May 15, 2012

Memorandum

To: Senator John Arthur Smith, Chairman, Luciano "Lucky" Varela, Vice Chairman, and Members of the Legislative Finance Committee

From: Maria Griego, LFC Program Evaluator

Through: David Abbey, LFC Director, and Charles Sallee, LFC Deputy Director

Re: SHARE Cash Accounting Controls

Problem: General ledger cash account balances do not match the balance in the state's cash accounts at the bank. During the 2012 legislative session, the DFA and the STO reported to LFC staff that the state has hundreds of thousands of unreconciled entries in SHARE representing billions of dollars. The DFA received a special appropriation for $200 thousand in the 2012 GAA to assist in acquiring resources to address this issue. Additionally, the DFA is working to award a small services contract to a CPA firm to assist in researching and creating an action plan to address the variances in SHARE.

While it appears that there is no real dollar impact to the state general fund, making sure the general ledger correctly reflects state funds is essential. When referring to cash transactions, the general ledger is the state's check register, and it is used to record all cash outflows (warrants) and all cash inflows (deposits). Agencies use cash/fund balances to create budget requests, and the Legislature uses this information to make appropriations.

There are many possible contributing factors to this problem, including outdated business practices; manual processes for agencies using systems outside of SHARE, such as Medicaid; and insufficient training for agencies on SHARE. The Financial Control Act requires the DFA to complete timely account reconciliations to ensure the general ledger in SHARE accurately reflects bank balances at the State Treasurer's Office. The DFA has not been performing this monthly book to bank reconciliation.

Background: The state implemented SHARE in 2006 to serve as the state's central accounting system. This makes SHARE the general ledger. Additionally, SHARE houses other accounting processes that had previously been performed manually or through other systems. Before SHARE was implemented, the STO managed the entire deposit process: agencies would deliver their deposits to the STO, which would then enter the data into TRACS (STO's cash management system) and deliver the deposit to the bank. In 2001, the STO decided to allow agencies to complete their own deposits, while the STO continued to manage the deposit data in TRACS. With SHARE implementation, the role of TRACS was replaced by agencies entering their deposit information directly into SHARE. Having individual agencies involved in the deposit process has resulted in delays in matching bank deposit data to SHARE.

The DFA manages the process for warrants, which has not changed significantly since the implementation of SHARE. The DFA still creates warrants, and if payment is being sent out electronically, voids the warrant and instead submits an electronic transfer request. The DFA provides copies of warrants to the STO to allow them to validate outflows from the state's warrant accounts, then allowing these items to post correctly to the general ledger.

Beyond this daily activity of taking in deposits and making payments out of the state's cash accounts, the DFA is statutorily responsible for reconciling all accounts held at the STO on a monthly basis. This would mean confirming that the cash balances posted to the general ledger in SHARE match back to the bank statements for each of the state's bank accounts at the end of any given month. Not completing this process would put the DFA out of compliance with statute. However, auditors have not issued a finding for the DFA in relation to their reconciliation responsibility.

LFC program evaluation staff performed a special review of the HSD's negative cash balances and its request for a special appropriation in December 2011. Through field work for the review, staff identified process weaknesses, knowledge gaps, and overall confusion over the role of SHARE in reporting cash balances. These concerns were brought to the attention of the State Treasurer and the State Controller.

The Controller prepared a document identifying various areas where errors in SHARE may have occurred leading to variances between the general ledger and bank statements for the state's cash accounts. However, the DFA is unable to pinpoint the amount of errors causing the general ledger to be out of balance with cash account bank statements. This memo seeks to summarize the issue, clarify the risk, and lay out next steps.

Issues:

1. ***Business Practices and Accounting Controls***
    - There is currently no monthly cash general ledger reconciliation process to confirm cash balances reported by SHARE accurately reflect bank cash balances. Standard accounting practice dictates a monthly reconciliation of bank statements to the general ledger. This is also required by state statute.

- Cash balances reported by the DFA are acquired through SHARE on the same day every month, regardless of whether all activity for the month has been recorded in SHARE, meaning the balances may not be final. Agencies reconcile their fund balances to this data.
- Large multi-item entries are allowed to be made into SHARE without sufficient supporting documentation for the STO to validate these large entries. This complicates the STO's ability to manage their daily validation of bank activity.
- Entries can be made into SHARE after the month has ended. The standard practice is to close the books on a specific date and any outstanding items would be addressed in the following month, but would be clearly identified when performing the monthly reconciliation process.
- Agencies are required to make entries into SHARE to report deposits. However, information required to make these entries is not available until the deposit posts at the bank. So agencies are consistently making entries into SHARE late, and the STO consistently has issues with agencies not entering data timely or correctly.

