

Commonwealth of Virginia Fiscal Fundamentals



# **Agency Risk Management & Internal Control Standards (ARMICS)**

# HISTORY OF ACCOUNTING IN VA

- 1980 Through 1991
- 1992 Through 2001
- 2002 Through Present

# REVENUES AND EXPENSES

- Fortune 36 Company
- 100,000 Employees
- Budgeted Revenues and Expenditures  
Approximately \$37 Billion Each Year of the  
Biennium

# DECENTRALIZED ACCOUNTING

- 230 Agencies
- 15 Major Four Year Colleges and Universities
- 23 Community Colleges
- 22 Other Component Units

# DECENTRALIZED ACCOUNTING

- Legacy System CARS 1978
- Cash Basis
- Updated CARS II 1986
- No Real Change
- Cobol Programming
- EA Project

# CAFR REPORTING

- Comptroller Directives
- Start With CARS
- Gather Modified Accruals and Full Accruals
- Word and Excel

# BEST MANAGED STATE

- Triple A Triple Bond Rating
- Unqualified Opinion
- Certificate of Excellence in Financial Reporting

# VIRGINIA COMPTROLLER RESPONSIBILITIES

- Code of Virginia §§ 2.2-800 and 2.2-803
- COMPTROLLER RESPONSIBLE FOR ACCOUNTING AND FINANCIAL REPORTING STATEWIDE
- Comptroller Is Responsible For Internal Control Statewide



# The Sarbanes-Oxley Act



# What is SOX?

"An act to protect investors by improving the accuracy and reliability of corporate disclosures required by securities laws, and for other purposes."

# Why SOX? Scandals, including:

- **WorldCom** – Bernie Ebbers (CEO, 63), 25 years prison – \$11 billion lost
- **Dynegy** – Jamie Olis (VP Finance, CPA, attorney, 38), 24+ years prison – \$105 million lost by 13,000 members in UC Retirement Plan alone
- **Adelphia** – John Rigas (founder, 80) 15 years prison, Timothy Rigas (CFO, 48) 20 years – \$100 million stolen
- **Tyco** – Dennis Kozlowski (CEO, 58) and Mark Swartz (CFO, 44) convicted – 8-1/3 to 25 years prison – pair must pay \$134 million in restitution, \$105 million in fines – “looted” Tyco for \$547 million (NY state courts)
- **Enron** – Ken Lay (CEO, 63) – 4,000 lost jobs & pensions, creditors lost \$65 billion – trial set for January 2006

# Scandals? So what?

Like hundreds of pension funds throughout the country, VRS has suffered losses from investments in Enron and WorldCom ... VRS provides benefits to more than 104,000 retirees and has 310,000 active members.

Virginian-Pilot (August 22, 2002)

# VRS losses?

- **WorldCom  $\approx$  \$50 million.**
- **Enron  $\approx$  \$60 million.**

“Those losses represent only a sliver of the billions in value erased from VRS by the two-year decline in the stock market.”

Jeff Shapiro, Richmond Times-Dispatch (July 3, 2002)

# Does SOX Apply to States?

- Not yet.
- Circular A-123 was revised Dec 2004 to mandate SOX-like standards for Federal agencies.
- The Federal government is expected to apply A-123 to states in the future.
- SOX and ARMICS address parallel issues, and both stem from COSO standards.

# A-123 Federal Requirements

- Federal Managers must take systematic and proactive Measures to:
- **Implement Cost Effective I/C**
- Assess Adequacy of I/C In Programs and Operations
- **Separately Assess & Document I/C Over Financial Reporting**
- Identify Improvements, Take Corrective Action & Report Annually on I/C

# NEW SAS

- NEW GROUP OF SAS 102 THRU 112
- SAS 112
- AUDITOR REQUIREMENTS
- MATERIAL WEAKNESSES IN IC
- AUDIT OPINION
- BOND RATING



# SUMMARY SO FAR

- Antiquated General Ledger System
- Loss of Accounting Staff Within State Agencies
- New Suite of SAS
- More Emphasis On Internal Control
- Valuable Reputation To Protect
- Perfect Storm

# ARMICS

- 122 Page Document
- Comptroller's Directive
- Force of Law
- Based on the 1992 COSO Standards

