

**REPORT TO THE
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMISSION**

**FOR THE QUARTER
JANUARY 1, 2003 TO MARCH 31, 2003**



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April 9, 2003

The Honorable Kevin G. Miller, Chairman
and
Members, Joint Legislative Audit and Review Commission
General Assembly Building
Capitol Square
Richmond, Virginia 23219

This transmits our quarterly summary of reports issued for the period January 1, 2003 through March 31, 2003.

The *Executive Summary* includes reports that may be of special interest to the members of the Commission. We have included a report in the summary for the sole purpose of bringing to your attention matters of significance. These summaries do not include all findings within a report or all reports with findings.

The *Summary of Reports Issued* lists all reports released during the quarter and shows reports that have audit findings.

We will be happy to provide you, at your request, any reports in their entirety or you can find all reports listed in this document at our website <http://www.apa.state.va.us/reports.htm>. We welcome any comments concerning this report or its contents.

Sincerely,

Walter J. Kucharski
Auditor of Public Accounts

WJK:aom

EXECUTIVE SUMMARY

DEPARTMENT OF AVIATION

AVIATION WORLD'S FAIR SUSPENDED

Background

The Aviation World's Fair 2003 was going to celebrate the one-hundredth-anniversary of the first powered and controlled flight of a manned machine by the Wright Brothers. Virginia and its partner, the state of North Carolina, planned to host this one-time event at the Newport News-Williamsburg International Airport in April 2003. Kallman Worldwide, incorporated as "Aviation World's Fair, Inc.," was organizing the event. Other organizations and agencies directly involved in the Aviation World's Fair 2003 included, but were not limited to: the Secretariats of Transportation, Commerce and Trade, and Natural Resources in Virginia, the North Carolina Aeronautics Council, Virginia jurisdictions and airports, and the staff and agents of federal, state, and local elected officials.

Grounds for Suspension

In October 2002, just five months before the scheduled event, the Commonwealth suspended all financial support for the Aviation World's Fair. The Commonwealth's decision to withdraw financial support for the event was supported by its discovery that the event planner was unable to reach minimum goals for advance ticket sales, unable to sign sponsors for the event, and unable to generate significant exhibitor revenues.

The event planner initially planned for \$1 million in paid visitors, \$18 million in corporate sponsorships, and 1,600 trade show exhibitors. Approximately one year before the scheduled event, the planner had no corporate sponsors and less than 100 exhibitor spots filled. The original plan was to begin selling tickets one year before the event. However, the event planner provided only non-refundable tickets to the public beginning in September 2002, just seven months before the event. In addition to the inability to meet these goals, the event planner was unable to secure a \$1 million performance bond to cover the cleanup costs for the project.

Contingent Liability

Aviation has a contingent liability associated with the cancellation of the Aviation World's Fair. Aviation paid the event planner \$1.5 million in accordance with the memorandum of agreement for duties performed. However, on November 22, 2002, the event planner requested additional reimbursement of approximately \$4.2 million under the memorandum of agreement which states that the event planner "shall be compensated for all work completed prior to termination, subject to the availability of funds, provided said work was previously scheduled on annual program plans and contracted for in discrete, particularized contracts." Aviation feels it has met its obligations under the memorandum of agreement and does not intend to make any further payments.

Status and Funding of the Project

Over the past two years in preparation for the Aviation World's Fair, Aviation participated in approximately \$27 million in permanent infrastructure improvements at the Newport News-Williamsburg International Airport supported by state, federal, and local funds. Aviation approved the airport's master plan

that originally called for the construction of these improvements over a span of 10 to 20 years. The airport accelerated construction to serve site requirements of the Aviation World's Fair.

The Commonwealth decided to suspend financial support of the Aviation World's Fair before starting any temporary infrastructure projects because the event planner could not reach the minimum goals for advance ticket sales, sign any major sponsors for the event, or generate significant exhibitor revenues. The temporary infrastructure projects were specifically necessary for the Fair, such as fencing, parking, roadways, and walkways.

