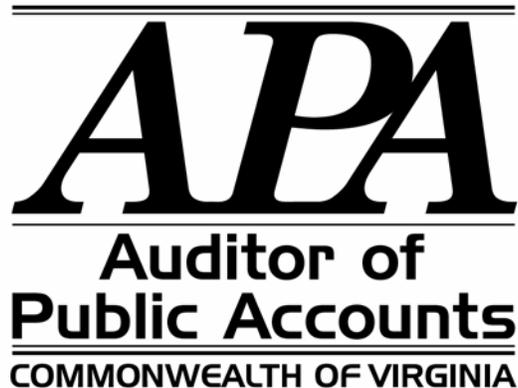


**REPORT TO THE
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMISSION**

**FOR THE QUARTER
October 1, 2004 TO December 31, 2004**



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Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

January 7, 2004

The Honorable Lacey E. Putney, 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 October 1, 2004, through December 31, 2004. Because of the number of report included, the Table of Contents and the Executive Summary organizes the reports by Audit, Legislative Reviews and Other Reviews.

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:whb

EXECUTIVE SUMMARY

DEPARTMENT OF MINORITY BUSINESS ENTERPRISE

This report includes a finding “Consolidate Fiscal and Procurement Operations with Another Agency” that recommends that the Department consider using one of the state’s service bureaus or a larger agency to provide these services. We have recommended, in several prior audit reports, the consolidation of the Department’s fiscal and procurement activity with another large agency. However, the Department’s management did not concur with our recommendation to consolidate operations. We continue to find internal control weaknesses in the Department’s fiscal operations that are inherent given the size of the agency and its inability to retain qualified individuals to perform fiscal duties. These conditions make it difficult for segregation of duties to occur.

In addition to the control issues cited above, the Secretary of Commerce and Trade has approved several transactions of a unique nature that an independent review and recording process would have thoroughly documented. As an example, the Secretary authorized the use and employment of employees of the Director’s corporation as both temporary employees and contractors. Additionally, the Director has had a special arrangement with the Secretary and Governor concerning his travel costs and salary. A permanent professional fiscal and procurement staff would have documented these arrangements, and in a small agency, this is not always possible.

We are recommending that the Governor and Secretary of Commerce and Trade consider consolidating the fiscal and procurement functions within a larger agency. Consolidation would enable the Department to focus on its programmatic responsibilities and should be a less costly alternative to hiring a qualified fiscal officer.

COMMONWEALTH TRANSPORTATION FUND AGENCIES OF THE SECRETARY OF TRANSPORTATION

This report discusses the financial activities of all agencies reporting to the Secretary of Transportation. The agencies are the Departments of Transportation, Motor Vehicles, Rail and Public Transportation, and Aviation, the Motor Vehicle Dealer Board and the Virginia Port Authority. We will also issue a report on the financial statements of the Virginia Port Authority as required by certain bond indentures. In addition, we will issue a separate report to discuss Transportation’s prior year audit findings.

The transportation agencies oversee land, air, and water transportation in the Commonwealth. Responsibilities include collecting revenues from taxes, licenses, and vehicle registrations to fund operations; developing and maintaining highways, ports, and airports; and assisting in the development of private and local rail and mass transportation, highways, ports, and airports.

Generally our audit of these agencies internal control matters that we consider reportable conditions, but not material weaknesses; a proper recording and reporting of transactions, and some instances of noncompliance with applicable laws and regulations tested that are required to be reported under Government Auditing Standards. The two findings of note follow.

- The Department of Motor Vehicles should assess needs and develop policies and procedures over the Fuels Tax program.
- The Department of Rail and Public Transportation should strengthen internal controls in the budgeting and accounting support functions. Including the management’s consideration of partnering with another larger or several smaller agencies to obtain support services.

