

Audit Report

Department of Veterans Affairs

August 2010



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

August 17, 2010

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Department of Veterans Affairs (DVA) for the period beginning May 21, 2007 and ending January 4, 2010. DVA assists veterans, their families and survivors in obtaining federal, state, and local benefits provided by law in recognition of their service to state and country. DVA also manages five veterans' cemeteries, maintains four veterans' war memorials, and operates and manages the Charlotte Hall Veterans Home.

Our audit disclosed that DVA had not established adequate controls over cash receipts, purchases and disbursements, close-out transactions, and property. For example, procedures were not place to ensure certain collections were deposited.

The response from DVA to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by DVA.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* Denotes item repeated in full or part from preceding audit report

Background Information

Agency Responsibilities

The Department of Veterans Affairs (DVA) delivers services and administers programs to assist veterans, their families and survivors, in obtaining federal, state, and local benefits provided by law in recognition of their service to state and country. DVA provides administrative services through eight veterans service centers, and operates and maintains five veterans' cemeteries, four veterans' war memorials, and offices in Annapolis and Baltimore. DVA also manages the Charlotte Hall Veterans Home (CHVH). CHVH provides care for Maryland veterans who are unable to care for themselves due to disability or advancing age or who have the need for skilled nursing care. According to the State's records, DVA's operating expenditures for fiscal year 2009 totaled approximately \$19.6 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated November 2, 2007. We determined that DVA satisfactorily addressed two of the findings. The remaining three findings are repeated in this report.

Findings and Recommendations

Cash Receipts

Finding 1

Adequate internal controls had not been established over collections at two locations.

Analysis

The Department of Veterans Affairs (DVA) had not established adequate internal controls over recording and depositing its collections, including federal reimbursements and donations, received at two locations. According to agency records, these two locations received approximately \$821,500 during fiscal year 2009. Specifically, collections received at both locations were not verified to deposit by an employee independent of the cash receipts process. For example, at one location, the employee who performed the deposit verifications also received and recorded the collections in the State's accounting records. Furthermore, at the other location, the deposit verification process was inadequate as the initial receipt record was not used to verify the deposit. Finally, at both locations the dates the collections were received were not recorded. Recording the date of receipt would help DVA ensure that the collections were deposited timely.

The Comptroller of Maryland's *Accounting Procedures Manual* requires that both the recordation of collections into the State's accounting records and the reconciliation of the initial recordation of collections to the amount deposited be performed by an employee independent of the cash receipts function. The *Manual* also generally requires that receipts be deposited no later than the first working day after the day of receipt. According to the State's records, DVA collected approximately \$1.2 million during fiscal year 2009.

Recommendation 1

- a. We recommend that DVA ensure that an employee independent of the cash receipts function, using the initial record of receipt, verifies that collections are subsequently deposited, and that this process is documented;**
- b. ensure that collections are recorded in the State's accounting records by an employee independent of the cash receipts function; and**
- c. record the receipt date of collections.**

We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Purchases and Disbursements

Finding 2

Proper internal controls were not established over the processing of purchasing and disbursement transactions.

Analysis

DVA did not fully use the security features of the State's Financial Management Information System (FMIS) to establish proper internal controls over purchasing and disbursement transactions. Consequently, unauthorized transactions could be processed which may not be readily detected. During fiscal year 2009, DVA used FMIS to process disbursements totaling approximately \$13.7 million.

Specifically, two employees could both initiate and process certain purchasing or disbursement transactions without being subject to independent approval, and one of these employees could also release disbursement transactions to the Comptroller of Maryland's General Accounting Division for payment. The same condition regarding these two employees was commented upon in our preceding audit report.

Recommendation 2

We recommend that DVA fully use the available FMIS security features by establishing independent online approval requirements to ensure that only authorized transactions were processed (repeat).

Budget Closeout Transactions

Finding 3

Year-end expenditure entries were not supported.

Analysis

DVA recorded general fund accrued expenditures totaling approximately \$171,000 and \$607,000 at June 30, 2008 and June 30, 2009, respectively, for which adequate supporting documentation was not on file. We were advised by DVA management that the amounts accrued were estimates of expenditures incurred that had not been paid as of fiscal year-end; however, DVA could not explain how the estimated amounts of the accruals were determined. Our subsequent testing of certain of these accrued expenditures disclosed that these transactions were offset by valid disbursements in the subsequent year.

The Comptroller of Maryland's *State Policy on Accounts Payable, Accrued Expenditures and Encumbrances* states that expenditures should be accrued only when goods or services have been received prior to fiscal year end but not paid for. The *Policy* further states that agencies must maintain proper detailed documentation to support the accrual. A similar condition was commented upon in our preceding audit report related to fiscal year 2006.

Recommendation 3

We recommend that DVA comply with the aforementioned policy and record accrued expenditures only when adequately supported (repeat).

Property

Finding 4

Adequate accountability and control was not established over DVA's property.

