided by State agencies/departments; and,

4. The Treasurer's Office could provide no documentation regarding its approval of reconciliation procedures, as required by law, for any of the bank accounts that are maintained by State agencies/departments.

According to 32 V.S.A. § 431: "Each agency or department of the state shall be required to obtain the approval of the treasurer to establish and maintain a bank account of a selected bank as well as develop procedures, approved by the treasurer, to reconcile a bank account." In addition, 32 V.S.A. § 401 (b) requires that "[t]he Treasurer shall keep an accurate accounting in books of account of all moneys received by the State from whatever source and of all moneys withdrawn from the Treasury of the State upon warrants issued by the Commissioner of Finance and Management."

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit copies of the June 30th bank statement and a reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required State agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

According to the Treasurer's Office there were approximately 189 bank accounts in FY 2002 that had been approved by the Treasurer's Office. As of April 2003, the Treasurer's Office had only received approximately 50 percent of the required information for these bank accounts.

Recommendation:

We recommend that the Treasurer's Office implement adequate policies and procedures to help ensure the accurate accounting and safeguarding of all funds in all bank accounts that have been established by State agencies/departments. These policies and procedures should include the following:

- Developing and maintaining a master list of all bank accounts established by State agencies/departments and ensuring that prior approval was granted to establish these accounts;

- Appropriate and timely follow-up with agencies/departments that do not comply with the requirements established by the Treasurer for reporting and reconciling all bank accounts;

- Reviewing the bank account reconciliation information submitted by agencies/departments to identify and require reconciliation of variances between the balance reported by the bank and the balance reported by the agency/department; and,

- Request, review, approve and document reconciliation procedures for all agency/department bank accounts that have been approved by the Treasurer's Office.

Agency/Department Response:

The Treasurer's Office has contacted delinquent agencies from the fiscal year 2002 process to obtain the required information. All delinquent account data has been submitted. The Treasurer's Office has requested similar bank account information for fiscal year 2003 and has experienced significant improvement in timeliness.

In addition, the Treasurer's Office now maintains the following procedures:

a) Requests are sent to all banks to submit data on State of Vermont accounts, to the attention of the Office of State Treasurer. This provides independent verification of agency balances and also provides a control to assure that all bank accounts are properly authorized.

b) Data submitted by the banks is entered to a master sheet.

c) Agencies are requested to send a copy of the June 30th statement as well as a questionnaire specific to each account.

d) Information on these accounts is added to the master list by a second individual.

e) Security is provided in the spreadsheet to assure that bank data and agency data are not entered by the same individual. This provides additional internal control safeguards through segregation of functions.

f) The Treasurer's Office sent a separate correspondence dated July 18, 2003, to all agencies requesting that they send a narrative description of their current reconciliation procedures. These will be reviewed by the Treasurer's Office. Agencies that do not submit sufficient documentation or whose procedures demonstrate inadequate safeguards will be provided remedial assistance.

g) The Internal Auditor at the Treasurer's Office will complete reconciliation of the bank and agency account data submissions. Any unreconciled variances will be reported to the Deputy Treasurer for review with the agency.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-07-FS**

Agency/Department: Office of the State Treasurer

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During audit work on the Pension Trust Funds, we noted that the Treasurer's Office has not adopted rules to implement and administer the provisions of the Defined Contribution Retirement Plan as required under 3 V.S. A. § 500(h).

Recommendation:

We recommend that the Treasurer's Office comply with the requirements of 3 V.S.A. § 500(h) and adopt rules through the Administrative Procedures Act process to implement and administer the Defined Contribution Retirement Plan.

Agency/Department Response:

A Plan Document and a Trustee Agreement have been developed and approved; these documents provide plan design and the rules for administering the Defined Contribution Plan consistent with 3 V.S.A. § 500.

Although the State Treasurer has the statutory responsibility to offer and administer the Defined Contribution Plan, the Office has historically chosen to contract with a third party administrator to provide administrative, investment and record keeping services for the plan. As a result, the Treasurer's Office believes there is no need to adopt additional rules to administer the plan. We will, however, review this recommendation with staff from the Attorney General's Office.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-08-FS**

Agency/Department: Office of the State Treasurer

Standard:

When using an outside service provider, the user department must obtain a Statement on Auditing Standards (SAS) No. 70 report that outlines the tests of internal controls completed by service auditor when conducting an independent audit of the service provider. The Codification of Statements on Auditing Standards, AU § 324.46 states that the service auditor (auditor preparing SAS No. 70 Report) should delineate the complimentary user organization controls, if it "became evident … that the system was designed with the assumption that certain controls would be implemented by the user organization." The SAS No. 70 Report states "customers also need to implement and maintain effective internal control" and "to evaluate its own internal control to determine if certain [delineated] procedures are in place."

In addition, SAS No. 78 requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

The Treasurer's Office is responsible for maintaining proper internal control over the State Retirement System Investments, the Abandoned Property Fund and the Vermont Common Trust Investment Account and has taken certain steps to discharge that responsibility.

State Retirement System Investments – The Treasurer's Office uses State Street Bank as the custodian of the system's assets and uses several investment managers to manage those assets. The investment managers are responsible for buying and selling investments on behalf of the State. The Treasurer's Office requests and obtains a SAS No. 70 review of the internal controls that exist at State Street Bank. A second control procedure is the use of an investment consultant to evaluate the performance of the investment managers and the investment managers perform reconciliations of their transactions with State Street Bank.

Abandoned Property Fund - The Treasurer's Office contracts with Affiliated Computer Services, Inc. (ACS, Inc.) as an outside service provider to provide auditing services to recover unclaimed funds reportable to the State.

Vermont Common Trust Investment Account – The 2000 Legislature authorized the establishment of a trust investment account to be administered by the State Treasurer for the purpose of investing restricted funds. The Treasurer's Office utilizes a trust organization (Chittenden Trust Co.) and three-contracted fund managers (Prentiss, Smith & Co., Inc.; Hanson Investment Management, Inc., and National Life Capital Management) for providing custodial and management services over the Vermont Common Investment Account.

During our audit test work, we noted that the Treasurer's Office had not requested the required SAS No. 70 report from the outside service provider for the Vermont Common Trust Investment Account and did not document its review of the required SAS No. 70 reports from the other outside service providers.

Recommendation:

We recommend that the Treasurer's Office:

- Request the required SAS No. 70 report from all outside service providers;
- Implement adequate policies and procedures to ensure the reports are properly reviewed in a timely manner;
- Document its review of the reports; and,
- Follow-up on any internal control deficiencies identified in the reports.

Agency/Department Response:

The Treasurer's Office has received the SAS No.70 report from ACS since 2000 and also receives the report for State Street Bank. The Treasurer's Office recently added the Chittenden Bank and other vendors to its request list. We will review all of our service providers to determine if any other such requests need to be made.

Additional controls are in place at the Treasury to act in concert with these reports as part of this Office's own internal control review. For instance, a review of State Street's reconciliation process with investment managers is conducted. The Treasurer's Office is reconciling the Common Trust cash and investments at Chittenden Trust to the cash and investments reported by the money managers (National Life, Prentiss Smith, and Hanson). In the case of ACS, the receipt of a release exhibit that ties back to the check and unclaimed property report with sign-off by the remitting agency is reviewed.

We do recognize that a more formal process documenting review and follow-up is needed and have begun steps to accomplish this. These include a comprehensive inventory of areas subject to SAS No.70 review and a checklist to document Treasury review of external controls and corresponding internal systems.

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-09-FS**

Agency/Department: **Agency of Transportation**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

The audit of the Transportation Fund's accounts over the past three fiscal years identified the following internal control weaknesses that demonstrate ineffective internal control procedures:

- Reconciliation of ending book balances in the Agency's STARS financial management information system to ending book balances in the State's financial management information system are not being completed in a timely manner. While the State's current VISION system is used to produce state-wide financial statements that are audited, the STARS system is used to manage the Agency's financial activity by project. At the time of our audit, with the exception of capital assets, the Agency's accounts for June 30, 2002 were not reconciled from STARS to VISION until October 2003; and,

- The STARS system has no accounts receivable control account. There is a FHWA sub-billing system but this system does not feed into a general ledger control account.

We also noted the Motor Vehicle Department's fund, International Registration Plan to Foreign States, declined by approximately $868,000 in comparison to the prior year. For FY 2002, the balance was $141,568. At the time of our audit, it appeared that this account had not been reconciled for FY 2002.

Further, during the current year's audit, we also noted the Federal Highway Administration (FHWA) Receivable balance reported as of June 30, 2002 differed significantly between STARS and VISION. The year-end balance is determined by taking the previous year balance, adding current year expenditures and subtracting the federal receipts. At one point during our audit the STARS balance was $18,088,428 and the corresponding VISION balance was $11,797,317 – a difference of approximately $6.3 million. This difference appears to be due to the ongoing lack of a reconciliation process between STARS and VISION for the federal receivables.

Recommendation:

We recommend that the Agency of Transportation develop and implement written policies and procedures to assure that the ending balances of all accounts, whether in STARS or not, are reconciled to the financial management system on a timely basis.

Agency/Department Response:

We agree that account reconciliation between VISION and STARS has not been timely. In order to correct this, a special project team was formed and goals for completion of the reconciliation analysis for fiscal year 2002 were set and accomplished. A special project team is now working on fiscal year 2003 to provide a timely reconciliation. We expect to complete future years on schedule.

