

E20B
State Treasurer

Operating Budget Data

(\$ in Thousands)

	FY 05	FY 06	FY 07	FY 06-07	% Change
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>	<u>Prior Year</u>
General Fund	\$5,445	\$4,363	\$4,956	\$592	13.6%
Special Fund	921	785	808	23	3.0%
Reimbursable Fund	<u>28,730</u>	<u>33,710</u>	<u>34,606</u>	<u>896</u>	<u>2.7%</u>
Total Funds	\$35,095	\$38,858	\$40,370	\$1,512	3.9%

- The fiscal 2007 general fund allowance provides additional funds for personnel costs including four new positions. The general fund allowance also provides funds for information technology systems replacement, consulting services associated with the planned replacement of banking reconciliation system, and additional funds for banking contract costs.
- The increased cost of commercial insurance policies and greater use of the State Insurance Trust Fund to cover operating costs accounts for changes in the reimbursable fund allowance.

Personnel Data

	FY 05	FY 06	FY 07	FY 06-07
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>
Regular Positions	54.00	55.00	59.00	4.00
Contractual FTEs	<u>1.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Total Personnel	55.00	55.00	59.00	4.00

Vacancy Data: Regular Positions

Turnover, Excluding New Positions	1.98	3.35%
Positions Vacant as of 12/31/05	10.00	18.18%

- The turnover rate applied to the Treasurer's Office decreased from 4.49% for fiscal 2006 to 3.35% for existing positions in fiscal 2007, thus increasing the amount of funds available to support personnel-related costs.

Note: Numbers may not sum to total due to rounding.

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- The allowance includes funding for four new positions to maintain the daily reconciliation of the depository and disbursement accounts.

Analysis in Brief

Major Trends

Reconciliation of the State’s Main Bank Accounts: In fiscal 2003 the average number of days it took to reconcile accounts exceeded 60 days. However, in fiscal 2005 a combination of restructured reconciliation procedures for additional staff resources has reduced the average number of days to reconcile the State’s main depository and disbursement accounts to less than 10 days.

Investment Portfolio Continues to Outperform the 90-day U.S. Treasury T-bill: The Treasurer’s Office investment portfolio outperformed the average 90-day U.S. Treasury T-bill rate in each of fiscal 2002 through 2004. Although the State’s portfolio did not outperform the T-bill rate in fiscal 2005, the average interest rate earned by the State in fiscal 2005 was 98 basis points higher than the rate earned in fiscal 2004.

State Insurance Claims Processing: The number of new claims filed has increased substantially and is expected to remain at current levels for the foreseeable future. The Managing for Results measures submitted by the Treasurer’s Office only provides claims adjudication data. This analysis provides a summary of claims loss data for several components of the State Insurance Trust Fund (SITF). The fiscal 2007 allowance includes funds to purchase and install additional modules to a new risk management information system purchased in fiscal 2006 intended to continue to improve claims processing and risk management.

Issues

Bank Reconciliation Project Results in \$37 Million Write-down: A \$37 million discrepancy between the cash balance reflected in the State’s records and the cash balance records of the custodian bank resulted in the Comptroller reducing the fiscal 2005 general fund closing balance by \$37 million. **The Department of Legislative Services (DLS) recommends that the Treasurer brief the committees on the actions taken to ensure that such a discrepancy does not occur again.**

Unfunded Liability in State Insurance Trust Fund Continues: Despite increased appropriations statewide for insurance premiums, the SITF still has an unfunded liability projected for the end of fiscal 2006. **DLS recommends that the Treasurer’s Office continue to seek full SITF funding and comment on the loss prevention measures implemented to reduce the incidence of insurance claims.**

Recommended Actions

	<u>Funds</u>	
1. Delete funding and PINs for new positions.	\$ 171,944	4.0
Total Reductions	\$ 171,944	4.0

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State Treasurer

Operating Budget Analysis

Program Description

The State Treasurer is responsible for the management and protection of State funds and property. To carry out these responsibilities, the State Treasurer selects and manages the depository facilities for State funds, issues or authorizes agents to issue payments of State funds, invests excess funds, safeguards all State securities and investments, and provides insurance protection against damage to State property and liability of State employees. The State Treasurer also administers the sale of Maryland general obligation bonds and serves as a member of the Board of Public Works (BPW). The State Treasurer's Office consists of four programs: treasury management; insurance management; insurance coverage; and bond sale expenses.

The goals of the Treasurer's Office are to:

- accurately reconcile all Treasury State bank accounts;
- maximize investment earnings for the State's surplus funds in accordance with State law; and
- process all agency and third party claims submitted to the Insurance Division.

Performance Analysis: Managing for Results

The Treasurer's Office fiscal 2007 Managing for Results (MFR) submission includes measures for the reconciliation of the State's main depository and disbursement accounts, rate of return on the State's investment portfolio, and claims adjudication rate for claims presented under the State Insurance Trust Fund (SITF) and the Maryland Tort Claims Act. Exhibits 1 through 6 present data on several performance measures, as well as SITF claims loss data not included in the MFR submission.

- ***Objective:*** *Reconcile the State's main depository, main disbursement, and income tax refund accounts within 30 days of receipt of the bank statement.*

As shown in **Exhibit 1**, the number of account transactions processed increased steadily in each of fiscal 2003 through 2005. What was once a deplorable reconciliation measure in fiscal 2003 with a reconciliation taking over 60 days to complete has improved dramatically in fiscal 2005 with reconciliation taking less than 10 days to complete. While the 2005 measure is by no means inadequate, further improvement in this measure is projected with the future implementation of a new automated reconciliation system.

Exhibit 1
Total Receipt and Disbursement Transactions
Fiscal 2003 – 2007

	<u>FY 03</u> <u>Actual</u>	<u>FY 04</u> <u>Actual</u>	<u>FY 05</u> <u>Actual</u>	<u>FY 06</u> <u>Est.</u>	<u>FY 07</u> <u>Est.</u>
Total Number of Receipt and Disbursement Transactions	9,670,000	11,455,000	12,350,000	12,750,000	13,000,000
Receipts and Disbursements (\$ in Millions)	\$175,570	\$180,834	\$179,258	\$183,250	\$188,500
Avg. # Days to Reconcile	>60	>30	>10	<7	<5

