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, 2021, 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 23, 2021. 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; Special Environmental Revolving Fund	0.06%	0.07%
Business-Type Activities	State Lottery Fund; Energy Efficiency Utility Fund	10.07%	21.38%
Special Fund	Universal Service Fund	1.50%	1.70%
State Lottery Fund	State Lottery Fund	100.00%	100.00%
Aggregate Remaining Fund Information	Energy Efficiency Utility Fund	0.42%	2.70%
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 2021-001, 2021-002, 2021-003 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 deficiency described in the accompanying schedule of findings and responses as item 2021-004 to be a significant deficiency.

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 23, 2021

Material Weakness in Internal Control Over Financial Reporting

Finding 2021-001 – Financial Close and Reporting –Department of Labor

Condition

The Vermont Department of Labor did not have controls properly implemented to ensure that unearned revenue, federal grant revenue, employer tax revenue, and related receivables 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

Our audit procedures detected material misstatements to revenue, unearned revenue, and receivables related to Emergency Relief Funds (ERF) for reimbursable employers, (those employers that pay based on actual claims as opposed to a flat percentage rate of wages). ERF cash received as of June 30, 2021 was accrued in error as reimbursable employer receivables and unearned revenue. However, the State met eligibility requirements for revenue recognition at year end. The result was an overstatement of reimbursable employer receivables and unearned revenue of $21,269,384, an understatement of ERF federal grant revenue of $26,582,184, an overstatement of reimbursable employer revenue of $23,358,701, and an understatement of ERF federal grants receivable of $3,223,483.

Effect

Reimbursable employer receivables, unearned revenue, and reimbursable employer revenue were materially overstated while federal grant revenue and federal grant receivables were materially understated. The State recorded adjustments to correct the errors.

Cause

The Department'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

After further discussion with CLA and the State's Department of Finance and Management, the Department understands the justification underlying the finding identified, as the finding is required by nature of the fact that there were material adjustments to the Department's financial statements made during, and as a result of, the audit review. While the Department acknowledges this finding and understands the continued need to ensure proper reporting of financial statements, including the need to incorporate the adjustments made during this review, the Department would like to ensure the audit record reflects the steps taken that led to this finding.

In preparing the Department’s financial statements, staff proactively reached out to the State’s Department of Finance and Management to review the manner in which the Department was reporting its financials. During the State fiscal year, significant new funding sources and transactions were managed by the Department as part of the response to the COVID-19 global pandemic and the federal programs enacted by the CARES Act. These types of programs and corresponding revenues were new and have never been reported by the Department prior to FY 2021. Thus, as mentioned above, the Department worked with the State to ensure that we were reporting the information in the most accurate manner prior to submitting the official financial statements.

In working with the Department of Finance and Management and CLA for the ACFR Audit, the manner in which the financial statements were presented was reviewed. After extensive discussion, and further research and review by CLA, it was determined that the Department needed to make material adjustments to the Department’s financial statements in order to more accurately reflect the state of the Department’s finances.

The Department would argue that the above steps taken both prior to and during the audit review period indicate that there are internal controls in place over financial reporting and that the Department does not need to implement any significant changes or alterations in our current practices of compiling and reviewing our financial statements. Moving forward, the Department will ensure that the lessons learned from this review are incorporated into our future preparations, and we will continue to collaborate with the Department of Finance and Management and with our State auditors to ensure we are reporting financial information in the most accurate manner.

Material Weakness in Internal Control Over Compliance

<u>Finding 2021-002 – Unemployment Claims – Department of Labor</u>

Condition

The Regular Unemployment Insurance program is administered by the Vermont Department of Labor and gives financial aid to unemployed individuals. In 2020, the federal government created new temporary unemployment insurance programs, including the Pandemic Unemployment Assistance (PUA) program, the Pandemic Emergency Unemployment Insurance (PEUC), and the Federal Pandemic Unemployment Compensation (FPUC) program, to further help individuals who lost their jobs due to COVID-19. The COVID-19 pandemic significantly increased the unemployment rate nationally and in Vermont. Before the pandemic, the national unemployment rate was about 4% in January 2020 and about 3% in Vermont. By April 2020, the national unemployment rate and the Vermont rate both increased to about 15%. The estimated unsupported claims and payments from these programs are significant to the State of Vermont.

