Audit Report

Department of Veterans Affairs

December 2013

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

December 6, 2013

Karl S. Aro
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, 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 January 5, 2010 and ending December 7, 2012. DVA assists veterans and 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 several deficiencies in DVA's fiscal operations. Specifically, DVA had unresolved federal fund deficits in several programs totaling approximately $1.4 million at June 30, 2012. Additionally, DVA recorded unsupported year-end transactions totaling approximately $375,000 allowing it to retain appropriations at the end of fiscal years 2011 and 2012 that would have otherwise been reverted to the State's General Fund. DVA also did not have adequate documentation justifying sole source procurements to one contractor for information technology services, and supporting documentation was not obtained and reviewed for the related payments.

We also noted control and record keeping deficiencies over cash disbursement transactions, cash receipts, payroll, and equipment. For example, independent verifications were not performed to ensure that certain collections were subsequently deposited.

DVA's response to this audit 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,

Thomas J. Barnickel III, CPA
Legislative Auditor

301 West Preston Street · Room 1202 · Baltimore, Maryland 21201
410-946-5900/301-970-5900 · Fax 410-946-5999/301-970-5999
Toll Free in Maryland 877-486-9964 · Fraud Hotline 877-FRAUD-11

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

Executive Summary

Legislative Audit Report on the Department of Veterans Affairs (DVA)
December 2013

- **Federal fund revenue transactions totaling approximately $1.4 million were recorded in the State's Financial Management Information System at June 30, 2012 to offset deficit balances in several DVA federal programs. If federal funds are not available for these year-end revenue transactions, general fund appropriations or deficiency appropriations may be needed to eliminate these deficits. DVA also recorded unsupported year-end general fund expenditure transactions totaling approximately $375,000 at the end of fiscal years 2011 and 2012, allowing these funds to remain available for DVA's use in the subsequent fiscal years (Findings 1 and 2).**

  DVA should ensure all year-end revenue transactions are properly supported and continue to work with DBM to implement corrective action to resolve the deficit balances. Additionally, DVA should record year-end expenditure transactions only when adequately supported.

- **DVA did not have written documentation justifying sole source procurements for information technology services and did not submit the related contracts to the Board of Public Works (BPW) for approval. Supporting documentation was not obtained and reviewed for the related payments. The contractor was paid $799,200 during the period from July 2009 through May 2013 (Finding 3).**

  DVA should comply with State procurement regulations, including maintaining written justification for sole source procurements, and should seek retroactive approval of the contracts from BPW. DVA should also obtain and review supporting documentation to verify amounts billed.

- **Disbursements were paid using a method that allowed for the direct payment of invoices without electronically matching them to the purchase orders and receiving reports, as applicable, to ensure agreement (Finding 4).**

  As required by State policy and procedures, DVA should use the appropriate online method to process payment transactions.

- **Control and record keeping deficiencies were noted over cash receipts, payroll, and equipment (Findings 5-7).**

  DVA should take the recommended actions to improve controls and record keeping in these areas.

Background Information

Agency Responsibilities

The Department of Veterans Affairs (DVA) delivers services and administers programs to assist veterans and their families and survivors in obtaining federal, state, and local benefits provided by law in recognition of their service to the 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 take care of 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 2012 totaled approximately $23.8 million ($15.3 million in federal funds, $7.8 million in general funds, and $700,000 in special funds).

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the four findings contained in our preceding audit report dated August 17, 2010. We determined that DVA satisfactorily addressed two of the findings. The remaining two findings are repeated in this report.

Findings and Recommendations

Budget Closeout Transactions

Finding 1
Unsupported federal fund revenue transactions totaling approximately $1.4 million were recorded to offset deficit balances in several federal programs as of June 30, 2012.

Analysis
The Comptroller of Maryland – General Accounting Division (GAD) recorded federal fund revenue transactions totaling $1.4 million in the State's Financial Management Information System on behalf of the Department of Veterans Affairs (DVA) to offset deficit balances that existed in several of its federal programs as of June 30, 2012**.** Management personnel at DVA and GAD could not provide any documentation supporting that the recorded federal fund revenue would be received. According to GAD, these deficits resulted from federal fund expenditures incurred during prior years dating back to at least fiscal year 2007. If federal funds are not available for these revenue transactions, general fund appropriations (or deficiency appropriations) may ultimately be needed to eliminate these resulting deficits. GAD requires that detail documentation be maintained to support revenue transactions recorded as part of the year-end closing process.