Aviation used various sources to finance the Commonwealth's share of the capital project. During fiscal year 2001, Aviation began seeking authorization to borrow \$15 million from the Virginia Resource Authority to cover the Commonwealth's share of the projects scheduled at Newport News. The Department of Accounts approved a Treasury Loan of \$7,392,822 for Aviation to use as interim financing while waiting for General Assembly approval of long term financing through the Resource Authority. A stipulation of the Treasury loan was to reserve funds equivalent to the loan amount. Given this stipulation in fiscal year 2002, Aviation decided to cancel the Treasury loan and use the funds it was required to reserve in the Commonwealth Airport Funds and Aviation Special Funds for the improvements.

Meanwhile Aviation still awaited the approval of the \$15 million loan from the Resource Authority. Aviation anticipated using the loan proceeds to replenish \$4.4 million in Aviation Special Funds and \$3.0 million in Commonwealth Airport Funds. In February 2002, the General Assembly approved a loan amount of only \$6.6 million. The loan amount was far short of the requested amount of \$15 million. As a result, Aviation was unable to replenish its special funds and had to delay funding originally allocated to other local airports.

Upon completion of the Newport News-Williamsburg International Airport project, Aviation will have granted a total of \$12.5 million on the project, with Peninsula Airport Commission contributing \$2.9 million and the Federal Aviation Administration contributing \$13 million.

DEPARTMENT OF MOTOR VEHICLES

Operating Fund Deficit

During 2002, Motor Vehicles' cash flow problems continued and required that the department obtain a Treasury Loan to meet its vendor obligations. The on-going cash problems over the past five years without adjusting spending patterns has converted a \$3.4 million surplus in 1997 to a cash deficit of (\$1.8 million) in 2002 and with unpaid bills added to the cash deficit, the total deficit is approximately (\$8 million).

As a condition of receiving the Treasury loan, Motor Vehicles had to develop a loan repayment plan and plan to resolve Motor Vehicles' cash flow problems. In addition to this plan, Motor Vehicles, like the rest of state government, has been subject to budget reductions.

Motor Vehicles has implemented budget reductions to address its long-term cash flow issues and its need to control costs. At this point, it is unclear whether management has taken sufficient steps to control long-term costs. Initial indications show that there is an increase in revenue, which appears to be primarily from the approved increased fees. Recent actions to reduce staff and begin recovering a portion of the credit card merchant's fee should also help to reduce costs.

Additionally, Motor Vehicles' management will need to consider the necessity of retaining some minimum level of cash reserves to fund on-going operations or to have a permanent line-of-credit to meet their obligations. The amount of this reserve will depend on the ultimate effect of the budget reductions and other actions management takes. This report discusses the lack of adequate cash reserves and highlights the problems management will face if it does not have access to this operational funding mechanism.

This report provides background on Motor Vehicles' cash flow problems and how management plans to implement the budget reductions. Motor Vehicles' management will need to monitor its progress as it implements the Treasury Loan Repayment plan and the budget reductions.

POTOMAC RIVER FISHERIES COMMISSION

Construction of New Office Building

The Commission has placed excess cash into both the Maryland and Virginia Local Government Investment Pools and designated a portion of these investments for the future construction of a new office building. As of June 30, 2002, the building fund totaled \$330,074 after the purchase of land adjacent to the existing office building for approximately \$175,000 in fiscal year 2000 and architect design fees paid in 2002.

Since completing the building design, the Commission is now negotiating with a bank to secure a construction loan up to \$300,000. This loan amount combined with the \$330,000 designated for the building should cover the building cost of about \$650,000.

The Commission receives more than \$310,000 in General Fund appropriations annually from Maryland and Virginia to support their operations. Over the past year, both Maryland and Virginia have experienced significant revenue shortfalls, causing budget reductions and personnel layoffs.

The Commission has had its support from Virginia reduced by nearly \$20,000 in fiscal year 2002. Current budget projections for both Maryland and Virginia indicate that support to the Commission will continue to be less than in previous years.

We recommend that the Commission defer construction of a new office building until the Maryland and Virginia fiscal situation stabilizes. The Commission, by obtaining a loan in a period of reduced appropriations, could place the Commission at risk of having to commit their operating budget to making debt service payments.

