SCIENCE MUSEUM OF VIRGINIA

SPECIAL REPORT

AUGUST 2006

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

This special report discusses the financial condition and internal controls of the Science Museum of Virginia through June 30, 2006. The audit is an extension of our audit of the Virginia Museums for the fiscal year ended June 30, 2005, which we issued as of August 9, 2006.

CONTENTS

	Pages
REPORT	1- 6
AGENCY RESPONSE	7-18

Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

August 15, 2006

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission

Board of Trustees
Science Museum of Virginia

During our audit of the Science Museum of Virginia for the year ended June 30, 2005, we encountered issues, which resulted in our expansion of the audit to include the fiscal year ended June 30, 2006. During our audit, it also came to our attention that the Science Museum had a cash deficit and that the State Comptroller had ceased paying the Science Museum's bills. In accordance with Chapter 951 of the 2005 Act of the Assembly Section 4-1.01 (Appropriation Act), we notified the appropriate officials of the cash deficit on June 22, 2006.

As noted below, the Science Museum Management accumulated sufficient resources to have cash on hand to pay the bills submitted to the State Controller for processing. However, upon further analysis, the Science Museum incurred an operating structural deficit, which has worsened over time. A number of factors have contributed to this situation and correction of operating structural deficits may require actions beyond controlling or defraying costs.

We believe our report and its findings provide Management and the Board with a point to begin addressing the issues causing the financial condition. In examining the finances of the Science Museum, we have worked with Management and staff. We elected to communicate these finding in this separate report; a second report contains some comparisons of the Science Museum's operations with other Commonwealth-supported museums issued on August 9, 2006, for the year ended June 30, 2005.

This report consists of two primary components: a discussion of the current fiscal condition and factors we believe contributed to this condition. The second component discusses some overall internal control and operational concerns and proposed recommendations to address these issues. We have elected to include a number of internal control issues since their correction can occur in a number of ways depending on how Management and the Board address the overall internal control concerns.

Fiscal Condition

For the fourth consecutive year, the Science Museum has spent in excess of its appropriations and revenue collections incurring significant financial difficulties. In fiscal years prior to 2006, the Science Museum did not incur a cash deficit although it held and did not process significant amounts of unpaid vendor invoices and other bills. In fiscal 2005, despite efforts to cut personal and contractual services costs, the overall structural deficit reached $777,341.

As a result of the Science Museum's attempt to pay vendors on time and meet other obligations, the Science Museum incurred a cash deficit during fiscal 2006 for which it was able to accumulate sufficient cash reserves to have a positive year-end balance. However, during fiscal 2006, the structural deficit still grew to approximately $891,394. As a result of the cash deficiencies that began in December 2005, the State Comptroller stopped processing all payments with the exception of maintenance reserve and payroll in June 2006.

	Deficit as of June 19, 2006	Deficit as of June 30, 2006	Changes	
Cash balances in accounting system:				
Net cash balance	$ (131,243)	$ 80,907	$ 212,150	A
Payables in accounting system	126,720	-	(126,720)	B
Payables not in accounting system:				
Payables	273,997	161,739	(112,228)	C
Loan from SMV foundation	270,000	270,000	-	
Due to General Fund for central agency services	89,434	-	(89,434)	
Total payables	760,151	431,739		
Net surplus/deficit	$ (891,394)	$(350,832)		

[A] SMV collected an additional $376,500 in deposits during the last ten days of the fiscal year.

[B] The Department of Accounts (DOA) found these transactions included numerous errors. As a result, the Science Museum either removed the transaction from the system or corrected them. DOA paid the corrected items on June 30, 2006.

[C] Payables processed as of June 30, 2006.

In 2005, the Science Museum significantly missed their special fund revenue collections projections by 11 percent as shown in Table 1. As a result, the Science Museum collected less in total funding than policy makers had anticipated and caused Management to operate the Science Museum as if it had an eight percent funding cut.