Criteria

The Regular Unemployment Insurance program is a joint program between federal and state governments. In Vermont, individuals must meet several criteria to qualify for Regular Unemployment benefits. State law requires individuals to be monetarily entitled to receive unemployment insurance, meaning they must have received the minimum qualifying amount of wages of $2,949 from insured employment in one quarter of their base period, and the total of the three remaining quarters in their must equal or exceed 40% of the highest quarter earnings in the base period. The new federal programs established during the pandemic had fewer verification requirements than the State's Regular Unemployment Insurance program. For example, in April 2020, the United States Department of Labor (USDOL) stated that PUA claimants did not need to provide proof of employment or self-employment to qualify for PUA, nor did PUA consider the individual's principal source of income as part of the self-certification process. On December 27, 2020, Congress amended the law to require claimants to provide documentation to substantiate their employment or self-employment to be eligible to receive PUA. The Department should require all PUA claimants, those who previously received PUA payments and those who will file new PUA claims, to provide employment/self-employment documentation as required by USDOL.

Context

Tests of effectiveness over controls surrounding PUA claims, for the period beginning December 27, 2020 through year end, identified the following deficiencies in required documentation:

- Thirty-eight (38) out of thirty-eight (38) PUA claims samples tested had no evidence of review nor timely review of wage support;
- Nineteen (19) out of thirty-eight (38) PUA claims samples tested had no documentation to support claims payment amount;
- Nine (9) out of thirty-eight (38) PUA claims samples tested had documentation that did not support the claims payment amount.

Effect

The Department paid a significant amount of unsupported claims through the unemployment insurance program as a result of the COVID-19 pandemic. Claims were paid without the required wage support documentation and without review by the Department as required by USDOL.

Cause

The Department was unable to respond in a timely and effective manner to address the significant increase in claims and federal funds received in Fiscal Year 2021. The Department relied on an inadequate computer system during the pandemic to manage the program, resulting in various system errors and processing delays.

Recommendation

We recommend the State and the Department perform a thorough risk assessment over the unemployment insurance program and design controls and processes to address identified risks. Seeking continuous improvement to your risk assessment and internal processes is key to strengthening governance, risk management, internal controls, program management and overall operations within the program.

Management Response

The Department acknowledges and accepts this finding.

The Pandemic Unemployment Assistance (PUA) program did not exist prior to the COVID-19 global health pandemic. Unlike the unemployment insurance program, which has been in existence since 1935, the PUA program did not have the inherent checks and balances built into the system to ensure proper program administration. Instead, state workforce agencies were expected to build the PUA program from the ground up with little guidance from the USDOL all the while managing through a pandemic that caused unprecedented upheaval in the employment status of millions of citizens.

It is accurate that the Vermont Department of Labor was not able to implement the necessary checks and balances into the PUA program to ensure proper program eligibility. As has been pointed out in the audit finding, it was not until nine months *after* the start of the PUA program that Congress passed legislation that *required* documentation to be provided to substantiate program eligibility. At that time, due to the significant and unprecedented strains on the Department of Labor's resources, the newly established documentation requirements were not able to be implemented prior to the end of the PUA program.

The Department acknowledges that the lack of the ability to review claimant financial eligibility may have resulted in improper payments. It is important to point out that UIPL 16-20, Change 4 was issued on January 8, 2021, providing no time for UI programs to implement the required changes while still continuing to provide vital economic assistance to tens of thousands of individuals. The only other recourse available to the Department at that time would have been to stop program payments from issuing until the new eligibility requirements were reviewed. This would have left claimants without benefits for months while the Department used our limited financial and staff resources to implement the necessary changes.

