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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited, in accordance with the 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 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, 2020, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 29, 2020. Our report includes a reference to other auditors who audited the financial statements of certain funds and component units of the State, which represent the indicated percent of total assets and total revenues as described in our report on the State's financial statements and as presented in the following tables. Additionally, 100% of the information disclosed in Note V-E was also audited by other auditors. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those other auditors.

Opinion Unit	Entity	Percent of Opinion Unit's Total	
		Assets	Revenues / Additions
Governmental Activities	Universal Service Fund	0.04%	0.10%
Business-Type Activities	State Lottery Fund; Energy Efficiency Utility Fund	5.54%	21.38%
Special Fund	Universal Service Fund	1.15%	2.10%
State Lottery Fund	State Lottery Fund	100.00%	100.00%
Aggregate Remaining Fund Information	Energy Efficiency Utility Fund	0.42%	6.17%
Aggregate Discretely Presented Component Units	Vermont Student Assistance Corporation; University of Vermont and State Agricultural College; Vermont State Colleges; Vermont Housing Finance Agency; Vermont Economic Development Authority; Vermont Housing and Conservation Board; Vermont Municipal Bond Bank; Vermont Educational and Health Buildings Financing Agency; Vermont Veterans' Home	100.00%	100.00%

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and responses, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2020-001 and 2020-002 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2020-003, 2020-004 and 2020-005 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

State of Vermont's Response to Findings

The State's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The State's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Boston, Massachusetts
December 29, 2020

Material Weakness in Internal Control Over Financial Reporting

Finding 2020-001 – Accounts Receivable – Department of Liquor Control

Condition

The State did not have controls properly implemented to ensure that accounts receivable for the Department of Liquor Control were recorded accurately.

Criteria

The State's Internal Controls Best Practice Series memorandum over accounts receivable indicates that departmental best practices include the maintenance of an accurate record of receivables transactions. The use of automated systems (e.g. VISION) should be utilized, where practical, to facilitate processing and reconciliation.

Context

The audit procedures detected an overstatement of accounts receivable of approximately $1,046,720, which was the result of the state recording accounts receivable for cash receipts that had been received by the State as of June 30, 2020.

Effect

The State recorded adjustments to correct the accounts receivable balance.

Cause

The State's internal controls related to the review of the year end reconciliation of accounts receivable were not sufficient to detect the misstatements.

Repeat Finding

The finding is a repeat of a finding in the immediately prior year. The prior year finding number was 2019-001.

Recommendation

We recommend that policies and procedures be improved and implemented to ensure that internal controls over financial reporting include procedures to adequately detect misstatements in accounts receivable to ensure these balances are reported accurately.

Management Response

The Department of Liquor and Lottery (DLL) agrees with the finding. In order to correct this finding, we have updated our year-end Accounts Receivable CAFR procedures to include the use of new query created by Department of Finance & Management (DFM). The new query will help identify accounts receivable payments deposited in the bank prior to the fiscal year end, but not recorded in the accounting system to after year end close. Any payments received that are identified as related to a prior year item ID will be accrued to cash.

Material Weakness in Internal Control Over Financial Reporting

<u>Finding 2020-002 – Financial Close and Reporting –Department of Labor</u>

Condition

The Department of Labor did not have controls properly implemented to ensure that Federal Grant receivable and related revenues were recorded accurately.

Criteria

Generally accepted accounting principles require nonexchange revenues meet eligibility requirements (such as the incurrence of expenses) prior to recognition and accrual. This encompasses nonexchange federal funding received in advance of eligibility requirements being met.

Additionally, the State's Internal Controls Best Practice Series memorandum over accounts receivable indicates that departmental best practices include the maintenance of an accurate record of receivables transactions.

Context

The audit procedures detected an overstatement of revenue of $172,247,848 related to Federal Pandemic Unemployment Compensation (FPUC) funds received by the State prior to June 30, 2020. The entire balance of the FPUC funds received was accrued as revenue prior to the State meeting eligibility requirements for recognition. A correcting adjustment was made by the State to reverse the accrual and report the balance as unearned revenue.