Recommendations:

The DFA should:

- Identify current practices in place at the DFA, the STO, and agencies related to SHARE entries. Obtain any written procedures currently being used.
- Review procedures for making entries into SHARE, including requirements for supporting documentation. Determine if procedures need to be revised or if additional training is required.
- Enforce the current accounting calendar defining when accounting periods will be closed in SHARE and establish when account reconciliations need to be complete. Publish fund balances after reconciliation process is finalized.

2. ***Correcting historical differences in cash balances between SHARE and bank statements***

- The DFA's Financial Control Division (FCD) identified thirty-six areas where errors may have occurred across an estimated 1.6 million transactions. However, the FCD is not able to pinpoint the size of these errors, and is unable to perform a full SHARE to bank reconciliation at this time.
- The FCD is currently seeking consultation services through a small purchase contract to assist in identifying cash balance discrepancies in SHARE and developing an action plan to correct these issues.
- The Legislature appropriated $200 thousand in the 2012 GAA to assist in correcting the variances in SHARE. Based on the magnitude of transactions entered into SHARE by state agencies, identifying and correcting discrepancies could be a lengthy and costly process involving a contract for a team of consultant CPAs working over a year or more. The current appropriation will likely be insufficient.
- If items are not corrected, taking a significant write-off would be high profile. While there appears to be zero impact to actual cash in the state's bank accounts, large dollar corrections in SHARE could easily be misinterpreted as a reflection on the strength of the state general fund. If we take no action, this

issue will continue to exist, and will follow into any replacement system for SHARE adopted in the future.

Recommendations:

The DFA should:

- Determine a plan to review and determine errors to be corrected, resources required to complete this project, and associated costs.

3. *SHARE Upgrade*

- SHARE is currently 3 upgrades behind, which poses a risk for getting valuable technical support from the vendor. While there is an option to not upgrade SHARE and obtain technical support through other means, there are many benefits to upgrading. These include:
  - Better Functionality: In the case of the cash management module used at the STO, upgraded software would provide more detail and would reduce manual workarounds currently being used.
  - Better Disaster Recovery: If SHARE experienced any system failures, Oracle would be able to assist in fixing the issue, therefore reducing time to bring the system into working order.
- The state currently pays $500 thousand a year to Oracle to maintain SHARE. Including in this fee is the right to transition to available system upgrades. Therefore, no further appropriations would be required to upgrade SHARE.

Recommendation:

The DFA should:

- Confirm steps required to move forward with SHARE system upgrade in partnership with the DoIT.

4. *Separation of duties between the DFA, the STO, and individual agencies*

- There are many sources of data for SHARE managed by various entities, without a clear process of the how these sources should interact or who should be handling which part of the process.
- There is no clear separation of duties between the DFA and the STO on the management of cash balances. DFA currently downloads secure bank data, uploads this data into SHARE, and then hands the process off to the STO to complete daily reconciliation of deposits and warrants.
- Agencies are responsible for entering deposit data into SHARE's Cash Management module, which the STO then uses to validate deposit activity posted at the bank. If agencies do not complete this step in a timely manner, outstanding deposits will not post to the general ledger.
- The STO is currently responsible for confirming agencies have adequate budget for warrants processed through SHARE after the warrant has cleared the bank, which falls outside their intended role, and also duplicates the process the DFA uses to approve warrants for issue.

Recommendation:

The DFA and the STO should:

- Use standard accounting practices as a guide to establish roles for the STO, the DFA, and agencies. For example, the STO should be designated as the custodian of all banking data, agencies should be responsible for confirming budget dollars are available for warrants being issued, and the DFA should be reconciling cash account balances monthly.

Conclusion and Next Steps: Current cash discrepancies in the general ledger appear to be the product of maintaining business practices that are either obsolete or ineffective in the current environment, as well as insufficient training and guidance when putting deposit management duties in the hands of individual agencies. In addition to these operational weaknesses, the DFA is not meeting its statutory responsibility to ensure the general ledger correctly reflects our bank account balances on a monthly basis. This type of oversight is crucial to ensuring that the state's finances are properly managed.

LFC staff's conclusion is that the DFA and the STO need to create a plan to address these deficiencies and correct errors preventing general ledger cash balances from being correctly reported. The DFA should present an update at their fall budget hearing addressing the issues described here, including defining roles and responsibilities in conjunction with the STO, a plan to upgrade SHARE in partnership with DoIT, and the results of the contracted review from an independent CPA firm which the DFA is currently scoping. LFC staff will continue to monitor this situation and report back periodically to the Committee.