



**STATE OF VERMONT**

Management Letter of Observations and Recommendations

June 30, 2014



**KPMG LLP**  
Suite 400  
356 Mountain View Drive  
Colchester, VT 05446

December 18, 2014

The Speaker of the House of Representatives,  
President Pro-Tempore of the Senate,  
and the Governor of the State of Vermont:

Ladies and Gentlemen:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Vermont (the State) as of and for the year ended June 30, 2014, 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, we considered the State's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized on the attached schedule of observations and recommendations.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies and material weaknesses, and communicated them in writing to the Speaker of the House of Representatives, the President Pro-Tempore of the Senate, the Governor and management of the State of Vermont on December 18, 2014.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements as a whole, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the State's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The State's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.



The Speaker of the House of Representatives,  
President Pro-Tempore of the Senate,  
and the Governor of the State of Vermont  
December 18, 2014  
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This communication is intended solely for the information and use of management, the Speaker of the House of Representatives, the President Pro-Tempore of the Senate, and the Governor of the State of Vermont, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

*KPMG LLP*

# STATE OF VERMONT

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#### **Statewide – Workforce Recruitment, Hiring, Retention, and Planning**

##### ***Background***

The State of Vermont (the State) is a multibillion-dollar enterprise that has many diverse and complex business functions and decentralized operations. The State also operates in a dynamic environment and is exposed to many different risks and challenges.

##### ***Observation***

Over the past several years, there has been a significant amount of employee turnover throughout many state departments. This has resulted in a tremendous loss of institutional knowledge and possibly significant deficiencies in highly specialized areas and functions. The effects of this are already starting to be seen as evidenced by the types of financial statement and compliance findings noted for the current audit. Examples include:

- 1) Department of Children and Families (DCF) – There have been significant personnel changes within DCF that are responsible for both fiscal and programmatic monitoring over subrecipients. Due to the lack of, or out of date, written policies and procedures surrounding what types of monitoring activities are performed and when, there has been several deficiencies noted during our audit related to subrecipient monitoring. We have found that monitoring activities were not properly documented and not performed within standard time periods defined by the Agency of Human Services. We also noted the lack of knowledge of staff assigned as audit contacts surrounding the subrecipient monitoring process and as a result it took months to gather audit requests. Audit requests were often partially complete or had incorrect data.
- 2) Department of Environmental Conservation – There has been turnover in the Facilities Engineering Division Construction Section, leaving only one individual who is responsible for monitoring Davis-Bacon compliance for construction projects under both the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund. Due to the lack of staff, it took several months to receive the supporting documentation for the audit requests. Once documentation was received, we noted there did not appear to be documented policies or procedures for monitoring compliance with Davis-Bacon. Each project had different forms of support depending on which staff member was documenting the review.
- 3) Agency of Education – There have been significant personnel changes within the Agency that are responsible for both fiscal and programmatic monitoring over subrecipients. Due to the lack of, or out of date, written policies and procedures surrounding what types of monitoring activities are performed and when, there has been several deficiencies noted during our audit related to subrecipient monitoring. We have found that monitoring activities were not properly documented or were not performed within standard time periods defined by the Agency.
- 4) Agency of Human Services – During our audit, we noted that there are no written procedures surrounding the compilation of several key federal reports related to programs such as Medicaid and TANF. The Agency has been able to compile these reports in accordance with Federal regulations; however, they have needed the assistance of former employees who have transitioned to other positions within State government. Had these former employees not been available for questions and assistance, the Agency would have struggled with preparing these reports accurately and timely.

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- 5) Agency of Commerce and Community Development (ACCD) – During our audit over the Community Development Block Grant, we noted a significant increase in federal funding over the past several years. As a result of the increase in federal funding, the number of subrecipients has grown while the number of employees has remained the same, causing insufficient staffing to perform required duties. The Agency has added limited service positions to assist with the administration of the new federal disaster recovery funding; however, there has been no increase in staff or capacity for audit reviews and financial management. Further, it appears new staff within the Agency are not yet fully trained to perform all their job duties.
- 6) Department of Public Safety (DPS) – During our audit over the Homeland Security Program, we noted that there has been a significant increase in the number of grants that are managed by the DPS, and this number will continue to grow as DPS will be assuming the overall oversight and management of the Public Assistance-Disaster Assistance Grants program. While the number of grantees and federal grants managed by DPS has grown, DPS has experienced significant turnover in its grants management staff. This has resulted in a decline of on-site reviews being performed as part of its subrecipient monitoring procedures to a level that is below the required amount outlined within its grant management manual.
- 7) Department of Labor – During our audit, we noted that there are no written procedures surrounding the compilation of several key federal reports related to programs such as the WIA Cluster. During the current year, the individual responsible for the completion of the quarterly WIA Cluster reports left the Department, and it was a significant struggle for the Department to compile the quarterly reports, many of which were not filed timely.

The above examples highlight the need for the State to review its written policies and procedures and ensure that accurate and sufficient documentation exists for State personnel to efficiently and effectively perform State functions. Written documentation will help to ensure continuity of service and minimize the loss of institutional knowledge.

#### ***Recommendation***

We recommend that the State develop a formal plan for updating its written policies and procedures. We further recommend that the State review its procedures for training employees and ensuring that personnel have the necessary tools to effectively perform their job functions.

#### ***Management Response***

The Department of Human Resources (DHR) agrees that it is important to capture existing knowledge to allow for smooth transitions between employees and not impede organizational work and processes. We believe that knowledge transfer is most valuable when it is integrated into a set of policies for knowledge generation and capture. To that end, the DHR Workforce Development Division offers succession planning consultation and workshops to agencies and departments and our trainings stress the importance of knowledge transfer. This is important because successful succession planning requires not only filling key positions and roles with qualified and effective individuals, but ensuring they are recipients of the institutional knowledge of the organization and their predecessors and colleagues. Additionally, the DHR developed and launched a two-tiered training curriculum for managers and supervisors in April 2015, that provides instruction on key topics such as: Using the Performance Management System for Results; Laws, Policies and Labor Relations; Cultural Competence and Diversity in the Workplace. The underpinning of each tier is a strengths-based approach to supervision which encourages

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supervisors to appreciate and recognize those areas where an employee performs well and to support the employee in areas where he/she is challenged. We expect the culmination of these efforts will be a more engaged and effective workforce.

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#### **Statewide – Uniform Administrative Requirements**

##### ***Background***

On December 25, 2013, OMB issued final guidance, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*. The final guidance supersedes and streamlines requirements from OMB Circulars A-21, A-87, A-110, and A-122; Circulars A-89, A-102, and A-133; and the guidance in Circular A-50 on Single Audit Act follow-up. The final guidance consolidates the guidance previously contained in the aforementioned citations into a streamlined format that aims to improve both the clarity and accessibility. The new regulations will be in effect for all federal awards or funding increments provided after December 26, 2014.