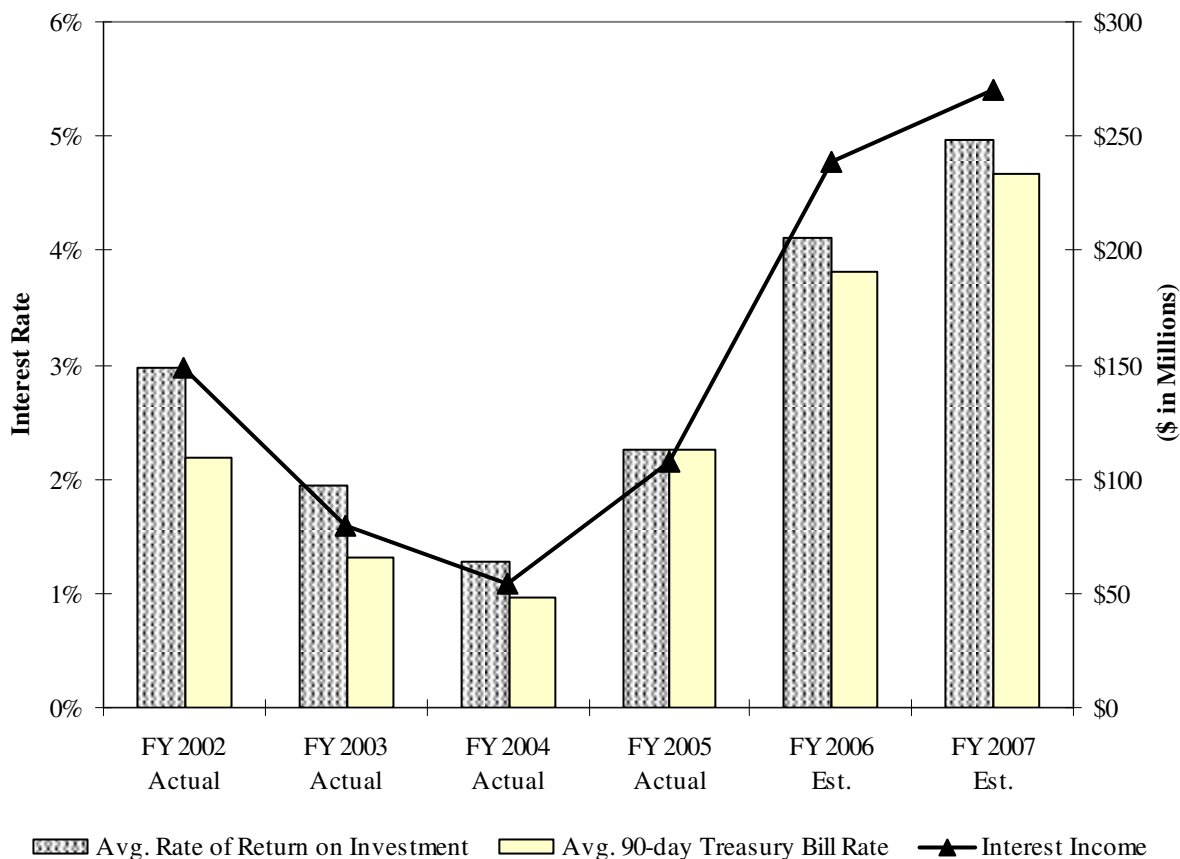
Source: Department of Budget and Management

The failure to properly reconcile the State's main bank accounts on a timely basis can be traced to accounting irregularities and omissions dating back to the early 1990s. Misunderstood processes resulted in the continued utilization of a poor monthly reconciliation which, based on the recent \$37 million write-down in the State's books (discussed in Issue 1 of this analysis), was inadequate. In 2002 the Treasurer identified the implementation of a new automated system as a top priority. After an extended procurement process, a contract was awarded to TrinTech, Inc., to deliver an automated reconciliation package as one component of system reform. When it became apparent that the existing reconciliation procedures were inadequate and did not provide accurate and reliable daily cash reconciliation, the implementation of a new automated system was put on hold. The Treasurer's Office now reports that the implementation of a new automated reconciliation system is under review, and the previously purchased TrinTech system is currently under evaluation. Initial review indicates that the TrinTech system will not support the enhanced process and procedures developed by the Treasurer's Office during the reconciliation process overhaul conducted over the last two years, although the review is not complete. The fiscal 2007 allowance includes funds for consultant services to begin addressing the banking reconciliation automation project.

- **Objective:** *Earn a rate of return on the investment portfolio that exceeds the average 90-day U.S. Treasury bill rate by 25 basis points on an annual basis.*

The Treasurer's Office is also responsible for maximizing investment earnings for the State's surplus funds. **Exhibit 2**, which shows the rate of return on the investment portfolio as compared to the average 90-day U.S. Treasury rate, indicates that the Treasurer's investment portfolio outperformed the average T-bill rate in each of fiscal 2002 through 2004. However, the 80 basis points difference achieved in fiscal 2002 was reduced to 62 basis points in fiscal 2003 and 31 points in fiscal 2004. In fiscal 2005 the Treasurer's investment portfolio achieved the same rate of return as the T-bill rate. The low interest rate environment has made it difficult to achieve better results.

Exhibit 2
Comparison of Investment Portfolio and 90-day U.S. Treasury Bill Rates
Fiscal 2002 – 2007