This issue was commented upon in our special report entitled *Statewide Review of Budgetary Closeout Transactions for Fiscal Year 2012*, dated January 22, 2013. We were advised that DVA has been in discussions with the Department of Budget and Management (DBM) to determine the necessary corrective actions (such as, obtaining a deficiency appropriation).

Recommendation 1
We recommend that DVA

a. ensure that all year-end revenue transactions recorded in the State's Financial Management Information System are properly supported, and
b. continue working with DBM to implement corrective action to resolve the deficit balances.

Finding 2
Year-end expenditure transactions recorded in the State's Financial Management Information System for fiscal years 2011 and 2012 were not supported.

Analysis
DVA recorded general fund expenditure transactions in the State's Financial Management Information System totaling approximately $375,000 ($295,000 at June 30, 2011 and $80,000 at June 30, 2012) without support substantiating their validity. These accrued expenditure transactions allowed DVA to retain unused appropriations that otherwise would have been reverted to the State's General Fund, allowing these funds to be available for DVA's use in the subsequent years. We were advised by DVA personnel that the amounts recorded were estimates of expenditures incurred that had not been paid as of fiscal year-end; however, DVA could not provide documentation as to how the estimated amounts were determined.

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 the fiscal year end but not paid. The *Policy* also states that agencies must maintain proper detailed documentation to support the accruals. Similar conditions were commented upon in our two preceding audit reports.

Recommendation 2
We recommend that DVA comply with the aforementioned policy and record accrued expenditures only when adequately supported (repeat).

Purchases and Disbursements

Finding 3
DVA did not have written sole source justification documenting the use of a contractor for information technology services. Additionally, supporting documentation was not obtained and reviewed for the related payments.

Analysis
DVA did not have adequate documentation justifying sole source procurements for information technology services at Charlotte Hall Veterans Home (CHVH). Specifically, since July 2009 DVA has awarded annual contracts (which were

federally funded[1]) for the development of a computerized patient record system (CPRS) and related network services for CHVH, continuing a sole source relationship that began with the contractor in 2008.

DVA advised us that its initial sole source contract in 2008 was the result of an agreement between DVA and the U.S. Department of Veterans Affairs (USDVA) for these information technology services that were to be performed by a certified network designer approved by USDVA. However, DVA did not have proper written documentation of USDVA's approval of this contractor nor could it justify the sole source relationship with the contractor. Given the nature of the services and that certain services were subcontracted, it seems unlikely that these services could only be provided by this contractor. Furthermore, these time and materials contracts were not approved by the Board of Public Works (BPW) since DVA believed BPW approval was not necessary due to USDVA's involvement. In August 2012, DVA began to consider other possible contractors to perform these information technology services but continued to pay its current contractor during calendar year 2013 without an executed contract.

Our review of five payments totaling approximately $46,800 disclosed that DVA did not obtain documentation (such as time and payroll records) to substantiate the validity of the labor charges included on the billings, including subcontracted work totaling approximately $16,200. According to the State's records, during the period from July 2009 to May 2013, the contractor was paid approximately $799,200 of which $58,600 was paid during calendar year 2013 without an executed contract.

State procurement regulations generally require that competitive bids be obtained for all procurements over $5,000 and that the reasons for sole source procurements be documented in writing. The regulations also generally require that procurements of services in excess of $200,000 be approved by BPW.

Recommendation 3
We recommend that DVA

a. **seek retroactive approval from the BPW for these contracts;**
b. **comply with the aforementioned State procurement regulations and execute written contracts with contractors providing services; and**
c. **obtain and review supporting documentation to verify amounts billed, including the aforementioned payments to the contractor.**

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[1] DVA funded this project with discretionary federal funds remaining after paying the CHVH management contractor.

Finding 4
DVA had not established proper payment processing procedures.

Analysis
DVA had not established proper payment processing procedures. Specifically, during the audit period, DVA processed all disbursement transactions on the State's Financial Management Information System, using a payment method that allowed for the direct payment of invoices without preparing purchase orders and electronically matching the purchase orders and receiving reports, as applicable, to the invoices to ensure agreement. Consequently, available automated controls were not used to ensure invoices processed for payment agreed with and did not exceed the approved procurements. During fiscal year 2012, according to the State's records, DVA processed all of its disbursements, totaling approximately $15.9 million, using the aforementioned payment method.

