

Department of Veterans Affairs

May 2005

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

May 26, 2005

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and
The Honorable John A. Keys, Commissioner
Department of Veterans Affairs
215 Eighth Avenue North
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Veterans Affairs for the period July 1, 2001, through January 31, 2005.

The review of internal control and compliance with laws and regulations resulted in a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

A handwritten signature in black ink that reads "John G. Morgan".

John G. Morgan
Comptroller of the Treasury

JGM/mb
05/047



STATE OF TENNESSEE
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February 8, 2005

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Veterans Affairs for the period July 1, 2001, through January 31, 2005.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the department's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Veterans Affairs is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit finding, and we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

We have reported other less significant matters involving the department's internal control and/or instances of noncompliance to the Department of Veterans Affairs' management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/mb

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Veterans Affairs
May 2005

AUDIT SCOPE

We have audited the Department of Veterans Affairs for the period July 1, 2001, through January 31, 2005. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of revenue, expenditures, equipment, payment card transactions, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

AUDIT FINDING

The Department Did Not Follow Certain Payment Card Policies and Procedures

The Tennessee Department of Veterans Affairs did not always follow the policies and procedures set forth in the *State of Tennessee Payment Card Cardholder Manual*. Returned payment cards were not canceled and destroyed, certain cardholders and approvers did not attend mandatory training classes or sign the cardholder agreement, cardholders split invoices, and approvers did not always approve the transaction logs.

Financial and Compliance Audit Department of Veterans Affairs

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Financial and Compliance Audit Department of Veterans Affairs

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Veterans Affairs. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission statement of the Department of Veterans Affairs is “to serve Tennessee’s Veterans and their families with dignity and compassion; to be the Veterans’ advocate by ensuring they receive quality care, support, entitlements, and the recognition earned in service to our Nation; and to enhance our citizens’ awareness of the sacrifices that Veterans have made for us.” In order to fulfill this mission, the department is organized into Field Services, Claims Services, State Veterans’ Cemeteries, and Administrative Services.

The Division of Field Services has the responsibility for referring veterans, their dependents, and their survivors to the services available to them.

The Division of Claim Services assists veterans, dependents, and veterans’ survivors in obtaining benefits and services to which they may be entitled under the laws administered by the United States Department of Veterans Affairs and other federal, state, and/or local governmental agencies.

The Field Services and Claims Services divisions have a network of 11 field offices and 95 county offices which collect and disseminate information to veterans, their dependents, and veterans’ survivors regarding earned federal and state entitlements and assistance.

The Division of State Veterans’ Cemeteries operates cemeteries in Knoxville, Nashville, and Memphis. The cemeteries serve as the final resting place for those who have faithfully

served in the Armed Forces of the United States, their dependents, and eligible members of the Tennessee National Guard.

The Division of Administrative Services is responsible for providing technical and administrative support to all areas of the department. The division responds to all requests from members of the General Assembly, the Office of the Governor, and veterans' service organizations.

During the period audited, the department also housed the Office of Homeland Security. The Office of Homeland Security is the office of state government having primary responsibility and authority for directing homeland security activities, including but not limited to planning, coordination, and implementation of all homeland security prevention, protection, and response operations. The Office of Homeland Security was moved from the Department of Veterans Affairs to the Governor's Office effective July 1, 2003.

An organization chart of the Department of Veterans Affairs is on the following page.

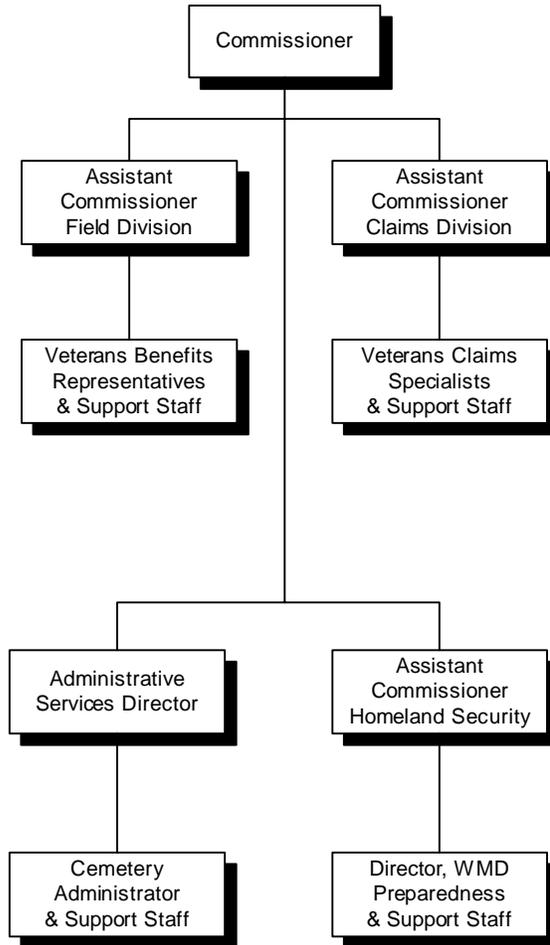
AUDIT SCOPE

We have audited the Department of Veterans Affairs for the period July 1, 2001, through January 31, 2005. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of revenue, expenditures, equipment, payment card transactions, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Veterans Affairs filed its report with the Department of Audit on May 16, 2002. A follow-up of the prior audit finding was conducted as part of the current audit. The current audit disclosed that the department has corrected the previous audit finding concerning policies and procedures over equipment.

