

Audit Report

Department of Veterans Affairs

November 2007



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

November 2, 2007

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Nathaniel J. McFadden, 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 March 11, 2004 and ending May 20, 2007.

Our audit disclosed that DVA recorded a liability for general fund expenditures totaling approximately \$1.8 million at June 30, 2006 that could not be substantiated. While a portion of these expenditures were subsequently incurred, an unliquidated balance of \$963,000 remained which should have been reverted to the General Fund. Additionally, certain collections were improperly recorded in the State's accounting records and should have been reverted to the General Fund. Finally, adequate controls were not established over cash receipts, purchases and disbursements, and property.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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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. The DVA also manages five veterans' cemeteries, maintains four veterans' war memorials, and operates and manages the Charlotte Hall Veterans Home (CHVH). CHVH provides care for military veterans residing in the State of Maryland who are unable to care for themselves because of disability or advancing age or have need of skilled nursing care in a comprehensive care setting. On November 11, 2004, spouses of veterans became eligible for admission to the CHVH. According to the State's records, the DVA's operating expenditures for fiscal year 2007 totaled approximately \$17.9 million.

Current Status of Findings From Preceding Audit Report

Our audit included a review to determine the current status of the two findings from our preceding audit report dated October 25, 2004. We determined that DVA had satisfactorily addressed the two findings.

Disallowed Costs

In our preceding audit report, we commented that DVA had not received federal reimbursement for certain funding requests totaling \$4 million. While the majority of these funds were subsequently collected, the federal government disallowed costs totaling approximately \$700,000. These disallowed costs pertain to per diem payments for veterans in the CHVH domiciliary facility. In this regard, a new wing was constructed at CHVH and the first veteran was admitted to the domiciliary facility on June 3, 2003. However, certain deficiencies were noted by the Federal Department of Veterans Affairs, and they did not recognize the new unit for the purposes of reimbursing per diem costs for domiciliary care veterans until August 18, 2004. This resulted in the disallowance of per diem payments requested for the period June 3, 2003 to August 18, 2004. DVA was provided the federal decision in a March 25, 2005 letter and was given an opportunity to file a formal appeal within 60 days. We were advised by CHVH management personnel that an appeal was not filed because they did not think they had a valid basis for the appeal.

Findings and Recommendations

Budget Closeout Transactions

Finding 1

Year-end expenditure entries totaling approximately \$1.8 million could not be substantiated, of which \$963,000 should have been reverted to the General Fund.

Analysis

The Department of Veterans Affairs (DVA) recorded general fund accrued expenditures totaling approximately \$1.8 million at June 30, 2006, for which adequate supporting documentation was not on file. While a portion of these accrued expenditures was subsequently incurred, as of May 31, 2007, an unliquidated balance totaling \$963,000 remained from the fiscal year 2006 accruals. Since the DVA could not substantiate that there were related fiscal year 2006 expenditures outstanding, these funds should have been reverted to the State's General Fund. Once we brought this situation to DVA's attention, this \$963,000 was reverted to the General Fund.

The *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. The *Policy* further states that agencies must maintain proper detail documentation to support the accrual. Any remaining funds at fiscal year-end should be reverted to the State's General Fund as required by the State Finance and Procurement Article of the Annotated Code of Maryland.

Recommendation 1

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

Cash Receipts

Finding 2

Cash receipts were not always deposited timely and, at one location, the deposit of receipts was not independently verified.

Analysis

The DVA did not always deposit cash receipts in a timely manner. For example, our test of 74 receipts totaling \$155,871 received at the Charlotte Hall Veterans Home (CHVH) disclosed that 37 receipts totaling \$63,705 were deposited from 4 to 47 business days after receipt. In addition, independent verifications were not performed to ensure that collections recorded on the prenumbered cash receipt forms at the CHVH were subsequently deposited. According to DVA's records, DVA's fiscal year 2007 cash receipts totaled \$2.7 million.