The Department of Information Technology's *Internal Control and Security Policy and Procedures Manual* states that a match payment method should be used for the purchase of services and commodities.

Recommendation 4
We recommend that DVA use the appropriate online method to process payment transactions to ensure that purchase orders are prepared for all applicable expenditures and that the purchase orders are matched with the related invoices and receiving reports (when applicable) prior to payment.

Cash Receipts

Finding 5
DVA did not perform independent verifications to ensure certain collections were subsequently deposited.

Analysis
DVA did not verify that collections initially recorded as received at its Baltimore fiscal office were subsequently deposited. Such collections, which consist primarily of federal reimbursements received from the U.S. Department of Veterans Affairs for veteran burial expenses, totaled approximately $759,400 during fiscal year 2012. A similar condition was commented upon in our preceding audit report.

The Comptroller of Maryland's *Accounting Procedures Manual* requires recording of checks immediately upon receipt and that a reconciliation of the initial recordation of collections to the amount deposited be performed by an employee independent of the cash receipts function. According to State records, during fiscal year 2012, DVA's cash receipt deposits totaled approximately $1.6 million.

Recommendation 5
We recommend that DVA ensure that an employee independent of the cash receipts function performs a documented verification that collections are subsequently deposited (repeat). We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Payroll

Finding 6
System access controls in the State's personnel management system were circumvented, allowing one employee to both initiate and approve personnel transactions.

Analysis
Personnel transactions were both initiated and approved by the same employee. Although one employee was given system access to initiate transactions in the State's personnel management system (such as adding new employees, deleting terminated employees, and processing salary adjustments), and a second employee was given access to approve them, the employee responsible for approving the transactions also routinely initiated the transactions by using the user-id and password assigned to the other employee. Consequently, inappropriate personnel transactions could occur without detection.

According to State's records, during fiscal year 2012, DVA processed 36 personnel transactions and payroll expenditures totaled approximately $4.4 million relating to 76 authorized positions for regular employees.

Recommendation 6
We recommend that DVA ensure the responsibilities for initiating and approving personnel transactions are properly separated by prohibiting the sharing of user-ids and passwords to the State's personnel management system.

Equipment

Finding 7
An equipment control account was not maintained and certain items were not recorded in the detail records.

Analysis
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, 2012, the book value of its equipment totaled approximately $6.1 million. Our review disclosed the following conditions:

- An independent control account was not maintained for DVA equipment, as required. A control account helps to maintain accountability over equipment and to ensure that all transactions have been properly recorded.

- Equipment items purchased were not always recorded in DVA's equipment records. Our January 2013 test of ten sensitive equipment items (such as computer and medical equipment) purchased during fiscal years 2010 to 2012, totaling $64,636, disclosed that three of the items, totaling $14,168, had not been recorded in the detail records. We were advised by DVA management that two of these items were returned to the vendor; however DVA could not provide any support for this assertion.

The DGS *Inventory Control Manual* requires the maintenance of an independent control account for all categories of equipment to properly reflect all transactions and that the detail records be reconciled to the related control account balance periodically. In addition, the *Manual* requires the recordation of all capital equipment items in the detail records for identification and control purposes.

Recommendation 7
We recommend that DVA comply with the aforementioned requirements of the DGS *Inventory Control Manual*.

Audit Scope, Objectives, and Methodology

We have audited the Maryland Department of Veterans Affairs (DVA) for the period beginning January 5, 2010 and ending December 7, 2012. 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 the 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 our audit included procurements and disbursements, cash receipts, property, federal fund reimbursements, and payroll. Our audit procedures included inquiries of appropriate personnel, inspections 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 for federal financial assistance programs and an assessment of DVA's compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including DVA.

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 the 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 related to conditions that we consider to be a 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 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.

Maryland Department of Veterans Affairs

Office of the Secretary

MARTIN O'MALLEY
GOVERNOR

ANTHONY G. BROWN
LT. GOVERNOR

EDWARD CHOW, JR.
SECRETARY

December 5, 2013

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Barnickel,

Enclosed please find the Department of Veterans Affairs (DVA) response to the findings and recommendations contained in the legislative audit for the period beginning January 5, 2010 and ending December 7, 2012. Enclosed you will find the Department's response and plan of correction that addresses each audit recommendation. In summary, DVA concurs fully with the seven 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, please contact me or Mr. John Kearns, Chief Financial Officer. Mr. Kearns can be reached at 410-230-4444 ext. 6460.

