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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, 2022, 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 22, 2022. 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 percentages of total assets and total revenues as described in our report on the State's financial statements and as presented in the table below. 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%	0.06%
Business-Type Activities	State Lottery Fund; Energy Efficiency Utility Fund	11.80%	44.77%
Special Fund	Universal Service Fund	0.79%	1.53%
State Lottery Fund	State Lottery Fund	100.00%	100.00%
Aggregate Remaining Fund Information	Energy Efficiency Utility Fund	0.53%	8.37%
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%

Report on 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 were not identified. However, as described in the accompanying schedule of findings and responses, we identified 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 2022-001, 2022-002, 2022-003, and 2022-004 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 2022-005 to be a significant deficiency.

Report on 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 Responses to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the State's responses to the findings identified in our audit and described in the accompanying schedule of findings and responses. The State's responses were not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

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

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Boston, Massachusetts
December 22, 2022

Material Weakness in Internal Control Over Financial Reporting

Finding 2022-001 – Cash Reconciliations – Department of Liquor and Lottery, Division of Liquor Control

Repeat finding – No

Condition

The Department of Liquor and Lottery, Division of Liquor Control (Department) did not implement internal controls established for cash and credit card sales receipts.

Criteria

The Department has policies and procedures established for month-end bank reconciliations which require the reconciliation of total receipts and month-end cash amongst the following:

1. Bank Statement
2. Dynamics365 Point of Sale (POS) system
3. VISION Trial Balance (statewide accounting system)

Such reconciliations should be performed accurately and reviewed by the Financial Director (or designee) within thirty (30) days of month-end.

Context

Our tests of effectiveness of internal controls over cash and credit card revenues identified the following control deficiencies:

- Twenty-four (24) of twenty-four (24) monthly reconciliations tested did not include sufficient documentation to support the reconciliation of monthly receipts recorded in VISION to the POS system.
- Twenty (20) of twenty-four (24) monthly reconciliations tested were not supported by underlying source data, such as the bank statement or VISION trial balance.
- Three (3) of twenty-four (24) reconciliations reported month-end bank balances that did not agree to the respective bank statement.
- Three (3) of twenty-four (24) monthly reconciliations tested were not approved within thirty (30) days of month-end.

Effect

Evidence was not sufficient to indicate that monthly reconciliations were performed in accordance with established policies and procedures.

Cause

Internal controls over cash and credit card sales receipts were not properly implemented.

Recommendation

We recommend that policies and procedures are implemented to ensure that cash and credit card 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.

Views of Responsible Officials and Planned Corrective Action

During FY22, the Accounting Office of the Department of Liquor and Lottery (DLL) experienced unusual staff shortages, which affected our implementation of appropriate internal controls over cash and credit card sales receipts. Now that DLL Accounting is fully staffed, we are able to and have been implementing the appropriate internal controls outlined in Liquor Control's policies and procedures for month end cash and credit card bank account reconciliations, which includes further documentation for its review and accuracy as follows:

1) Monthly reconciliations tested will include sufficient documentation to support the reconciliation of monthly receipts recorded in VISION to the bank deposits and transfers. Documentation will include: VT_AR _Transactions, for the period date range (first day of the month to the last day of the month), bank activity detail for date range and respective Bank Statement.

2) Monthly reconciliations will be appropriately recorded and reconcile to the respective month-end bank balances derived from the respective bank statements.

3) Monthly reconciliations will be reviewed and approved by the Financial Director within thirty (30) days of month-end.

Material Weakness in Internal Control Over Financial Reporting

Finding 2022-002 – Financial Close and Reporting –Department of Labor

Repeat finding – Yes, 2021-001

Condition

VDOL has not implemented the necessary internal controls to report the Unemployment Compensation Trust Fund in accordance with accounting principles generally accepted in the United States of America (GAAP).