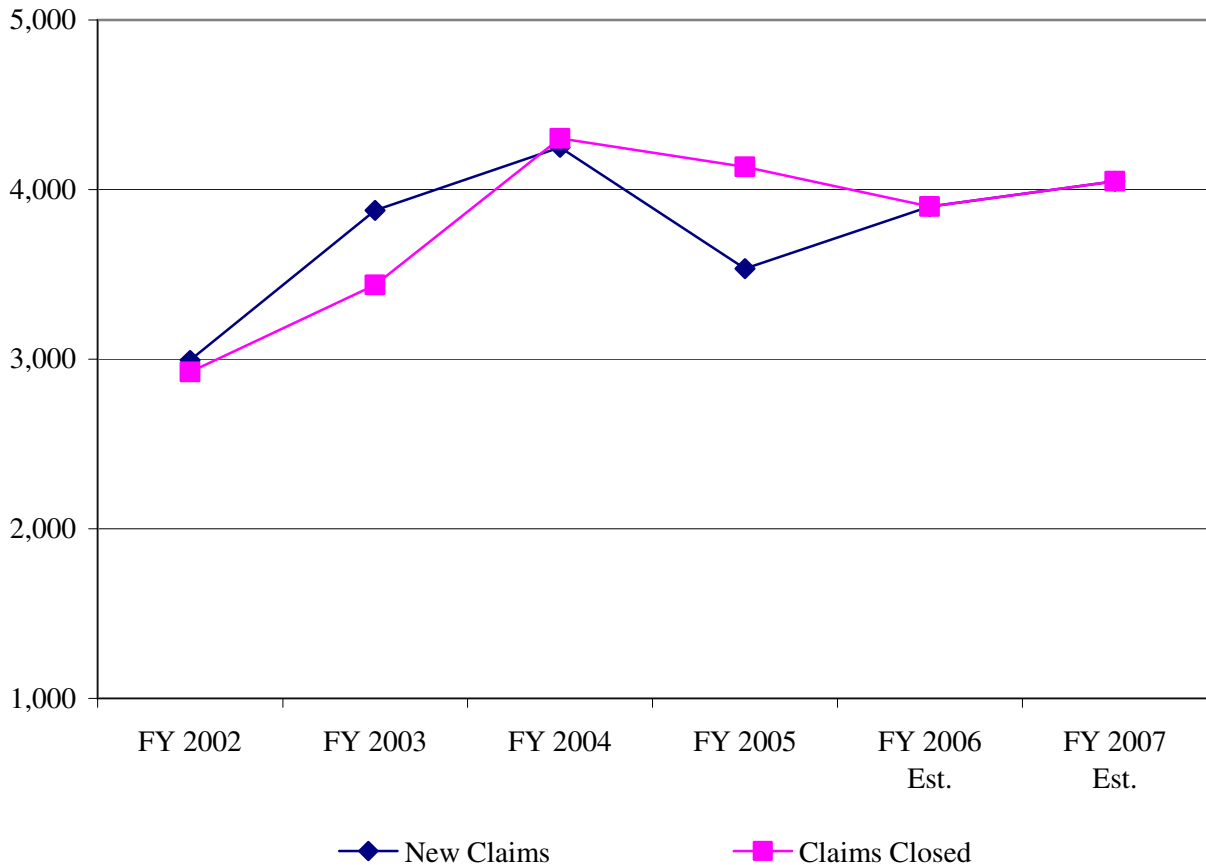
Source: State Treasurer’s Office

In its December 2005 report to the Legislative Policy Committee, the Treasurer conveyed that interest rates continued to increase during the first three months of fiscal 2006 with an average rate of return of 3.39%, and rates are expected to continue to climb as the Federal Reserve Board is expected to continue raising short-term rates in early calendar 2006. Exhibit 2 also shows the gross interest earned on the Treasurer’s investment portfolio. As one would expect, the sharp decline in interest rates and reduced fund balances during fiscal 2003 and 2004 resulted in diminishing returns on investments. As interest rates rise and fund balances grow – as they did in fiscal 2005 and are expected to do in both fiscal 2006 and 2007 – interest on the Treasurer’s investment portfolio should provide additional revenues to the State.

- **Objective:** Promptly and accurately investigate, analyze, and adjust all claims presented under the State Insurance Trust Fund and the Maryland Tort Claim Act. Claims should be adjudicated on a 1:1 ratio.

The Treasurer’s Office is also responsible for the efficient and cost-effective administration of the State Insurance Program that includes self-insurance and procurement of commercial insurance. **Exhibit 3**, which shows the rate at which new claims are received and processed by the Insurance Division, indicates that the number of claims processed exceeds the rate at which new claims are received thus reducing the number of open pending cases.

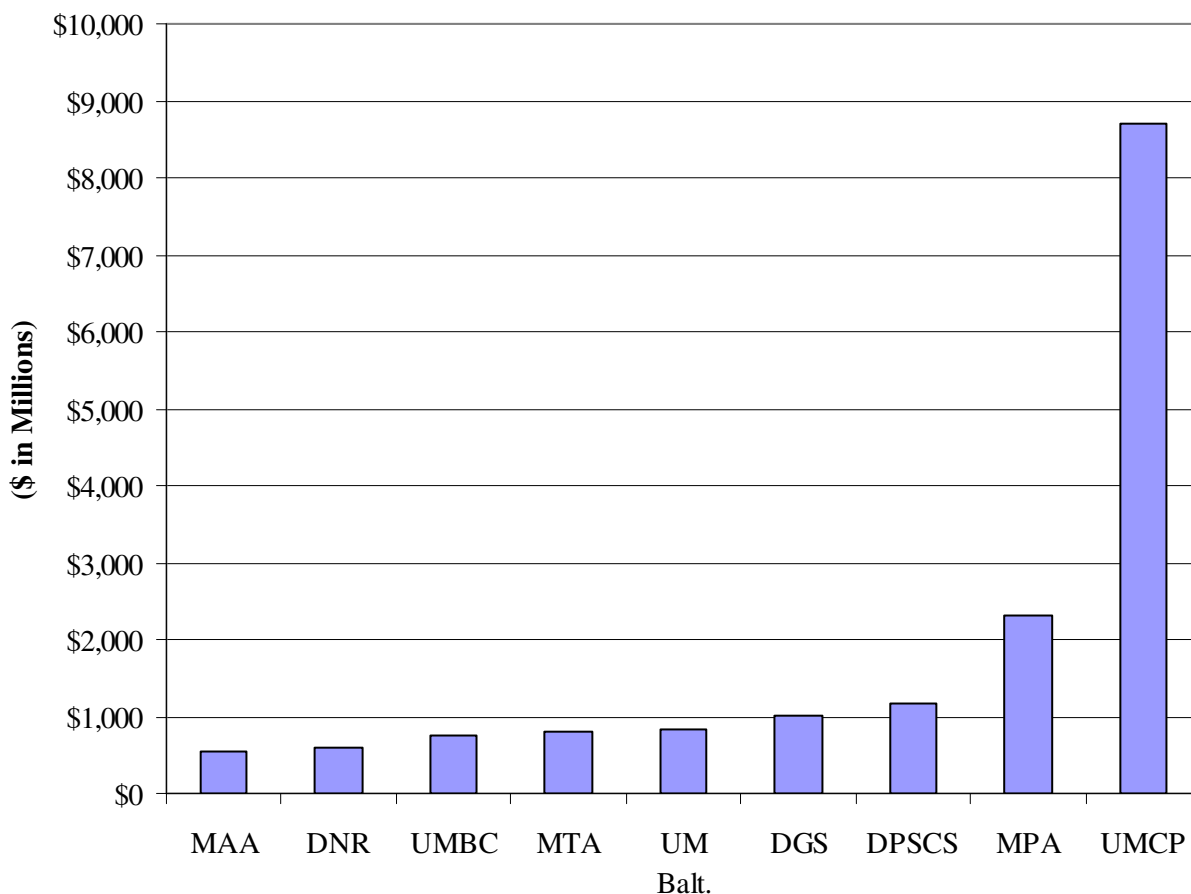
Exhibit 3
Insurance Division Third Party Claims Processing
Fiscal 2002 – 2007



Source: State Treasurer’s Office

This measure, while it demonstrates that the Insurance Division is able to process claims efficiently, does not provide information about the types of claims and the amount of claims losses, or identify agencies with the highest claims rates. This information, however, is compiled by the Insurance Division and provided in **Exhibits 4** through **6**.

Exhibit 4
State Insurance Trust Fund Incurred Property Claims
Fiscal 2000 – 2005 Total Combined Five-year Losses Above \$500,000