REVIEW OF THE FINANCIAL ACCOUNTING AND CONTROL OPERATIONS OF THE STATE COMPTROLLER INTERIM REPORT

We have completed our interim review of the operations of the State Comptroller as they relate to the Commonwealth's financial accounting and control operations practices as required by Section 1-2.2.B. of Chapter 4 of the 2004 Virginia Acts of Assembly, Special Session I. For this interim report, we are not making final recommendations for changes in the operations of the Comptroller's Office; those will be included in our final report, which we will issue in November 2005. However, we have several proposals based on our interim review, which we have summarized below and have detailed further in Chapter 4 of the report.

New Systems and Information Planning:

The Comptroller and the Chief Information Officer should develop a working group to begin a strategic planning effort to support the information system needs of the Commonwealth. They should pursue a strategy towards a statewide financial management information systems solution that addresses agency needs and results in operational efficiencies and effectiveness for the Commonwealth. They need to go beyond addressing current needs or new systems and address how the Commonwealth can take advantage of new technologies, meet its on-going financial management and information needs and maintain accountability.

Training and Communication:

The Comptroller should look for ways to ensure agency heads and managers understand their responsibility for establishing and maintaining accountability. This may include training, increased use of technology to provide more on-line guidance and tutorials, and better use of the CAPP Manual to prescribe and communicate minimum internal control practices for state agencies.

Potential Legislative Changes:

The General Assembly should consider legislative changes in the following areas:

- Line of Duty health benefits;
- Requirements for Comptroller's August 15th report;
- Comptroller's duties related to unclaimed property; and
- Comptroller's operation of a fiscal service center.

DEPARTMENT OF MOTOR VEHICLES COST ANALYSIS FOLLOW-UP REPORT

The Auditor of Public Accounts, as directed by Chapter 1042 of the Acts of Assembly of 2003 developed a cost accounting model designed to accurately and completely document the true total costs, both direct and indirect, of the activities and services provided by the Department of Motor Vehicles (Motor Vehicles). The following report discusses Motor Vehicles' efforts to implement the cost methodology and productivity measures recommended by the November 13, 2003, report.

Motor Vehicles staff has made progress in developing the structure and procedures necessary to implement the cost model. Generally, we observed that management needs to provide their staff guidance on what information is necessary for decision-making, cost control, and performance measurements. There is no clear indication of what information they need to provide for cost control and performance measurements. It is crucial to the success of this model that management establishes cost controls objectives and performance measurements, before designing the capture and reporting of information by the cost model. Tracking and identifying costs is only part of a performance management framework, which provides information that decision-makers can use to improve and communicate the results of government services. Without this guidance, the staff time and potential system changes will result in wasted resources of the agency and the Commonwealth.

In addition to the update on the cost model, we reviewed the general financial operations of Motor Vehicles. In connection with this review, since Motor Vehicles had not completed work on their cost model, we used our assumptions from last year to look at current operations. The cost model again illustrates the need for a balance between revenue collections and customer service. The Department of Motor Vehicles' management and decision makers must determine whether the current level of service is worth the cost to the taxpayer.

RECOMMENDATION:

We recommended that the General Assembly may wish to have the Governor submit with the next biennial budget, the plans to control cost and incorporate in the performance measurement process a balance of services between CSC and alternative services.

Originally, we reported on cash flow problems at Motor Vehicles and in the last two years, actions by the General Assembly and management of Motor Vehicles has addressed these issues. We also reported that a contributing factor to the cash flow problems was the need by Motor Vehicles to depend on and use any increase in revenues that the department generates. In fiscal year 2004 Motor Vehicles requested and received approval to spend an additional \$13 million for operating expenses. Each fiscal year Motor Vehicles consistently submits requests for additional operating appropriations. These requests for appropriations allow Motor Vehicles to spend any extra revenues generated. This activity uses up current, and commits future resources of the Commonwealth.

RECOMMENDATION:

The General Assembly may wish to restrict Planning and Budget's ability to authorize Motor Vehicles use of new revenues.