##### ***Observation***

The Uniform Administrative Requirements make significant changes to a number of areas that will affect the State's administration of its federal awards. Some of the changes affecting the State include:

**Subrecipient Monitoring** – Federal expectations over monitoring are clarified. The guidance outlines a series of “musts” stating that pass-through entities must:

- Clearly identify each subaward as a subaward and include standard data elements;
- Evaluate each subrecipient's risk of noncompliance for purposes of determining appropriate monitoring procedures to be performed;
- Monitor subrecipients to ensure subaward is used for authorized purpose, is in compliance with Federal regulations and terms of the grant agreement, and that performance goals are achieved;
- Verify the subrecipient is audited in accordance with Subpart F as applicable;
- Consider results of subrecipient audit on State;
- Consider the need for imposing specific subaward conditions; and
- Consider taking enforcement action against noncompliant subrecipients

**Fixed Price Grants** – Section 200.201 of the Uniform Guidance outlines the criteria for when a fixed price grant can be used and the oversight that is required. This criteria includes:

- Prior written approval from Federal awarding agency is required;
- The award amount may not exceed \$150,000;
- Payments under the fixed award must be based on meeting specific requirements of the Federal award, the project scope is specific and adequate cost, historical, or unit pricing data is available to establish a fixed amount award with assurance that the non-Federal entity will realize no increment above actual cost;
- Fixed awards cannot be used in programs which require mandatory cost sharing or match; and
- The grantee must certify in writing at the end of the Federal award that the project or activity was completed or the level of effort was expended. If the required level of activity or effort was not carried out, the amount of the Federal award must be adjusted.



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Audit Threshold – Effective for fiscal years beginning on or after December 26, 2014, the audit threshold will be increased to \$750,000 (from \$500,000). This may reduce the number of subrecipients that are required to have audits.

#### ***Recommendation***

We recommend that the State review the Uniform Administrative Requirements and evaluate the impact these regulations will have. The State should consider needed changes to its written policies as well as needed changes to its operating procedures.

#### ***Management's Response***

On December 2, 2014, the Agency of Administration released Bulletin 5 ~ Policy for Grant Issuance and Monitoring which was effective on December 26, 2014. This policy incorporates all of the requirements of the Uniform Guidance and identifies the guidelines to be used by State agencies and departments when issuing grants of State and/or Federal funds. It also requires all State agencies and departments to draft and implement a Granting Plan which outlines the processes they will use when issuing and monitoring grants in accordance with Bulletin 5 and the Uniform Guidance. Granting plans are to be submitted to Finance and Management by May 15, they will become effective on July 1, 2015, and are to be reviewed annually.

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#### **Statewide – Schedule of Expenditures of Federal Awards (SEFA)**

##### ***Background***

As described in §310(b)(3) of OMB Circular A-133, auditees must complete the Schedule of Expenditures of Federal Awards (SEFA) and include CFDA numbers provided in Federal awards/subawards and associated expenditures. The Department of Finance and Management (Finance) requires individual departments to prepare their portion of the expenditures that need to be reported on the statewide SEFA and this information is then compiled by Finance to prepare the complete SEFA. To facilitate the preparation process Finance provides a standardized form and instructions to all departments. Once the SEFA is prepared, Finance prepares a reconciliation of the SEFA to the State of Vermont's centralized accounting system, VISION, to help ensure that the expenditures reported on the SEFA appear reasonable.

##### ***Observation***

For those federal programs being audited annually as part of the A-133 audit, we request a detailed expenditure breakouts for each federal program from the department that is responsible for the administration of the federal program. To ensure that the expenditures breakout is accurate, we compare the total expenditures from the expenditure breakout for each program to the amount reported on the SEFA. During our testwork over the accuracy of the SEFA for the year ended June 30, 2014, we noted the following errors that were not detected during the SEFA preparation and reconciliation process by Finance:

- The Agency of Commerce and Community Development had incorrectly reported non-federal expenditures on the SEFA for the Community Development Block Grant program. The error was identified as part of our audit and the SEFA was subsequently revised, resulting in a reduction of expenditures reported on the SEFA of approximately \$850,000.
- The Agency of Human Services reported a prior period adjustment related to expenditures incurred but not reported during the year ended June 30, 2013 of approximately \$4.5 million within a federal report filed for the Medicaid program during the year ended June 30, 2014. These expenditures were not reported on the June 30, 2013 SEFA and were not included within the June 30, 2014 SEFA, as the prior period adjustments made during the current year for a different fiscal year are not reported on the SEFA. Often times these adjustments are not material overall but in this particular case, this was a material adjustment and there does not appear to be any controls in place to ensure that prior period adjustments are reviewed to determine whether or not they should be reported within the annual SEFA.
- The Agency of Human Services incorrectly reported a transfer of expenditures from the Children's Health Insurance Program to the Medicaid program. The expenditures of approximately \$6 million were reported as Children's Health Insurance Program instead of the Medicaid program.
- The Department of Buildings and General Services (BGS) received federal expenditures of approximately \$6.3 million, of which approximately \$1.6 million was received prior to the year ended June 30, 2014. As part of our audit of the State's financial statements, BGS recorded receivable related to the remaining \$4.7 million was recorded as of June 30, 2014. Upon further investigation related to receivable, it was determined that BGS had not identified and reported to Finance the federal expenditures incurred for the years ended June 30, 2012, 2013 or 2014.

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#### ***Recommendation***

We recommend that Finance reviews its process in place to determine the completion and accuracy of the data reported by individual Departments to prepare the annual SEFA in addition to the annual reconciliation to VISION that is performed. This may include selecting a sample of programs reported by the Department and requesting documentation to support the amounts reported on the SEFA, requesting federal grant award notices to ensure that expenditures are properly included on the SEFA, or reviewing a sample of cash draws performed within Departments to assist in identifying potential programs that have not been included on the SEFA.

#### ***Management's Response***

Beginning with the 2015 SEFA, departments will be required to submit their expenditure breakouts for audited programs to Finance with their SEFA submissions. These will be reviewed by Finance prior to submission of the SEFA to KPMG.

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#### **Office of the State Treasurer – IT Staffing**

##### ***Background***

During fiscal 2014, the State implemented Governmental Accounting Standards Board Statement No. 67, *Financial Reporting for Pension Plans*, (GASB 67). As a result of this implementation, there were significantly more IT-related requests for information that were needed from the Pension Gold System, the State's pension administration system, than in past years. These requests came from both the State's auditors as well as from outside auditors, which were performing testwork over participating plan employers. The request included additional census data queries with different report query parameters, some of which needed to be created.