# MODEL SIMPLER

- Simpler model to implement (stepping stone to ERM)
- Based on COSO 1992 Internal Control Integrated Framework
- Based on the internal control model with some risk management concepts retained
- Such as “tone at the top”
- Governs fiscal activities only

# What is **COSO**?

**C**ommittee **O**f **S**ponsoring **O**rganizations of the Treadway Commission (formed in 1985)



The Institute of Internal Auditors



# COSO Defines Internal Control

“Internal control is a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effective and efficient operations
- Reliable financial reporting
- Compliance with laws and regulations”

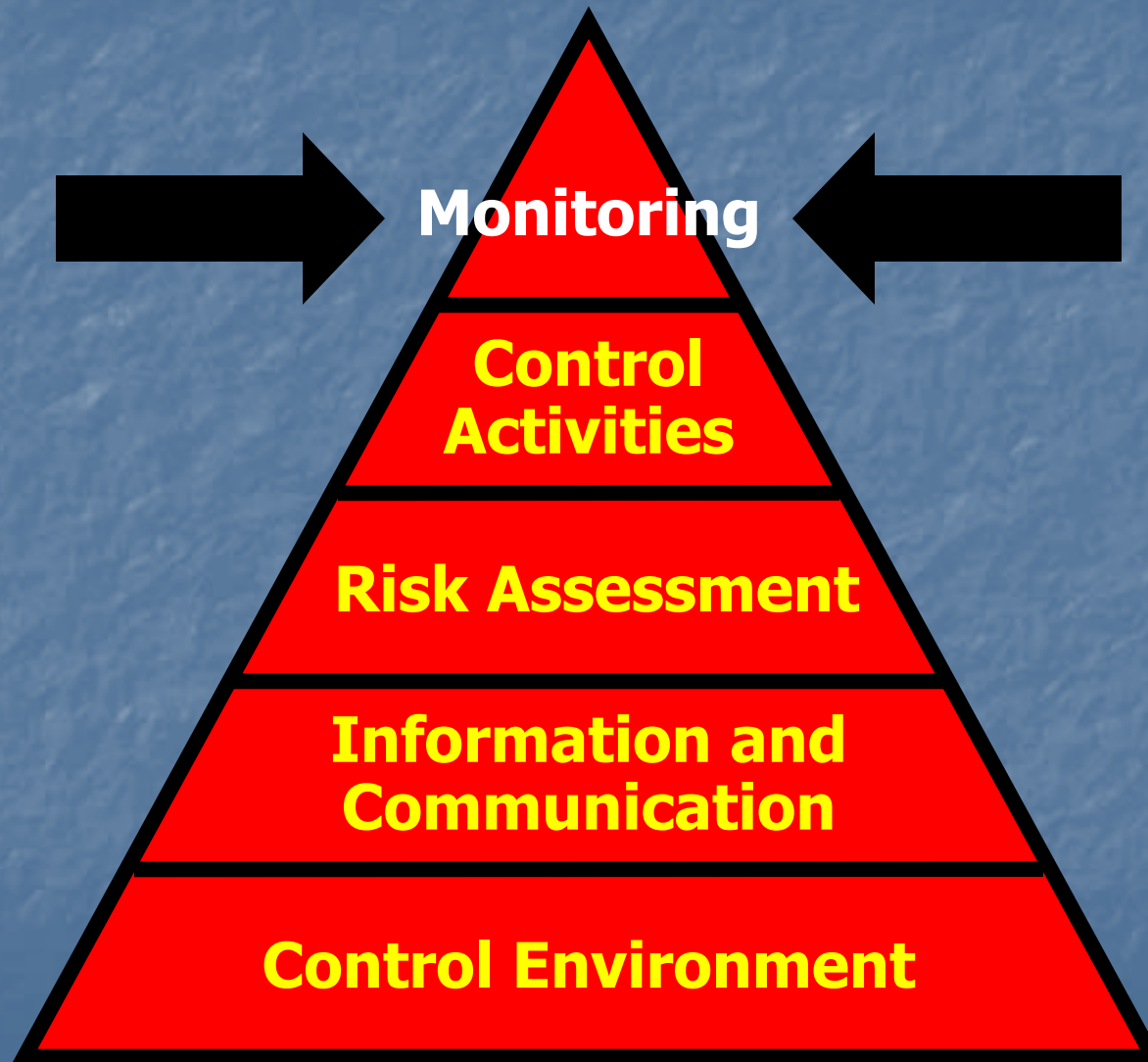
# Responsibility for Internal Control?