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-10-FS**

Agency/Department: **Department of Personnel**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work on the Long-Term Disability Fund and the Medical Insurance Fund Financial Statements prepared by the Department of Personnel we identified the following audit adjustments to the fund financial statements:

Long-Term Disability Fund - A VISION expense entry totaling $6,500 for contractual fees was not included in the fund financial statements when the figures were transferred from a special fund to the Long Term Disability Fund. This amount represents a material audit adjustment to the Long Term Disability Fund Financial Statements.

Medical Insurance Fund - Expenses totaling $634,852 for administrative services provided by CIGNA in May and June of 2002 were erroneously recorded in VISION as a 2003 expense. These expenses should have been accrued as an expense on the FY 2002 financial statements. This amount represents a material audit adjustment to the Medical Insurance Fund Financial Statements.

Recommendation:

We recommend that the Department of Personnel implement adequate internal controls and procedures to ensure all transactions in the VISION system are properly recorded and reviewed for accuracy and completeness.

Agency/Department Response:

Long-Term Disability Fund: *The $6,500 was recorded correctly in VISION, but not included in the Financial Statement. This error was due to not developing the Financial Statement from the Trial Balance. Staff now understands how to accurately develop the Financial Statement from the Trial Balance.*

Medical Insurance Fund: *Expenses totaling $634,852 for administrative services provided by CIGNA in May and June of 2002 were erroneously recorded in VISION as a 2003 expense. These expenses should have been accrued as an expense on the FY 2002 financial statements. This amount represents a material audit adjustment to the Medical Insurance Fund Financial Statements.*

Medical Fund: *We agree. Staff now understand how to accurately process these expenses in the system to make sure they apply back to the appropriate year.*

Recommendation: *The department has internal controls in place before approval of the final transaction. This is accomplished by having a second individual review VISION transactions against the original information. With regard to year-end accounting, a second individual will review the year-end accounting before finalizing.*

<u>Management Letter Comments</u>
Financial Statements
General Purpose Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-10-1-FS**

Agency/Department: Department of Personnel

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work on the Medical Insurance Fund Financial Statements prepared by the Department of Personnel we noted that the amount reported for incurred but not yet reported (IBNR) claims payable, totaling approximately $7.4 million, was not properly supported by an actuarial report.

According to information provided by the Department's actuarial consultant from Mellon the IBNR calculation for FY 2002 was based mainly on information provided from CIGNA using their book-of-business completion factors rather than a formal actuarial IBNR calculation.

Recommendation:

We recommend that in the future the Department of Personnel obtain an actuarial report containing the appropriate calculations and methodologies to adequately support the amounts reported in the financial statements for IBNR claims payable.

Agency/Department Response:

Due to the transition to new medical plans, mid-FY02, there was a lack of meaningful claims data to determine the IBNR calculation from actual experience of the new plans. For FY03 and future years, actual experience has been and will continue to be used by our consultants, and it will contain appropriate calculations and methodologies to adequately support the stated IBNR.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-11-FS**

Agency/Department: **Department of Buildings and General Services**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Buildings and General Services did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $242,825 was advanced to the Department of Buildings and General Services to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department submitted Imprest/Petty Cash Verification forms with an account balance of $100. The Department has not accounted for the remaining $242,725 in imprest/petty cash funds.

Recommendation:

We recommend that the Department of Buildings and General Services implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

Upon further review it was determined that the $242,825 called into question consisted of the following:

An amount of $232,700 advanced to Crawford and Company from which liability claims are paid in case of a non-timely reimbursement from the Department of Buildings and General Services (BGS). Funds are maintained and advanced by the Vermont State Treasurer. Payment *requests from the fund are made directly to the State Treasurer. The Department of Finance and Management reports these funds as advances on the State's entity-wide statements. Due to the prompt payment history by BGS, this fund has now been closed out and no further action is required.*

An amount of $10,000 advanced to Downs Rachlin and Martin Trust as payment for a non-refundable option to buy an easement located at Exit 17 on Interstate 89 in Colchester, Vermont. These funds are not imprest/petty cash. They should be accounted for as a prepaid expenditure, which would either be expensed if the option is not exercised or capitalized as a non-depreciable asset once the easement is purchased and included in the cost of the asset. The easement has been subsequently purchased.

Two petty cash accounts for $100 and $25, respectively. Forms were filed timely for these two accounts as required by the Department of Finance and Management closeout instructions.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-12-FS**

Agency/Department: Agency of Human Services
Department of Prevention, Assistance, Transition and Health Access

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit of the Special and Federal Fund Financial Statements we noted a number of deficiencies surrounding the Agency of Human Services' and Department of Prevention, Assistance, Transition and Health Access's internal controls related to the reporting of Medicaid Payables and Medicaid Receivables. Specifically, we noted the following deficiencies:

The figures reported on the Agency's Medicaid Payables report for June 30, 2002, form CMS-R199, dated September 27, 2002 were not adequately supported with back-up source documentation. The information reported on the September 27, 2002 report was based on a point-in-time query of the Medicaid database maintained by Electronic Data Systems Corporation (EDS), the State's Medicaid fiscal intermediary. Upon inquiry we were informed that the original query could not be replicated and that neither the Agency nor EDS retained a back-up copy of the query results. Two similar queries for the same accounts payable information produced in September of 2003 resulted in variances of $3 million higher and lower than what was reported on the Medicaid Payables form CMS-R199, dated September 27, 2002.

It also appears that the Agency changed its methodology from the manner in which the Medicaid Payables amount was calculated and reported in FY 2001. For FY 2001 the State based their Medicaid Payables calculation on the amounts paid for the four months of July, August, September and October 2001. In calculating the Medicaid Payables for FY 2002, it appears the Agency based its calculation on the amounts paid in the two months of July and August 2002. For FY 2001 the amounts related to September and October 2001 totaled approximately $9.9 million representing 16 percent of the total claims payable. For FY 2002 the amount of payables from these two corresponding months appear to total approximately $10.6 million, or 15 percent of the total claims payable. It appears that the amounts from these two months were not factored into the amount reported in the financial statements. The result is that the Medicaid Payables for FY 2002 may be understated by approximately $10.6 million.

During our audit of the Medicaid Receivables reported for June 30, 2002, on form CMS-R199, we noted that the amounts for drug rebates for the fourth quarter of FY 2002 were not reported resulting in an audit adjustment of an additional $7,382,046 in receivables for drug rebates for FY 2002.

Auditing staff experienced significant delays in receiving adequate back-up documentation from the Agency and EDS to support the Medicaid Receivables amounts initially reported for June 30, 2002. As was the case for the Medicaid Payables, neither the Agency nor EDS retained a back-up copy of the query results for the amounts initially reported for Medicaid Receivables on form CMS-R199 for June 30, 2002.

The Agency was unable to provide supporting documentation for other financial information reported on the Medicaid Receivables report for June 30, 2002, form CMS-R199 related to Third Party Liability, Probate Court Cases and the Allowances for Uncollectable Amounts.

Recommendation:

We recommend that the Agency and Department develop and implement written policies and procedures to ensure that:

- All amounts reported on the Medicaid Payables and Receivables Forms CMS-R199 are supported with adequate source documentation from the Department and from EDS before the forms are submitted to the federal government and to the Department of Finance and Management for financial reporting;

- All source documents and electronic spreadsheets related to Medicaid Payables and Receivables are retained for the period prescribed by the relevant record retention schedule and adequately safeguarded against accidental or deliberate disposal by the Agency, Department and EDS; and,

- The methodology used to calculate the Medicaid Payables amount reported in the financial statements is consistently applied from one year to the next. At a minimum these procedures should consider the flow of claims, a claims inventory and an actuarial study of the lags in payment.

We also recommend that the Agency and Department review the State's contract with EDS to ensure that the reporting requirements within the contract include the timely and accurate production of all financial reports that serve as back-up documentation for the amounts reported for Medicaid Receivables and Payables in the State's annual financial statements.

Agency/Department Response:

PATH and EDS are in the process of renegotiation the new contract for Medicaid Management Information Systems (MMIS). PATH will include the recommendations included in the findings from the audit as an action item EDS will need to provide a report with adequate source documentation for the Medicaid Provider Accounts Payable and Accounts Receivable. As part of the system upgrade, EDS, PATH, and AHS will develop written procedures, to insure the source documents are compliant and accurate to meet the need for reliable financial reporting for the State of Vermont. This component of the upgraded system should be implemented by July 1, 2005. We will try to manually adjust SFY'03, '04, & '05 until the new system is fully operational in SFY'06.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-13-FS**

Agency/Department: **Agency of Human Services Central Office**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Agency of Human Services Central Office did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification Forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $500 was advanced to the Agency of Human Services Central Office to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Agency of Human Services Central Office had not completed the Imprest/Petty Cash Verification Forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Agency of Human Services Central Office implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

We agree with the Recommendation. The Department of Health will adhere to the Department of Finance & Management's reporting requirements and deadlines for reports as outlined in the Year End Closing Procedures distributed by Finance & Management. The distribution of the Year End Closing Procedures will be used as our notice to begin preparation of the Imprest/Petty Cash Verification Form.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-14-FS**

Agency/Department: Department of Prevention, Assistance, Transition and Health Access

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit of the Department of Prevention, Assistance, Transition and Health Access's internal controls over its processing of cash receipts we noted the following deficiencies:

- FY 2002 payment coupons from service recipients of the Dr. Dynasaur, VHAP and Working Disabled programs were shredded and not available to confirm and reconcile the amount of payment by payee to the ACCESS and VISION systems;

- The Department's Administrative Services MS Excel-based Cash Receipts Log for FY 2002 was not available for our audit test work. According to the auditee a disgruntled employee may have destroyed the Cash Receipts Log.;

- The Department's Administrative Tally Sheet does not have sufficient detail about daily cash receipts to permit reconciliation between lockbox receipts, cash receipts at PATH offices, deposit tickets, VISION revenue transactions and service recipients' account credits in the ACCESS system; and,

- Source documents relating to the Department's Administrative Service cash receipt processing did not include any evidence to document supervisory review and approval.