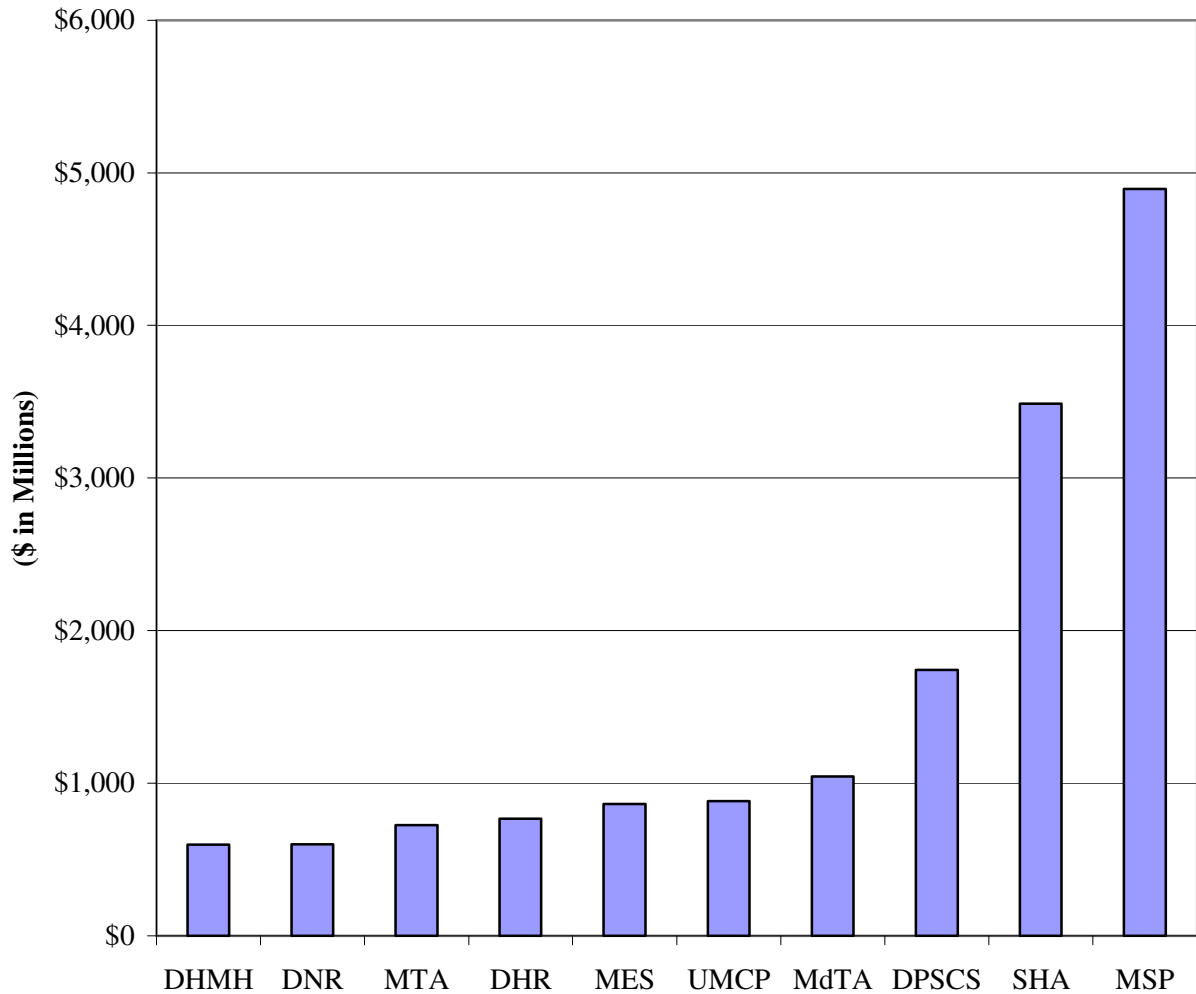


MAA – Maryland Aviation Administration
DNR – Department of Natural Resources
UMBC – University of Maryland Baltimore County
MTA – Maryland Transit Administration
UM Baltimore – University of Maryland, Baltimore

DGS – Department of General Services
DPSCS – Department of Public Safety and Correctional Services
MPA – Maryland Port Administration
UMCP – University of Maryland, College Park

Source: State Treasurer’s Office

Exhibit 5
State Insurance Trust Fund Incurred Automobile Claims
Fiscal 2000 – 2005 Total Combined Five-year Losses Above \$500,000

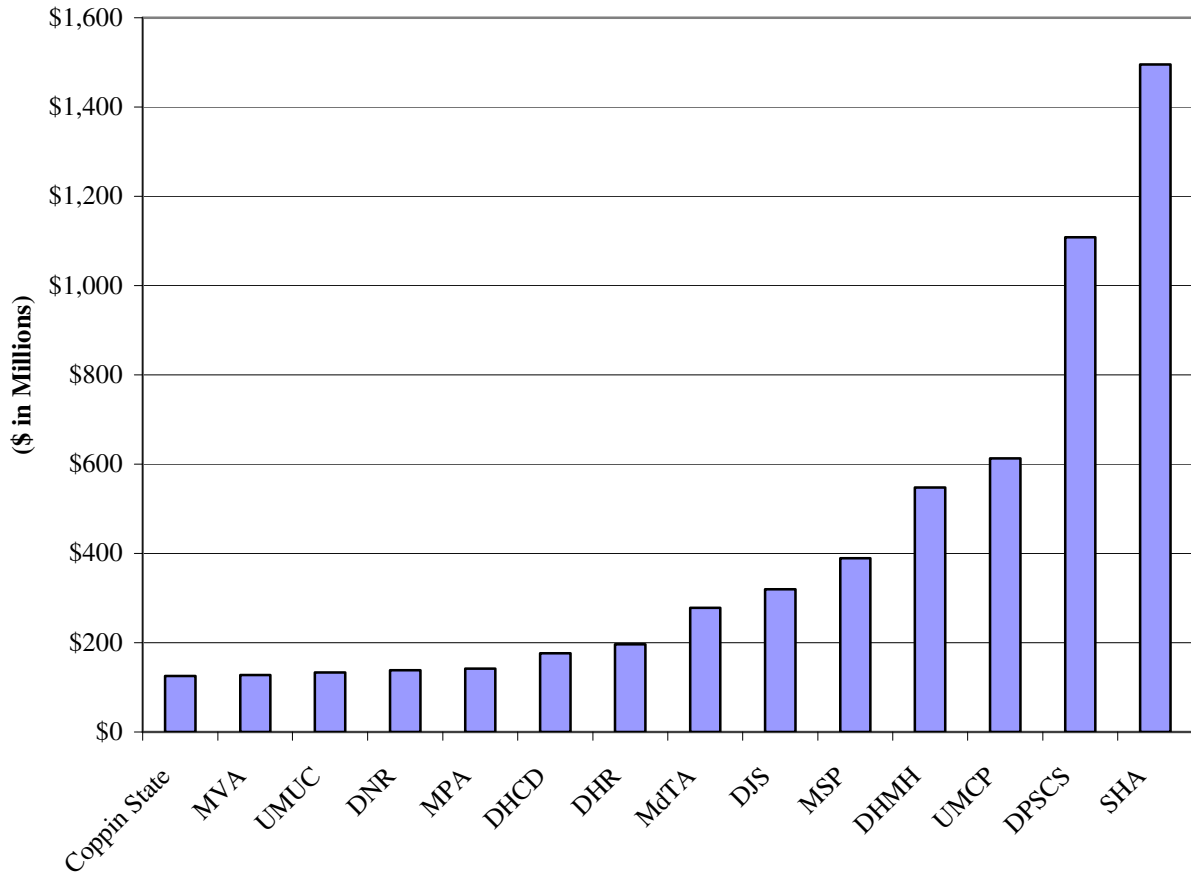


DHMH – Department of Health and Mental Hygiene
MES – Maryland Environmental Service
SHA – Maryland State Highway Administration

DHR – Department of Human Resources
MdTA – Maryland Transportation Authority
MSP – Maryland State Police

Source: State Treasurer’s Office

Exhibit 6
State Insurance Trust Fund Incurred General Liability Claims
Fiscal 2000 – 2005 Total Combined Five-year Losses Above \$100,000



MVA – Motor Vehicle Administration
UMUC – University of Maryland University College
DHCD – Department of Housing and Community Development
DJS – Department of Juvenile Services

Source: State Treasurer’s Office

Governor’s Proposed Budget

As shown in **Exhibit 7**, the fiscal 2007 allowance for the Treasurer’s Office is \$40.4 million in total funds which represents a \$1.5 million, or 3.9% increase over the fiscal 2006 working appropriation. Increased personnel expenditures, which accounts for a little over \$500,000 of additional planned spending, and additional excess commercial insurance costs in the amount of \$890,000, are the two biggest factors that contribute to the proposed budget increase. The fiscal 2007 proposed funding for each of the Treasurer’s Office’s programs is discussed in Exhibit 7.