Criteria

The Vermont Department of Labor (VDOL) is responsible for preparing the annual financial statements of the Unemployment Compensation Trust Fund in accordance with GAAP. The financial statements report the activity from the Fund's trial balance maintained by VDOL on a delegated accounting system separate from the statewide accounting system. The annual trial balances are adjusted by VDOL for accruals and reclassifications for GAAP presentation. The final GAAP financial statement is submitted to the Department of Finance and Management for inclusion in the statewide Annual Comprehensive Financial Report.

Context

Revenues and accounts receivable from reimbursable and contributory employers reported in the initial draft 2022 GAAP financial statements of the Unemployment Compensation Trust Fund were not supported by related source records maintained in systems outside of VDOL's delegated accounting system. VDOL was unable reconcile the financial statement balances to the source records and subsequently requested third-party assistance to perform the reconciliations as well as propose the journal entries necessary for GAAP financial statement presentation.

Material journal entries were required to properly present the Unemployment Compensation Trust Fund in accordance with GAAP. Such entries included a reduction of accounts receivable of $21.3 million as well as a reduction of employer revenues of $23.4 million. It was also determined that several data reports generated from the source records to substantiate the receivables and revenues were produced incorrectly and were reprogrammed to facilitate audit testing.

Effect

Reimbursable employer revenues and receivables were materially overstated, and the State recorded adjustments to correct the errors.

Cause

VDOL's internal controls over financial reporting were not in place to ensure its financial statements were presented in accordance with GAAP. The internal controls also did not ensure proper substantiation of the balances reported in the financial statements.

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 reported accurately and are adequately supported by source records.

Views of Responsible Officials and Planned Corrective Action

The Department acknowledges and accepts this finding. This is a repeat finding from last year's ACFR audit.

In March 2022, during the fiscal year under review, the Department lost both the unemployment insurance finance manager and the senior finance administrator within the cashiers unit of the Unemployment Insurance Division, the only two full time positions within that unit. Both individuals had been with the Department for more than 10 years. In previous years, the Department was able to rely on the expertise of our cashiers office staff and this shortfall did not present itself.

The Department is currently diligently working to replace the finance manager position. In the meantime, the Department is working to conduct a review of the functions, documentation, and internal controls of the unemployment insurance cashiers office to ensure that the program has the appropriate procedures and materials in place for proper financial reporting moving forward. The Department expects to conduct this review over the second half of fiscal year 2023.

In the meantime, the Department will explore other options to determine whether additional staff can be cross trained on the preparation of UI financial reporting to ensure the Department has the needed support moving forward so a loss of critical staff does not create a significant knowledge gap.

Material Weakness in Internal Control Over Compliance

<u>Finding 2022-003 – Unemployment Claims Compliance – Department of Labor</u>

Repeat finding – Yes, 2021-002

Condition

The Regular Unemployment Insurance program is administered by the Vermont Department of Labor (VDOL) 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%. While the State's unemployment rate declined to 2.2% percent in June 2022, the estimated unsupported claims and payments from these programs were significant to the State.

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 $2,999 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 have required all PUA claimants, including those who previously received PUA payments, to provide employment/self-employment documentation as required by USDOL. The PUA program ended September 4, 2021.

Context

Tests of effectiveness over controls surrounding PUA claims identified that thirty-eight (38) out of thirty-eight (38) PUA claims samples tested had no evidence of review nor timely review of wage support.

Effect

VDOL 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

VDOL was unable to respond in a timely and effective manner to address the significant increase in claims and federal funds that continued throughout fiscal year 2022.

Recommendation

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

Views of Responsible Officials and Planned Corrective Action

The Department acknowledges and accepts this finding, and as this is a repeat finding from last year's ACFR audit, the Department maintains the same response and corrective action plan.

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. In calendar year 2022, the Department began the process of retroactively reviewing all PUA claims that were filed and paid after the date of UIPL 16-20, Change 4 to ensure that proper documentation was provided to ensure program eligibility. Where appropriate, claims are being placed into an overpayment status and collection efforts will ensue.