In response to this and other report findings, the Board implemented a new, more conservative budgeting methodology in 2006 that resulted in a more reliable estimate that missed by only three percent. While future increases in General Fund appropriations will provide more liquidity in the budget, it is still imperative the Science Museum continually monitor and improve their special revenue estimation methodology due to continual increases in payroll and other fixed expenses. The Science Museum is dependent on special fund revenues to cover almost all of their non-payroll operating costs.

The Science Museum and the Board also need to keep policy makers aware of how effective the Science Museum is at meeting its estimates. Where future significant variances between estimate and actual collections occur within a biennial budget cycle or appear to have some long term potential, the Science Museum's Management should set out these factors in the document that accompanies the budget bill.

Further, by not accurately projecting special fund revenues, policy makers such as the General Assembly are assuming that the Science Museum has the ability to collect and support a larger portion of their operating costs than they actually collect. An overestimation of revenue collections also tends to distort the Science Museum's dependence on General Fund support to keep operations funded. This reliance on special fund revenue collections makes accurate projection and collection of special fund revenue essential for the long-term fiscal health of the Science Museum. The reason for the variance appears to come from a structural problem within the methodology of projecting revenues and not adjusting budgeted amounts for changing economic conditions.

Additionally, since this is a problem that has existed for several years, policy makers may believe that the Science Museum generally is maintaining and providing a level of service that not collecting the special fund revenue prevents. Further, by not including more accurate projections of special fund revenues in the budget, it appears that the Science Museum has greater flexibility to absorb potential changes in funding or service delivery.

In addition to the change in budgetary methodology, the Board instituted a number of oversight actions to control and potentially eliminate the Science Museum's continuing deteriorating cash position. The Board's plan would have significantly addressed the deteriorating cash position had they received both timely and correct information from Management. The following section "Internal Control and Operational Concerns" discusses the circumstances contributing to untimely and incorrect information.

Table 1

Special Revenue Collections

	Special Revenue Estimates	Special Revenue Collected	Difference Over/ (Under)	Percentage Over/(Under) Estimate
2006	$3,956,544	$3,831,096	$(125,448)	(3.17%)
2005	4,422,717	3,917,562	(505,155)	(11.42%)

Table 2

Expenditure Funding Sources

	General Fund	Special Revenue	Other Funds	Total Operating Expenses
2006	$4,940,239	$3,673,502	$459,591	$9,073,331
2005	4,151,759	4,342,062	169,324	8,663,145

Payroll Expenses

	Payroll Expenses	Payroll Expenses as a percentage of Total Operating Expenses	Percentage of Payroll covered by Special Revenue
2006	$5,363,751	59%	7%
2005	5,300,771	61%	22%

Table 3

Revenues

	General Fund	Special Revenue Estimates	Other Nongeneral Fund Revenue Estimate	Total Estimated Funding
2006	$4,963,022	$3,956,544	$388,000	$9,307,566
2005	4,158,003	4,422,717	778,074	9,358,794

	Total Estimated Funding	Total Funding Collected	Difference Over/ (Under)	Percentage Over/(Under) Estimate
2006	$9,307,566	$9,643,603	$ 336,037	4%
2005	9,358,794	8,636,513	(722,281)	(8%)

INTERNAL CONTROL AND OPERATIONAL CONCERNS

Staffing and Knowledge Base

The Science Museum has experienced 100 percent turnover in the finance area, which contributes to a lack of institutional and accounting knowledge. Additionally, since Management had not documented policies and procedures, the remaining and new staff did not have a basis to understand their duties and determine what work was a priority. In addition, other management personnel do not possess both the technical knowledge and expertise to operate the finance area and ensure the accuracy and timeliness of information as discussed below. These factors have contributed to the Board not receiving timely and accurate information to monitor the implementation of their corrective action plan.

The Science Museum finds itself in the position of having to address three fundamental issues in order to move forward. The first is ensuring that essential operational functions such as budgeting, revenue collection, payroll, and vendor payments are completed and properly recorded. Second, Management will need to determine the necessary level of staffing to provide continuity of fiscal operations. The cost of maintaining sufficient and knowledgeable staff may ultimately be cost prohibitive. Therefore, we believe that the Board should examine and consider a staffing model, which will require the sharing of resources or the purchase of services. The Board should consider an approach that separates the support functions from the operational functions and seek an alternative that provides on-going expertise and services in budgeting, accounting, human resources, procurement, and other general services. This examination should consider the use of shared or purchased services that has the ability to not subject the Board to the loss of timely and accurate information when turnover occurs. Finally, Science Museum Management should address the issue of preparing reliable fiscal information and other needed data for financial reporting.