VIRGINIA BIOTECHNOLOGY RESEARCH PARK AUTHORITY

Improve Controls over Financial Reporting

The Virginia Biotechnology Research Park Authority (the Park) needs to continue to improve and strengthen both its financial reporting and record-keeping function. Our audit found several errors and inconsistencies in the recording and subsequent reporting of transactions that resulted in material adjustments to the Park's financial statements. One contributing factor is the lack of detailed accounting policies and procedures. Although the Park developed accounting procedures in March 2002, they do not contain sufficient detail to ensure consistent and proper recording of transactions in the financial system. For example, the

Park's procedures do not include a chart of accounts and do not provide sufficient detail on transaction processing or reconciliation and closing procedures.

Overall, the Park needs to strengthen their financial reporting and record-keeping function. They should review and improve their current accounting policies and procedures by defining their chart of accounts, as well as providing sufficient detail on transaction processing and reconciliation and closing procedures. The Park's policies and procedures should address how to record transactions for activities that are unique to the Park, such as build-outs and the Park's relationship with the Virginia Biosciences Development Center. The Park also needs to ensure that adequate procedures exist for a proper supervisory review of critical transactions and processes. It is our understanding that the Park is continuing to work on developing a more detailed set of accounting policies and procedures, and has committed to have them in place by March 2003.

Finally, we recommend the Park review and evaluate the staffing and workload for the financial reporting function due to many new responsibilities that they assumed within the past year. The Park needs to address these areas not only to improve their annual financial statement report, but also to ensure that financial information used throughout the year for decision-making is reliable and consistent.

VIRGINIA COLLEGE SAVINGS PLAN

Transitioning Board Governance

The Virginia College Savings Plan (Plan) is a relatively new organization that has been in existence since 1995. Both management and the Board have concentrated on getting various programs up and running and responding to new state and federal legislation, which has occurred almost every year since the start of the Plan. Management and the Board need to continue their transition from the initiation of the Plan to a mature organization. This transition includes continuing to move towards an anticipatory rather than reactive approach to operations.

In making the transition, management and especially the Board need to continue their current efforts to develop a process that involves both management and the Board in the policy setting, planning, and oversight functions. Additionally, the Board should set forth its expectation of management and the information and policies it needs to review to exercise its oversight responsibilities.

The Board should enhance its committee structure to address the key components of the Plan's operations and should continue to refine and review the function, roles, and responsibilities of each committee. The enhancement of standing committees will provide the Board with a framework for making decisions that have a significant impact on the Plan. How the Board enhances its committees, whether by subject matter or operational function, is not as important as making sure the Board sets a structure that provides both the committees and the Board with information in the following key areas.

- Investment Management – The Board should use its Investment Committee as a model when considering how to establish other committees. The Investment Committee should continue to regularly receive information concerning investment performance and activity that allows it to monitor investments within the guidelines and policies established by the Board. The Committee's ongoing review determines if its investment guidelines and policies require revision. The

Board should work with the Committee to determine what type of information it needs to make decisions.

- Actuarial Assumptions and Contract Pricing – The Board should consider establishing an anticipated schedule that allows for the receipt of all key information from the actuary, financial reporting, marketing and other external groups deemed necessary to evaluate, consider, and decide on the appropriate pricing of contracts. In order to achieve this objective the Board will need to continue working with management and its outside consultants to ensure that all parties understand their duties and responsibilities in providing the Board information. The Board should clearly articulate its needs and hold all parties accountable for providing timely information.
- Financial Performance, Budgetary, and Other Monitoring – The Board needs to review periodically its requirements for information including the frequency, format, and content of the reports it expects from management and others. Some of the information requirements may be as basic as monthly budget versus actual spending reports or as complex as actuarial information and its impact on pricing considerations. The Board should continue to examine what it considers necessary to make sound business decisions and then assure themselves that management has complied with their needs. The Board should recognize that over time these baseline information requirements will change to meet changing needs.

The Board, as part of its regular meeting schedule, should arrange to have those individuals and organizations that support the Plan to discuss their progress in meeting the Board's objectives and goals. Clearly, the Board does meet with the actuary and investment consultant, but this schedule should also include the external auditor and other experts the Board thinks can assist them in performing their oversight responsibilities.

The items above are a partial list of items that the Board may wish to consider and review. None of these suggestions are a reflection on the current Board or management, but are an indication of the need to continue the transition into an organizational approach to issues and other considerations facing the Board.