Sincerely,

Edward Chow, Jr.

Edward Chow, Jr.

Department of Veterans Affairs (DVA) Response
to Legislative Audit Report Findings
December 2013

Budget Closeout Transactions

Finding 1
Unsupported federal fund revenue transactions totaling approximately $1.4 million were recorded to offset deficit balances in several federal programs as of June 30, 2012.

Recommendation 1
We recommend that DVA

a. ensure that all year-end revenue transactions recorded in the State's Financial Management Information System are properly supported, and

b. continue working with DBM to implement corrective action to resolve the deficit balances.

Agency Response: DVA concurs with recommendations.

a. At closeout the DVA Fiscal Unit will properly recognize revenue and expenses to be accrued or deferred and will ensure that all year-end revenue transactions are properly recorded in the State's Financial Management Information System.

   In addition, DVA is establishing a procedure for review and sign off by senior management for all closing schedules and supporting documents.

b. The majority of these deficits relate to federal grants from the 1990s with final expenditures in 2005 and 2007, prior to the current administration. Due to changes in administration and personnel, the closeout bookkeeping on these accounting entries was not completed as it should have been.

   DVA is working with the DBM to resolve these long-standing unsubstantiated accrued revenues. DVA has requested deficiency appropriations for the FY2015 fiscal year. DVA understands that deficiency appropriations are not always approved. While the deficiency appropriation is the only way to correct this accounting issue, DVA will continue to request the deficiency appropriation until it is approved.

Finding 2
Year-end expenditure transactions recorded in the State's Financial Management Information System for fiscal years 2011 and 2012 were not supported.

Recommendation 2
We recommend that DVA comply with the aforementioned policy and record accrued expenditures only when adequately supported (repeat).

Agency Response: DVA concurs with recommendations.

DVA is identifying the supporting documentation associated with these year-end transactions. For FY2011, $241,000 was spent for Charlotte Hall Veterans Home and the Service Program, and $54,000 was reverted to the General Fund. For FY2012, $10,000 was spent for the Service Program and the Executive Program; $60,000 was reverted to the General Fund, and $10,000 is still accrued.

DVA has discussed closeout issues with the State Comptroller's General Accounting Division (GAD) and will conform to State Policy on Accounts Payable, Accrued Expenditures and Encumbrances. Future closeout procedures will properly reflect revenue representation in the period earned and match expenses to the revenue earned; and accrued expenditures will only be recorded when adequate supporting documentation exists. In addition, DVA is establishing a procedure for review and sign off by senior management for all closing schedules and supporting documents.

Purchases and Disbursements

Finding 3
DVA did not have written sole source justification documenting the use of a contractor for information technology services. Additionally, supporting documentation was not obtained and reviewed for the related payments.

Recommendation 3
We recommend that DVA

a. **seek retroactive approval from the BPW for these contracts;**
b. **comply with the aforementioned State procurement regulations and execute written contracts with contractors providing services; and**
c. **obtain and review supporting documentation to verify amounts billed, including the aforementioned payments to the contractor.**

Agency Response: DVA concurs with recommendations.

a. Charlotte Hall Veterans Home was selected by the U.S. Department of Veterans Affairs to be the pilot site for the installation of a new U.S. VA Computerized Medical Records System, a U.S. VA proprietary system. The U.S. VA required DVA use the vendor approved by their Department. Since this was a federally funded, federal program with a federally selected vendor, DVA was not aware that state procurement guidelines applied.

   DVA is working with DoIT Procurement to seek retro-active approval for these IT services from the Board of Public Works.

b. The CFO of DVA has been trained on the proper procurement procedures and, going forward DVA will comply with State of Maryland procurement laws.

   DVA has obtained supporting documentation to verify billing amounts, including the payments made to the US VA IT vendor. DVA is in the process of reviewing the supporting documentation and verifying billings. This review will be completed by January 31, 2014.

c. Processes are now in place at CHVH to include vendor documentation with all invoices (to include timesheets and material lists) before payments will be approved for processing.