This is the result of the continuously changing eligibility requirements built from hastily implemented legislation and program design. The Department has already begun the process of developing the necessary features into the Department's PUA system and has begun the auditing of claims to ensure retroactive program eligibility. Where appropriate, claims will be placed into an overpayment status and collection efforts will ensue.

Material Weakness in Internal Control Over Financial Reporting

Finding 2021-003 – Unemployment Claims – Department of Labor

Condition

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

Criteria

The Department does not have written policies and procedures established for month-end reconciliations of claims disbursements bank accounts. The Office of the State Treasurer requires that reconciliation procedures for each bank account are provided for review annually. In the absence of a policy, best practices require that the reconciled report should be available for review by the Financial Manager (or designee) within thirty (30) days of month end.

Context

Tests of effectiveness over controls surrounding PUA claims, for the period beginning December 27, 2020 through year end, identified the following deficiency in required bank reconciliation documentation:

Thirty-eight (38) out thirty-eight (38) PUA claims samples tested had bank reconciliations that were prepared and approved more than 30 days after month end. Such reconciliations were for the period December 2020 through June 2021 and were prepared by the Department in December 2021.

Effect

Documentation of the reconciliation of the claims disbursements bank accounts was not sufficient to indicate the reconciliations were performed in accordance with the established procedures of the Department and best practices established by the Vermont State Treasurer's Office.

Cause

Reconciliations over the claims disbursements bank accounts were not properly implemented by the Department and were not provided timely to the Vermont State Treasurer's Office for review.

Recommendation

We recommend that policies and procedures are implemented to ensure that claims disbursements bank account reconciliations are performed in accordance with established policies, procedures and best practices. Additionally, we recommend sufficient documentation be maintained to support the performance of the reconciliations in accordance with established policies and procedures and that such documentation is reviewed by the Department timely.

Management Response

The Department acknowledges and accepts this finding.

Throughout the period of review, the Department of Labor was facing unprecedented challenges in administering its UI program through the global heath pandemic of COVID-19. The Department became the only financial lifeline for tens of thousands of individuals and was tasked with developing and implementing five additional benefit programs in addition to managing claims volumes never before experienced in Vermont. Throughout this period, the Department's limited resources focused on prioritizing people over process and many reporting functions were suspended.

One of those functions was the month end reconciliation as identified in this finding. The justification behind this decision was that financial staff worked within the UI program's numerous bank accounts on a daily basis reconciling as payments were processed. The Department acknowledges that best practices require that reconciliation reports be available within 30 days of month end.

The Department is committed to ensuring proper program administration.

Significant Deficiency in Internal Control Over Financial Reporting

Finding 2021-004 – Tax Disbursements –Department of Taxes

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 has policies and procedures established for month-end reconciliations of tax disbursements bank accounts that require the reconciled report should be available for review by the Financial Manager (or designee) 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:

Fourteen (14) out of twenty-two (22) monthly reconciliations tested did not include sufficient documentation to support that all reconciliations were prepared within thirty (30) days of month-end. We noted that the reconciliations with exceptions related to the months occurring on or before March 31, 2021. As of April 1, 2021, the Department implemented a new electronic reconciliation and review process. No exceptions were noted in the final quarter of the fiscal year.

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 are 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 including retirements and several departures led to the monthly reconciliation work falling behind. Several new employees including a new Director of Finance were brought on board during fiscal year 2021. The monthly reconciliations had not been completed timely for many months and after an in-depth review, it was decided to completely overhaul the process to an electronic format. This overhaul resulted in many improvements which have made the reconciliations easier to audit and far more comprehensive. All of the source documentation for the reconciliations is now attached to the file. All of the reconciliations for fiscal year 2021 were completed using this new method.

The reconciliations for all seven of the Departments bank accounts can now be completed in just a few days. All monthly reconciliations for the fiscal year ended June 30, 2022 have been completed timely.