Exhibit 7
Governor's Proposed Budget
State Treasurer
(\$ in Thousands)

How Much It Grows:	General Fund	Special Fund	Reimb. Fund	Total
2006 Working Appropriation	\$4,363	\$785	\$33,710	\$38,858
2007 Governor's Allowance	<u>4,956</u>	<u>808</u>	<u>34,606</u>	<u>40,370</u>
Amount Change	\$592	\$23	\$896	\$1,512
Percent Change	13.6%	3.0%	2.7%	3.9%

Where It Goes:

Personnel Expenses

Salary and benefits for four new positions (includes turnover at 20.4%).....	\$172
Increments and position reclassification (includes five positions reclassified to the Executive Pay Plan).....	160
Employee and retiree health insurance	81
Employee retirement and unemployment.....	26
Reduced turnover rate for existing positions (from 4.49 to 3.35%)	53
Deferred compensation.....	9

Treasury Management Division Nonpersonnel Changes

Reduced funding for training and staff development, Department of Budget and Management telecommunication costs, printing and advertising, and office supplies....	-82
Consultant costs for automation of disbursement reconciliation system.....	80
Additional cost associated with software application maintenance – agency replaced AS 400 operating system with IBM i5s due to system failure as an emergency procurement during fiscal 2006.....	38

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Where It Goes:

Three-year capital lease – includes replacement of AS 400s with IBM i5s and three-year planned replacement of PCs and accompanying software, printers, servers, and network infrastructure upgrades	94
Additional banking contract costs – banking contracts are based on fixed charges for transactions with fluctuating volumes	90
Insurance Division Nonpersonnel Changes	
Replacement of PCs and file cabinets	8
Provide enhancements to the new Risk Management System procured in fiscal 2006 and 2007, and provides funds for enhancements to the system including a virtual filing system and Litigation Management System	-125
Insurance coverage – mostly attributable to Maryland Transit Administration excess liability policy	890
Other	18
Total	\$1,512

Note: Numbers may not sum to total due to rounding.

Treasury Management Division

The Treasury Management Division includes the administrative and operating functions for the banking, investment, and information technology functions. Banking Services reconciles the State’s principal depository and disbursement accounts, the Investment Division focuses on the short-term investment of State funds and oversees securities lending operations, and the Information Technology (IT) Division provides the data processing and technology infrastructure needed to operate the State Treasurer’s Office.

The fiscal 2007 allowance for the Treasury Management Division is \$6.1 million and is comprised of \$4.9 million in general funds, \$507,000 in special funds derived primarily from investment fees collected by the office, and \$686,000 in reimbursable funds. Overall, the allowance provides \$617,820, or 11.2% more than what has been appropriated in fiscal 2006, most of which is general funds and attributable to increased salary and fringe benefit expenditures. Personnel costs for 40 positions, including 4 new positions in the allowance, account for just over \$3.0 million in proposed funding and represents almost a \$400,000 increase over the fiscal 2006 working appropriation. As shown in **Exhibit 8**, the 4 new positions in the budget account for an additional \$172,000 in proposed expenditures.

Exhibit 8
Salary and Fringe Benefits Cost for New Positions

<u>Position</u>	<u>Salary</u>	<u>Fringe</u>	<u>Turnover</u>	<u>Total</u>
Treasury Specialist VI	\$38,578	\$15,437	-\$11,029	\$42,986
Treasury Specialist V	38,578	15,437	-11,029	42,986
Treasury Specialist V	38,578	15,437	-11,029	42,986
Treasury Specialist V	38,578	15,437	-11,029	42,986
Total	\$154,312	\$61,748	-\$44,116	\$171,944

Source: Fiscal 2007 Budget Bill, Section 12

The Treasurer's Office indicates that these new positions are needed to maintain and keep current the reconciliation function within the Banking Division. The Department of Legislative Services (DLS) notes that the low salary level for these positions makes it difficult to fill the positions. Moreover, the office is currently operating with 10 vacancies, 3 of which have been vacant for more than a year, out of a staff of 50. **DLS recommends that the funding and PINs for the 4 new positions be deleted; and instead, the Treasurer's Office should work to have existing long-term vacant positions reclassified and filled to meet the needs of the Banking Division's personnel requirements.**

Significant nonpersonnel-related expenditures for the Treasury Management Division are as follows:

- Consultant services for the planned future implementation of a new automated account reconciliation system adds \$80,000 in general funds to the budget.
- The master equipment lease for the replacement of IBM AS/400 computer system with a new IBM i5 computer system was approved by BPW on February 1, 2006, on an emergency procurement basis. Failure of the existing system necessitated immediate replacement in order to ensure uninterrupted processing of the State's disbursements. This lease and the planned purchase of PCs and accompanying software, printers, servers, and network infrastructure upgrades adds \$94,000 to the budget.
- Banking contract fees, based on fixed charges for transactions with fluctuating volumes, as well as new services needed as a result of the reconciliation project, account for a little over \$2.5 million in Treasury Management Division expenditures, second only to personnel expenditures. These costs increase by \$90,000 in the budget based on projected transaction volume.

Insurance Management Division

The Insurance Management Division determines the insurance requirements to protect State property and personnel, procures commercial insurance, and sets State agency premiums for self-insurance.

Funded entirely with reimbursable funds from the SITF, the Insurance Management Division's fiscal 2007 budget allowance provides a little over \$2.1 million of which \$1.4 million goes to support personnel expenditures for 19 positions. Personnel expenditures increase by \$103,000 due mostly to increments and increased employee and retiree health insurance. The most significant nonpersonnel-related adjustment to the budget is a \$125,000 reduction for computer maintenance contracts. In fiscal 2006 the division began implementing a new risk management system designed to provide a more efficient management of the State's insurance claims process. The fiscal 2007 allowance provides \$75,000 to implement enhancement to the system, which is a reduction from the \$200,000 appropriated in fiscal 2006.