##### ***Observation***

While performing testwork over the pension census data, we noted that there was only one full-time individual in the IT department within the Office of the State Treasurer. This resulted in a strain on resources to perform IT-related functions, create reports, and run queries.

##### ***Recommendation***

As day-to-day operations become more IT driven, we recommend that the Office of the State Treasurer review their IT staffing needs to ensure that there is adequate capacity to oversee and perform IT-related functions. This will help ensure that they are able to maintain and improve operations, to fulfill internal and external requests, as well as to ensure no unnecessary delays occur.

##### ***Management's Response***

Two positions were vacant due to staff voluntary separations in September 2014. Both positions have been filled.

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#### **Statewide – Accounts Receivable**

##### ***Background***

The State primarily operates on a cash basis throughout the year and then manually converts to an accrual basis at the end of the year for financial reporting purposes. The State's accounting process is very decentralized and relies heavily on the individual departments and agencies to properly and accurately record activity on a timely basis in the State's VISION accounting system as well as to provide year-end closing information to the Department of Finance and Management (Finance) in the form of the year-end closing packages. Finance provides the individual departments and agencies with annual guidance on generally accepted accounting principles and the form and content of the information that is required in the year-end closing packages but relies on the individual departments and agencies to completely and accurately compile the data.

In order to capture the receivable data for the financial statements, Finance requires individual departments to prepare CAFR-1 forms. This form is a template that includes VISION chart-field information (i.e., fund, deptid, and account) for all items reported in the previous fiscal year, with subtotals by Business Unit. The departments must determine the full accrual, modified accrual, and an estimate of the uncollectible amounts of receivables. They must also report the amount of undeposited cash on hand, deferred revenue, and refund of receipts as of the end of the fiscal year. There are also columns that compare last year's reported amounts to the current year's submitted amounts and if there are large changes in these amounts, there is a column to explain these differences. Along with the CAFR-1 form submission the department must submit a copy of the procedures used for estimating the allowances for uncollectible receivables. Also included in Finance's year-end closing instructions is the following requirement:

*Your department is required to maintain a detail listing to support the receivables reported on the CAFR-1. This listing should be readily available should the receivable be selected for detail testing by the auditor.*

##### ***Observation***

While performing testwork over year-end accounts receivable balances, we experienced significant delays with the Department for Children and Families (DCF) and Vermont State Judiciary (Judiciary) providing the underlying accounts receivable detail. The initial detail provided by DCF was missing 82 pages of detail that totaled to the amount reported on the CAFR-1 form submitted to Finance, and the initial detail provided by Judiciary did not agree to the amounts reported on the CAFR-1 form submitted to Finance.

##### ***Recommendation***

We recommend that the Department of Finance and Management review its year-end closing instructions and work with the departments to ensure that data used to prepare the financial statements is complete and accurate and is supported by underlying records.

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#### *Management's Response*

The Department of Finance & Management (Finance) appreciates KPMG's observations and recommendations related to Statewide Accounts Receivable. Finance will continue to work with State Agencies and Departments to improve their knowledge relating to financial accounting and reporting, and internal controls to help ensure the data which they provide is complete and accurate. Finance has already started on the tasks listed in the recommendations. Over the past few months we have met with some of the Departments that had issues in the past to discuss ways for them to improve their accounts receivable reporting. We have updated the year-end closing instructions to add extra emphasis of the need to maintain a detailed listing to support the receivables reported on the CAFR-1. We added new questions related to accounts receivables on the annual Internal Control Self-Assessment that is sent to all Agencies and Departments. Finance will provide guidance on receivable accruals in the Internal Controls Newsletter that is published around year-end. In addition, Finance is planning on providing additional communications to Business Managers during the time frame the CAFR 1 is being prepared to ensure they maintain the support for the receivables they have reported.

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#### **Vermont State Judiciary – Accounts Receivable and Allowance for Uncollectible Accounts Receivable**

##### ***Background***

The State primarily operates on a cash basis throughout the year and then manually converts to an accrual basis at the end of the year for financial reporting purposes. The State's accounting process is very decentralized and relies heavily on the individual departments and agencies to properly and accurately record activity on a timely basis in the State's VISION accounting system as well as to provide year-end closing information to the Department of Finance and Management (Finance) in the form of the year-end closing packages. Finance provides the individual departments and agencies with annual guidance on generally accepted accounting principles and the form and content of the information that is required in the year-end closing packages but relies on the individual departments and agencies to completely and accurately compile the data.

In order to capture the receivable data for the financial statements, Finance requires individual departments to prepare CAFR-1 forms. This form is a template that includes VISION chart-field information (i.e., fund, deptid, and account) for all items reported in the previous fiscal year, with subtotals by Business Unit. The departments must determine the full accrual, modified accrual, and an estimate of the uncollectible amounts of receivables. They must also report the amount of undeposited cash on hand, deferred revenue, and refund of receipts as of the end of the fiscal year. There are also columns that compare last year's reported amounts to the current year's submitted amounts and if there are large changes in these amounts, there is a column to explain these differences. Along with the CAFR-1 form submission, the department must submit a copy of the procedures used for estimating the allowances for uncollectible receivables.

Vermont State Judiciary (Judiciary) is responsible for the collection and processing for several types of revenue including Fines, Forfeits and Penalties, Fees, as well as Other Revenue. Fines, forfeits and penalties are typically administered by the courts as fines and are recorded in the Transportation Fund for traffic-related violations and the Special Fund for mainly public defender fees or surcharges. Fees are primarily related to court tech fees or failure to pay fines and are recorded within the Special Fund. Other Revenue within the General Fund represents a variety of revenue streams including adoption fees, certification, estates and trusts, family related fees, Superior and Supreme Court costs, etc.

The current calculation of Judiciary accounts receivable is based on a complex series of Vermont Automated Docketing System (VTADS) queries aggregating multiple systems, due to the different divisions within Judiciary and multiple locations across the State. The limitations of VTADS and the steps required to extract amounts-due information at the case level and convert it to an accounts receivable report create the possibility of error.

Judiciary also reports to Finance its estimate of uncollectible revenues. Judiciary applies a methodology utilizing a sample of known fines and associated collections to generate a collection rate. To develop an estimate of uncollectible receivables, this collection rate is then applied to the entire pool of known fines, which is reported on the CAFR-1 form.

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#### ***Observation***

While performing testwork over accounts receivables, we noted that for fiscal 2014 Judiciary reported \$38.7 million in receivables on the CAFR-1 form, of which \$24.0 million (or 62%) was determined to be uncollectible. During our testwork, we noted fines dating back to 1992. To determine the amount deemed uncollectible, an average of the amount outstanding from 1992 through 2009 as a percentage is applied to the total amount of fines ordered as of 2014 fiscal year-end since 1992 to determine an average outstanding fine amount, which is then divided by the total of the actual fines outstanding to develop a percentage deemed to be uncollectible. This percent is applied to outstanding balances not collected within 60 days following fiscal year-end, regardless of the type of revenue. As there is currently no write-off policy for fines that are determined to be uncollectible, the receivable and uncollectible balances are consistently high.