Budget and Budget Execution

The first issue we believe Management must address is ensuring the Science Museum has a realistic and reliable budget for funding sources, expenses, and capital outlay commitments. Science Museum Management cannot continue the daily operations of the Science Museum without recognizing funding

inflows and spending limitations. Currently, Management and staff have an inadequate understanding of the Science Museum's budgeting and accounting. In addition, many of the accounting and transaction processes and procedures are undocumented.

While the Board took action to make the special revenue fund budget more realistic and achieved this objective, the actions taken to amass cash by year-end to cover the budget draws into question if the Board is aware of all revenue sources and their on-going collection. Within ten days, Management accumulated and deposited over $376,000 by collecting outstanding amounts from school divisions, the Science Museum Foundation making more timely deposit of admission revenues, and receiving the Science Museum's share of the gift store profits.

These actions generated almost four percent of the Science Museum's overall budget within the last ten days of the fiscal year. The amount is also over ten percent of the special revenue fund's anticipated collections. The Board needs to examine if these amounts represent dependable revenue sources, if these types of collection efforts can exist throughout the year, and whether these actions have any negative impact on next year's revenue.

The ability to generate this level of cash in a short period clearly indicates that not all sources of revenues are part of the budgeting process. Further, there is a need to more closely link the budget process to the accounting processes and have the same internal control mechanism to review for accuracy and completeness.

Management must also ensure processes have adequate internal controls. Transactions must have proper budgetary authorization, as well as timely processing and supervisory approval of the resulting transaction. Currently, there are delays in transferring and depositing admission accounting entries without any supervisory review, purchases made without budgetary approval, purchase orders issued after delivery of goods, vendor invoices partially paid or held due to cash flow limitations, and payments and loans incorrectly recorded in the accounting system.

This lack of adequate controls is our primary concern due to the Board's and Management's need to rely on financial information from the accounting system.

Management Oversight

Management must seriously consider their role in operations in their efforts to resolve the issues identified in this report. In addition to the policies and procedures previously discussed, Management should determine what necessitates their oversight and at what level. When defining this role, Management should consider assessing and monitoring staff levels relative to workloads, cross-training for critical processes, and developing a monitoring mechanism for key processes.

We believe these steps and their order of priority provide Management with the direction necessary to properly address the highest risk areas of the Science Museum's operations. The Board has already made satisfactory efforts to begin addressing these issues. In all of the Board's and Management's efforts, they should strive to create an environment where they and the staff understand how their processes provide assurance that all transactions have appropriate authorization and are properly recorded.

Ensuring that daily operational functions are completed and properly recorded will provide integrity to the financial information. To achieve this, Management should conduct a review of all year end transactions for reasonableness and make any necessary adjustments. Moving forward, Management should define all daily, monthly, and annual processes and implement internal controls that ensure the correct recording of transactions and provide appropriate budgetary oversight.

Policies and Procedures

As indicated earlier, the Science Museum will need, at some point, to define all daily, monthly, and annual processes to ensure the correct recording and budgeting authorization of all transactions and document the process in policies and procedures. The extent of this documentation will depend on Management's decisions related to defining a staffing model to meet the operational needs of the Science Museum.

Current conditions within the finance area arose from the loss of key staff and lack of anyone having an overall understanding of the work and processes necessary to maintain operations and prepare interim and year end reports, including reports to the Board. The current staffing levels place the Science Museum at risk that these types of problems could arise in the future with the loss of some of the key staff. With limited staff, having well documented policies and procedures is necessary to ensure continuity of operations during key position vacancies and to provide documented processes staff can follow.