The procedures identified the State also accrued accounts receivable and revenue in the amount of $54,208,200 for FPUC revenues that met eligibility requirements for recognition. A correcting adjustment was made by the State to reverse this accrual and reduce unearned revenue because the FPUC funds were received by the State as of June 30, 2020.

Effect

Accounts receivable and revenue were materially overstated and unearned revenue was materially understated. The State recorded adjustments to correct the errors.

Cause

The State's internal controls over financial reporting did not ensure recognized revenues met eligibility requirements nor did they ensure accounts receivable represented valid receivable accruals.

Recommendation

We recommend that policies and procedures over the year-end reconciliation and review of financial statement balances be strengthened to help ensure the balances are recorded accurately and that revenues are recognized in the proper period.

Management Response

The Vermont Department of Labor recognizes the finding identified by CLA and provides the following Management Response. Due to the COVID-19 pandemic, the Department has implemented and managed multiple newly established federal and state programs with unprecedented volumes. During the preparation and review of the financial statements, the Department had internal conversations about how to book these new revenues. In hindsight the Department recognizes it booked the revenues incorrectly. In response to the finding, the Department will review the current policies, procedures, and process memos regarding year-end reconciliation and review to ensure proper recording moving forward and to ensure that proper controls are included.

Significant Deficiency in Internal Control Over Financial Reporting

<u>Finding 2020-003 – Tax Disbursements –Department of Taxes</u>

Condition

The Department of Taxes did not adequately document the implementation of internal controls over bank accounts utilized for tax disbursements.

Criteria

The Department of Taxes' policies and procedures established for month-end reconciliations of tax disbursements bank accounts require the following on each reconciliation report:

1) The signature of the preparer and date of preparation should be included on the reconciliation report.

2) The signature of the reviewer and date of review should be included on the reconciliation report.

3) The reconciled report should be available for review by the Financial Manager within thirty (30) days of month end.

Context

Tests of effectiveness of internal controls over tax disbursements identified the following deficiencies in documentation of the month-end tax disbursements bank account reconciliations:

> 1) Eight (8) out of twenty-four (24) monthly reconciliations tested did not include the signature of the preparer or the date of preparation on the reconciliation report.
>
> 2) Eleven (11) out of twenty-four (24) monthly reconciliations tested did not include the signature of the reviewer or the date of review on the reconciliation report.
>
> 3) Twelve (12) out of twenty-four (24) monthly reconciliations tested did not include sufficient documentation to support that all reconciliations were prepared within thirty (30) days of month-end.

Effect

Documentation of the reconciliation of the tax disbursements bank accounts was not sufficient to indicate the reconciliations were performed in accordance with established policies and procedures.

Cause

Reconciliations over the tax disbursements bank accounts were not properly implemented.

Recommendation

We recommend that policies and procedures be implemented to ensure that tax disbursements bank account reconciliations are performed in accordance with established policies and procedures. Additionally, we recommend sufficient documentation be maintained to support the performance of the reconciliations in accordance with established policies and procedures.

Management Response

The Department of Taxes agrees with this finding. Multiple staffing changes in the Finance Division and the onset of the COVID 19 pandemic contributed to the monthly reconciliation work falling behind. The employee who was handling the reconciliations retired suddenly in January of 2020. In early March of 2020, after Governor Scott declared a state of emergency, the majority of the Department's employees were transitioned to working remotely. This transition happened very quickly, and all of the employees working on the monthly reconciliations transitioned to working remotely. This presented some new challenges.

A new Director of Finance was appointed by the Commissioner in November of 2020. Several new employees have joined the Finance Division. The process for completing the monthly reconciliations is being completely overhauled such that all reconciliations moving forward will be more auditable and will include source documentation. We have prioritized the proper and timely completion of the monthly reconciliations for all accounts.

Significant Deficiency in Internal Control Over Financial Reporting

<u>Finding 2020-004 – Taxes Receivable–Department of Taxes</u>

Condition

The Department of Taxes did not have controls properly implemented to ensure that taxes receivable and the related allowances for uncollectible accounts recorded accurately.