- Governing Boards
- Executive Management (Agency Heads)
- Senior and Line Management (including CFOs and Fiscal Officers)
- Supervisors and Staff
- **EVERYONE IS RESPONSIBLE!**

# ARMICS INTERNAL CONTROL DEFINITION

- Ongoing Process Led by Agency Head To Design and Provide Reasonable Assurance that these types of Objectives Will Be Achieved:
  - **Effective and Efficient Operations**
  - Reliable Financial Reporting
  - **Compliance With Laws and Regulations**
  - Stewardship and Safeguarding of Assets

# First COSO Internal Control Model





# Control Environment

The foundation on which everything rests:

- The “tone” of the agency
- Management’s philosophy
- Integrity and ethics
- Commitment to competence
- Accountability
- Policies and procedures

# ARMICS

- Basis For ARMICS Covered In Pages 3-7 of the Document
- Background
- Vision Statement
- Long-Term Objective

# ARMICS

- Internal Control Basics Covered in Pages 8-12
- **Glossary Of Terms**
- Best Practices
- **Control Activities**
- Control Environment and Risk Assessment
- **Information and Communication**
- Monitoring

# ARMICS

Pages 13-35 Address the Heart of the  
"ARMICS Standards"

Control Environment is extremely Important  
and has major impact –positive or  
negative on internal Control

Top management Attitude

# ARMICS

- Important Concepts
- Reasonable Risks
- Integrity and Ethical Values

# ARMICS

- The ARMICS Document addresses the “Internal Control Assessment” on page 36 and provides an Internal Control Assessment Guide As Appendix A on Pages 37-68. Appendix A is further broken down into “Three Reporting Stages”

# ARMICS

- Stage 1 (pages 40-59) Agency Level Assessment
- Stage 2 (pages 60-67) Process or Transaction Level Assessment
- Appendix A-1 (pages 69-109) Process or Transaction Level Control Questionnaires
- Appendix A-2 (pages 110-122) Process Control Assessment Example
- Stage 3 simply list the requirements for an effective corrective action plan on page 68.

# ARMICS DELIVERABLES

- Certification by September 30, 2007 That the Agency Level Internal Control Assessment Has Been Completed
- Certification by March 31, 2008 That the Process and Transaction Level Has Been Completed
- Certification by June 30, 2008 That Corrective Action Plans Have Been Completed



# AICCO

- Accounting and Internal Control Compliance Oversight Unit
- Mission: To Evaluate and Report On Agency Financial Accountability, Compliance and Internal Control With The Goal of Assisting Agencies In Meeting Their Responsibilities For Providing Reliable And Accurate Financial Information, For Protecting Commonwealth Resources and For Supporting And Enhancing The Recognition Of Virginia As The Best Managed State

# AICCO

- Objectives
- To Improve Financial Accounting and Reporting In The Commonwealth of VA
- To Improve the Internal Control Structure Over General Ledger Accounting, Financial Reporting, Safe Guarding of Assets, and Compliance with Laws and Regulations
- To Provide Training and Assistance to all State Agencies With the Goal of Helping State Agencies Meet Their General Accounting and Financial Reporting Responsibilities
- To Provide Services That will help the Commonwealth Retain its Triple A Triple Bond Rating and Remain the Best Managed State in The Union.

# AICCO UNIT MAKEUP

- Director and Two Assistant Directors
- 5 ARMICS Quality Assurance Analysts
- 6 Financial Reporting Quality Assurance Analysts
- 2 General Ledger Reconciliation Quality Assurance Analysts
- 2 Training Specialists
- 2 Decentralized Review Specialists

# Funding

- Business Case
- Secretary of Finance, Chief of Staff and The Governor, and the General Assembly
- 14 New Positions
- Additional General Funds Approximately \$2 Million

# Hiring Strategy

- Recruit at Colleges and Universities
- Advertise
- Mix of Experienced and Inexperienced
- Training In-House

# Work-plan

- Risk Based Approach
- Standard Programs
- 3 yr. Cycle

# References

The Comptroller's Directive and Agency Risk Management & Internal Control Standards are available from

[http://www.doa.virginia.gov/ARMICS/ARMICS\\_main.cfm](http://www.doa.virginia.gov/ARMICS/ARMICS_main.cfm)

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