As a result of these deficiencies we were unable to audit the occurrence and completeness of the Department's cash receipt processes.

Recommendation:

We recommend that the Department of Prevention, Assistance, Transition and Health Access develop and implement written policies and procedures to ensure that:

- All source documents are retained for the period prescribed by the Department's record retention schedule;
- All source documents and electronic spreadsheets related to the control of the cash receipts processes are retained and adequately safeguarded against accidental or deliberate disposal;
- All cash receipt tracking documents should record sufficient information to support daily cash receipt reconciliations; and,
- All transactional source documents should include evidence of supervisory review and approval.

Agency/Department Response:

PATH took many of the recommendations and developed new procedures to address concerns. The issue with the payment coupons was reviewed and a more secure internal control was developed. For instance, procedures were changed to issue only one coupon per month. This eliminated one participant sending two coupons for one monthly statement. Coupons are secured by the Lockbox contractor and double counted by independent sources. The totals are verified by state staff and unreconciled checks are added to PATH's daily receipts and deposited. The coupons are maintained for 6 months as a safety feature to address any complaints by beneficiaries about unresolved payments. If no complaints are received, the daily storage of coupons is destroyed after six months.

To eliminate loss of data the Department's Administrative Tally Sheet (Cash Log) is maintained daily and now stored on the F:Drive which is backed up by Computer Services Division and stored in a secure space.

The Department's Administrative Tally Sheet (Cash Log) has been modified to incorporate data to allow for reconciliation between lockbox receipts, cash receipts at PATH offices, deposit tickets, VISION revenue transactions and service recipients' account credits in ACCESS. We now reconcile on a daily basis.

Source documents relating to the Department's Administrative Service cash receipt processing is reviewed daily and the summary document is initialed indicating that the daily activity has been reviewed by the supervisor.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-15-FR**

Agency/Department: Department of Corrections

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Corrections did not comply with the reporting requirements for bank accounts established by the Treasurer's Office.

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit a June 30th reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required state agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

According to statements provided by banks, there were 26 bank accounts administered by the Department of Corrections in FY 2002. As of June 1, 2003 the Treasurer's Office had not received the required June 30, 2002 reconciliations and completed Department Bank Account Questionnaires for any of the 26 bank accounts administered by the Department of Corrections. The June 30, 2002 bank balances for these 26 accounts totaled $600,375.79.

Recommendation:

We recommend that the Department of Corrections implement adequate policies and procedures to ensure that all bank accounts controlled by the Department are reconciled on a timely basis to help ensure the accurate accounting and safeguarding of funds in the accounts. We also recommend that the Department implement the necessary policies and procedures to ensure timely compliance with the Treasurer's bank account and reconciliation reporting requirements to properly account for all funds.

Agency/Department Response:

The Department of Corrections has implemented the following schedule to insure that all bank accounts administered by the Department are reconciled for the fiscal year end and reported on a "Department Bank Account Questionnaire" to the Treasurer's Office in a timely manner:

July 25 – All questionnaires due to the DOC Business Office
July 30 – Submission by the DOC Business Office to the Treasurer's Office

Using the above schedule, the DOC did submit the SFY 2003 questionnaires in a timely manner.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-16-FS**

Agency/Department: Department of Corrections

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Corrections did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $27,900 was advanced to the Department of Corrections to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that Department of Corrections implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The Department of Corrections has implemented the following schedule to insure that all imprest/petty cash accounts administered by the Department are reconciled for the fiscal year end and reported on a "Imprest/Petty Cash Verification Form" to the Department of Finance and Management in a timely manner:

July 15 – All forms due to the DOC Business Office
July 18 – Submission by the DOC Business Office to the Department of Finance and Management

Using the above schedule, the DOC did submit the SFY 2003 forms in a timely manner.

<u>**Management Letter Comments**</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-17-FS**

Agency/Department: Office of Child Support

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Office of Child Support did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,000 was advanced to the Office of Child Support to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Office of Child Support had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Office of Child Support implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

Thank you for the opportunity to reply to your Management Letter comment regarding the Imprest/Petty Cash Verification Form for the fiscal year ended June 30, 2002. Attached please find a copy of the referenced form. As you will see, the form is dated July 10, 2002 and to the best of our recollection, it was mailed to the Department of Finance and Management, through the State Inter-Office (pink) Mail on that date. I am unable to explain why the Department of Finance and Management never received the form. However, had anyone from the Department of Finance and Management or the Office of the State Auditor contacted us at any time between the due date *of July 19, 2002 and the date of your letter, July 21, 2003, we would gladly have provided a copy of the form.*

The Office of Child Support has in place procedures to insure that the Imprest Cash account is reconciled monthly. In addition, at the end of the fiscal year, someone other than the person who performs the monthly reconciliation performs the year-end reconciliation. The process is completed as soon as the June bank statement is received and the Imprest/Petty Cash Verification Form is a result.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-18-FS**

Agency/Department: **Department of Health**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Health did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $4,400 was advanced to the Department of Health to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department of Health had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Department of Health implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

We agree with the Recommendation. The Department of Health will adhere to the Department of Finance & Management's reporting requirements and deadlines for reports as outlined in the Year End Closing Procedures distributed by Finance & Management. The distribution of the Year End Closing Procedures will be used as our notice to begin preparation of the Imprest/Petty Cash Verification Form.

<u>Management Letter Comments</u>
Financial Statements
Basic inancial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-19-FS**

Agency/Department: **Department of Developmental and Mental Health Services**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Developmental and Mental Health Services did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,750 was advanced to the Department of Developmental and Mental Health Services to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department of Developmental and Mental Health Services submitted Imprest/Petty Cash Verification forms with account balances of $1,400. The Department has not accounted for the remaining $350 in imprest/petty cash funds.

Recommendation:

We recommend that the Department of Developmental and Mental Health Services implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

DDMHS went through a substantial office reorganization at the time which the Imprest/Petty Cash Verification Forms were to be submitted. Due to such, one form was erroneously omitted. However, the $1,750 referenced in your observation as being used to establish imprest/petty cash accounts is the correct amount, and the difference between that and the $1,400 reported is related to that one missing report.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-20-FS**

Agency/Department: **Vermont Veterans' Home**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Vermont Veterans' Home did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $10,800 was advanced to the Vermont Veterans' Home to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Vermont Veterans' Home had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Vermont Veterans' Home implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

In response to the Management Letter Comments correspondence we received on July 24th, we would like to make it known that there are two Imprest/Petty accounts involved with your findings. Please be advised that the $10,000. account is strictly a checking account and that every month a reconciled copy of the Bank Statement is sent to the Treasurer's Office along

with a copy to James Reardon. In doing so, we believed we were in compliance.
As for the $800.00 Petty Cash account, that was also reconciled at year end as well as every time requests for replenishments are made. With the change of personnel, a copy of the Verification Form was not sent to the Department of Finance and Management, however we do have a reconciled Petty cash form for FYE02 available.

In the future, we will make sure that Robin Durkee of the Department of Finance and Management receives the required forms at year-end for both accounts.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-21-FS**

Agency/Department: Governor's Commission on Women

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Governor's Commission on Women did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,207 was advanced to the Governor's Commission on Women to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Governor's Commission on Women had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Governor's Commission on Women implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The Governor's Commission on Women closed our Imprest Petty Cash fund on May 16, 2001. It is my understanding from Robin Durkee in Finance that they (finance) didn't formally close the account until June 30, 2003.

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-22-FS**

Agency/Department: **Agency of Natural Resources Central Office**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Agency of Natural Resources did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,300 was advanced to the Agency of Natural Resources to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Agency submitted Imprest/Petty Cash Verification forms with account balances of $800. The Agency has not accounted for the remaining $500 in imprest/petty cash funds.

Recommendation:

We recommend that the Agency of Natural Resources implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The remaining $500.00 imprest/petty cash fund has been filed with the Department of Finance & Management, Financial Operations Division, for Fiscal Year 2002.

New procedures for year-end reporting have been implemented by the Agency of Natural Resources that will ensure that this omission does not occur again.

<u>**Management Letter Comments**</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-23-FR**

Agency/Department: Vermont Environmental Board

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Vermont Environmental Board did not comply with the reporting requirements for bank accounts established by the Treasurer's Office.

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit a June 30th reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required state agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

According to statements provided by the bank, there was one account administered by the Vermont Environmental Board in FY 2002. As of June 1, 2003 the Treasurer's Office had not received the required June 30, 2002 reconciliation and completed Department Bank Account Questionnaire for the one bank account administered by the Board. The June 30, 2002 bank balance for the account totaled $5,743.78.