STUDY OF TELECOMMUNICATION TAX STRUCTURE

The Joint Subcommittee to Study the State and Local Taxation of the Entire Telecommunications Industry and Its Customers within the Commonwealth has been reviewing ways Virginia could restructure its telecommunications taxes and fees. In reviewing this restructuring, the joint subcommittee recognized the need for more information on the revenue impact from existing state and local telecommunications taxes and fees. Therefore, the General Assembly requested that the Auditor of Public Accounts collect information, before the 2005 Session, to determine whether the new tax structure will fully replace revenues provided to state and local governments by current telecommunications taxes and fees.

The results of our study found that projected revenue, based on maximum rates in the legislation, does not generate sufficient revenues to fully replace all revenues resulting from the current state and local taxes and fees that are subject to repeal. There is an estimated \$34 million deficiency between the current revenue base of \$391 million and the projected revenues of \$357 million.

FOLLOW-UP ON THE SPECIAL REVIEW OF THE CASH MANAGEMENT AND CAPITAL BUDGETING PRACTICES OF THE DEPARTMENT OF TRANSPORTATION

Our review has found that Transportation has made significant progress or completed most of the recommendations made in our 2002 special report. Complete implementation of these changes will take at least four to five years.

Over the last two years, Transportation's management has started not only implementing recommendations, but more importantly begun implementing a change in the corporate and cultural structure of the organization. The success of change with Transportation will depend on whether a true structural change in organization takes place. The measure of success will require a substantial long-term commitment by management to not only making the change, but to prevent backsliding into Transportation's old approaches.

In some ways, the accomplishments to date are the easy part of change. The harder part lays ahead in funding and implementing new systems, continuing to make the changes to get closer to capital budgeting process, and overcoming Transportation's corporate and cultural structure to improve project management. The success of this effort is highly dependent on management guidance and direction, and current management has demonstrated their dedication towards this effort. If any management change occurs, it is essential that they have the same commitment; otherwise, progress may be negatively impacted.

Transportation is restoring fiscal accountability by implementing several budgetary and financial changes, including adopting a debt management policy and model. Additionally, they are establishing a methodology to identify statewide transportation priorities and developing project management policies.

Transportation has completed several budgetary and financial changes, including attempts to make the Six-Year Improvement Program a realistic management tool and reduce the projects with a deficit status. However, to ensure accurate matching on cash inflows and outflows, Transportation must begin estimating the cost of projects by fiscal year. Transportation does not currently have sufficient controls and processes in place to manage the rate at which they spend funds.

For major projects, Transportation has begun assigning a project management team that follows a project from its inception to its completion. However, it is still too early in the process to determine if the policies put into place will provide Transportation with better project management. However, the actions to date are those considered best practices in both the private and public for large organizations.

Maintenance is still an area of concern at Transportation. The growing maintenance requirements and the limited ability to budget on a needs-based approach increases the risk of inappropriately applied funding. Once the asset management system is fully implemented a needs-based approach will be possible and Transportation will be able identify and prioritize maintenance projects.

REVIEW OF THE COMMONWEALTH'S CAPITAL OUTLAY PROCESS

The buildings, infrastructure, land, parks, and other facilities owned by the Commonwealth of Virginia represent a real property investment of \$13.3 billion. For many Commonwealth citizens, this is the face of state government. The Commonwealth's real property environment has many stakeholders and involves a vast and diverse inventory of assets, which the Commonwealth uses for a wide variety of missions.

Since 1999, the Commonwealth has spent \$3 billion on capital projects and \$246 million on maintenance projects. In fiscal year 2004, the Commonwealth has spent \$680 million on capital projects and \$30 million on maintenance projects.

The manner in which the Commonwealth invests and monitors the acquisition, construction, improvement, and maintenance of these assets is a significant endeavor. This effort is especially critical in the current budget environment. Funding needs for this investment varies as well. Currently, the Commonwealth funds the majority of capital outlay with the issuance of bonds.