As a result, staff have difficulty setting and enforcing policies and procedures that ensure commitments do not exceed available resources, and data used for reporting is incomplete and inappropriately compiled. No one has an overall understanding of the processes necessary to maintain operations, especially since the Science Museum has experienced 100 percent turnover in the finance area.

Because maintaining policies and procedures is not normally a priority of any operation, they tend to become dated and of limited use. We recommend that Management conduct a periodic review of these policies and procedures that cycle through the entire document over a three to five year period.

Other Internal Control Matters

During the audit, we encountered documents, records, and other materials that contained errors. We also noted circumstances in which personnel did not follow normal state operating and accounting procedures. Many of these observations related to the activities of staff no longer with the Science Museum or when new staff were learning their duties and responsibilities. We have not included these items since we believe it is more important for Management and the Board to address the issues in this letter. When correcting procedural errors, the Board or Management may reassign or seek an alternative solution which could potentially use up scarce resources.

We discussed this report with Management at a meeting held on August 21, 2006.

AUDITOR OF PUBLIC ACCOUNTS

SW/kva

SMV

August 23, 2006

Mr. Walter J. Kucharski
Auditor of Public Accounts
The James Monroe Building
101 North 14th Street, 8th Floor
Richmond, Virginia 23219

RE: Response of the Science Museum of Virginia to
Special Report, Science Museum of Virginia, August 2006

EXECUTIVE SUMMARY

The Special Report on the Science Museum of Virginia contains two major findings: operations during the past few years with a structural deficit, and internal controls and operations problems exacerbated by turnover in the Museum's Finance Department during the past two years.

The Board of Trustees and the staff of the Science Museum appreciate your efforts in assisting them address financial matters at the Museum. All recognize both the seriousness of the problems you have identified and the importance of developing solutions to them, applying those solutions effectively, and tracking Museum performance closely to prevent any recurrence. All are committed to taking actions, and continuing actions already begun, that will assure the Museum fully meets its obligations. In particular, the Board of Trustees has adopted a budget for FY2007 which provides for no cash deficit and no structural deficit and has continued a process begun in 2004 through the Museum's Joint Finance Committee (which currently has five Trustees among its members) to monitor Museum admission revenues on a weekly basis and Museum financial performance on a monthly basis and advise the Board of Trustees of any deviations from budget so the Board can amend the budget as necessary to assure no such deficits. Through the Museum's Joint Finance Committee, the Board of Trustees is also considering all of your recommendations concerning internal control matters. Moreover, in January 2006 the Board of Trustees created a Long Range Planning Committee to consider the adequacy for the next five years and beyond of SMV's existing long range plan in fulfilling SMV's statutory purpose, in particular by assuring a structural balance between the Museum's funding sources and its financial commitments, with a special concern to cost-of-living changes in personnel costs, and other uncontrollable increases (such as for utilities). As part of this effort, the Board of Trustees and Museum staff will assure that the Museum perform in accord with the Commonwealth's Prompt Payment procedures and operate without working capital loans from its Foundations or other sources;.

SCIENCE MUSEUM OF VIRGINIA
WALTER R.T. WITSCHEY, PH.D., DIRECTOR
2500 WEST BROAD STREET, RICHMOND, VIRGINIA 23220-2054 • VOICE 804-864-1499 • FAX 804-864-1560 • www.smv.org
DANVILLE SCIENCE CENTER • VIRGINIA AVIATION MUSEUM • BELMONT BAY SCIENCE CENTER • RICE RIVERCENTER

While a number of important corrective steps have been taken, with some progress evident, much remains to be accomplished over the next several years.

Corrective steps already taken include: reduction of the structural deficit from $777,341 at June 30, 2005 to $350,832 at June 30, 2006; closing year-end 2006 with Accounts Payable current, and lower than a year earlier; implementing a new, more conservative budgeting methodology in 2006 that resulted in a more reliable revenue estimate; better estimating Special Fund revenues (missing revenues by 11.4% in FY 2005, but estimating within 3.2% in FY 2006. (Table 1); Total revenue collected was under the estimate by 8% in FY 2005 but above the estimate by 4% in FY 2006. (Table 3); In addition to the conservative budgeting methodology action discussed above, the Board of Trustees instituted a number of oversight actions to control and potentially eliminate the Museum's continuing deteriorating cash position; making "satisfactory efforts to begin addressing these [management oversight] issues."