Recommendation:

We recommend that the Vermont Environmental Board implement adequate policies and procedures to ensure that all bank accounts controlled by the Board are reconciled on a timely basis to help ensure the accurate accounting and safeguarding of funds in the accounts. We also recommend that the Department implement the necessary policies and procedures to ensure timely compliance with the Treasurer's bank account and reconciliation reporting requirements to properly account for all funds.

Agency/Department Response:

The required bank reconciliation has been completed for Fiscal Year 2002 and filed with the State Treasurer's Office.

New procedures for year-end reporting have been implemented by the Agency of Natural Resources that will ensure that this omission does not occur again.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-24-FR**

Agency/Department: **Department of Forrest, Parks and Recreation**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Forest, Parks and Recreation did not comply with the reporting requirements for bank accounts established by the Treasurer's Office.

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit a June 30th reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required State agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

According to statements provided by banks, there were eight bank accounts administered by the Department of Forest, Parks and Recreation in FY 2002. As of June 1, 2003 the Treasurer's Office had not received the required June 30, 2002 reconciliations and completed Department Bank Account Questionnaire for two of the eight bank accounts administered by the Department. The June 30, 2002 bank balances for these two accounts totaled $29,173.47.

Recommendation:

We recommend that the Department of Forest, Parks and Recreation implement adequate policies and procedures to ensure that all bank accounts controlled by the Department are reconciled on a timely basis to help ensure the accurate accounting and safeguarding of funds in the accounts. We also recommend that the Department implement the necessary policies and procedures to ensure timely compliance with the Treasurer's bank account and reconciliation reporting requirements to properly account for all funds.

Agency/Department Response:

The Agency of Natural Resources Director of Administrative Services has instituted a comprehensive "Year End Closing Procedures" checklist. This list is reviewed at least once a week with all Business Managers within ANR during the closeout process to ensure all requirement documents have been completed and forwarded to the requesting agency.

This process will ensure compliance with this standard.

Department of Forests, Parks & Recreation two remaining bank reconciliations indicate a dollar amount of $29,173.47. I have completed a bank reconciliation for the State Park Credit Card account, Bank account 6-00290827 which has a June 30, 2002 balance of $21,620.88 rather than the $29,032.33 which was relayed to me. Also, Bank account #84507458 at the Chittenden with a June 30, 2002 balance of $141.14 is part of an imprest cash account for which the reconciliation is not required.

A copy of the bank reconciliation for Account 6-00290827 has been forwarded to the State Treasurer's Office.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-25-FS**

Agency/Department: **Department of Forests, Parks, and Recreation**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Forests, Parks, and Recreation did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $27,050 was advanced to the Department of Forests, Parks, and Recreation to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department of Forests, Parks and Recreation had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Department of Forests, Parks and Recreation implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The Agency of Natural Resources Director of Administrative Services has instituted a comprehensive "Year End Closing Procedures" checklist. This list is reviewed at least once a week with all Business Managers within ANR during the closeout process to ensure all requirement documents have been completed and forwarded to the requesting agency.

The required FY2002 forms have been sent to Department of Finance & Management, Financial Operations Division. However, I do not agree with the dollar amount of $27,050 which you have listed. My records indicate that the total is $27,850 which is the amount I used when filing the required forms.

Also, the Department will develop and implement the necessary policies and procedures to ensure this omission doesn't occur again.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-26-FR**

Agency/Department: **Department of Fish and Wildlife**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Fish and Wildlife did not comply with the reporting requirements for bank accounts established by the Treasurer's Office.

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit a June 30th reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required State agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

According to statements provided by the bank, there was one account administered by the Department of Fish and Wildlife in FY 2002. As of June 1, 2003 the Treasurer's Office had not received the required June 30, 2002 reconciliation and completed Department Bank Account Questionnaire for the one bank account administered by the Department. The June 30, 2002 bank balance for the account totaled $0.

Recommendation:

We recommend that the Department of Fish and Wildlife implement adequate policies and procedures to ensure that all bank accounts controlled by the Department are reconciled on a timely basis to help ensure the accurate accounting and safeguarding of funds in the accounts. We also recommend that the Department implement the necessary policies and procedures to ensure timely compliance with the Treasurer's bank account and reconciliation reporting requirements to properly account for all funds.

Agency/Department Response:

The Agency of Natural Resources Director of Administrative Services has instituted a comprehensive "Year End Closing Procedures" checklist. This list is reviewed at least once a week with all Business Managers within ANR during the closeout process to ensure all requirement documents have been completed and forwarded to the requesting agency.

Also, the Department will develop and implement the necessary policies and procedures to ensure this omission doesn't occur again.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-27-FS**

Agency/Department: **Department of Fish and Wildlife**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Fish and Wildlife did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $100 was advanced to the Department of Fish and Wildlife to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department of Fish and Wildlife had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Department of Fish and Wildlife implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The Agency of Natural Resources Director of Administrative Services has instituted a comprehensive "Year End Closing Procedures" checklist. This list is reviewed at least once a week with all Business Managers within ANR during the closeout process to ensure all requirement documents have been completed and forwarded to the requesting agency.

This process will ensure compliance with this standard.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-28-FS**

Agency/Department: **Vermont Racing Commission**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Vermont Racing Commission did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $100 was advanced to the Vermont Racing Commission to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Vermont Racing Commission had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Vermont Racing Commission implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for imprest/petty cash funds.

Agency/Department Response:

The Vermont Racing Commission will work with the Department of Finance and Management to determine the status of the imprest/petty cash account.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-29-FS**

Agency/Department: **Vermont Human Rights Commission**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Human Rights Commission did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $250 was advanced to the Human Rights Commission to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Human Rights Commission had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that the Human Rights Commission implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

It appears that, for FY02, the Vermont Human Rights Commission somehow overlooked submitting the required information regarding its Imprest Cash Account. The Commission has previously and since, always submitted the necessary information regarding its Imprest Cash Account to the Department of Finance and Management. The Vermont Human Rights Commission will redouble its effort to ensure that required verification forms are submitted in a timely manner.

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-30-FS**

Agency/Department: Vermont Life

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that *Vermont Life* did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,200 was advanced to *Vermont Life* to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, *Vermont Life* had not completed the Imprest/Petty Cash Verification forms required by the Department of Finance and Management to account for the funds.

Recommendation:

We recommend that *Vermont Life* implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

At the end of FY02, I filled out the Treasurer's Office Bank Account Questionnaire for the Imprest Cash Account (used for refunds and maintained at $1,000) and submitted it to the Treasurer's Office, under the impression that since it was a checking account that it was the proper form to be submitted. Since I did not receive it back from the Treasurer's Office telling me that I did not have to do their questionnaire and the Department of Finance and Management did not tell me *that they had not been received, I did not realize I had filled out the incorrect form. I do not find a copy of the form for the Imprest Cash Account used as the cash drawer for in-house sales ($200) and so, conclude it was not done.*

In FY03 I inquired of the Treasurer's Office which form I should be filling out and consequently, FY03 was done within the required time frame on the proper forms. A check of my records shows that FY01 was also done within the required time frame using both forms. If you would like copies of those years or the Treasurer's Office Questionnaire submitted for FY02, please let me know.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-31-FS**

Agency/Department: Vermont Lottery Commission

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Vermont Lottery Commission did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $300,000 was advanced to the Vermont Lottery Commission to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Vermont Lottery Commission submitted Imprest/Petty Cash Verification forms with an account balance of $214,192.38. The Commission has not accounted for the remaining $85,807.62 in imprest/petty cash funds.

Recommendation:

We recommend that the Vermont Lottery Commission implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

At 6/30/2002, the imprest/petty cash account had a balance of $146,894 and receivables from the Treasurer's office of $136,750 and $216,356. This is a total of $500,000. The $500,000 includes the $300,000 advanced as 'petty cash' from the Treasurer's Office and an additional $200,000 from the Vermont Lottery Online checking account, based on a request from the bank to increase *the amount. The receipts from the Treasurer's Office are attached.*

The amount of $214,192.38 is actually the balance in our Vermont Lottery Winners Account, Chittenden Bank Account #670265730. This is not the petty cash account.

We reported the petty cash balance for the fiscal year ended June 30, 2002, to Gayle Rowe of the Treasurer's Office.

Agency/Department: **Office of the Defender General**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Office of the Defender General did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $2,100 was advanced to the Office of the Defender General to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Office of the Defender General submitted Imprest/Petty Cash Verification forms with an account balance of $100. The Office has not accounted for the remaining $2,000 in imprest/petty cash funds.

Recommendation:

We recommend that the Office of the Defender General implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

I received your memorandum of July 21, 2003 with attached Comment #2002-02FS for Office of the Defender General. In this comment the observation is made that "As of June 30, 2003, the Office of the Defender General submitted Imprest/Petty Cash Verification forms with an account balance of $100. The Office has not accounted for the remaining $2,000 in imprest/petty cash *funds." This information is not correct. As of June 30, 2003, the Office of the Defender General had reported the full $2,100 in imprest/petty cash funds to the Department of Finance and Management. We reported the $100 petty cash fund to the Department of Finance and Management in July 2002, and reported $2,000 imprest checking accounts to the Treasurer's Office in July 2002. I became aware in May 2003 that we had not reported the $2,000 imprest checking accounts to the Department of Finance and Management, and on May 14, 2003, our accountant completed the paperwork on these two accounts and provided it to the Department of Finance and Management.*

Our year-end closing checklist now provides for reporting of all three imprest/petty cash funds to the Department of Finance and Management. In fact, we completed the three FY 2003 reports on July 1, 2003.