Executive Pay Plan Position Changes

The fiscal 2007 budget includes the reclassification of five existing positions into the Executive Pay Plan. **Exhibit 9** shows the position classification, scale, and fiscal 2007 salary for each position. The Treasurer's Office reports that the positions were reclassified to the Executive Pay Plan in June 2005. Since the reclassifications took place after enactment of the fiscal 2006 budget, the positions first appear as reclassifications in the fiscal 2007 budget. The Treasurer's Office has been able to fund the additional salary and fringe benefit costs associated with the reclassifications during fiscal 2006 using savings resulting from a vacancy rate that exceeds the office's budgeted turnover rate. **DLS recommends that the Treasurer comment on the need and justification for the position reclassifications, and any plans for additional reclassifications to the Executive Pay Plan not already listed in the fiscal 2007 budget as introduced.**

Exhibit 9 Positions Added to the Executive Pay Plan for Fiscal 2007

<u>Positions Classification</u>	<u>Scale</u>	<u>Fiscal 2007 Salary</u>
Executive VI	9906	\$96,373
Executive V	9905	96,004
Executive V	9905	95,838
Executive V	9905	95,272
Executive V	9905	91,273

Source: Fiscal 2007 Budget Bill, Section 12

Issues

1. Bank Reconciliation Project Results in \$37 Million Write-down

Over the past two years, the Treasurer's Office has been working on reconciling the difference between the State's main bank accounts and the State's accounting records in the RStars accounting system. This process disclosed an unaccounted difference of \$37 million in which the cash balance reflected in the State's records exceeded the cash balance in the records of the custodian banks.

To eliminate the difference, the \$37 million was written off by the Comptroller after consultation with the Department of Budget and Management (DBM), the Office of the Attorney General, and legislative leadership. The Comptroller recorded an adjusted journal entry to reduce the State's general ledger cash balance as of June 30, 2005, and the fiscal 2005 general funds revenue by \$37 million.

According to the Treasurer's Office, the \$37 million cumulative difference is the result of various accounting disparities and erroneous transactions dating back to at least 1995. No evidence of wrongdoing or misappropriation of any State funds was uncovered during the reconciliation. Moreover, the Treasurer's Office indicates that the cash reconciliation is now prepared on a daily basis.

Improved Banking Reconciliation Procedures

When the Treasurer's Office first discovered discrepancies between the State's main bank accounts and the State's accounting records in the RStars accounting system, the Treasurer immediately called for the re-reconciliation of all bank transactions dating back to July 2003. This included the implementation of a restructured deposit match reconciliation process which required matching bank transactions made by over a hundred agencies generating several hundred million transactions annually. To help with this task, the fiscal 2006 budget included a fiscal 2005 deficiency appropriation in the amount of \$975,000 to fund additional contractual auditors dedicated to the reconciliation project. During this process, the Banking Division discovered that several reconciliation functions were not being completed. As a result, the division reevaluated the entire reconciliation process and implemented more thorough processing controls and numerous transaction verification procedures to ensure a complete and accurate daily accounting. Furthermore, the Treasurer's Office is undertaking a detailed evaluation of its automation systems requirements for the eventual implementation of a new automated bank reconciliation system. The fiscal 2007 allowance provides funds to conduct a needs analysis for this system. Initial review of the current TrinTech system indicates that it will not support the new reconciliation procedural requirements implemented by the Treasurer's Office.

Although the \$37 million write-off raises questions about the integrity of State financial management, the Treasurer's Office has worked diligently to address the situation. **DLS recommends that the Treasurer brief the committees on the new banking reconciliation procedures and processes that are intended to ensure that such a situation does not repeat itself.**

Furthermore, the Treasurer should brief the committees on the timetable and estimated costs for the planned implementation of a new automated banking reconciliation system.

2. Unfunded Liability in State Insurance Trust Fund Continues

The State provides insurance protection through the purchase of specific excess commercial insurance policies and through self-insurance from the SITF. The SITF self-insurance program is designed to cover State agencies and employees for claims related to property, motor vehicle, torts, and officer and employee liability. Although the Insurance Division in the Treasurer’s Office’s procures commercial insurance policies for certain risks, most of the coverage is provided through the SITF. Premiums charged to State agency budgets on an annual basis provide the source of revenues to the SITF.

Exhibit 10, which provides the SITF actual and estimated fund account for fiscal 2002 through 2007, shows SITF remains underfunded as determined by the actuarial analysis conducted by an independent actuary. This situation, exacerbated by increased claims losses and rising costs for excess commercial coverage, was somewhat mitigated by increased State budgeting for agency premiums beginning in fiscal 2005. However, the gap between the actuarial recommended balance and ending cash balance at the end of fiscal 2006 is still estimated at \$19 million. Moreover, the unfunded liability, which is the difference between the ending cash balance and the actuarially recommended Generally Accepted Accounting Principles (GAAP) reserve, is estimated at \$6 million at the close of fiscal 2006 (the actuarially recommended fund balance uses the worst case assumption that there will be no future loss payment recoveries of any type while the GAAP reserve includes a loss funding reduction factor to include probable loss payment recoveries). This “unfunded liability,” while small in comparison to the unfunded liability of the State’s pension system, is something the bond rating agencies take into consideration when reviewing the State’s current AAA bond rating. The Treasurer’s Office reports that it annually submits premium funding requests to DBM in the amount necessary to maintain the SITF as the actuarially recommended balance. DBM has asked the Treasurer’s Office to also submit a minimum premium budget request based on anticipated pay-outs for the upcoming year that does not consider the actuarial liability. The amount DBM has budgeted has been below even the minimum request submitted by the Treasurer’s Office.

Appendix 5 provides a fiscal summary of the individual insurance programs funded through the SITF for fiscal 2002 through 2007.

Exhibit 10
Actual and Estimated SITF Fund Accounting
(\$ in Thousands)

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Estimate</u>	<u>Estimate</u>
Beginning Balance	\$28,997	\$19,884	\$11,357	\$5,247	\$10,050	\$10,623
Transfers and Recoveries	552	434	632	542	600	600
Agency Premiums	8,013	8,679	10,844	20,033	21,000	22,280
Excess Policy Coverage	-1,140	-5,050	-4,787	-4,945	-6,008	-5,647
Losses	-9,953	-11,068	-11,315	-9,111	-12,900	-12,900
Operating Costs	-1,585	-1,504	-1,484	-1,716	-2,119	-2,123
Transfers to General Fund	-5,000	0	0	0	0	0
Ending Cash Balance	\$19,884	\$11,357	\$5,247	\$10,050	\$10,623	\$12,833
Actuary Recommended Balance	23,827	23,827	30,393	29,503	29,503	29,503
Actuarial Shortfall	-\$3,943	-\$12,470	-\$25,146	-\$19,453	-\$18,880	-\$16,670
Actuary Recommended GAAP Reserve	9,309	13,375	16,314	18,581	16,654	n/a
Unfunded GAAP Liability	\$0	-\$2,018	-\$11,067	-\$8,531	-\$6,031	n/a

Source: State Treasurer's Office

Factors contributing to the declining fund balance:

- ***Costs to Procure Excess Commercial Insurance Blanket Coverage Increased Dramatically in the Wake of the September 11, 2001, Terrorist Attacks:*** As shown in Exhibit 9, the State paid just over \$1.1 million for excess commercial insurance in fiscal 2002 compared to an average of \$4.9 million annually in fiscal 2003 through 2005 for the same coverage. These costs are not expected to revert back to fiscal 2002 levels.
- ***Officers and Employee Liability Losses Increase Well in Excess of Agency Premiums:*** Officer and employee liability losses totaled just under \$500,000 in fiscal 2000 and 2001, well under the amount of agency premiums collected, which averaged approximately \$1.3 million.