We compared the Commonwealth capital outlay process to general business practices and suggested best practices for government. We identified four areas where changes in the process could provide decision makers with more accurate information and increase budget and accountability oversight without adding substantial cost to the process.

1. Under the current capital outlay appropriation process, the Commonwealth approves and commits funding to an entire project based on a conceptual design. This practice can increase the need for modifications to the original cost estimation and project scope after project approval. A phased-in approach may help mitigate some of the risks involved and result in more accurate project cost estimations.
2. After a project receives approval and becomes part of the capital budget, unless there is a significant change, the project remains in the Appropriation Act at the full amount with no change until completed, which may be several years. Except for legislative inquiry, there is no comprehensive reporting of progress or funding status on previously approved projects. Further, agency or institution management can request and receive administrative approval to transfer funds among projects without the General Assembly's knowledge.
3. Consideration of the Total Life Cycle Cost occurs during project planning and not during the final design phase. If an agency makes major changes during the final design phase, this exercise may be ineffective.
4. The Bureau of Capital Outlay Management's (BCOM) role in the capital outlay process is often confused with General Services' role as the Capitol Square area project manager. As a result, the role of BCOM has become unclear, and neither agencies nor institutions can clearly articulate the value BCOM adds to the process. Because BCOM has not defined its role, it continues to require information it may not need to perform its function. The Director of General Services should consider whether BCOM should provide only limited oversight on projects, assume a traditional role of project manager, or have some other responsibilities.

REVIEW OF PAYROLL AND HUMAN RESOURCE SYSTEMS

The payment of salaries and benefits for public employees is one of the Commonwealth's largest expenses. Given the magnitude of these expenses, it is critical that the Commonwealth has the ability to analyze, monitor, and control its human resources and related costs.

Currently, the Commonwealth operates separate central systems for personnel and payroll. In 1986, the Commonwealth implemented the Commonwealth Integrated Payroll/Personnel System as its primary payroll system, but chose not to take advantage of the system's personnel functions because the Commonwealth had already implemented the Personnel Management Information System several years prior. These systems are not compatible and therefore, a significant amount of duplicate data is collected, critical internal controls commonly associated with integrated payroll and human resource systems are missing, and the systems do not fully meet all of the Commonwealth's business requirements.

Based on the results of our review we recommend the replacement of the current payroll and personnel systems with a statewide integrated payroll and personnel system that would meet the Commonwealth's needs and be mandatory for use by all agencies and institutions. The Information Technology Investment Board should define the new integrated system as a Commonwealth enterprise standard. There are two basic implementation options. The first option would require all agencies and institutions to use the integrated system upon implementation. The second option would allow agencies and institutions that currently operate independent payroll and personnel systems to continue using these systems in the interim, but develop data standards to report uniform data for collection and use in a statewide data warehouse. During this interim period, agencies and institutions should develop plans for the long-term transition to the new system.

Before making any decisions on replacing the systems, the Commonwealth should conduct a cost benefit analysis to determine the costs associated with operating and maintaining the current systems versus the cost of implementing, operating, and maintaining a new core system. This analysis should identify the business requirements of individual agencies and define the enterprise of the Commonwealth. It is the responsibility of the Department of Accounts, Department of Human Resource Management, and the Virginia Information Technologies Agency to consider the issues identified in this report and work with decision makers to implement the recommendations in the most beneficial manner for the Commonwealth.

SUMMARY OF REPORTS ISSUED

SUMMARY OF REPORTS ISSUED

The following reports on audit were released by this Office during the period October 1, 2004, through December 31, 2004. Those reports which included findings in the area of internal controls or compliance are indicated by an (*) asterisk.