Finding 4
DVA had not established proper payment processing procedures.

Recommendation 4
We recommend that DVA use the appropriate online method to process payment transactions to ensure that purchase orders are prepared for all applicable expenditures and that the purchase orders are matched with the related invoices and receiving reports (when applicable) prior to payment.

Agency Response: DVA concurs with recommendations.

The CFO of DVA has been trained on the proper procedures and, going forward the recommendation to establish a match payment method for the purchase of services and commodities will be incorporated into purchases and disbursements using available FMIS security features.

Specifically:
(1) The Fiscal Unit will enter purchase orders into FMIS prior to purchases.
(2) As invoices are received, the Fiscal Unit will match vendor invoices with copies of the corresponding receiving report.
(3) Vendor invoices will be entered into FMIS and FMIS vouchers will be generated when vendor invoices are electronically matched (in a two-way match) with the corresponding purchase order.

Cash Receipts

Finding 5
DVA did not perform independent verifications to ensure certain collections were subsequently deposited.

Recommendation 5
We recommend that DVA ensure that an employee independent of the cash receipts function performs a documented verification that collections are subsequently deposited (repeat). We advised DVA on accomplishing the necessary separation of duties using existing personnel.

Agency Response: DVA concurs with recommendations.

This finding was for an accounting process issue that DVA resolved during the audit.

By December 2012 DVA had instituted changes to the cash receipts internal controls as noted by auditors. DVA implemented a process so that immediately upon receipt, copies of checks are date-stamped and deposits are independently verified and documented.

As a part of that, DVA now has a cash receipts log which includes space for dates of verification and the initials of the required independent deposit verifier, an employee who is outside of the cash receipts process and without any cash receipts duties.

All funds received *did* properly benefit the cemetery program; moneys were spent on items such as grave liners, upkeep of the cemeteries, etc. DVA has verified that the $759,400 was spent on veteran's burials and cemetery upkeep in accordance with U.S. VA requirements and guidelines, after review there is no evidence of criminal conduct and no suggestion of fraud.

Payroll

Finding 6
System access controls in the State's personnel management system were circumvented, allowing one employee to both initiate and approve personnel transactions.

Recommendation 6
We recommend that DVA ensure the responsibilities for initiating and approving personnel transactions are properly separated by prohibiting the sharing of user-ids and passwords to the State's personnel management system.

Agency Response: DVA concurs with recommendations.

The Secretary issued a directive on June 21, 2013 to all Program Directors emphasizing that passwords are not to be shared and all personnel are required to follow proper electronic security procedures in creating and protecting passwords. Responsibilities for initiating and approving personnel transactions are now properly separated.

The personnel system (MS310) initiator's password has been changed and is no longer shared with the personnel officer. The DVA Fiscal Unit now follows proper IT security procedures for entering personnel information into the MS310 system; initiator will create and forward to the personnel officer for review and authorize and then forward to DBM for approval.

DVA CFO has verified that all 36 personnel transactions were correct.

Equipment

Finding 7
An equipment control account was not maintained and certain items were not recorded in the detail records.

Recommendation 7
We recommend that DVA comply with the aforementioned requirements of the DGS Inventory Control Manual.

Agency Response: DVA concurs with recommendations.

In FY12 the Agency completed the inventory of fixed assets and the sensitive inventory. As of FY13, DVA now has one consolidated inventory database that includes all DVA divisions and operations.

Accountable Officers have been appointed for Service, Cemetery and Veterans Home Programs and they will abide by the duties as outlined in Section III, .01 B (Duties of Accountable Officers) of the DGS Inventory Control Manual. Accountable Officers will use the DGS inventory templates (Fixed Asset Inventory Record (FAIR), Excess Property Declaration, and Report of Missing or Stolen Personnel State Property) as property additions and deletions occur; this process to be implemented no later than January 31, 2014.

DVA is in the process of implementing an inventory control account. On a quarterly basis the DVA CFO will reconcile Inventory Control Account with the consolidated inventory database maintained by the Property Officer. The inventory control account will be in place by January 31, 2014 and the quarterly reconciliations will be implemented by March 31, 2014.

AUDIT TEAM

Matthew L. Streett, CPA, CFE
Audit Manager

Erin D. Erdley, CPA
Senior Auditor

Jason M. Goldstein
Staff Auditor