Department of Veterans Affairs Organization Chart



OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUE

Our objectives in reviewing revenue controls and procedures at the Department of Veterans Affairs were to determine whether

- revenue transactions were accurate and valid,
- cash collected during the audit period was deposited timely and accounted for in the appropriate fiscal year,
- physical controls over cash were adequate, and
- records were reconciled with Department of Finance and Administration reports.

We interviewed key department personnel to gain an understanding of procedures and controls for collecting cash and reconciling reports. We tested a nonstatistical sample of revenue transactions for the period July 1, 2001, to November 30, 2004, to determine whether the receipts were supported and recorded timely. In addition, we observed monthly reconciliations to Department of Finance and Administration reports.

Based on the testwork performed, we determined that revenue transactions were accurate and valid. Receipts were recorded and deposited timely, and physical controls were adequate. In addition, we determined that records were regularly reconciled.

EXPENDITURES

Our objectives in reviewing expenditure controls and procedures at the Department of Veterans Affairs were to determine whether

- expenditures were for goods or services authorized and received and were recorded as the correct object code and amount,
- homeland security expenditures were for goods or services authorized and received,
- payments were made in a timely manner,
- payments for travel were in accordance with Comprehensive Travel Regulations, and
- auditee records were reconciled with Department of Finance and Administration reports.

We interviewed key department personnel to gain an understanding of procedures and controls over expenditures. We tested a nonstatistical sample of expenditures and an additional sample of Department of Veterans Affairs' homeland security expenses for the period July 1, 2001, through November 30, 2004, for approvals and evidence of receipt. We tested the expenditures for accurate recording, timely payment, and compliance with Comprehensive Travel Regulations. In addition, we observed reconciliations to Department of Finance and Administration reports.

As a result of our testwork, we determined that expenditures were recorded correctly and were for goods authorized and received. We determined that payments were made timely and were in compliance with Comprehensive Travel Regulations. We also determined that reconciliations were being performed.

EQUIPMENT

Our objectives in reviewing equipment controls and procedures at the Department of Veterans Affairs were to determine whether

- the information on the property listing was accurate, and
- property and equipment were adequately safeguarded.

We interviewed key department personnel to gain an understanding of procedures and controls for safeguarding and accounting for equipment. We tested a nonstatistical sample of equipment items as of December 1, 2004, to determine if the items agreed by description, tag number, and location with the equipment listing. Based on testwork performed, we determined that property and equipment were adequately safeguarded and the information on the property listing was accurate.

PAYMENT CARD TRANSACTIONS

Our objectives in reviewing payment card transactions were to determine whether

- procurement cards were being utilized appropriately for authorized goods and services,
- the department was adhering to the control policies related to procurement cards,
- procurement cards were being used with authorized vendors,
- invoices were not split with procurement card transactions,
- procurement card users were staying within the set maximums, and
- terminated cardholder privileges were promptly revoked.

We interviewed key department personnel to gain an understanding of procedures and controls over payment card expenditures. We performed analytical procedures on the population of transactions for the period October 21, 2003, through September 16, 2004, to look for unauthorized vendors, split invoices, and spending over the set maximums. We also tested a nonstatistical sample of the payment card transactions to look specifically for those types of problems and to determine if the goods and services were authorized and whether control procedures were in place.

As a result of our testwork, we determined that payment card transactions were being utilized appropriately for authorized goods and services, procurement cards were being used with authorized vendors, and procurement card users were staying within set maximums. We also determined that the agency was not adhering to the control policies related to procurement cards, certain invoices were split with payment card transactions, and terminated cardholder privileges were not promptly revoked. See the following finding.

The department did not follow certain payment card policies and procedures

Finding

The Tennessee Department of Veterans Affairs did not always follow the policies and procedures set forth in the *State of Tennessee Payment Card Cardholder Manual*. Returned payment cards were not canceled and destroyed, certain cardholders and approvers did not attend mandatory training classes or sign the cardholder agreement, cardholders split invoices, and approvers did not always approve the transaction logs. The department also established a departmental payment card manual to supplement the state's requirements. However, the central office did not retain documentation that payment card transactions were submitted within five days after approval, as required by the supplemental manual.

During the audit period, there were nine payment cards returned to the agency coordinator for various reasons. The *State of Tennessee Payment Card Cardholder Manual* states that unused cards should be canceled and destroyed. Based on a review of payment cards that were returned, two of nine cards (22%) were not canceled until after the auditor informed the department of the oversight. Also, all nine returned cards (100%) were kept in the employees' files rather than being destroyed.