State Agencies and Institutions

Judicial Branch

Virginia State Bar for the year ended June 30, 2004

Executive Offices

Division of Selected Agency Support Services for the year ended June 30, 2004
Governor's Cabinet Secretaries for the year ended June 30, 2004

Executive Departments

Administration

Board of Elections for the two-year period ended June 30, 2004

Commerce and Trade

Department of Minority Business Enterprise for the year ended June 30, 2004*
Virginia Biotechnology Research Park Authority for the year ended June 30, 2004
Virginia Commercial Space Flight Authority for the year ended June 30, 2004
Virginia Employment Commission for the year ended June 30, 2004
Virginia Racing Commission for the year ended June 30, 2004

Education

WNSB-FM Radio Station (a public telecommunications entity licensed to Norfolk State University) as of June 30, 2004

Colleges and Universities

Virginia Polytechnic Institute and State University Intercollegiate Athletic Programs for the year ended June 30, 2004

Finance

Revenue Stabilization Fund Letter dated December 1, 2004*

Health and Human Resources

Department of Aging for the three-year period ending June 30, 2004

Department of Medical Assistance Services for the year ended June 30, 2004*

Public Safety

Department of Alcoholic Beverage Control of the Commonwealth of Virginia for the year ended June 30, 2004

Technology

Innovative Technology Authority for the year ended June 30, 2004

Innovative Technology Authority, including its blended component unit, the Center for Innovative Technology, for the year ended June 30, 2004

Transportation

Virginia Port Authority for the year ended June 30, 2004

Independent Agencies

State Lottery Department (Lotto South) Report on Applying Agreed-Upon Procedures for the Period April 1, 2003 through March 31, 2004

State Lottery Department (Mega Millions) Report on Applying Agreed-Upon Procedures for the Period April 1, 2003 through March 31, 2004

State Lottery Department of the Commonwealth of Virginia for the year June 30, 2004

Virginia College Savings Plan for the year ended June 30, 2004

Special Reports

2004 Report to the General Assembly

Commonwealth Transportation Fund Agencies Of The Secretary Of Transportation*

Department of Motor Vehicles Cost Analysis Follow-Up Report, dated December 2004*

Department of Transportation dated December 1, 2004*

Follow-up on the Special Review of the Cash Management and Capital Budgeting Practices of the Review of the Financial Accounting and Control Operations of the State Comptroller Interim Report dated November 18, 2004*

Report to the Joint Legislative Audit and Review Commission for the Quarter July 1, 2004 to September 30, 2004

Report on Collections of Commonwealth Revenues by Local Constitutional Officers for the year ended June 30, 2004*

Review of the Commonwealth's Capital Outlay Process dated November 2004*

Special Review Of Payroll And Human Resource Systems*

Study of Telecommunication Tax Structure dated October 2004

Virginia Employment Commission Network Vulnerability Assessment and Penetration Test Report*

Clerks of the Circuit Courts

Cities:

City of Richmond Clerk of the Circuit Court for the period July 1, 2003 through September 30, 2004

City of Richmond Clerk of the Circuit Court - John Marshall for the period July 1, 2003 through September 30, 2004

City of Staunton Clerk of the Circuit Court for the period January 1, 2003 through September 30, 2004

Counties:

County of Alleghany Clerk of the Circuit Court for the period April 1, 2003 through September 30, 2003

County of Arlington Clerk of the Circuit Court for the period April 1, 2003 through September 30, 2004*

County of Cumberland Clerk of the Circuit Court for the period January 1, 2003 through June 30, 2004

County of Fairfax Clerk of the Circuit Court for the period April 1, 2003 through September 30, 2004*

County of Frederick Clerk of the Circuit Court for the period July 1, 2002 through September 30, 2004

County of Goochland Clerk of the Circuit Court for the period April 1, 2003 through September 30, 2004

County of Greensville Clerk of the Circuit Court for the period April 1, 2003 through June 30, 2004*

County of Prince Edward Clerk of the Circuit Court for the period October 1, 2003 through September 30, 2004

County of Southampton Clerk of the Circuit for the period April 1, 2003 through June 30, 2004