However, losses incurred in fiscal 2003 and 2004 exceeded agency premiums drawing the balance in the account down.

- ***Tort Claims and Losses Exceeded Premiums:*** In fiscal 2001 through 2003, tort claim losses exceeded agency premiums. Adding to the cost was an increase in the tort claims cap from \$100,000 to \$200,000, beginning October 1, 1999. Premiums have been increased in order to keep pace with annual anticipated losses.
- ***Transfer of \$5 Million for SITF in Fiscal 2002:*** Chapter 440, Acts of 2002 (the Budget Reconciliation and Financing Act of 2002) transferred \$5 million from the available fund balance to the general fund. This was reduced from the proposed \$11 million transfer.
- ***Use of SITF to Fund Operations:*** In each fiscal year, as represented in **Appendix 5**, the amount of SITF funds used by the Treasurer’s Office to fund the operations of the Insurance Management Division has generally increased.

Loss Prevention Program Implementation

Not wanting to rely solely on increased agency premiums to address the SITF fund balance, the Treasurer’s Office has also implemented a loss prevention program designed to reduce claims losses. This process was started with the hiring of a loss prevention manager – this position was added during fiscal 2004 through the authority granted to BPW to add positions to the State budget during the fiscal year – charged with implementing loss mitigation programs. Some of the early highlights of the loss prevention program efforts include:

- the promotion of pipe leak detection methods in buildings with research and medical labs;
- the compilation of agency loss data – agencies with poorest lost history contacted for action plan meetings;
- the joint meeting with the Maryland Emergency Management Agency and selected agencies in flood prone areas to identify future flood mitigation action plans;
- the exchange of fire loss data and safety violation citation information from the State Fire Marshal in order to increase corrective action plan compliance; and
- the promotion of infrared thermographic imaging of electrical systems to reduce fire and mechanical breakdowns.

In fiscal 2006, the Insurance Division’s risk management efforts will concentrate on reducing the high incidence of property loss claims resulting from fires, machinery breakdowns, water damage, and property damaged caused by vehicle collisions. The Treasurer’s Office reports that some

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State-owned facilities are failing to meet even minimum safety inspection requirements, especially in the area of fire alarm system testing and maintenance. With almost 3,000 State buildings to inspect and with budget and staffing cuts affecting the management of building maintenance, the Treasurer's Office reports that comprehensive State-level oversight is needed to reduce property losses resulting from fire in State-owned buildings.

DLS recommends that the Treasurer's Office continue to seek full SITF funding to the level recommended by the actuary. DLS also recommends that the Treasurer continue to implement risk management strategies to reduce the incidence of claim losses.

Recommended Actions

	<u>Amount Reduction</u>		<u>Position Reduction</u>
1. Delete funding and PINs for 4 new positions. The Treasurer’s Office currently has 10 positions vacant, 3 of which have been vacant for more than a year. The Treasurer’s Office should work with the Department of Budget and Management to reclassify existing vacant positions to assume the responsibilities proposed for the 4 new positions in the fiscal 2007 allowance.	\$ 171,944	GF	4.0
Total General Fund Reductions	\$ 171,944		4.0

Current and Prior Year Budgets

Current and Prior Year Budgets State Treasurer (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2005					
Legislative Appropriation	\$3,652	\$621	\$0	\$29,428	\$33,701
Deficiency Appropriation	1,768	0	0	0	1,768
Budget Amendments	25	300	0	0	325
Reversions and Cancellations	0	0	0	-699	-699
Actual Expenditures	\$5,445	\$921	\$0	\$28,729	\$35,095
Fiscal 2006					
Legislative Appropriation	\$4,339	\$785	\$0	\$33,710	\$38,834
Budget Amendments	24	0	0	0	24
Working Appropriation	\$4,363	\$785	\$0	\$33,710	\$38,858

Note: Numbers may not sum to total due to rounding.

Fiscal 2005

Significant adjustments to the fiscal 2005 budget included:

- \$1.77 million general fund deficiency appropriation to provide additional funds necessary to fund several of the State's general banking contracts that were re-bid during fiscal 2005 and to fund contractual services necessary to accurately reconcile the State's depository and disbursement accounts.
- General funds of \$25,000 were added for the cost-of-living adjustment. Funds were budgeted in DBM and subsequently transferred to each agency.
- \$300,000 of additional special funds were appropriated to pay the expenses incurred in the issuance of State bonds.

Audit Findings

Audit Period for Last Audit:	October 1, 2000 – October 31, 2002
Issue Date:	December 2003
Number of Findings:	16
Number of Repeat Findings:	5
% of Repeat Findings:	31.2%
Rating: (if applicable)	

- Finding 1:** The office did not adequately reconcile the cash balance in the State’s main bank accounts with the corresponding balance recorded on the State’s accounting records. Due to a number of significant problems DLS identified with regard to the office’s purported reconciliations, the State’s cash balance could not be adequately determined.
- Finding 2:** An automated bank account reconciliation system, which cost \$1.6 million, was not successfully implemented due, in part, to inadequate contract specifications developed by the office.
- Finding 3:** The office did not require the bank to provide State agencies with adequate deposit documentation to help ensure that all collections were properly deposited.
- Finding 4:** The office did not ensure that the lockbox contractor transferred the available balance to the State daily, as required.
- Finding 5:** **The office did not ensure that all interest earned on funds in State agency bank accounts was transferred to the State’s general fund, as required.**
- Finding 6:** The office did not ensure that electronic fund deposits were recorded properly in the Financial Management Information System in a timely manner.
- Finding 7:** **Certain individuals had the ability to unilaterally modify disbursement and investment account fund transfer agreements.**
- Finding 8:** The office did not adequately ensure that all State agency bank accounts were properly authorized.
- Finding 9:** **The office did not ensure that check clearance patterns were reviewed and certified in accordance with federal regulations.**

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- Finding 10:** The office did not adequately monitor State agency’s reporting of Federal Cash Management Improvement Act activity.
- Finding 11:** Lack of supervisory review and approval of capital lease amortization schedules contributed to collection and payment errors.
- Finding 12:** Certain fees for support services to State agencies were assessed by the office without being authorized.
- Finding 13:** Security procedures for minicomputer production data and program files and the program change process were inadequate.
- Finding 14:** The information systems disaster recovery plan was incomplete and not current.
- Finding 15:** Procedures and controls were not adequate over unrepresented checks.
- Finding 16:** Unredeemed minibond funds were not properly transferred to the Unrepresented Bond and Coupon Fund or the Comptroller’s Abandoned Property Fund, as required.

*Bold denotes item repeated in full or part from preceding audit report.