<u>Management Letter Comments</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-33-FS**

Agency/Department: **Office of the Attorney General**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Office of the Attorney General did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $1,622.46 was advanced to the Office of the Attorney General to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the AG's Office submitted Imprest/Petty Cash Verification forms with an account balance of $1,036.89. The AG's Office has not accounted for the remaining $585.57 in imprest/petty cash funds.

Recommendation:

We recommend that the Office of the Attorney General implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

The petty cash verification forms provided a reconciliation of the Attorney General's Petty Cash account established on August 22, 2001 with an initial balance of $1,000. An additional $36.89 was accumulated through interest credits which created an ending balance of $1,036.89. This is the amount certified in our July 1, 2002 Petty Cash Verification and indeed is the correct *amount. Finance & Management indicates that there had been an account established on February 24, 1976 which had never been eliminated and for which I have no records. This discrepancy was not known until your office brought this issue to our attention. Finance and Management has closed this 1976 account as of 8/28/2003 via Journal Entry #0000334227. The records of Finance and Management now agree with the certification provided by this office.*

Management Letter Comments
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-34-FS**

Agency/Department: **Department of Motor Vehicles**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Department of Motor Vehicles did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification Forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $6,396 was advanced to the Department of Motor Vehicles to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Department submitted Imprest/Petty Cash Verification Forms with account balances of $4,945. The Department has not accounted for the remaining $1,451 in imprest/petty cash funds.

Recommendation:

We recommend that the Department of Motor Vehicles implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

DMV reviewed the imprest /petty cash verification forms and determined that it had omitted petty cash from three drawers in Montpelier. The list submitted to Finance & Management in the amount of $4,945 excluded $1,412.38 in error. The new total petty cash amount is $6,357.38. The remaining difference from the general ledger balance is $38.62. Cash in the amount of $30.00 was used to conduct an authorized investigation. The Department has accounted for all cash funds with the exception of $8.62. Adequate procedures are in place to ensure accurate reporting of petty cash funds.

Section II

Management Letter Comments
Source: Fiscal year 2002 OMB Circular A-133
Federal Single Audit

Management Letter Comments
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-01-FSA**

Agency/Department: Agency of Human Services – Office of Economic Opportunity

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Community Services Block Grant (CFDA #93.569)

Requirement:

A pass through entity is responsible for:

- Identifying to the subrecipient the Federal award information (e.g. CFDA title and number, award name, name of Federal agency) and applicable compliance requirements;

- Monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers Federal awards in compliance with Federal requirements;

- Ensuring required audits are performed and requiring the subrecipient to take prompt corrective action on any audit findings; and,

- Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable Federal regulations.

Factors such as the size of the awards, percentages of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures.

Monitoring activities may take various forms, such as reviewing reports submitted by the subrecipient, performing site visits to the subrecipient to review financial and programmatic records and observe operations, arranging for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations, reviewing the subrecipient's single audit or program specific audit results and evaluating audit findings and the subrecipient's corrective action plan.

The requirements for subrecipient monitoring are contained in the A-102 Common Rule ('___.37 and '____.40 (a)), OMB Circular A-110 ('___.50(a)), Federal awarding agency program regulations, and the terms and conditions of the award.

Finding:

The Office of Economic Opportunity (the "Office") grants approximately 95 percent of its annual Community Services Block Grant (CSBG) award to five Community Action Agencies (CAAs) for the provision of community support services. During our testwork over subrecipient monitoring, we noted the following:

- An A-133 audit report is required to be submitted when a subrecipient expends more than $300,000 in federal funds. The audit reports are reviewed and a letter is sent to the CAA to discuss any issues that were noted during the Office's review. During our testwork over the monitoring of the audit reports, we noted 4 out of 5 instances where the A-133 audit report was obtained by the Office but had not been reviewed.

- Annually the Office conducts an onsite monitoring visit for all of its subrecipients. During the monitoring visit the Office reviews the subrecipient's control processes, a sample of cash receipts and disbursements and overall compliance with program regulations. Upon completion of the review, the Office sends a letter to the subrecipient summarizing findings and any required corrective action. During our testwork, we noted 1 out of 5 instances where the summary letter was not completed.

Questioned Costs:

None.

Recommendation:

We recommend that the Office review its existing subrecipient monitoring policies and procedures and implement the necessary measures to ensure that audit reports are obtained, reviewed and followed up on.

Agency/Department Response:

Corrective Action Plan: *All audit reports have been reviewed and letters sent to subrecipients. A "Schedule of Audit Reports" has been setup using Excel. The Schedule indicates which sub-recipients must submit audit reports, the dates that the reports are received by OEO, the dates that the audits are reviewed by OEO, and the date that the letters of review are sent to the sub-recipients as well as the dates that the audits are cleared by OEO.*

This Schedule is posted on the OEO Business Manager's bulletin board for review and updating.

Completion Date of Corrective Action: *This corrective action was taken on April 22, 2003.*

Contact Person: Richard J. Germana, OEO Business Manager, 241-2456.

Management Letter Comments
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-02-FSA**

Agency/Department: Agency of Human Services – Office of Economic Opportunity

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Community Services Block Grant (CFDA #93.569)

Requirement:

Earmarking:

- States must use at least 90 percent of the allotted funds for subgrants to eligible entities (42 USC 9907(a)(1)).

- State administrative expenses, including monitoring activities, may not exceed the greater of $55,000 or 5 percent of CSBG funds. Such expenditures must be made from the portion of funds remaining to a State after subgranting at least 90 percent of funds to eligible entities (42 USC 9907(b)(2)).

Finding:

At the beginning of each grant period, the Office of Economic Opportunity (the "Office") reviews the federal grant award and makes an initial determination on how funds will be expended in accordance with the federal earmarking requirements. Based on this analysis, grant agreements are executed with subrecipients and the remaining portion of funds are used for administrative purposes. During our review of the program, we noted that although the Office was in compliance with the earmarking requirements for FY 2002, they do not have any control procedures in place to monitor earmarking requirements using actual expenditures.

Questioned Costs:

None.

Recommendation:

We recommend that the Office implement the necessary control policies and procedures to monitor the earmarking requirements to help ensure that the required earmarking percentages are met based on actual expenditures incurred.

Agency/Department Response:

All quarterly cost allocation reports, to the AHS Administrative Services Division, have quarterly maximum amounts of CSBG administration allowed OEO indicated on the spreadsheet column.

All subrecipient payments are based on their grant agreements with OEO. The maximum amount of each grant is based on the allocation formula, done on an Excel spreadsheet. The subrecipient grants are modified when OEO receives its notice of final award amount, so as to assure the 90% pass through requirement is met.

Further, a ledger of all CSBG award allocations and expenditures is and has been maintained since the inception of the Community Services Block Grant.

Completion Date of Corrective Action: *The corrective action regarding the cost allocation reports was taken on April 22, 2003.*

Contact Person: Richard J. Germana, OEO Business Manager, 241-2456.

Management Letter Comments
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-03-FSA**

Agency/Department: Agency of Human Services – Department of Aging and Disabilities

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Rehabilitation Services – Vocational Rehabilitation Grants to States (CFDA #84.126)

Requirement:

The State plan must assure that:

(1) An individualized plan for employment (IPE) is developed and implemented in a timely manner for each individual determined to be eligible for vocational rehabilitation services or, if the designated State unit is operating under an order of selection in accordance with Sec. 361.36, for each eligible individual to whom the State unit is able to provide services; and,

(2) Services will be provided in accordance with the provisions of the IPE. (34 CFR 361.45-46).

Finding:

Once a participant is determined to be eligible for services under the Vocational Rehabilitation Program, an IPE is developed by the counselor and the participant. The IPE includes information on the job the participant has selected, the services that the participant will need to obtain and maintain the job and timeliness. The IPE is documented on Form VR 48 and signed by both the counselor and the participant. The IPE is reviewed annually to ensure that it is accurate based on the participant's current circumstances.

During our testwork over the IPE process we selected a sample of 25 participants and noted the following:

- One instance where an applicant applied for services on February 1, 2000 and was certified eligible on February 26, 2001, however and IPE was not developed and no formal closure was noted to indicate that participation in the program had ended.

- Four instances where there did not appear to be an annual review of the IPE:

    - In one case, the IPE was signed October 2, 2000 and there are consistent notes in the file through April 2001, indicating participant involvement. The next notes were dated March 12, 2002 when the counselor called the serving agency to check on the participant's status;

    - In two instances there were continuous notes in the files but there was no indication that any of these notes were intended to represent a formal yearly review; and,

    - In one case the participant changed VR offices and the review appears to have been overlooked.

Questioned Costs:

Not determinable.

Recommendation:

We recommend that the Department review its current practices over conducting annual reviews and implement the necessary measures to help ensure that client files contain the proper documentation of the IPE process and that reviews are being performed on a timely basis.

Agency/Department Response:

Step 1 - The issue of documenting the annual IPE review was noted in the most recent record review by staff from the Rehabilitation Services Administration. Consequently, corrective action was implemented earlier this year and involved a discussion of this requirement during regional staff meetings in all VR regions. These reviews were completed on May 15, 2003.

Step 2 - The Rehabilitation Services Coordinator will randomly sample case records during local office reviews on an on-going basis. Sampling will continue until offices are showing at least a 95 percent rate of compliance with this requirement.