The Comptroller of the Treasury's *Accounting Procedures Manual* requires that receipts be deposited no later than the first business day after receipt. Untimely deposits increase the possibility of loss or misappropriation and result in a loss of investment income to the State.

Recommendation 2

We recommend that the DVA deposit all cash receipts in a timely manner as required by the *Accounting Procedures Manual*. We also recommend that an employee independent of the cash receipts function verify that all recorded collections were subsequently deposited, and that this verification be documented.

Finding 3

Certain receipts received by the CHVH were improperly recorded as special fund revenue.

Analysis

Our review disclosed that certain receipts received by the CHVH were improperly recorded as special fund revenue rather than general fund revenue or expenditure reductions as required by the Comptroller of the Treasury. In this regard, our test of 74 receipts totaling \$155,871 disclosed that 5 receipts totaling \$62,569 were improperly recorded as special fund revenue. These receipts represent payments received from the contractor operating the CHVH for reimbursement of expenses initially paid by CHVH, as required by the terms of the contract. During fiscal

year 2007, the contractor made payments to CHVH totaling \$123,107 (including the majority of the aforementioned \$62,569) which were improperly coded as special fund revenue.

The Comptroller of the Treasury's *Accounting Procedures Manual* requires that an expenditure reduction be recorded when the amount received represents the recovery or refund in whole or in part of an expenditure made in the current fiscal year. Refunds of prior year expenditures should be reported as general fund revenue.

Recommendation 3

We recommend that DVA ensure that all reimbursements of expenditures received from the contractor operating the CHVH are properly recorded as either general fund revenue or expenditure reductions based on whether the reimbursement related to a current or prior year expenditure. In addition, we recommend that DVA review all receipts received from the contractor and identify those receipts improperly recorded as special fund revenue and revert these funds to the State's General fund. The results of this review should be documented and retained.

Purchases and Disbursements

Finding 4

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. According to the State's records, during fiscal year 2006, DVA used FMIS to process disbursements totaling approximately \$10.5 million.

Specifically, two employees could both initiate and process certain purchasing or disbursement transactions that were not subject to independent approval, and one of these employees could also release disbursement transactions to the

Comptroller of the Treasury – General Accounting Division for payment. In addition, adequate verifications were not performed to ensure that goods and services were received. Specifically, our test of 13 payments made during fiscal years 2006 and 2007 totaling approximately \$241,000 disclosed that 6 payments totaling approximately \$104,000 lacked adequate documentation supporting that the related goods or services had been received.

Recommendation 4

We recommend that DVA establish adequate procedures to ensure that only authorized transactions were processed and that documentation supporting the receipt of goods and services is received prior to processing the related vendor invoices.

Property

Finding 5

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' *Inventory Control Manual*. According to DVA records, as of May 30, 2007, the book value of its property totaled approximately \$60.2 million (land, buildings and improvements - \$55.2 million; equipment - \$5 million). Our review disclosed the following conditions:

- There was an inadequate segregation of duties related to the headquarters equipment. Specifically, the employee who maintained the detail records also conducted the related physical inventory. Additionally, 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.
- Detail records were not always accurate. We identified 14 donated items, including computer equipment, received by CHVH that were not included in the detail equipment records. In addition, our test of 15 equipment purchases totaling \$39,040 disclosed that only 5 of these items with a total cost of \$18,116 were recorded in the detail records at a total cost of \$14,650.

- DVA deleted missing equipment totaling \$50,372 from its records without obtaining the required approval from DGS.
- During the audit period, the headquarters office replaced its existing detail records with a new asset management tracking system. A physical inventory was conducted to establish the new detail records. However, the results of the physical inventory were not compared to the existing detail records. Consequently, missing items had not been identified and investigated, and DGS approval had not been obtained to remove the assets not sighted during the physical inventory from the detail records.
- DVA did not submit an annual report of fixed assets to DGS as required for the periods ending June 30, 2006 and June 30, 2005.

The DGS *Inventory Control Manual* prescribes the procedures and recordkeeping requirements to be followed by State agencies.