Improve Timeliness of Financial Reporting

Management and the Board need to recognize the necessity of having timely financial statements and related fiscal information, when considering the pricing of contracts. A key component of both the financial statements and the pricing is the actuarial valuation. The actuarial valuation is a key factor in measuring historical performance and determining the Plan's future needs to fund contracts.

In addition to management and the Board's need for timely financial statements, the Plan is a critical component of the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The proper and timely preparation and inclusion of all critical components of the Commonwealth in the CAFR is essential in the Commonwealth maintaining its Triple A bond rating. An opinion qualification resulting from the exclusion of a critical component such as the Plan could jeopardize the bond rating.

It has historically taken the Plan's Director of Finance between four to five months to complete the statements, although the Plan must submit financial statements including footnotes to the Department of Accounts within 60 days of fiscal year-end. One of the limitations in the current financial reporting process is the receipt of the actuarial valuation, which according to the current contract, the actuary must complete by September 1.

The actuary did not provide the final valuation until January 2003. The actuary did provide preliminary valuation amounts to the Plan on October 29 and a draft of the valuation report on November 15, which was earlier than previous years. The Plan worked more closely with the actuaries during the past year to provide the actuary with information needed to perform the valuation. However, the Plan needs to continue to work with the actuary, as well as other external parties involved in the valuation process, to ensure completion of the final valuation report by the contractual deadline.

The second limitation to the timely preparation of financial statements is the commitment of sufficient resources to complete the financial statements. Currently, the Director of Finance prepares the financial statements and attempts to perform all her other duties. As a result, the Director of Finance did not complete the statements until November, which was three months after the Department of Accounts deadline.

The Plan provided the Department of Accounts preliminary financial statements only within the 60 days allowed, however, these statements did not include footnotes and required several material adjustments to properly show the Plan's financial condition. Further, the Plan could not provide support for the amounts on these statements at the time of submission. For fiscal year 2003, the Plan has hired additional staff that will be available at year-end to assist in the accumulation of data and preparation of financial statements.

The final limitation in the financial reporting process is the Plan's use of the Commonwealth's statewide accounting system. In order to facilitate timely reporting, the Plan is implementing its own accounting system, rather than relying on the statewide accounting system, which will better accommodate the nature of the Plan's complex transactions. In addition, this new system will eliminate double keying of accounting data, providing additional staff hours to assist in the preparation of financial statements. By completing implementation within the next year, the Plan will eliminate inefficiencies in its current operations and gain more flexibility for obtaining relevant and timely financial data.

SUMMARY OF REPORTS ISSUED

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The following reports on audit were released by this Office during the period January 1, 2003 through March 31, 2003. Those reports which included findings in the area of internal controls or compliance are indicated by an (*) asterisk.

State Agencies and Institutions

Executive Departments

Administration

Department of General Services for the year ended June 30, 2002*
Department of Human Resource Management for the year ended June 30, 2002
Local Government Investment Pool for the year ended June 30, 2002
Virginia War Memorial Foundation for the year ended June 30, 2002

Commerce and Trade

Department of Business Assistance for the year ended June 30, 2002
The Virginia Removal or Rehabilitation of Derelict Structures Fund for the year ended June 30, 2002
Virginia Employment Commission for the year ended June 30, 2002*
Virginia Public School Authority for the year ended June 30, 2002
Virginia Small Business Financing Authority for the year ended June 30, 2002

Education

Southwest Virginia Higher Education Center for the year ended June 30, 2002
Virginia Biotechnology Research Park Authority for the year ended June 30, 2002*
Virginia College Savings Plan for the year ended June 30, 2002*

Colleges and Universities

The College of William and Mary for the year ended June 30, 2002*
The College of William and Mary, Intercollegiate Athletic Programs for the year ended June 30, 2002
University of Virginia for the year ended June 30, 2002*

Colleges and Universities (continued)

University of Virginia, Intercollegiate Athletic Programs for the year ended
June 30, 2002
Virginia Commonwealth University for the year ended June 30, 2002*
Virginia Commonwealth University, Intercollegiate Athletic Programs for the year
ended June 30, 2002