Timelines: Step 1 is complete and Step 2 will be implemented in all scheduled visits after July 1, 2003.

Contact Person: Thomas A. Pombar, Rehabilitation Services Coordinator, 241-2728.

<u>Management Letter Comments</u>
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-04-FSA**

Agency/Department: Agency of Human Services – Department of Aging and Disabilities

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Rehabilitation Services – Vocational Rehabilitation Grants to States (CFDA #84.126)

Requirement:

To provide reasonable assurance that matching and maintenance of effort requirements are met using only allowable funds or costs which are properly calculated and valued.

Finding:

During our review of the Department's procedures over matching and maintenance of effort, we noted that while the Department was in compliance the requirements for FY 2002, there is no formal documentation on how these requirements are being monitored throughout the year.

Questioned Costs:

None.

Recommendation:

We recommend that the Department review its current practices and implement the necessary control policies and procedures to help ensure that the matching and maintenance of effort requirements are adequately monitored and that the process is documented.

Agency/Department Response:

DAD monitors expenses quarterly at the completion of the cost allocation. The VISION system has to provide meaningful management reports that can track expenditures monthly or more often to specific programs across DEPTID's and compare them to budgeted amounts. DAD will continue to work with AHS staff in developing the creation of VISION reports that will provide this type of data in a timely format that does not require heavy manipulation of data by financial staff.

Completion Date of Corrective Action: *As soon as possible in the State Fiscal Year 2004.*

Contact Person: James Giffin, Business Manager, 241-2410.

Agency/Department: Agency of Transportation

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Airport Improvement Program (CFDA #20.106)

Highway Planning and Construction (CFDA #20.205)

Federal Transit Administration Cluster:
Capital Investment Grants—Capital Grants (CFDA #20.500)
Formula Grants—Urbanized Area Formula Program (CFDA #20.507)

Requirement:

The applicable reporting forms are as follows:

1. Request for Advance or Reimbursement (SF-270 or FAA Form 5100-61). Recipients use the SF-270 to request Federal drawdowns for capital planning grants; and,

2. Outlay Report and Request for Reimbursement for Construction Program (SF-271 or FAA Form 5100-60). Recipients use the SF-271 to request Federal drawdowns for capital improvement grants.

Finding:

The Agency uses an internal accounting system, STARS, to track and monitor expenditures on a project basis. The expenditure information is interfaced with the State of Vermont's centralized accounting system, VISION, on a daily basis. During State FY 2002, the STARS system was not reconciled to the VISION system to ensure that the data interface was working properly and that expenditures were properly and accurately recorded.

Questioned Costs:

Not determinable.

Recommendation:

We recommend that the Agency implement the necessary policies and procedures to ensure that STARS and VISION are reconciled in a timely manner.

Agency/Department Response:

We agree. VAOT staff and VISION staff have successfully completed the interface programs needed. These programs will help ensure a more timely reconciliation process in the future.

Scheduled Completion Date: *Current.*

Contact Person: Raylene Jacobs, Chief Financial Officer, (802) 828-2834.

<u>**Management Letter Comments**</u>
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-06-FSA**

Agency/Department: Agency of Transportation

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Highway Planning and Construction (CFDA #20.205)

Requirement:

A pass-through entity is responsible for:

- Identifying to the subrecipient the Federal award information (e.g., CFDA title and number, award name, name of Federal agency) and applicable compliance requirements;

- Monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers Federal awards in compliance with Federal requirements;

- Ensuring required audits are performed and requiring the subrecipient to take prompt corrective action on any audit findings; and,

- Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable Federal regulations.

Factors such as the size of awards, percentage of the total program's funds awarded to subrecipients, and the complexity of the compliance requirements may influence the extent of monitoring procedures.

Monitoring activities may take various forms, such as reviewing reports submitted by the subrecipient, performing site visits to the subrecipient to review financial and programmatic records and observe operations, arranging for agreed-upon procedures engagements for certain aspects of subrecipient activities, such as eligibility determinations, reviewing the subrecipient's single audit or program-specific audit results and evaluating audit findings and the subrecipient's corrective action plan.

The requirements for subrecipient monitoring are contained in the A-102 Common Rule ('___.37 and '___.40(a)), OMB Circular A-110 ('___.50(a), Federal awarding agency program regulations, and the terms and conditions of the award.

Finding:

Within the Highway, Planning and Construction program, there are two Agency divisions that grant funds to subrecipients — Policy and Planning and Program Development. Policy and Planning grants funds to regional and metropolitan planning commissions to facilitate, promote and coordinate public participation in the transportation planning process and Program Development grants fund to municipalities to facilitate the development of local facilities such as bike paths and park-and-rides.

Both divisions enter into signed grant agreements with each subrecipient which outline the terms, scope and responsibilities of the grant. Included in the grant agreements are the project costs that are agreed upon by the parties, which includes the federal and state matching share. The project cost is the maximum limiting amount that will be paid to the subrecipient unless the agreement is amended. The Agency monitors subrecipients through receipt of invoices and receipt of annual audited financial statements and A-133 audit reports for entities with federal expenditures greater than $300,000. During our review of the Agency's granting process and monitoring procedures, we noted the following:

- One out of the 15 subrecipients selected for test work had expenditures, which exceeded the grant agreement's maximum limiting amount;

- Five out of the 15 subrecipients had not submitted an audit report within the required 9-month timeframe; and,

- Ten out of the 15 subrecipient audit reports had not been monitored or reviewed in a timely manner.

Questioned Costs:

$2,600. This represents the amount paid to the subrecipient over the grant agreement's maximum limiting amount.

Recommendation:

We recommend that the Agency review its existing subrecipient monitoring policies and procedures and implement the necessary measures to adequately monitor subrecipients to help ensure that all expenditures are allowable and in compliance with federal regulations.

Agency/Department Response:

We agree. The Agency Audit Section is responsible for reviewing and responding to Single Audit reports. All Single Audit findings reports received for fiscal years 1999 through 2001 have been reviewed by the Audit Section. The Agency will revise its subrecipient monitoring procedure for grantees who receive less than the Single Audit threshold.

Scheduled Completion Date: *Current.*

Contact Person: Mike Pollica, Chief of Audit, (802) 828-3506.

Management Letter Comments
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-07-FSA**

Agency/Department: Agency of Natural Resources

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Capitalization Grants for Drinking Water State Revolving Fund (CFDA #66.468)

Requirement:

The State shall establish a separate account, or series of accounts, that is dedicated solely to providing loans and other forms of financial assistance from the Drinking Water State Revolving Fund (DWSRF). All loan repayments (including principal and interest) interest earnings on investments, capitalization grants (except that portion the State intends to use as set-asides), State match and transfers from the Clean Water State Revolving Fund (CWSRF) must be credited directly to DWSRF. A State must maintain separate and identifiable accounts for the portion of the capitalization grant to be used for set-aside activities (40 CFR sections 35.3550(f) and (g)).

Transfers between the DWSRF and the CWSRF must be approved by the State Governor (40 CFR section 35.3530(c)). Repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 20 years after project completion, with the exception that loans qualified for disadvantaged communities can be amortized over 30 years (40 CFR sections 35.3525(a) and (b)(3)).

Finding:

In accordance with Federal guidelines, the Agency maintains a separate bank account that is only used for providing loans and other forms of financial assistance to qualified borrowers through the DWSRF. All municipal loan applicants are required to complete a loan application through the Vermont Municipal Bond Bank and all private systems complete a similar application through the Vermont Economic Development Authority (VEDA). Once the loan is approved the Vermont Municipal Bond Bank, or VEDA in the case of a private system, disburses the funds as directed by the Agency. To track the loan disbursement activity at each lending institution, the Agency's

Facilities Engineering Division (FED) receives monthly disbursement statements from the Vermont Municipal Bond Bank and quarterly statements from VEDA. The FED reconciles these statements to an internally prepared audit sheet that is utilized to track loan disbursements to ensure only the approved amount of funds were released to the applicant.

During our test work over loan disbursements, we noted that the Department had not completed three out of the four quarterly bank reconciliations for the VEDA account. Upon our request, the Department did complete the reconciliations.

Questioned Costs:

None.

Recommendation:

We recommend that the Department implement the necessary control policies and procedures to ensure that the necessary account reconciliations are performed in a timely manner in order to help ensure the integrity of the assets maintained in the DWSRF.

Agency/Department Response:

Corrective Action: *All bank statements will be reconciled by DEC within 10 business days of receipt.*

Anticipated Completion Date: *Action completed, as of May 20, 2003.*

Contact Person: Jill Gould, DEC Business Manager, 241-3810.

<u>Management Letter Comments</u>
OMB Circular A-133
Federal Single Audit
For the Fiscal Year Ended June 30, 2002 **Comment #2002-08-FSA**

Agency/Department: Agency of Natural Resources

Standard:

The American institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Federal Grants:

Capitalization Grants for Drinking Water State Revolving Fund (CFDA #66.468)

Requirement:

The State shall establish a separate account, or series of accounts, that is dedicated solely to providing loans and other forms of financial assistance from the Drinking Water State Revolving Fund (DWSRF). All loan repayments (including principal and interest) interest earnings on investments, capitalization grants (except that portion the State intends to use as set-asides), State match and transfers from the Clean Water State Revolving Fund (CWSRF) must be credited directly to DWSRF. A State must maintain separate and identifiable accounts for the portion of the capitalization grant to be used for set-aside activities (40 CFR sections 35.3550(f) and (g)).