#### ***Recommendation***

We recommend that Vermont State Judiciary (Judiciary) consider implementing a policy that allows for uncollectible receivables and the related allowance for uncollectible accounts to be charged off on a timely basis once management has determined that the receivables are uncollectible.

We also recommend that Judiciary perform a retrospective review over the allowance for uncollectible receivables estimate, to help ensure that the methodology is reasonable and to substantiate the assumptions used in the calculation.

#### ***Management's Response***

Judiciary supports the recommendation to implement a policy that allows for uncollectible receivables and the related allowance for uncollectible account to be charged off. Given that some Judiciary receivables date back to 1992, any other enterprise would charge off these debts based on a calculation to determine they are uncollectible. Judiciary, however, is concerned that writing off bad debts will create a legal implication that the underlying offense or penalty is waived. Since these receivables are the result of a court assessed penalty, Judiciary has concerns about writing off the amounts owed without a judgment by the court. Judiciary therefore seeks guidance as to a process for writing off bad debt while retaining the underlying legal judgments, if that is possible.

Judiciary concurs with the recommendation to perform a retrospective review over the allowance for uncollectible receivable estimate, and is pleased to report that it has developed draft written procedures for calculation of its CAFR-1 submission. These draft procedures were presented to the Department of Finance and Management's Division of Financial Operations (Statewide Reporting), where they received a favorable response. The documentation will be finalized in advance of the FY15 CAFR-1 reporting season.



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#### **Agency of Transportation – Accounts Receivable**

##### ***Background***

The State primarily operates on a cash basis throughout the year and then manually converts to an accrual basis at the end of the year for financial reporting purposes. The State's accounting process is very decentralized and relies heavily on the individual departments and agencies to properly and accurately record activity on a timely basis in the State's VISION accounting system as well as to provide year-end closing information to the Department of Finance and Management (Finance) in the form of the year-end closing packages. Finance provides the individual departments and agencies with annual guidance on generally accepted accounting principles and the form and content of the information that is required in the year-end closing packages but relies on the individual departments and agencies to completely and accurately compile the data.

In order to capture the receivable data for the financial statements, Finance requires individual departments to prepare CAFR-1 forms. This form is a template that includes VISION chart-field information (i.e., fund, deptid, and account) for all items reported in the previous fiscal year, with subtotals by Business Unit. The departments must determine the full accrual, modified accrual, and an estimate of the uncollectible amounts of receivables. They must also report the amount of undeposited cash on hand, deferred revenue, and refund of receipts as of the end of the fiscal year. There are also columns that compare last year's reported amounts to the current year's submitted amounts and if there are large changes in these amounts, there is a column to explain these differences. Along with the CAFR-1 form submission, the department must submit a copy of the procedures used for estimating the allowances for uncollectible receivables.

##### ***Observation***

One of the Agency of Transportation's revenue sources is International Registration Plan (IRP) revenue, which relates to a registration system designed to permit Diesel Vehicles to operate in all states with a single registration. There is "IRP in State" revenue (account #410160), which relates to Vermont truck drivers. This registration is due on an annual basis, therefore all fees collected relate to the fiscal year in which they are collected, and no accrual is deemed necessary at year-end. There is also "IRP from Foreign" revenue (account #410180), which is paid to the State of Vermont from other jurisdictions for apportioned registrations based on mileage driven in the State of Vermont. "IRP from Foreign" fees are due monthly and, therefore, July's cash receipts relate to the prior fiscal year and are accrued for at year-end.

While performing testwork over accounts receivable at the Agency of Transportation, we noted that they inadvertently recorded receivables related to "IRP in State" and "IRP from Foreign" based on collections in July and August, which was not in accordance with their accrual methodology noted above.

##### ***Recommendation***

We recommend that the Agency of Transportation review their accrual methodology for each revenue source and create a formal written document detailing their accrual methodology for each revenue source. This will help to ensure that the receivables reported to Finance and Management on the CAFR-1 form are complete, accurate, and reported consistently in accordance with State policy.

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*Management's Response*

AOT has documented its accrual methodology for each revenue source.

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#### **Department of Taxes – Allowance for Uncollectible Receivables**

##### ***Background***

The State primarily operates on a cash basis throughout the year and then manually converts to an accrual basis at the end of the year for financial reporting purposes. The State's accounting process is very decentralized and relies heavily on the individual departments and agencies to properly and accurately record activity on a timely basis in the State's VISION accounting system as well as to provide year-end closing information to the Department of Finance and Management (Finance) in the form of the year-end closing packages. Finance provides the individual departments and agencies with annual guidance on generally accepted accounting principles and the form and content of the information that is required in the year-end closing packages but relies on the individual departments and agencies to completely and accurately compile the data.

In order to capture the receivable data for the financial statements, Finance requires individual departments to prepare CAFR-1 forms. This form is a template that includes VISION chart-field information (i.e., fund, deptid, and account) for all items reported in the previous fiscal year, with subtotals by Business Unit. The departments must determine the full accrual, modified accrual, and an estimate of the uncollectible amounts of receivables. They must also report the amount of undeposited cash on hand, deferred revenue, and refund of receipts as of the end of the fiscal year. There are also columns that compare last year's reported amounts to the current year's submitted amounts and if there are large changes in these amounts, there is a column to explain these differences. Along with the CAFR-1 form submission, the department must submit a copy of the procedures used for estimating the allowances for uncollectible receivables.

##### ***Finding***

While performing testwork over the taxes receivable and the related allowance for uncollectible receivables at the Department of Taxes, we noted that the Tax Department uses the Cohort Survival Method to calculate the allowance for uncollectible accounts. This method looks at what percentage of outstanding receivables are still outstanding after 1, 2, 3, 4, and 5 years. The model calculates an average of how much is still outstanding after 3 years and uses that average percentage to calculate the allowance. The Tax Department has been using this allowance methodology for many years, but has not performed a retrospective review of their allowance estimates to determine if the estimate is reasonable year to year.

##### ***Recommendation***

We recommend that the Department of Taxes perform a retrospective review over the allowance for uncollectible receivables estimate to help ensure that the methodology is still reasonable and to substantiate the assumptions used in the calculation.

##### ***Management Response***

We appreciate KPMG's comments to perform a retrospective review over the allowances for uncollectible receivables to ensure our methodology is still reasonable, and we agree this type of review would have merit. Currently with our legacy system getting the detailed information to perform this analysis has proven difficult. Our new VTAX system that we are transitioning to will have the ability to provide us the detail information to allow us to perform this analysis. In the future as this transition is complete we will plan to perform the recommended retrospective review.