Analysis

DVA did not adequately account for its property. Specifically, record keeping procedures were inadequate and were not in accordance with the Department of General Services' (DGS) *Inventory Control Manual*. According to DVA records, as of June 30, 2009, the book value of its property totaled approximately \$64.4 million (land, buildings and improvements - \$58.7 million; equipment - \$5.7 million). Our review disclosed the following conditions:

- There was an inadequate segregation of duties related to certain equipment. Specifically, the employee who maintained the detail records for cemeteries, monuments, and headquarters equipment also conducted the related physical inventory.
- Independent control accounts were not maintained for any DVA property, as required. As a result, the records could not be used to effectively control equipment.
- Physical inventories of sensitive property were not completed as required. Specifically, we noted that as of February 2010, the most recent physical inventory of sensitive equipment for cemeteries, monuments, service offices, and headquarters was completed in June 2008.
- Property purchased was not always recorded in DVA's property records. Our test of five items purchased during fiscal years 2007 to 2009 totaling \$77,250 disclosed that two of the items totaling \$37,720 had not been recorded in the detail records.

- DVA did not submit an annual report of fixed assets to DGS as required for the periods ending June 30, 2007, June 30, 2008, and June 30, 2009.

The DGS *Inventory Control Manual* requires that the employee who maintains the detail equipment records not conduct the related physical inventories, and that physical inventories of sensitive equipment be conducted annually. The *Manual* further requires that control and detail records be accurately maintained, and that annual reports of fixed assets be submitted to DGS. Similar conditions were commented upon in our preceding audit report.

Recommendation 4

We recommend that DVA take immediate action to comply with the aforementioned requirements of the DGS *Inventory Control Manual* (repeat). We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have audited the Department of Veterans Affairs (DVA) for the period beginning May 21, 2007 and ending January 4, 2010. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DVA's financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included procurements and disbursements, cash receipts, property, and payroll. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observations of DVA's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include an evaluation of internal controls or an assessment of DVA's compliance with federal laws and regulations pertaining to federal financial assistance programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies.

DVA's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DVA's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to DVA that did not warrant inclusion in this report.

DVA's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DVA regarding the results of our review of its response.

APPENDIX



Maryland Department of Veterans Affairs

Office of the Secretary

MARTIN O'MALLEY
GOVERNOR

ANTHONY G. BROWN
LT. GOVERNOR

EDWARD CHOW, JR.
SECRETARY

August 13, 2010

Mr. Bruce A. Myers, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Myers:

Enclosed please find the Department of Veterans Affairs (DVA) response to the findings and recommendations contained in the legislative audit for the period beginning May 21, 2007 and ending January 4, 2010. Enclosed you will find the Department's response and plan of correction that addresses each audit recommendation. In summary, DVA concurs fully with the four Auditor's findings and has taken action based on the recommendations. Separately, an electronic version of our response was e-mailed to response@ola.state.md.us.

If you or your staff has any questions or need additional information, please contact me or Mr. John R. Kearns, Chief Financial Officer. Mr. Kearns can be reached at 410-230-4444 X 6460.

Sincerely,

A handwritten signature in black ink that reads "Edward Chow, Jr." The signature is written in a cursive style.

Edward Chow, Jr.
Secretary

**DEPARTMENT OF VETERANS AFFAIRS
RESPONSE TO OFFICE OF LEGISLATIVE AUDITS
AUDIT REPORT FOR THE PERIOD
May 21, 2007 – January 4, 2010**

Cash Receipts

Finding #1

Adequate internal controls had not been established over collections at two locations.

Recommendation 1

- a. We recommend that DVA ensure that an employee independent of the cash receipts function, using the initial record of receipt, verifies that collections are subsequently deposited, and that this process is documented;
- b. ensure that collections are recorded in the State's accounting records by an employee independent of the cash receipts function; and
- c. record the receipt date of the collections

We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Agency Response: Agency concurs. To ensure compliance the two locations, Veterans Home and agency's fiscal unit, instituted the above recommendations in their cash receipts internal control process. Additional personnel have been added to the internal control to ensure segregation of duties.

Purchases and Disbursements

Finding #2

Proper internal controls were not established over the processing of purchasing and disbursement transactions.

Recommendation 2

We recommend that DVA fully use the available FMIS security features by establishing independent online approval requirements to ensure that only authorized transactions were process (repeat).

Agency Response: The Agency fully recognizes the noted internal control faults. The faults are the result of inadequate staffing of the fiscal unit as there are only two employees providing fiscal support services. These same employees are multitasked with personnel, payroll, time keeping and large procurement for requisition orders in FMIS. Therefore; the Agency cannot make use of available FMIS security features. That said, previous audit finding of adequate verification of invoices were corrected - new procedures were incorporated into the fiscal business process.

In prior budget builds the Agency has addressed the fiscal staffing shortfall by requesting additional staffing to no avail. Given the continued emphasis for compliance with internal control policies and security procedures the Agency's 2012 budget build will once again attempt to alleviate this fault with a request for additional staffing.

Budget Closeout Transactions

Finding #3
Year-end expenditure entries were not supported.

Recommendation 3

We recommend that DVA comply with the aforementioned policy and record accrued expenditures only when adequately supported (repeat).

Agency Response: Agency agrees with the findings and related recommendation.

Property

Finding #4

Adequate accountability and control was not established over DVA's property.

Recommendation 4

We recommend that DVA take immediate action to comply with the aforementioned requirements of the DGS Inventory Control Manual (repeat). We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Agency Response: MDVA agrees with the overall recommendation to comply with Inventory Control Manual requirements and will strive for FY 2011 to complete and annual fixed assets inventory report. As a result of auditor's recommendation an additional employee from the Service program has been assigned collateral duty to assist in inventory control.

AUDIT TEAM

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