Transfers between the DWSRF and the CWSRF must be approved by the State Governor (40 CFR section 35.3530(c)). Repayment of loans shall begin within one year after project completion, and loans shall be fully amortized over not more than 20 years after project completion, with the exception that loans qualified for disadvantaged communities can be amortized over 30 years (40 CFR sections 35.3525(a) and (b)(3)).

Finding:

The Agency maintains a separate account with the Chittenden bank where all DWSRF loan principal and interest repayments, interest earnings and state matching funds are deposited. During our test work over borrower repayments, we noted that the Agency does not have any procedures in place for determining when loans should enter repayment status or for determining the project completion date. As a result, the Department does not have any policies and procedures in place to ensure that the repayment of all loans begins within one year after the project completion date.

All municipal water system loans are processed through the Vermont Municipal Bond Bank and all private water system loans are processed through the Vermont Economic Development Authority. The Agency relies on these two institutions to ensure that the borrowers repay their loans on a timely basis. We were unable to identify the population of loans that should have entered repayment status and therefore were unable to test this compliance requirement.

Questioned Costs:

Not determinable.

Recommendation:

We recommend that the Agency review its policies and procedures to ensure all loans enter repayment status within the appropriate time period in order to ensure compliance with the above stated requirements.

Agency/Department Response:

Corrective Action: *A Tracking System will be implemented which will identify the final contract completion date for the construction work being performed under each loan. Based on this date, the required loan repayment start date will be calculated. As part of the bank reconciliation process, repayments received will be compared to required repayment start dates.*

Anticipated Completion Date: *The tracking system will be fully implemented by December 31, 2003. New loans and loan amendments will become part of the tracking system as executed, existing loans will be researched and added to the tracking system by December 31, 2003.*

Contact Person: Jill Gould, DEC Business Manager, 241-3810.

Section III

Management Letter Comments
Source: Financially-Related Audits
Vermont Court System

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-01-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

According to 32 V.S.A. § 431: "Each agency or department of the state shall be required to obtain the approval of the treasurer to establish and maintain a bank account of a selected bank as well as develop procedures, approved by the treasurer, to reconcile a bank account."
In addition 32 V.S.A. § 401 (b) requires that "[t]he Treasurer shall keep an accurate accounting in books of account of all moneys received by the State from whatever source and of all moneys withdrawn from the Treasury of the State upon warrants issued by the Commissioner of Finance and Management."

In a June 6, 2002 Memorandum regarding its FY 2002 Year End Closing Procedures, the Treasurer's Office reminded State agencies/departments of their responsibility to reconcile all bank accounts monthly and required them to submit a June 30th reconciliation for each bank account to the Treasurer by July 31, 2002. The Treasurer's Office also required State agencies/departments to complete a separate "Department Bank Account Questionnaire" for each bank account in order to collect information specific to each account. The account specific information includes the type of account, source of funds, types of expenditures and information related to the personnel responsible for receiving and depositing the funds, recording the receipts, authorizing expenditures or withdrawals, and reconciling the bank statements.

During our audit test work over cash we noted that a number of Courts did not comply with the reporting requirements for bank accounts established by the Treasurer's Office. According to statements provided by banks, there were 100 Court-related bank accounts in FY 2002. As of June 1, 2003 the Treasurer's Office had not received the required June 30, 2002 reconciliations and completed Department Bank Account Questionnaires for 29 of the 100 Court bank accounts. The June 30, 2002 bank balances for these 29 accounts totaled $502,008.45.

Recommendation:

We recommend that the Court Administrator's Office implement adequate policies and procedures to ensure that all bank accounts controlled by the Courts are reconciled on a timely basis to help ensure the accurate accounting and safeguarding of funds in the accounts. We also recommend that the Court Administrator's Office implement the necessary policies and procedures to ensure timely compliance with the Treasurer's bank account and reconciliation reporting requirements.

Agency/Department Response:

A separate packet of instructions is mailed to each court manager outlining year-end requirements and corresponding deadlines. Forms in the fiscal year-end packet for courts to complete are distributed to court managers along with written instructions to return them directly to the Court Administrator's Office, Finance Department. However, not all forms are completed and returned by managers in a timely fashion. In addition, some managers return their completed forms directly to the Treasurer's Office which complicates any method of tracking the responses.

With the implementation of VISION fund accounting, financial processing requirements at the department level have increased significantly. With limited time and limited resources, proper follow-up procedures are lacking. For some time, the Court Administrator's Office has had only one position designated in the Finance Department to monitor and reconcile the accounting procedures for all courts. Based on the current limitations of available staff time dedicated to this function, every reasonable effort is being made to ensure compliance.

Courts are routinely reminded via email each month and again at the end of each fiscal quarter to submit their deposit packets and accounting reports. A reminder email to complete and submit the year-end information can be included in the future. This department will forward to the Court Administrator a list of those courts or programs that have not complied in a timely manner to the instructions so he may direct court managers to complete their financial responsibilities promptly.

<u>**Management Letter Comments**</u>
Financial Statements
Basic Financial Statement Audit
For the Fiscal Year ended June 30, 2002 **Comment #2002-02-FR**

Agency/Department: **Court Administrator's Office**

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance assets are safeguarded against unauthorized acquisition, use, or disposition; reasonable assurance regarding the reliability of financial reporting; compliance with applicable laws and regulations; and effectiveness and efficiency of operations.

Observation:

During our audit test work over cash we noted that the Vermont Judiciary and the Court Administrator's Office did not comply with the reporting requirements for imprest/petty cash accounts established by the Department of Finance and Management.

In the May 3, 2002 Year End Closing Procedures for FY 2002, the Department of Finance and Management required State agencies/departments to complete and submit Imprest/Petty Cash Verification forms for all imprest/petty cash accounts by July 19, 2002. According to information provided by the Department a total of $220,779.69 was advanced to the Vermont Judiciary to establish imprest/petty cash accounts as of June 30, 2002. As of June 20, 2003, the Vermont Judiciary and the Court Administrator's Office submitted Imprest/Petty Cash Verification forms with account balances of $4,100. The Vermont Judiciary and the Court Administrator's Office have not accounted for the remaining $216,679.69 in imprest/petty cash funds.

Recommendation:

We further recommend that the Vermont Judiciary and the Court Administrator's Office implement adequate policies and procedures to ensure timely compliance with the Department of Finance and Management's reporting requirements and properly account for all imprest/petty cash funds.

Agency/Department Response:

A separate packet of instructions is mailed to each court manager outlining year-end requirements and corresponding deadlines. Forms in the fiscal year-end packet for courts to complete are distributed to court managers along with instructions to return them directly to the Court

Administrator's Office, Finance Department. However, the form itself instructs everyone to return it directly to Financial Operations. The process of receiving completed forms is therefore inconsistent. In addition, only petty cash funds were reported in the past to the Treasurer's Office. Disbursement accounts at the courts were not reported using the Petty Cash Verification form. ***This is the first time we have been notified that disbursement accounts need to be reported using the petty cash process.*** *The Treasurer's Office has modified the Petty Cash Verification form for year-end FY03 to include a separately labeled form for each court and the account that needs to be reported. These have been distributed to each court as part of the FY03 year-end closing.*

With the implementation of VISION fund accounting, financial processing requirements have increased significantly at the department level. Based on the limited availability of staff time, every reasonable effort is being made to ensure compliance with year-end requirements. Courts are routinely reminded via email each month and again at the end of each fiscal quarter to submit their deposit packets and accounting reports. A reminder email to complete and submit the year-end information can be included in the future. This department will forward to the Court Administrator a list of those courts or programs that have not complied in a timely manner to the instructions so he may direct court managers to complete their financial responsibilities promptly.

__Management Letter Comments__
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-03-FR**

Agency/Department: Office of the Court Administrator

Standard:
The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation*:*
During our test work on the internal controls over cash we noted that the List of Fines Due to the State as of the Quarter Ended June 30, 2002 totaled $405,944 at the following courts: Rutland District $274,293, Orleans District $74,841, Essex District $16,619, and Caledonia District $40,191. These amounts represent accounts receivable from fines assessed and not paid.

The List of Fines Due State at the Rutland Family Court represents Public Defender fees that were contracted for and unpaid. The report totals $10,600 with $8,600 or 81 percent past due. Some of the dockets date from 1994.

Upon further review we compared the total Fines and Fees Due to State at all District and Family Courts for the fiscal years ending June 30, 2001 and June 30, 2002, and noted a 20 percent increase statewide as outlined below:

	June 30, 2001	June 30, 2002	Percent Change
Addison District	$ 66,763	$ 83,036	24%
Bennington District	195,730	195,729*	0%
Caledonia District	46,179	57,787*	25%
Chittenden District and Family	339,080	505,085	49%
Essex District and Family	6,841	2,955	-57%
Franklin District and Family	48,108	68,144	42%
Grand Isle District and Family	5,781	8,735	50%
Lamoille District and Family	14,308	27,035	89%
Orange District and Family	60,961	54,505	-11%
Orleans District	68,191	74,841	10%
Rutland District	221,414	293,113*	32%
Washington District	168,085	118,409*	-30%
Windham District	183,708	231,190	26%
Windsor District and Family	175,648	208,025	18%
	$1,600,797	$1,928,589	20%

* Totals are for September 30, 2002 as June 30, 2002 totals were unavailable.