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#### **Unemployment Compensation Trust Fund – Uncollectible Accounts**

##### ***Background***

The Vermont Department of Labor (VDOL) is responsible for determining the allowance for uncollectible accounts for the Unemployment Compensation Trust Fund. The allowance consists of a portion for benefit overpayments and a portion for uncollectible employer taxes.

- The allowance for benefit overpayments is calculated by reserving 100% of balances greater than 2 years old and reserving 40% of balances less than 2 years old
- The allowance for uncollectible employer taxes is calculated by reserving 100% of accounts that are in legal, suspense, or pending bankruptcy and reserving 50% for accounts that are inactive or in appeal.

##### ***Observation***

While performing testwork over the claimant receivable allowance, we noted that the VDOL experienced increased collections as a result of the Federal Government's Treasury Offset Program, which was implemented toward the end of calendar year 2013. The Treasury Offset Program is a centralized offset program, administered by the Bureau of the Fiscal Service's Debt Management Services (DMS), to collect delinquent debts owed to federal agencies and states. Due to the newness of the program and uncertainty regarding how much would be collected through the program the VDOL did not adjust its allowance methodology for fiscal 2014.

##### ***Recommendation***

We recommend that the VDOL reevaluate the allowance methodology and assumptions to ensure that the allowance conveys the department's best estimate for the uncollectible accounts and that considers the Treasury Offset Program.

##### ***Management's Response***

In reference to the Recommendations, the VDOL has reviewed our uncollectible accounts allowance methodology and we have made no changes at this time for FY2015 as explained below:

**Benefit Overpayments:** Vermont implemented the Treasury Offset Program (TOP) during calendar year 2013. Since inception, VDOL has received a total of approximately \$1,156,000 as a result of the program. However, receipts from CY2013 to CY2014 dropped significantly – by 50%. The amount submitted to TOP for the 2014 tax year was \$3,585,994 and the net amount collected was \$774,677; which is only 21.6%. For the 2015 tax season we submitted \$3,887,383 to TOP. To date we have recovered \$380,812 (or 9.8% of submitted) for tax year 2015. Based on the large decrease of receipts from year to year, we would like another year of data to analyze before making any changes to the BOP methodology.

**Employer Uncollected Debt:** The Treasury Offset Program (TOP) to collect past due employer contributions from Vermont Employers is not expected to be implemented until the end of calendar year 2015/beginning on calendar year 2016. As such, at this point there is no data on how the TOP will affect the collectability of delinquent taxes. We will review the TOP data annually for at least 2 full years after implementation before making any changes to the employer methodology.

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#### **Department of Financial Regulation Captive Insurance Division – Captive Insurance Tax**

##### ***Background***

Annually, captive insurance companies in the State of Vermont are required to pay a tax based on premiums reported as of December 31. Companies are required to submit this tax annually in February per 8 V.S.A § 6014. The State allows sister captive entities that have a tax sharing agreement to consolidate for premium tax purposes. As this is a required payment and varies by entity, the Department of Financial Regulation (DFR) does not bill for this type of revenue. This source of revenue is collected and processed by the State of Vermont Tax Department, and DFR reconciles payments received to premiums reported within each company's annual report.

##### ***Observation***

While performing control testwork over the processing of this revenue source, we noted several captive insurance companies filed as part of a consolidation of multiple captive insurance companies. The spreadsheet used by DFR to recalculate the tax due showed a tax calculation as if the entity was not part of a consolidation, resulting in a tax amount that did not agree to the amount reported and paid by the entity. During discussions with the Captive Insurance Administrative Assistant, we noted that she prepares a separate recalculation for consolidated entities to compute the tax due, however, it is not documented and, therefore, we were unable to test this control.

##### ***Recommendation***

We recommend that DFR review the procedures that are in place to ensure the completeness and accuracy over the collection of the captive insurance tax and ensure that sufficient documentation is maintained to support their control activities.

##### ***Management's Response***

The Vermont Department of Financial Regulation (DFR) Captive Insurance Division has carefully considered the observation and recommendation and as recommended, we will undertake a review of control procedures to ensure the completeness and accuracy of the collection of the captive premium tax, and the complete documentation thereof.

The observation references a "spreadsheet used by DFR to recalculate the tax due." Each and every premium tax return is recalculated after verifying the reported premiums from the captive insurance company's annual report, filed with DFR. Consolidated returns are recalculated separately, and then reallocated on the spreadsheet to the individual entities that comprise the consolidated group. The allocated premium tax is used to populate an internal database. We will in the future amend the spreadsheet and the process so that the computation of consolidated tax returns is thoroughly documented and readily verifiable. We are working with the tax department to revise the tax form, and developing a new database. As we implement these changes, we will continue to assess our procedures and controls to ensure that our operations are functioning at optimum.

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#### **Liquor Control Fund – Inventory Reports and Journal Entries**

##### ***Background***

The Liquor Control Fund is a major enterprise fund reported in the State's financial statements. The financial activity for this fund is managed by the Department of Liquor Control (the DLC).

##### ***Observation***

###### ***Inventory***

While performing inventory testwork at the DLC, we noted that there appeared to be a lack of working knowledge surrounding the year-end inventory report due to changes in staffing within the information technology (IT) department, which caused timing delays. As part of our testwork over the DLC's inventory, we observed inventory counts held at 5 of the State's 79 retail locations across the State. As part of our inventory count observation and testwork, we selected a sample of inventory items from the floor and agreed the count to the inventory count sheet and the inventory report. We also selected a sample of inventory items from the inventory report and agreed the count to the bottles on the floor. For each inventory count we observed, we requested reports from RIMS, the DLC's inventory system, to roll forward the inventory from the inventory count date to year-end. A total of four reports for each inventory count were needed to perform this testwork one detailing the inventory before the count, one detailing the adjustments made during the count, one detailing the inventory after the count, and the final, which rolled forward the inventory from the date of the count to year-end. The reports from RIMS should have agreed to the receipts from the registers from the day of the inventory observation, and the report that we used to roll forward the balance to year-end should have agreed to the year-end inventory report from RIMS, which agreed to the inventory balance reported on the financials. However, in most cases, the first and second version of the reports did not agree to our count sheets and other inventory reports received during the inventory count observations due to errors in how the reports were generated from the system. As a result of these errors, numerous reports needed to be generated and additional supporting documentation provided in order to support the variances.