Criteria

The State's Internal Controls Best Practice Series memorandum over accounts receivable indicates that departmental best practices include the maintenance of an accurate record of receivables transactions. The use of automated systems (e.g. VISION) should be utilized, where practical, to facilitate processing and reconciliation.

Context

The audit procedures detected an understatement of the allowance for uncollectible taxes receivable of $25,066,691 due to an error in the calculation of the State's additional reserve for uncollectible taxes receivable. Taxes receivable due dates were extended in the VTAX system during fiscal year 2020 because of changes in the State's tax filing deadlines in response to the COVID-19 pandemic. This resulted in the improper exclusion of certain receivables from the additional reserve query in VTAX because the query was not updated to account for the extensions. The additional reserve query was subsequently corrected and re-run in the VTAX system and a correcting entry was made by the State to increase the allowance for uncollectible taxes receivable.

Additionally, the audit procedures detected an understatement of $10,792,349 of taxes receivable and an understatement of $9,713,114 of the related allowances for uncollectible taxes receivable, resulting in a net understatement of taxes receivable in the amount of $1,079,235. The State's taxes receivable policy includes the calculation of taxes receivable and the related allowances for persons and entities that owe tax liabilities but do not file tax returns by the State's filing deadlines. The calculation was not performed in the VTAX system during fiscal year 2020 due to complications arising from the COVID-19 pandemic. A calculation was subsequently performed to estimate the taxes receivable and related allowance for uncollectible accounts by using historical data and a correcting entry was made by the State to increase the taxes receivable and related allowance for uncollectible taxes receivable.

Effect

Taxes receivable were misstated in multiple opinion units. The State subsequently recorded adjustments to correct the misstatements.

Cause

The State's internal controls related to the recording of accounts receivable did not detect the misstatements.

Recommendation

We recommend that policies and procedures over the year-end reconciliation and review of taxes receivable and the related allowances for uncollectible accounts be strengthened to ensure the balances are recorded accurately.

Management Response

The Department of Taxes agrees with this finding. The changes to the tax filing deadline in 2020 and the temporary suspension of our regular monthly billing processes in response to the COVID-19 pandemic created some unique challenges for the Department's accounts receivable. We have also begun a comprehensive review of our policies and procedures for determining the year end taxes receivables and the allowance for uncollectible accounts for future years. This will include new procedures for mitigating the impact of possible future changes to the filing deadlines on our year end receivables.

The Finance Division has a new Director and several new employees. We are working with all of the employees responsible for the preparation of the CAFR-1 to ensure that they have reviewed and understand our internal policies and procedures. We plan to consult with the Department of Finance and Management to discuss the issues which arose in the prior year and to review our process for preparing the CAFR-1 prior to its submission in future years.

Significant Deficiency in Internal Control Over Financial Reporting

Finding 2020-005 – Federal Grants Receivable –Department of Public Safety

Condition

The Department of Public Safety did not have controls properly implemented to ensure that federal grants receivable were recorded accurately.

Criteria

The State's Internal Controls Best Practice Series memorandum over accounts receivable indicates that departmental best practices include the maintenance of an accurate record of receivables transactions. The use of automated systems (e.g. VISION) should be utilized, where practical, to facilitate processing and reconciliation.

Context

Audit procedures detected an overstatement of federal grants receivable of $9,653,623. The State recorded federal grant receivables from the Federal Emergency Management Agency (FEMA). However, an approved federal grant agreement was not in place as of June 30, 2020.

Effect

Federal grants receivable were overstated for receivables that were not eligible for recognition at June 30, 2020. The State subsequently recorded an adjustment to correct the federal grants receivable.

Cause

The State's internal controls surrounding the recording of accounts receivable did not detect the misstatements.

Recommendation

We recommend that policies and procedures over the year-end reconciliation and review of federal grants receivable be strengthened to ensure the balances are recorded accurately.

Management Response

The Department of Public Safety does not contest the finding. As a corrective action we are in the process of updating our year-end Accounts Receivable CAFR-1 procedure to include the requirements of GASB Statement 33 and specific instructions regarding financial reporting for the FEMA Public Assistance Program.