Recommendation:

We recommend that the Court Administrator's Office strengthen its policies and procedures for the collection of fines assessed by the Courts. Similar efforts have been undertaken in Iowa, New York and Virginia and procedures and policies could be adopted from those states, as well as from Vermont's Office of Child Support.

At a minimum, the Court Administrator's Office should consider the following remedies:

- Examine the benefit of seeking statutory authority similar to Vermont's Office of Child Support to:

    - Intercept Federal and State tax refunds awarded to individuals or corporations;

    - Revoke an individual's state license (such as driver's or professional license);
    - Garnish wages; and,

    - Intercept any lottery winnings;

- Provide training and dedicate time and resources to County Clerk's offices to ensure the timely collection of fines and fees owed to the state; and,

- Hire an additional person to work solely on the collection of accounts receivable for all courts, and whose position could be funded, in part, with the overdue fines and fees they collect.

Agency/Department Response:

We agree in large part with the auditor's recommendation. The Judiciary will request the Administration to submit legislation to enhance the tools to collect overdue fines. However, an analysis of receivables over time shows that after ten years 99% of what is due the state is paid using current methods. So the question of whether it is cost effective for the state to pay for additional staff resources to devote to collections is debatable. Additional resources may collect the money a little sooner but certainly will not enhance the amount that is ultimately collected. What would make more sense is for the State of Vermont to establish a collection function with the Agency of Administration or the Treasurer's Office where the collection tools could be consolidated and to which state departments could forward overdue obligations.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-04-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

During our test work on the internal controls over cash we noted Deputy Clerks at the Caledonia District and Superior Courts, Essex District, Family and Superior Courts, Orleans District, Family and Superior Courts, and Rutland Superior Court prepare quarterly reports and bank reconciliations for the review and approval by the Court Managers. One person at the Fair Haven Probate Court handles cash collections, records cash transactions and signs quarterly reports. We did not find any documentation or evidence during our test work of managerial review or approval.

Recommendation:

We recommend that the Court Managers review and sign or initial the reports and bank statement reconciliations prior to sending them to the Court Administrator's Office. In one-person offices, the Probate Judge could review the reports. The forms should be modified to include spaces for the Manager's initials and date of review.

We further recommend that managerial review and approval of quarterly reports and bank reconciliations be included in the Court Administrator's Manual of Instructions.

Agency/Department Response:

We agree with the auditor's recommendation. Starting with FY04, monthly deposit worksheets for all courts includes an "approving signature block" for court managers. Any deposit submitted to the Finance Department without an "approval signature" will be promptly returned to the court manager for review. Courts are routinely reminded, via email, each month and again at the end of each fiscal quarter to submit their deposit packets and accounting reports in a timely manner.

With the implementation of VISION fund accounting, financial processing requirements at the department level have increased significantly. Based on the current limitations of available staff time dedicated to this function, every reasonable effort is being made to ensure compliance. A list of courts not meeting these specified deadlines will be submitted to the Court Administrator for further needed action.

We also agree that the accounting manuals of instruction need updating and revision. These manuals will be updated over time as staffing permits.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-05-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

The Court Administrator's Manual of Instructions (Section II. C. Page 5) states: "Deposits must be made whenever the total amount of money, regardless of account, is $250 or more, except that deposits are not required more frequently than daily."

During our test work on the internal controls over cash we noted that deposits frequently exceeded the recommended amount specified in the Court Administrator's Manual of Instructions. At the Caledonia Superior Court, Cash Receipts were deposited every two weeks during the Quarter Ended March 31, 2002 in amounts averaging $1,180 per deposit. At the Rutland Family Court, there were three deposits averaging $4,071 during the Quarter Ended June 30, 2002, while in the Quarter Ended March 31, 2002 there were four deposits averaging $4,320.

Recommendation:

We recommend that the Court Administrator's Office monitor the Family and District Courts' compliance with the procedures for making deposits as outlined in the Manual of Instructions to help ensure the reliability of accounting records and the safety of State assets.

Agency/Department Response:

We agree with the auditor's recommendation that the minimum deposit amount stated in the current Manual of Instructions needs to be increased and more reflective of the fine amounts collected. We will review the average deposits and set a level more indicative of today's environment. In addition, our education department will be requested to train more staff in the courts to enter deposits into the VISION accounting system.

Management Letter Comments
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-06-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

During our test work on the internal controls over cash we noted that there are inadequate facilities to store cash receipts at the Orleans District Court and the Rutland Family Court.

At the Orleans District Court, receipts are currently stored in a file cabinet. Bail receipts are in cash and can be received during weekends. The Court uses a courier service which picks up the bank deposit twice weekly. At the Rutland Family Court, cash receipts are stored in an unlocked file cabinet located by the desk of the Assistant Clerk and in view of counter operations.

Recommendation:

We recommend the purchase and installation of fireproof safes with locks for secure storage of cash receipts collected until deposited or courier arrival at these courts.

Agency/Department Response:

We agree with the auditor's recommendation. We will request of the Legislature money to purchase fireproof storage for cash for each of the courts.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-07-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

During our test work on the internal controls over cash we noted that refund checks are processed in the VISION System for fines and fees paid in the wrong court or when incorrect amounts are paid. There does not appear to be any notification to the courts when the refund checks have been issued.

We also noted that one Assistant Clerk performs all processing of receipts and entry into the VISION System at the Rutland District and the Rutland Superior Courts. No other accounting personnel have received training in the VISION System at these two courts.

The courts do not print a report from the VISION System that verifies deposits of fees collected. Complete processing of deposits should involve printing the completed transactions after posting to ensure proper posting in the system.

Recommendation:

We recommend that notification be provided to all Courts when a refund check has been issued, through printing reports at the court or through these reports being sent to the courts by the Court Administrator's Office.

We also recommend that more than one person in each court be trained in VISION to allow for continued processing of receipts and deposits on a timely basis during the times when the clerk is unavailable.

We further recommend the Court Administrator's Office work with the VISION Help Desk to provide training in printing reports that would validate posting of deposits in the VISION System.

Agency/Department Response:

1) The Court Administrator's Office, Finance Department, does send a copy of the VISION panel shot to the court for each refund issued.

2) At the present time, all court manager's plus at least one designated staff person at each court have received training in VISION. The only exception is in the Probate Courts where only the Register's have received training. At any given time, staff turnover in the courts can reduce the number of personnel trained to use the VISION accounting system. There is not enough staffing at the vast majority of courts to dedicated more staff to VISION.

3) A month-end query report has been designed to identify deposits not posted. This report is being generated and reviewed in the Court Administrator's Office, Finance Department. In order for court managers to generate and review this report, they would need additional VISION training in Query Reporting. We agree the Court Administrator's Office could work with the VISION Help Desk to provide Query Report training. However, this requires a large amount of time and effort and also needs to fit within the overall training schedule and budget for the entire court system. In addition, the VISION Help Desk staff would need to be available for this training. A better approach would be to modify the VISION system so that court managers could print a panel shot that shows deposits posted.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-08-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

The Court Administrator's Manual of Instructions (Section I. D. Page 2) states: "Where at all possible the duties in the accounting areas should be given to more than one person."

During our test work on the internal controls over cash we noted that the Deputy Clerk operating the Juror Account at the Orleans Superior Court handles cash, has signature authority for check signing and records cash transactions. The effect is one person controls the Disbursements Account.

We also noted that an Assistant Clerk has complete control of the Disbursements Account at both the Rutland Family Court and the Orleans District Court. These accounts are used to pay guardians' expenses. The clerk's tasks include deposit of advances, writing and signing checks, checking account reconciliation, preparation of summary sheets and signing the quarterly reports.

Recommendation:

We recommend a separation of operational and accounting responsibilities, involving the Court Manager or another person, to review and approve the quarterly reports, bank reconciliations, approve and sign the checks to increase the internal control over Disbursements Accounts.

Agency/Department Response:

We agree with the auditor's recommendation. However, the size of the various courts and the limited number of staff to perform the work of the court is a huge consideration when requiring more than one person to perform a set function. Where possible, a reasonable operating standard needs to be developed and implemented uniformly at the court level. As time permits, we will review the procedures on a court by court basis to see what can be changed to improve internal controls.

<u>Management Letter Comments</u>
Financially-Related Audits
Internal Controls over Cash
For the Fiscal Year Ended June 30, 2002 **Comment #2002-09-FR**

Agency/Department: Office of the Court Administrator

Standard:

The American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No.78, requires that proper internal controls be in place to provide reasonable assurance regarding the reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations.

Observation:

During our test work on the internal controls over cash we noted that there is no up-to-date accounting manual of instructions for staff reference at the following courts: the Orleans District, Probate Family and Superior Courts; the Essex Probate, District and Family Courts; the Caledonia District. Probate, Superior and Family Courts; the Fair Haven Probate Court; and, the Rutland Probate, Superior, Family and District Courts.

Recommendation:

We recommend that the Court Administrator's Office develop and implement an up-to-date accounting manual of instructions for staff reference.

Agency/Department Response:

We agree with the auditor's recommendation. Due to the implementation of VISION, the accounting manual of instruction needs to be completely redesigned. However, given current resources, this will have to be accomplished on an incremental basis.

To obtain additional copies of this report contact:

Elizabeth M. Ready
State Auditor
Office of the State Auditor
132 State Street
Montpelier, VT 05633-5101
(802) 828-2281
1-877-290-1400 (toll-free in Vermont)
auditor@sao.state.vt.us

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