Finance

Agencies of the Secretary of Finance for the year ended June 30, 2002*

Health and Human Resources

Agencies Serving Virginians with Disabilities for the year ended June 30, 2002
Commonwealth Health Research Board for the year ended June 30, 2002
Department of Health for the year ended June 30, 2002*
Department of Mental Health, Mental Retardation, and Substance Abuse Services for
the year ended June 30, 2002*
Department of Social Services for the year ended June 30, 2002*
Tobacco Indemnification and Community Revitalization Commission for the year
ended June 30, 2002
Virginia Tobacco Settlement Foundation for the year ended June 30, 2002

Natural Resources

Department of Historic Resources for the period January 1, 2001 through
December 31, 2002
Potomac River Fisheries Commission for the year ended June 30, 2002

Public Safety

Department of Corrections and Virginia Parole Board for the year ended June 30, 2002*
Department of Criminal Justice Services for the years ended June 30, 2001 and
June 30, 2002*
Department of Emergency Management for the year ended June 30, 2002*

Technology

Department of Information Technology for the year ended June 30, 2002
Innovative Technology Authority for the year ended June 30, 2002
Innovative Technology Authority Including Its Blended Component Unit Center for
Innovative Technology for the year ended June 30, 2002

Transportation

Department of Aviation for the year ended June 30, 2002
Department of Motor Vehicles for the year ended June 30, 2002*
Department of Transportation for the year ended June 30, 2002*
Virginia Port Authority for the year ended June 30, 2002*
Virginia Port Authority, Annual Financial Report for the year ended June 30, 2002

Special Reports

Commonwealth of Virginia Single Audit Report for the year ended June 30, 2002*
Report to the Legislative Audit and Review Commission for the quarter October 1, 2002
to December 31, 2002

Clerks of the Circuit Courts

Cities:

City of Alexandria for the period January 1, 2002 through December 31, 2002*
City of Buena Vista for the period January 1, 2002 through December 31, 2002*
City of Hopewell for the period October 1, 2001 through September 30, 2002
City of Lynchburg for the period January 1, 2002 through December 31, 2002
City of Portsmouth for the period October 1, 2001 through September 30, 2002*
City of Roanoke for the period October 1, 2001 through September 30, 2002
City of Winchester for the period October 1, 2001 through September 30, 2002*

Counties:

County of Augusta for the period January 1, 2002 through December 31, 2002
County of Botetourt for the period October 1, 2001 through December 31, 2002
County of Brunswick for the period January 1, 2002 through December 31, 2002*
County of Craig for the period October 1, 2001 through September 30, 2002*
County of Cumberland for the period January 1, 2002 through December 31, 2002
County of Dinwiddie for the period October 1, 2001 through September 30, 2002*

Counties (continued):

County of Hanover for the period January 1, 2002 through December 31, 2002
County of Isle of Wight for the period January 1, 2002 through December 31, 2002
County of King and Queen for the period July 1, 2001 through September 30, 2002
County of King George for the period January 1, 2002 through December 31, 2002*
County of Mathews for the period January 1, 2002 through December 31, 2002
County of Montgomery for the period January 1, 2002 through December 31, 2002*
County of Nelson for the period January 1, 2002 through December 31, 2002
County of Nottoway for the period October 1, 2001 through September 30, 2002
County of Orange for the period January 1, 2002 through December 31, 2002
County of Page for the period January 1, 2002 through December 31, 2002
County of Pittsylvania for the period January 1, 2002 through December 31, 2002
County of Powhatan for the period July 1, 2001 through September 30, 2002*
County of Prince William for the period April 1, 2001 through September 30, 2002*
County of Rappahannock for the period October 1, 2001 through September 30, 2002
County of Rockingham for the period January 1, 2002 through December 31, 2002*
County of Russell for the period January 1, 2002 through December 31, 2002
County of Scott for the period January 1, 2002 through December 31, 2002*
County of Surry for the period January 1, 2002 through December 31, 2002
County of Westmoreland for the period October 1, 2001 through September 30, 2002*
County of York for the period October 1, 2001 through September 30, 2002

Treasurers - Turnover

Cities:

City of Hopewell for the period July 1, 2002 through January 31, 2003

Counties:

County of Buckingham for the period July 1, 2002 through January 31, 2003
County of Montgomery for the period July 1, 2002 through February 28, 2003