RESPONSE OF THE SCIENCE MUSEUM

In the first two paragraphs, the Special Report says,

During our audit of the Science Museum of Virginia for the year ended June 30, 2005, we encountered issues, which resulted in our expansion of the audit to include the fiscal year ended June 30, 2006. During our audit it also came to our attention that the Science Museum had a cash deficit and that the State Comptroller had ceased paying the Science Museum's bills. In accordance with Chapter 951 of the 2005 Act of the Assembly Section 4-1.01 (Appropriation Act), we notified the appropriate official of the cash deficit on June 22, 2006.

As noted below, the Science Museum management accumulated sufficient resources to have cash on hand to pay the bills submitted to the State Controller for processing. However, upon further analysis the Science Museum incurred a structural deficit, which has worsened over time. A number of factors have contributed to this situation and correction of structural deficits may require actions, which involve matters beyond controlling or defraying costs.

We believe that the audit includes judgment calls that cause some of deficit-related amounts in the report to be higher than appropriate. However, even using the auditor's own numbers, we point out that the Special Report documents the following:

- The structural deficit at June 30, 2005 was $777,341.
- The structural deficit at June 30, 2006 was $350,832 (an improvement).
- The structural deficit during the 2006 fiscal year peaked at $891,394.
- The peak structural deficit in the prior fiscal year is not reported.
- The Museum ended fiscal 2006 as it has all prior years, with a positive cash position and no cash deficit. Historically, ending the fiscal year without a cash

deficit is the basis on which all agencies and institutions have been judged for compliance with state law and regulation.

The events of the last current year (FY2006) are important, and are highlighted below.

EVENTS OF THE FOURTH FISCAL QUARTER OF FY 2006

The Museum did have temporary cash deficits within the last fiscal quarter (April-June 2006) but did not have a cash deficit as of June 30, 2006.

In the second fiscal quarter, the Museum (staff, SMV Joint Finance Committee, and Trustees) revised the Museum operating plan for the fiscal year to anticipate lower-than-forecast admissions receipts. In all, they revised the budget downward about $650,000 for the second half.

The cash flow plan then developed, expressly crafted to avoid cash deficits during the second half, and at year end, and followed by the Museum thereafter, absolutely depended upon timely reimbursement of Museum expenditures under two federal grants or, failing that, a Revenue Anticipation Loan, from the State Treasury, in equal amounts. Either would have supported the Museum's operations for the fiscal year 2006 without a cash deficit at any point in the year.

Federal reimbursement proved to be slow, but unfortunately, the Department of Accounts (DOA) refused to approve the Revenue Anticipation Loan requested by the Museum. DOA had approved such a loan in the prior year under similar circumstances. In fact, the Department of Accounts did not issue a rejection of the Museum's application, but simply did not reply, leading the Museum to believe a loan would be approved as in the prior year.

The Museum subsequently experienced a short-term cash deficit, and in June 2006, the Department of Accounts suspended paying vendor bills (except Maintenance Reserve invoices and employee expense reimbursements). Even when the Museum ultimately collected its federal grant reimbursements, and other receipts associated with peak revenue times in the spring, the Department of Accounts did not release and pay the Museum's bills with available cash. In the last few days of June, vendor bills held within the state accounting system were released for payment by DOA, but not before failing the state's "prompt pay" policy.

One other event took place that muddies the situation at this same time. A $400,000 repayment of the FY2005 loan from the SMV Foundation to the Museum was made by our prior Finance Director in July 2005 using 0100 General Funds. SMV learned that this payment should have been made from the 0200 Special Fund, since that was the fund into which the loan was originally recorded. The reversing $400,000 entry (in May 2006) added to our 0100 General Fund

balance but made the 0200 Special Fund balance negative. The Auditor and DOA did not think SMV could generate cash for the 0200 Special Fund in sufficient time or quantity to cover the deficit without stopping payments to vendors or, even worse, not entering obligations to pay into the state accounting system, CARS. That is what the new Finance Director, Jim Mahone, arrived to find and began to solve after May 10.