###### ***Journal Entries***

While performing journal entry testwork at the DLC, we noted that the staff involved in reviewing and posting journal entries and significant transactions do not appear to have appropriate accounting knowledge. For example, the accrual entries were initially booked incorrectly with debits and credits being posted backwards, and when Finance and Management identified the errors and requested that the DLC correct this error, the DLC recorded the reversal incorrectly as well. Finance and Management ultimately had to correct these journal entry errors for the DLC staff.

##### ***Recommendation***

We recommend that the Department of Liquor Control update their written policies and procedures documentation for the handling of its year-end inventory reports. We further recommend that the State review its procedures for training employees and ensuring that personnel have the necessary tools and knowledge to effectively perform their job functions.

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*Management's Response*

Inventory: DLC is preparing for user testing and roll out of a new Point of Sale System, which should provide all users much better reporting and functionality when it goes live in mid to late summer. Meanwhile, a newly formed Internal Control committee will be reviewing current department internal controls and will be updating and creating written process documentation.

Training: We appreciate these observations and will take them into consideration as the State determines employee training needs in the future.

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#### **Department of Human Resources - VTHR**

##### ***Background***

The State of Vermont Department of Payroll and Employee Services utilizes Vermont Human Resources (VTHR) Application to manage the employee time, payroll, and benefits. The VTHR application allows employees to enter time, manage benefits, and review payroll information. Management has the ability to review and approve time for employees and allows employees to select delegates to enter time on their behalf.

The VTHR application is managed and maintained by dedicated members of the Vermont Department of Information and Innovation (DII).

During fiscal year 2014, we performed a General Information Technology Controls (GITC) review over the VTHR system. The four GITC areas considered for tests of design comprised Access to Programs and Data, Program Changes, Program Development, and Computer Operations. Standard GITC control objectives were used for each of these areas as outlined below:

##### **Access to Programs and Data:**

- Information security is managed to guide consistent implementation of security practices and users are aware of the organization's position with regard to information security, as it pertains to financial reporting data.
- Logical and physical access to IT computing resources is appropriately restricted by the implementation of identification, authentication, and authorization mechanisms to reduce the risk of unauthorized/inappropriate access to the organization's relevant financial reporting applications or data.
- Procedures have been established so that user accounts are added, modified, and deleted in a timely manner to reduce the risk of unauthorized/inappropriate access to the organization's relevant financial reporting applications or data.
- Effective controls are in place to monitor the maintenance of access rights to the organization's relevant financial reporting applications or data.
- Controls used to provide appropriate segregation of duties within key processes exist and are followed.

##### **Program Change:**

- Controls are in place to ensure that any changes to the systems/applications providing control over financial reporting have been properly authorized by an appropriate level of management.
- Controls are in place to ensure that changes to applications and systems used during the financial reporting process are tested, validated, and approved prior to being placed into production.
- Controls are in place to restrict access for migrating changes into the production environment for systems and applications used during the financial reporting process.
- Controls are in place to ensure that system and application configuration changes related to financial reporting are tested, validated, and approved.



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- Controls are in place to appropriately address emergency changes to systems, applications, and infrastructure configuration.

#### Program Development:

- A System Development Life Cycle (SDLC) policy exists and is formally documented.

#### Computer Operation:

- Management has implemented appropriate backup and recovery procedures so that data, transactions, and programs that are necessary for financial reporting can be recovered.
- Management has implemented procedures to ensure accuracy, completeness, and timely processing of system jobs, including batch jobs and interfaces, for relevant financial reporting applications or data.
- Effective procedures exist and are followed to periodically test the effectiveness of the restoration process and the quality of backup media relevant to systems and applications used during the financial reporting process.
- Appropriate controls are in place over the backup media for systems and applications used during the financial reporting process, including that only authorized people have access to the tapes and tape storage.
- Management has defined and implemented problem management procedures to record, analyze, and resolve incidents, problems, and errors for systems and applications used during the financial reporting process in a timely manner.

#### ***Observation***

While performing our GITC review over the VTHR application, we noted the following:

- 1) Reliance is placed on the State of Vermont “Information Security Policy” established by DII, which was last revised in 2010.
- 2) Complexity for password parameters were not fully enabled. Weak passwords increase the risk that computer application access will be compromised, leading to a misuse or misappropriation of confidential and sensitive information. Currently the password parameters for the VTHR application are as follows: Expiration = 90 days; Account Lockout = 6 failed attempts; Minimum Characters = 8; Complexity = only requirement is at least 1 digit must be used; and Password History = 99.
- 3) It is important to perform a periodic review of active users and user access rights to identify and remove inappropriate system access as needed. DHR created a “Periodic Review of Access” spreadsheet, which was sent to each agency along with a request to appoint a delegate who will review. This spreadsheet detailed employees who have access to VTHR and their roles. Of the 93 agencies under review, 6 did not return the delegate form for 10 individuals. We also noted that only 1 delegate returned the role spreadsheet indicating the review of the user roles was attached.
- 4) A job schedule is defined for daily/weekly/monthly etc. processing jobs, and it is important to limit users who have the ability to modify the job schedule. We were unable to review a sample of 15 batch logs as it is VTHR policy to purge batch job logs after 2 weeks.

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- 5) The VTHR application does not have a disaster recovery policy in place nor is it tested on a periodic basis. Without appropriate and periodic restoration tests, assurance cannot be placed on the reliability of backup media to recover key systems, applications, and data assets in the event of an emergency.
- 6) Administrators have the ability to develop and migrate changes, which is a segregation of duties issue. This increases the risk that inappropriate and unauthorized changes could be made to software and moved undetected into production. To mitigate the segregation of duties issue, VTHR management holds meetings to review all changes on a weekly basis, however, there is no documentation to support the review.

#### ***Recommendation***

We recommend the following:

- 1) Information security policy and procedures should be reviewed on an annual basis to determine if updates are required for the policy.
- 2) The complexity requirement should be enabled further to include 1 special character and 1 upper and lower case to strengthen the password parameters to the application.
- 3) The role spreadsheet should be included in each delegation package returned to the Department of Human Resources.
- 4) All backup job logs should be retained for a minimum of 1 year for audit purposes.
- 5) In the event of a disaster, the agency should have a disaster recovery plan in place and test it periodically to determine if the plan is effective.
- 6) Meeting minutes should be formally documented and retained for evidence purposes, and roles should be restricted so users do not have the ability to develop and migrate changes.