Recommendation 5

We recommend that DVA comply with the requirements of the DGS *Inventory Control Manual*.

Audit Scope, Objectives, and Methodology

We have audited the Department of Veterans Affairs (DVA) for the period beginning March 11, 2004 and ending May 20, 2007. The audit was conducted in accordance with generally accepted government auditing standards.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DVA financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the current status of the findings contained 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. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the 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.

We did not audit DVA's federal financial assistance programs for compliance with federal laws and regulations because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies.

Our audit scope was limited with respect to the DVA's cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all of DVA's cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the banks' records.

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 conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the 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.

The 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

JAMES A. ADKINS
SECRETARY

October 30, 2007

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 March 11, 2004 and ending May 20, 2007. Enclosed you will find the Department's response and plan of correction that addresses each audit recommendation. In summary, DVA concurs fully with the five Auditor's findings and has taken action based on the recommendations. Separately, an electronic version of our response has been 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, appearing to read "James A. Adkins".

James A. Adkins
Secretary

**DEPARTMENT OF VETERANS AFFAIRS
RESPONSE TO OFFICE OF LEGISLATIVE AUDITS
AUDIT REPORT FOR THE PERIOD
March 11, 2004 – May 20, 2007**

Budget Closeout Transactions

Finding #1

Year-end expenditures entries totaling approximately \$1.8 million could not be substantiated of which \$963,000 should have been reverted to the general Fund.

Recommendation 1

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

Agency Response: The Department concurs with the audit recommendation and the previous practice that is not in compliance with proper accounting procedures has ceased and all future recordation of accrued expenditures will occur only when adequately supported. The findings stated that at June 30, 2006 Charlotte Hall Veterans Home year end expenditure entries totaled approximately \$1.8 million. The \$1.8 million reflected the combined close-out entries of fiscal years 2004, 2005, and 2006. These entries were marked for projects at the Charlotte Hall Veterans Home to repair and improve the physical plant. However, do to various reasons several projects were not initiated and the remaining balance of \$963,000 was reverted during FY 2007 Budget Close-Out.

The Charlotte Hall Veterans Home FY 2007 Close-Out did record accrued expenditures and encumbrances with supporting detail. Additionally, in compliance with the State policy an additional \$316,716 GF from the Service, Cemetery and Memorials programs were reverted as part of the FY 2007 Budget Close-Out.

Cash Receipts

Finding #2

Cash receipts received were not always deposited in a timely and, at one location; the deposit of receipts was not independently verified.

Recommendation 2

We recommend that the DVA deposit all cash receipts in a timely manner as required by the *Accounting Procedures Manual*. We also recommend that an employee independent of the cash receipts function verify that all recorded collections were subsequently deposited, and that this verification be documented.

Agency Response: The Department concurs with the auditors observations and strives to meet the requirement of depositing all cash receipts in a timely manner. Both the Baltimore fiscal unit and Charlotte Hall Veterans Home has reviewed its cash receipts policy and has strengthened areas of weakness. It should be noted that the Department's staffing authorization does not provide the resources to adequately resolve the internal controls issue of an employee independent of the cash receipts function review and verify all deposits to ensure all collections initially recorded on receipt forms are deposited.

There are difficulties that surround the timeliness issue when observing the procedures for collection and deposit of cash receipts. The Department's five veterans' cemeteries are located throughout the state and of austere administrative staffing. The cemetery superintendent receives the checks (cash receipts) and logs them as payment "dependent interments". On a weekly basis each cemetery forwards (mails) the package of checks to the Program Director located in Crownsville. Upon receipt, the Director logs the receipts and verifies each against dependent interment activity ensuring accountability. On a weekly basis, the Department's chief financial officer visits the Director's office and collects the package of cash receipts. The package is carried back to the fiscal unit in Baltimore where the fiscal unit enters the cash receipts into R*STARS. Thereafter a deposit slip is prepared and the deposits are made. There is an inherent delay in the deposits.