These events followed the abrupt resignation of the Museum's Finance Director at the end of February, and the hiring of a new Finance Director May 10—quite late in the year for grasping the full range of Museum activities.

In sum, the audits reflect the continuing struggle of the Museum to extricate itself from sharp budget cuts in prior administrations without latitude to make layoffs, several years enduring a national trend of lower museum attendance following 9/11/2001, and significant turnover in the Museum's Finance Department in FY 2006.

They also document the incremental successes in that struggle thus far. Among these are a reduced structural deficit year-to-year, and no year-end cash deficits. These successes leave the Museum, in the current year, tracking well on the final year of its financial plan to eliminate any structural deficit. A critical element of financial management in the future—a challenge fully grasped by Trustees and staff—is to create and follow a financial plan for five years that avoids these past problems.

The Special Report includes this table:

	Deficit as of June 19, 2006	Deficit as of June 30, 2006	Changes
Cash balances in accounting system:			
Net cash balance	$ (131,243)	$ 80,907	$ 212,150[A]
Payables in accounting system	126,720	-	(126,720)[B]
Payables not in accounting system:			
Payables	273,997	161,739	(112,228)[C]
Loan from SMV foundation	270,000	270,000	-
Due to General Fund for central agency services	89,434	-	89,434
Total payables	760,151	431,739	
Net surplus/deficit	$(891,394)	$(350,832)	

A. SMV collected an additional $376,500 in deposits during the last ten days of the fiscal year.
B. The Department of Accounts (DOA) found these transactions included numerous errors. As a result, the Science Museum either removed the transaction from the system or corrected them. DOA paid the corrected items as June 30, 2006.
C. Payables processed as of June 30, 2006.

1. The Special Report does not include items that the Museum includes in its own accrual analysis:

    a. Trade Accounts Receivable of $43,121.

    b. Expenditures reimbursable by the Virginia Department of Transportation (VDOT) under the Museum's TEA-21 grant in the amount of $142,968.

2. We calculate the structural deficit as of June 30, 2006 as follows:

Special Report "structural deficit"	($350,832)
Plus trade receivables and VDOT reimbursables	$186,089
Science Museum's structural deficit estimate	($164,743)

This is, of course, substantially better than a year ago, for which the Special Report shows a structural deficit of $777,341.

In the footnotes to this table, the Special Report says:

A. SMV collected an additional $376,500 in deposits during the last ten days of the fiscal year.

The implication is that this is somehow "abnormal." Part is, and part is not. We have discussed above the turnover in the Finance Department, and the arrival of a new Finance Director on May 10. Naturally, a portion of his efforts, given the cash situation, was to make sure that all invoices were processed, collected, deposited, and processed through the state accounting system.

Some receivables and reimbursements that had not been collected between finance directors were collected after the new Finance Director, Mr. Mahone, began work. Thus, a portion of these deposits resulted from new staff gaining sufficient experience to process a backlog of transfers and improve collections of accounts receivable (which in any case were only a small fraction of the revenues posted).

Further, the Museum's revenues are highly seasonal. June represents the end of our peak admissions season (and peak receipts.) June also is the end of the school year. Our contracts for Science Standards of Learning enrichment courses in the public schools are completed and billed, with receipts for the invoices typically arriving late in June (just before the school's fiscal year closes.)

The Special Report also says:

[B] The Department of Accounts (DOA) found these transactions included numerous errors. As a result, the Science Museum either removed the transaction from the system or corrected them. DOA paid the corrected items as cash became available.

The Museum takes exception to this characterization. While the Museum did have a new Accounts Payable clerk, and errors on entry at the beginning of her tenure did occur, the Museum corrected and processed these items.

Some level of errors necessarily and ordinarily occurs in the state's system, which processes $30 billion in payments each year, and "error correction" is a routine activity for both the Science Museum and the Department of Accounts.