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*Management's Response*

<b>Observation</b>	<b>Recommendation</b>	<b>Management Response</b>
Reliance is placed on the State of Vermont 'Information Security Policy' established by DII, which was last revised in 2010.	Information security policy and procedures should be reviewed on an annual basis to determine if updates are required for the policy.	Information Security has reviewed Security Policies on an informal basis annually. Formal review and refresh of Security Policies will be a priority of the new CISO who is starting in the Summer of 2015.
Complexity for password parameters were not fully enabled. Weak passwords increase the risk that computer application access will be compromised, leading to a misuse or misappropriation of confidential and sensitive information. Currently the password parameters for the VTHR application are as follows: Expiration = 90 days; Account Lockout = 6 failed attempts; Minimum Characters = 8; Complexity = only requirement is at least 1 digit must be used; and Password History = 99.	The Complexity requirement should be enabled further to include 1 special character and 1 upper and lower case to strengthen the password parameters to the application.	Changes to the VTHR password requirements to meet the complexity requirement will be configured in the VTHR system (CY Q3-2015).

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<b>Observation</b>	<b>Recommendation</b>	<b>Management Response</b>
<p>It is important to perform a periodic review of active users and user access rights to identify and remove inappropriate system access as needed. DHR created a ‘Periodic Review of Access’ spreadsheet, which was sent to each agency along with a request to appoint a delegate who will review. This spreadsheet detailed employees who have access to VTHR and their roles. Of the 93 agencies under review, 6 did not return the delegate form for 10 individuals. We also noted that only 1 delegate returned the role spreadsheet indicating the review of the user roles was attached.</p>	<p>The role spreadsheet should be included in each delegation package returned to the Department of Human Resources.</p>	<p>DHR has implemented an updated process for validating active users and appropriate access to the system as follows: 1.) The DHR Commissioner sends request for validation of all security coordinators to Appointing Authorities and Elected Officials in all areas paid out of the VTHR system. 2.) VTHR Security Officer sends security coordinators current list of users, roles and definitions of roles for validation. 3.) If agencies or departments do not comply, the request is escalated to the DHR Commissioner level for compliance.</p>
<p>A job schedule is defined for daily/weekly/monthly etc. processing jobs, and it is important to limit users who have the ability to modify the job schedule. We were unable to review a sample of 15 batch logs as it is VTHR policy to purge batch job logs after 2 weeks.</p>	<p>All backup job logs should be retained for a minimum of 1 year for audit purposes.</p>	<p>Logs from Batch Jobs are being retained for a year.</p>
<p>The VTHR application does not have a disaster recovery policy in place nor is it tested on a periodic basis. Without appropriate and periodic restoration tests, assurance cannot be placed on the reliability of backup media to recover key systems, applications and data assets in the event of an emergency.</p>	<p>In the event of a disaster the agency should have a disaster recovery plan in place and test it periodically to determine if the plan is effective.</p>	<p>The State of Vermont PeopleSoft implementations for The Department of Human Resources (VTHR) and Department of Finance (VISION) maintain a “warm DR site” capability. In the event of an infrastructure, network or other prolonged failure at the Primary site, the business users have the option of bringing up the application at the DR site. Server capacity at the DR site mirrors the Production environment with the same number of web servers, application servers and supporting network</p>

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<b>Observation</b>	<b>Recommendation</b>	<b>Management Response</b>
		<p>infrastructure such as firewall and load balancer resources. The databases are kept current with production using Oracle's DataGuard technology. Live production data is shipped over an encrypted VPN to maintain an RPO of 15 minutes. The current Primary Site for ERP is located in the Data Center at the National Life building in Montpelier, VT. The current Disaster recovery site is collocated leased space at TechVault in South Burlington, VT. A formal Disaster Recovery Plan will be fully documented (CY Q4-2015) in support of the HR Continuity of Operations Plan (COOP) in development. Although the DR environment has had limited testing to validate its functionality, a formal test plan will be developed (CY Q4-2015) with a plan to exercise it annually.</p>
<p>Administrators have the ability to develop and migrate changes, which is a segregation of duties issue. This increases the risk that inappropriate and unauthorized changes could be made to software and moved undetected into production. To mitigate the segregation of duties issue, VTHR management holds meetings to review all changes on a weekly basis, however, there is no documentation to support the review.</p>	<p>Meeting minutes should be formally documented and retained for evidence purposes, and roles should be restricted so users do not have the ability to develop and migrate changes.</p>	<p>Meeting minutes have been implemented for VTHR Ticket Meetings. Additionally, Change Requests, once signed, are attached to the Footprints tickets as well as paper copy by the requesting director. System Administrator roles and access rights are restricted to only those individuals required to have them to perform their duties. This enables the segregation of duties to the degree possible.</p>

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**Vermont Health Connect – IT Observations**

***Background***

The State uses the Vermont Health Connect (VHC) to process and determine eligibility for health insurance for both Medicaid and non-Medicaid determinations.

During fiscal year 2014, we performed a high-level information technology review over the VHC system. This review entailed looking at system access, program changes, program development, and computer operations. The objective of this review was to highlight and identify potential deficiencies that would prevent the VHC system from passing a General Information Technology Controls (GITC) test of design.

***Observation and Recommendation***

During our high-level information technology review of the VHC system controls, we noted the following potential deficiencies:

<b>Control Description</b>	<b>Observation</b>	<b>Recommendation</b>
Access to the Data Center housing the VHC application is restricted appropriately.	During the audit period, a review over the SOC 1 for the service organization that provides hosting and other services for the VHC application was not performed and as such, State management were not able to gain comfort that appropriate physical security and environmental controls were implemented and operating effectively relative to the data center within which the VHC application servers reside	We recommend that VHC review the SOC 1 report related to the third-party service provider in order to determine that physical security and environmental controls exist and are operating effectively relative to the data center within which the VHC application servers reside.
Administrative access to the VHC application, database, and operating system is restricted appropriately.	We noted that CGI, the State’s contractor, has access to all powerful IDs within the application, database, and operating system for the development and production environments. VHC does not have access to either development or production environments. VHC has not implemented a management review of CGI’s powerful access to the application, database, or operating system.	We recommend that VHC review the SOC 1 to determine that powerful IDs for the application, database, and operating system for the development and production environments are assigned to appropriate users based on job function and responsibility.