Cash Receipts continued

Finding #3

Certain receipts received by the CHVH were improperly coded as special funds revenue.

Recommendation 3

We recommend that DVA ensure that all reimbursements of expenditures received from the contractor operating the CHVH are properly recorded as either general fund revenue or expenditure reductions based on whether the reimbursement related to a current or prior year expenditure. In addition, we recommend that DVA review all receipts received from the contractors and identify those receipts improperly recorded as special fund revenue and revert these funds to the State general fund. The results of this should be documented and retained.

Agency Response:

We concur with the findings and Charlotte Hall Veterans Home has instituted the procedure to ensure proper recognition of revenue and expenditure reduction. A review was conducted of FY2007 special fund receipts and those items determined to be expenditure reductions were identified and subsequently reverted to the general fund. All supporting documentation will be retained for audit purposes.

Purchases and Disbursements

Finding #4

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

Recommendation 4

We recommend that DVA establish adequate procedures to ensure that only authorized transactions were processed and that documentation supporting the receipt of goods and services is received prior to processing the related invoices.

Agency Response

DVA readily recognizes the noted internal control faults. These faults mainly lay at the foot of inadequate staffing within the fiscal unit. There are only two employees providing fiscal services. The Department has initiated several attempts to acquire additional staffing to no avail. Staffing consisting of two personnel immediately falls apart due to multi tasking and leave. Therefore, the Department cannot make use of available FMIS security features due to insufficient authorized positions in the fiscal services unit. That said, the issue of adequate verification that came to light during the audit has been addressed and changes have been incorporated into procedures. For example; all invoices received from vendors that cannot be paired with a signed purchase order and or delivery receipt are forward to the respective operational unit for verification. To ensure a timely response and in compliance with Comptroller of the Treasury policy for timely payments the process is completed through faxes.

It should be noted that the fiscal unit is also serves as the personnel, payroll, time keeping, and large procurement unit for requisition and purchase orders in FMIS.

Property and Equipment

Finding #5

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

Recommendation 5

We recommend that DVA comply with the requirement of the DGS *Inventory Control Manual*.

Agency Response

We concur with the audit recommendations that the Department comply with the requirements of the DGS *Inventory Control Manual* and have addressed the conditions sited in the audit.

We do appreciate the helpful comments and observations of the two assigned auditors as this is an area that has severely lacked our attention. The Department is an austere staffed business operation with little latitude for collateral duties. This presents a problem when rules and regulations call for segregation of duties. During the past audit period one employee from the fiscal unit was assigned the collateral duty as inventory management for the entire department. It should be noted that the department fiscal unit consist of two personnel. The unit is responsible for the same duties as any other fiscal office plus time keeping, payroll, procurement, personnel and budgeting. The collateral duty was in conflict with primary timekeeping and fiscal duties. The Department did procure the bar code technology endorsed by the Department of General Services to assist in this pursuit in conducting physical inventory inspections at all facility locations on a time available basis. This individual left state government in 2005 creating a gap. In 2006 the Cemetery Program assistant director assumed the collateral duty as inventory control officer. He has recently completed the canvassing of the department's facilities and created for the first time since the Department's establishment a concise and detailed inventory.

The Veteran Home in the previous fiscal year has hired a new employee and given the designation of inventory control officer as one of her duties. The paring of both individuals provides the department with full coverage. It should be noted that the Department's austere staffing does not allow for a single designated position as the inventory officer. Separately from their activities an individual is designated as point of contact for property disposal. Also, the acquisition of the bar code technology has allowed for all inventoried items to have a barcode label placed on them when received. This information is then entered in to the database.

DVA did submit at the close of FY 2007 an annual report of fixed assets to DGS as required for the period ending June 30, 2007. Separately, a list is being prepared and will be submitted to the Department of General Services of items that could not be located so that these items can be dropped from the records.

AUDIT TEAM

Phyllis M. Clancy, CPA
Audit Manager

William R. Smith, CPA
Senior Auditor

Athenia M. Rock
Staff Auditor