More importantly, the Department of Accounts still did not pay these bills even as cash balances appeared in its accounting system. The bills were held until the last day of June, and then processed *en masse*. This deliberate withholding of payments despite positive cash balances aggravated an already severe problem with Museum vendors, as well as exacerbated the Museum's efforts to meet prompt pay requirements.

The Special Report says:

In 2005, the Museum significantly missed their special revenue collections projections by 11 percent. The Museum, therefore, collected less in total funding than policy makers had anticipated and caused management to operate the Museum as if it had an eight percent funding cut.

The Science Museum's record appears to have bettered that of other state agency museums during a time when museum attendance had fallen nationwide.

The Museum took prompt action during Fall 2005 when revenues did not meet projections, and would have taken further action in Spring 2006 had it known the Department of Accounts would not approve a Revenue Anticipation loan.

The budget the Trustees adopted for FY2007 forecasts revenue collections for that year as being below those for FY2006, even though its ARIMA forecasting model (recommended for our use by the Commonwealth) resulted in a less conservative budget with a forecast of greater revenue collections.

The Table 1 of the Special Report further documents the improvement in Special Fund revenue forecasts from 2005 to 2006. In 2005, the forecast was 11.4% too high. In 2006, the better forecast was only 3.2% too high.

The Special Report goes on to say:

Further, by not accurately projecting special fund revenues, policy makers such as the General Assembly are assuming that the Museum has the ability to collect and support a larger portion of their operating costs than they actually collect. An overestimation of revenue collections also tends to distort the Museum's dependence on General Fund support

to keep operations funded. This reliance on special fund revenue collections makes accurate projection and collection of special fund revenue essential for the long-term fiscal health of the museum. The reason for the variance appears to come from a structural problem within the methodology of projecting revenues and not adjusting budgeted amounts for changing economic conditions.

Additionally, since this is a problem that has existed for several years, policy makers may believe that the Museum generally is maintaining and providing a level of service that not collecting the special fund revenue prevents. Further, by not including more accurate projections of special fund revenues in the budget, it appears that the Museum has greater flexibility to absorb potential changes in funding or service delivery.

In this passage, the Special Report is referring to "estimates of non-general fund revenues" that appear in the Appropriation Act.

We are the first to assert that accurate non-general fund revenue forecasting is essential, but we point out that the estimates that appear in the Budget Act are prepared more than nine months before Museum Trustees approve the final annual budget. This means that, when approving the annual operating budget, the Trustees use a much more recent, more accurate forecast of non-general fund revenues.

There is, however, a systemic problem here that affects all agencies and institutions that generate revenues. It relates to how the budget approved by the institution is communicated back to policy-makers to update their estimates in the Budget Act of a year earlier.

Please see Tables 1, 2, and 3 in the letter. We believe that they all show significant improvements. In Table 1, we see that the Special Fund revenue estimate missed by 11.4% in FY 2005 but only missed by 3.2% in FY 2006.

In Table 3, we see that total revenue collected was under by 8% in FY 2005 but above estimate by 4% in FY 2006.

INTERNAL CONTROLS

In the section on internal controls, there is a considerable body of material with which the Museum's Joint Finance Committee is already dealing: proper staffing, proper controls, adequacy of financial systems, and others. The hard work implicit in this process has barely begun.

The single most important issue raised by this portion of the Special Report is this: What steps are required to ensure that personnel losses, in an agency with a small finance staff, do not cripple the operation. The Special Report makes several proposals, all of which are under active study by the Museum's Joint Finance Committee.

The Museum staff, SMV Joint Finance Committee, and the Trustees have taken a number of actions to deal with the internal control issues raised by the Special Report. They include:

- Seeking and hiring a Finance Director who thoroughly understood Commonwealth's accounting systems.
- Filling vacancies in the Finance Department, especially in budget analysis, Accounts Payable, and procurement with professionals having from eight to twenty years of experience in state accounting.
- Instituting a process to document internal procedures.
- Initiating conversations with other institutions to solve the problem of "no depth of staff" in critical positions.
- Instituted more timely reporting (up to of 25 days earlier than the state CARS system) of critical forward commitments, accounts payable, and accounts receivable.
- Implemented an annual budget with substantially more conservative special fund revenue forecasts than in recent prior years.
- Increased the speed of data entry into CARS for accounts payable.
- Changed the frequency of meeting of the SMV Joint Finance Committee from quarterly to monthly; increased the frequency of the reporting cycle to match; created a weekly reporting cycle to the Finance Committee for several key performance indicators.
- Changed the interface between CARS and the internal reporting system to provide more accurate, and more timely information