**Object/Fund Difference Report
State Treasurer**

<u>Object/Fund</u>	<u>FY05 Actual</u>	<u>FY06 Working Appropriation</u>	<u>FY07 Allowance</u>	<u>FY06 - FY07 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	54.00	55.00	59.00	4.00	7.3%
02 Contractual	1.00	0	0	0	0.0%
Total Positions	55.00	55.00	59.00	4.00	7.3%
Objects					
01 Salaries and Wages	\$ 3,561,916	\$ 3,942,327	\$ 4,443,354	\$ 501,027	12.7%
02 Technical & Spec Fees	73,410	11,000	4,000	-7,000	-63.6%
03 Communication	100,767	101,490	88,229	-13,261	-13.1%
04 Travel	25,335	32,800	33,000	200	0.6%
07 Motor Vehicles	7,757	6,201	12,310	6,109	98.5%
08 Contractual Services	4,682,128	3,590,937	3,670,630	79,693	2.2%
09 Supplies & Materials	152,583	232,289	182,886	-49,403	-21.3%
10 Equip - Replacement	118,387	0	97,600	97,600	N/A
11 Equip - Additional	18,094	1,800	4,410	2,610	145.0%
13 Fixed Charges	26,353,675	30,939,154	31,833,083	893,929	2.9%
14 Land & Structures	1,216	0	0	0	0.0%
Total Objects	\$ 35,095,268	\$ 38,857,998	\$ 40,369,502	\$ 1,511,504	3.9%
Funds					
01 General Fund	\$ 5,444,826	\$ 4,363,340	\$ 4,955,746	\$ 592,406	13.6%
03 Special Fund	920,742	784,524	807,678	23,154	3.0%
09 Reimbursable Fund	28,729,700	33,710,134	34,606,078	895,944	2.7%
Total Funds	\$ 35,095,268	\$ 38,857,998	\$ 40,369,502	\$ 1,511,504	3.9%

Note: The fiscal 2006 appropriation does not include deficiencies, and the fiscal 2007 allowance does not reflect contingent reductions.

**Fiscal Summary
State Treasurer**

<u>Program/Unit</u>	<u>FY05 Actual</u>	<u>FY06 Wrk Approp</u>	<u>FY07 Allowance</u>	<u>Change</u>	<u>FY06 - FY07 % Change</u>
01 Treasury Management	\$ 6,479,507	\$ 5,509,545	\$ 6,127,365	\$ 617,820	11.2%
01 Insurance Management	1,716,053	2,118,793	2,122,697	3,904	0.2%
02 Insurance Coverage	26,327,606	30,907,660	31,797,440	889,780	2.9%
01 Bond Sale Expenses	572,102	322,000	322,000	0	0%
Total Expenditures	\$ 35,095,268	\$ 38,857,998	\$ 40,369,502	\$ 1,511,504	3.9%
General Fund	\$ 5,444,826	\$ 4,363,340	\$ 4,955,746	\$ 592,406	13.6%
Special Fund	920,742	784,524	807,678	23,154	3.0%
Total Appropriations	\$ 6,365,568	\$ 5,147,864	\$ 5,763,424	\$ 615,560	12.0%
Reimbursable Fund	\$ 28,729,700	\$ 33,710,134	\$ 34,606,078	\$ 895,944	2.7%
Total Funds	\$ 35,095,268	\$ 38,857,998	\$ 40,369,502	\$ 1,511,504	3.9%

Note: The fiscal 2006 appropriation does not include deficiencies, and the fiscal 2007 allowance does not reflect contingent reductions.

**State Insurance Trust Fund
Fiscal 2002 – 2007**

Units of Measurement	2002	2003	2004	2005	2006	2007
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Estimated</u>	<u>Estimated</u>
State Insurance Trust Fund						
Combined Beginning Balance	\$28,997,624	\$19,884,565	\$11,358,447	\$5,248,591	\$10,051,982	\$10,625,069
Blanket Real and Personal Property						
Beginning Balance	\$7,065,007	\$4,727,980	-\$733,672	-\$5,972,242	-\$4,221,870	-\$4,329,990
Transfers and Recoveries	97,695	61,660	37,450	58,052	100,000	100,000
Agency Premiums	3,540,242	3,221,043	3,474,268	10,062,815	10,000,000	11,280,016
Excess Policy Coverages	-1,139,483	-5,049,427	-4,786,872	-4,945,267	-6,008,120	-5,646,540
Real Property Losses	-4,835,482	-3,694,928	-3,963,415	-3,425,228	-4,200,000	-4,200,000
Insurance Administration				0		
GAAP Adjustment						
Ending Balance	\$4,727,980	-\$733,672	-\$5,972,242	-\$4,221,870	-\$4,329,990	-\$2,796,514
Officers and Employees Liability						
Beginning Balance	\$4,105,695	\$4,047,733	\$1,920,366	\$1,624,939	\$3,491,947	\$3,991,947
Transfers and Recoveries						
Agency Premiums	999,972	1,457,909	1,391,088	2,996,170	3,000,000	3,000,000
Liability Losses	-1,057,934	-3,585,276	-1,686,515	-1,129,162	-2,500,000	-2,500,000
Ending Balance	\$4,047,733	\$1,920,366	\$1,624,939	\$3,491,947	\$3,991,947	\$4,491,947

	2002	2003	2004	2005	2006	2007
	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Actual</u>	<u>Estimated</u>	<u>Estimated</u>
Tort Claims Act						
Beginning Balance	\$4,913,350	\$7,076,086	\$6,281,063	\$6,296,992	\$6,896,876	\$6,896,876
Transfers and Recoveries	14,233	100	94	7,242		
Agency Premiums	1,470,038	2,000,003	3,984,223	3,975,080	4,500,000	4,500,000
Tort Losses	-3,321,535	-2,795,126	-3,968,388	-3,382,438	-4,500,000	-4,500,000
Transfer from Auto	4,000,000					
Ending Balance	\$7,076,086	\$6,281,063	\$6,296,992	\$6,896,876	\$6,896,876	\$6,896,876
Motor Vehicle Comprehensive and Liability						
Beginning Balance	\$12,913,574	\$4,032,765	\$3,890,688	\$3,298,901	\$3,885,028	\$4,066,235
Transfers and Recoveries	439,624	372,942	594,678	476,574	500,000	500,000
Agency Premiums	2,002,464	2,000,005	1,994,236	2,999,900	3,500,000	3,500,000
Motor Vehicle Losses	-738,049	-1,010,809	-1,696,766	-1,174,294	-1,700,000	-1,700,000
Insurance Administration	-1,584,848	-1,504,215	-1,483,935	-1,716,053	-2,118,793	-2,206,029
Transfer to Tort	-4,000,000					
Transfer to GF – Budget Rec. Act	-5,000,000					
Ending Balance	\$4,032,765	\$3,890,688	\$3,298,901	\$3,885,028	\$4,066,235	\$4,160,206
Combined Cash Fund Balance	\$19,884,565	\$11,358,447	\$5,248,591	\$10,051,982	\$10,625,069	\$12,752,516
Recommended Actuary Balance (Italics – Estimated)	\$23,827,000	\$23,827,000	\$30,393,000	\$29,503,000	\$29,503,000	\$29,503,000
Difference	-\$3,942,435	-\$12,468,553	-\$25,144,409	-\$19,451,018	-\$18,877,931	-\$16,750,484