Material Weakness in Internal Control Over Financial Reporting

Finding 2022-004 – Unemployment Claims Financial Reporting – Department of Labor

Repeat finding – Yes, 2021-003

Condition

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

Criteria

VDOL 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 July 1, 2021, through September 4, 2021, identified the following deficiencies in VDOL's bank reconciliation documentation:

- Thirty-eight (38) out thirty-eight (38) PUA claims samples were attached to bank reconciliations that had no evidence of preparer and reviewer sign offs.
- Ten (10) out of twelve (12) bank reconciliations tested were signed by neither a preparer nor a reviewer.
- One (1) out of twelve (12) bank reconciliations tested was not prepared and reviewed within 30 days of month end.

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 VDOL and best practices established by the Vermont State Treasurer's Office.

Cause

Reconciliations over the claims disbursements bank accounts were not properly implemented by VDOL and were not provided timely to the Vermont State Treasurer's Office for review in fiscal year 2022.

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 VDOL timely.

Views of Responsible Officials and Planned Corrective Action

The Department acknowledges and accepts this finding. This is a repeat finding from last year's ACFR audit.

As we mentioned in last year's audit response, the Department was forced to forgo certain best practices throughout the pandemic period due to limited resources and the need to ensure that the Department prioritized people over process and the payment of benefits during a global health and financial crisis.

Unfortunately, the Department lost the only two staff members trained in this function during this fiscal year as both our financial manager and financial administrator left the Department of Labor. Due to the limited resources available (the UI cashiers office typically consists of two full-time positions), the Department had to ensure that other duties were prioritized over end of month reconciliation reports. Unfortunately, despite exhaustive attempts, the Department was unable to replace the financial manager position throughout the remainder of the fiscal year under review.

Once the Department is fully staffed in the cashiers unit, the Department will be able to reintroduce end of month account reconciliations. In the meantime, the Department will explore other options to determine whether additional staff can be trained in end of moth account reconciliation.

Significant Deficiency in Internal Control Over Financial Reporting

<u>Finding 2022-005 –Bank Reconciliations– Agency of Natural Resources</u>

Repeat Finding - No

Condition

The Agency of Natural Resources (Agency) did not adequately implement reconciliation controls over one of its bank statements.

Criteria

The Agency maintains a delegated Volkswagen Environmental Mitigation bank account outside of the core bank accounts maintained by the Office of the State Treasurer. The Office of the State Treasurer requires the Agency to complete and submit a June 30th bank account reconciliation to the State's trial balance in VISION, along with supporting documentation, in a timely manner.

Context

The June 30th cash balance of the Volkswagen Environmental Mitigation bank account did not reconcile to VISION. We noted a discrepancy between the June 30th bank and VISION balances of $4.3M as part of our cash testing. The bank reconciliation completed by the Agency noted no such discrepancy.

Effect

Cash and revenue were understated in VISION. As a result, the State recorded an adjustment of $4.3M to correct the understatement.

Cause

Reconciliations over the bank account to VISION were not properly implemented.

Recommendation

We recommend that policies and procedures are implemented to ensure that the bank account reconciliations are performed in accordance with the guidelines established by the Office of the State Treasurer. Additionally, we recommend sufficient documentation be maintained to support the accurate performance of the reconciliations.

Views of Responsible Officials and Planned Corrective Action

It is important to note that the actual cash was drawn into the account based on a DEC request but the transactions to record it in Vision, as noted here, is what did not occur. This occurred during a staffing shortage we have been suffering for the past twenty-four months and specifically in the position that was historically performing this bank reconciliation. When we performed the bank reconciliations in FY22, there was a misunderstanding as to which queries in the State of Vermont's Vision Accounting System that needed to be run in order to balance Vision to the Bank Statement. The Vision query that we were using turned out to be a query that represented just the download of the bank statement that the Treasurer's Office was uploading into Vision and did not actually contain information from Vision related accounting entries. This meant that we were essentially balancing the bank account against the bank account and not the bank account against Vision entries.

While we did have a written SOP for the reconciliation of this bank account, it is missing “job aid” details. We now are clear on which queries need to be run in Vision to ensure we are balancing the bank account to Vision going forward and we will update this SOP with these details so this error does not reoccur in the future regardless of staff turnover.