In sum, the Science Museum has addressed, and will continue to actively address the three major issues raised in the internal controls portion of the audit, which were:

1. Ensure essential processes are completed and recorded timely;
2. Provide adequate staffing
3. Provide reliable management reporting

COMMENTS IN THE SPECIAL REPORT ABOUT TRUSTEE ACTIONS

In several instances, the Special Report comments favorably about actions taken by the Board of Trustees. For example, it is encouraging that he notes the following:

In response to this and other report findings, the Board of Trustees implemented a new, more conservative budgeting methodology in 2006 that resulted in a more reliable estimate that missed projections by only three percent. [page 2 as to Fiscal Condition]

In addition to the conservative budgeting methodology action discussed above, the Board of Trustees instituted a number of oversight actions to control and potentially eliminate the Museum's continuing deteriorating cash position. [page 3 as to Fiscal Condition]

While the Board took action to make the special revenue fund budget more realistic and achieved this objective, the actions taken to amass cash by year-end to cover the budget draws into question if the Board is aware of all revenue sources and their on-going collection. [page 5 as to Budget Development, Execution, and Monitoring]

We believe these steps and their order of priority provide management with the direction necessary to properly address the highest risk areas of the Museum's operations. The Museum's Board has already made satisfactory efforts to begin addressing these issues. [page 5 as to Management Oversight]

The Special Report does not acknowledge that the Museum's Trustees, Joint Finance Committee and management made measurable progress in addressing the fiscal issues raised in his Audit Report for FY2004 that the Museum including

(a) pay all Museum payables on a timely basis,

(b) have no outstanding loans from the SMV Foundation or otherwise, and

(c) bring its fixed asset inventory up to date in accordance with the state FAACS system.

In fact, the Museum ended FY2006 with:

(a) all payables current (unlike FY2005 which ended with some payables overdue),

(b) a $270,000 loan from SMVF (rather than the $400,000 loan from SMVF at the end of FY2005), and

(c) its fixed asset inventory up to date in all categories except "exhibits."

Also, the Trustees adopted a budget for FY2007 which provides for the Museum to end FY2007 with no cash deficit and no structural deficit, in that (a) all payables will be current and those not payable will be covered by cash in hand, and (b) no loan from the SMV Foundation or otherwise will be outstanding.

CONCLUSION

The Board of Trustees and the staff of the Science Museum recognize the gravity and the urgency of the concerns raised in the Special Report, and in their conversations with the Auditor of Public Accounts.

Some initiatives to address these issues were begun long ago; some begun recently. The Trustees and staff fully recognize that the corrective work and careful tracking of Museum progress toward adequate solutions is the work of several years.

The Museum's Joint Finance Committee (which includes five Trustees as members) is actively dealing with all of the issues raised by the Auditor of Public Accounts and is also monitoring the Museum's FY2007 budget on a monthly basis. As may be required, and after completing its work on financial issues as described above, the Museum's Joint Finance Committee will make recommendations to the Trustees on which the Trustees will act. Moreover, the Museum's Joint Finance Committee will advise the Trustees of any deviations from the FY2007 budget so that the Trustees can amend that budget to assure no deficit spending.

The Museum's Strategic Planning Committee has been directly charged to consider the concerns raised in this report about Structural Deficits, financial planning over a five-year horizon, and the implications of cost changes in the environment (compensation cost-of-living increases; utility cost) that directly affect the Museum's ability to maintain structural balance in its financial picture.

In sum, the Science Museum believes its Trustees and staff are fully cognizant of the issues and concerns raised in the Special Report, and have taken, or will soon take the actions required, that will, over time, correct these matters.

Sincerely,

Walter R. T. Witschey

Director
Science Museum of Virginia