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<b>Control Description</b>	<b>Observation</b>	<b>Recommendation</b>
<p>The organization performs periodic review of active users and user access rights for in-scope systems to identify and remove inappropriate system access.</p>	<p>We noted that the periodic access review was completed this year by the Director of Operations for VHC. Additionally, the department managers with knowledge of appropriate access for each user were not included within the review process.</p>	<p>We recommend that a listing of users with roles for VHC are generated for each department and distributed to the appropriate managers. Each manager should review his/her staff to determine appropriateness of access and send any changes back to a centralized IT staff member to make any necessary changes. Documentation should be retained for the year as audit evidence to support performance of the control as well as any changes made resulting from the periodic review.</p>
<p>Change request to information systems and applications providing control over financial reporting are approved by VHC management.</p>	<p>We noted that VHC does not perform a review to verify that the changes being discussed with CGI are implemented as approved. VHC does not review the production logs to determine only approved changes to the application, database, and operating system are being implemented.</p>	<p>We recommend VHC management review changes to the application, database, and operating systems by obtaining the relevant production logs in order to verify that all changes made were approved by VHC and that changes were made in accordance with VHC instruction.</p>
<p>Monitoring procedures are designed to provide reasonable assurance around completeness and timeliness of system and data processing. Systems logs are reviewed on a regular basis to confirm that batch jobs are completed in a timely and proper order.</p>	<p>We noted that CGI performs job and backup scheduling for the VHC application. VHC management does not perform a review to determine that batch jobs and backup jobs are completed as scheduled.</p>	<p>We recommend that VHC monitor performance of batch and backup jobs in order to determine that they have been completed and issues with incomplete jobs are resolved in a timely manner.</p>

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<b>Control Description</b>	<b>Observation</b>	<b>Recommendation</b>
Monitoring procedures are in place to review the user control considerations within the third-party service providers SOC 1.	During the audit period, a review over the CGI SOC 1 for User Control Considerations was not performed and as such, State Management were not able to gain comfort that VHC has appropriate controls in place to mitigate the risks identified within the SOC 1 that VHC is responsible for.	We recommend that VHC review the CGI SOC 1 User Control Considerations to determine if VHC has controls in place to mitigate the risk(s) identified within the CGI SOC 1 report that VHC would be responsible for.

***Management's Response***

Several of the issues observed have already been resolved and approved by CMS and others are in various stages of completion.



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#### **Energy Efficiency Utility Fund**

##### ***Background***

Per Governmental Accounting Standards Board, Statement No. 14, *The Financial Reporting Entity* (GASB 14), paragraph 59, the primary government and its component units may have identical or different fiscal year-ends. A common fiscal year-end for the primary government and all component units is encouraged. The advantages and disadvantages of a common fiscal year-end should be considered when determining the practicality of making such a requirement. If it is determined that a common fiscal year-end is impractical, the reporting entity (which reports using the primary government's fiscal year) should incorporate financial statements for the component unit's fiscal year ending during the reporting entity's fiscal year. If the component unit's fiscal year-ends within the first quarter of the reporting entity's subsequent fiscal year, it is acceptable to incorporate that fiscal year of the component unit, rather than the fiscal year ending during the reporting entity's fiscal period. Of course, this should be done only if timely and accurate presentation of the financial statements of the reporting entity is not adversely affected.

##### ***Observation***

The Public Service Board ("Board") is a board of the State of Vermont whose budget is established by the Vermont State Legislature. As such it is effectively part of the State and operates on the State's fiscal year for budgetary and financial reporting purposes. For presentation in the State's Comprehensive Annual Financial Report (CAFR), the activities of the Board are presented within the Special Fund and follow the accounting conventions of "governmental funds" – that is, modified accrual basis of accounting.

One of the Board's responsibilities is to oversee Vermont's Energy Efficiency Utility Program (EEU Program) that provides energy efficiency services to residential and business electricity and heating-and-process-fuel consumers throughout Vermont. As a program operated by the Board, the EEU Program appears to be a State program that is an integral part of the Board that is ultimately subject to the oversight of State officials. The EEU Program does not appear to be an entity that is legally separate from either the Board or the State. The EEU currently operates, and has a separate audit, on a calendar year; however, as a part of the Board and, in turn, the State, it is unclear why the activities of the EEU Program would be accounted for and reported on a calendar year basis rather than on the fiscal year basis followed by the Board and State.

Additionally, with regard to reporting the State's CAFR, the Board, as indicated above, is reported on the modified accrual basis of accounting as part of the State's Special Fund. However, the EEU program in addition to being presented on a calendar year basis is also presented as an enterprise fund and follows the accrual basis of accounting. These inconsistencies result in the State not conforming to the requirements of GASB Statement 14, as amended, which establishes the standards for defining and reporting on the State's financial reporting entity.

##### ***Recommendation***

With the current size of the EEU Program and based on our understanding of the structure of the State, the Board, and the EEU Program, we believe that the EEU Program needs to be accounted for as a Special Fund of the State, follow the modified accrual basis of accounting and report its results on the State's fiscal year to avoid negatively impacting the opinion on the State's CAFR.

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#### *Management's Response*

The Board discussed the issues raised by KPMG and a notice was sent to all participants in Energy Efficiency Utility proceedings. After receiving responses the Board decided a June 30 year end audit, using the governmental funds format, for the Vermont Energy Efficiency Utility Fund will be completed starting June 30, 2015. The contract with the firm conducting the current audit is in the process of being amended.

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#### **Agency of Transportation – Deletions in Construction-in-Process**

##### ***Background***

Capital assets, as defined by the State's capitalization policy, are fixed assets that cost at least \$5,000 and provide future economic benefit for a minimum of two years. Infrastructure assets, as defined by the State's capitalization policy, are physical resources utilized primarily by the public that cost at least \$50,000 and provide future economic benefit for a minimum of three years (e.g., road, bridges, dams, airports, etc.). The State's capitalization policy maintains that all capital assets over \$5,000 and infrastructure assets over \$50,000 are to be capitalized. The State's capitalization policy also states that Construction-in-Process (CIP) projects are to be capitalized and recorded within 60 days after the asset is ready for its intended use.

Departments are responsible for maintaining accurate and complete records regarding the acquisition, status, and disposal of all fixed assets and to comply with all applicable accounting and regulatory requirements.

##### ***Observation***

During testwork over CIP at the Agency of Transportation (AOT), we noted the following:

- 1) We selected 7 CIP additions for testing and noted 1 instance where the estimate summary was not properly approved by the construction manager prior to payment or addition to CIP. AOT's control procedures require that the construction manager approve invoices prior to payment to ensure that the invoices are accurate.
- 2) During the testwork over CIP deletions at the AOT, we noted several instances where projects were not entered into VISION within 60 days of the acceptance/in-service date, but rather several months after the in-service date. During inquiries as to the cause it was noted that there was a breakdown in communication between the project managers and accounting department, whereby the accounting department was not included on several emails distributing the completion and acceptance memos.

##### ***Recommendation***

We recommend that the Agency of Transportation review their internal control procedures over the review and approval process of estimate summaries prior to payment or addition to CIP to ensure the accuracy of the payment to the vendor. We further recommend that the Agency review their internal control procedures over the movement in CIP to ensure that projects are capitalized in a timely manner and in accordance with the State's capitalization policy.

##### ***Management's Response***

AOT has appropriate internal controls to prevent material CIP misstatements in the State's Comprehensive Annual Financial Report. The missing CIP addition approval was an isolated error. The AOT Accounting section is reviewing the engineer's completion and acceptance notification process for internal control improvements to be submitted to management by 05/31/2015 and implemented by 06/30/2015.