Not all payment card cardholders and approvers attended the cardholder training class, and not all payment card cardholders and approvers signed the "Cardholder [Approver] Agreement for State of Tennessee Payment Card Issued by U.S. Bank." The *State of Tennessee Payment Card Cardholder Manual* states that the cardholder and the designated approver/supervisor must agree to and sign the agreement and attend a cardholder training class prior to a cardholder receiving a state payment card. Based on the review of the cardholder files, 2 of 27 cardholders (7%) and one of 14 approvers (7%) did not receive training. Two additional cardholders (7%) and one additional approver (7%) did not sign the cardholder agreement.

A review of all payment card transactions revealed three instances in which the cardholder appeared to split invoices with one vendor to circumvent the \$400 single purchase limit. The instances involved sets of invoices on the same day to the same vendor that accumulated in amounts over \$400. The *State of Tennessee Payment Card Cardholder Manual* has controls established statewide for the payment card program. The highest dollar amount most cardholders can spend on a single purchase is \$400. Purchase amounts over \$400 should go through the regular procurement process. The manual states, “Purchases **shall not** be artificially divided so as to appear to be purchases under \$400. Such practice is referred to as a ‘split invoice’ and is specifically prohibited under TCA section 12-3-210.”

The department’s payment card approvers did not properly certify the transaction log. The *State of Tennessee Payment Card Cardholder Manual* requires a transaction log to be maintained for all state payment card purchases. The cardholder must certify each log sheet by signing and dating it. The log and receipts are then forwarded to the designated approver for review and approval. The approver will then certify the log and forward it to the payment card coordinator of the agency for payment approval. However, the approvers did not certify the transaction log for 3 of 25 payment card transactions reviewed (12%).

The Veterans Affairs payment card coordinator did not have documentation to verify that payment card reconciliations performed by the cardholders were submitted by the supervisors to the Department of Veterans Affairs’ central office in a timely manner for 13 of 25 payment card reconciliations reviewed (52%). The cardholder manual requires the approver to review, certify, and forward the logs in a timely manner in order to meet agency cycle deadlines. The departmental cardholder manual requires the submission of the documentation by the approvers to the central office to be not later than the fifth business day after approval. The date when the central office received the required documentation could not be verified because the date the central office received the documentation was not recorded.

Failure to follow the policies and procedures set forth in the *State of Tennessee Payment Card Cardholder Manual* increases the risk that payment cards will not be used properly and potentially exposes the department to fraudulent expenditures. Unused cards that have not been canceled and destroyed could be found and used for fraudulent purposes. Cardholders who are not trained or have not signed cardholder agreements are more likely to unknowingly misuse the cards. Signed agreements make disciplinary action and recoupment of funds that were used for improper purposes much easier for the state. When the logs are not approved by the supervisors, improper transactions could occur and go undetected.

Recommendation

The Commissioner should ensure that payment cards are canceled and destroyed when no longer in use. The Department of Veterans Affairs payment card coordinator should ensure that the policies and procedures set forth in the *State of Tennessee Payment Card Cardholder Manual* and the *Veterans Affairs Payment Card Cardholder Manual* are followed and that disciplinary action is taken when split invoices are detected. Split invoices represent a knowing

circumvention of rules which reflects on the department's overall control environment, and such abuses should not be tolerated. All payment card cardholders and approvers should attend the required training classes, and the payment card coordinator should require documentation of their attendance prior to issuance of the card. Supervisors should be trained to look for abuses, such as splitting invoices, and should take action when split invoices are detected. Payment card transactions should be processed timely but should not be approved for payment without the supervisors' authorization on the transaction logs.

Management's Comment

We concur. Corrective measures have been taken to strengthen and ensure all policies and procedures as set forth in the Payment Card Cardholder Manual are being followed. All payment cards returned have been disposed of in accordance with the Payment Card Cardholder Manual. All authorized employees have been trained and the designated approver/supervisor agreements have been signed after training and prior to issuance of payment card. Purchase procedures and daily limits have been reaffirmed with all card holders. Transaction log and receipts are maintained and forwarded to payment card coordinator. Measures have been taken to ensure payment cards are used properly and not expose the department to fraudulent expenditures.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the Department of Veterans Affairs' responsibility letters due June 30 of 2004, 2003, and 2002 and the December 31, 2003, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;
- documentation to support the Department of Veterans Affairs' evaluation of its internal accounting and administrative control was properly maintained; and
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*.

We interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the Department of

Veterans Affairs' procedures. We also reviewed the June 30, 2004; June 30, 2003; and June 30, 2002, responsibility letters and the December 31, 2003, internal accounting and administrative control report to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration.

We determined that the Financial Integrity Act responsibility letters were submitted on time. However, a weakness was noted for the late submission of the internal accounting and control report. We also determined that the support for the internal accounting and administrative control report was properly maintained, and procedures used were in compliance with *Tennessee Code Annotated*.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of Veterans Affairs filed its compliance reports and implementation plans on June 17, 2004; June 27, 2003; and June 25, 2002.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

ALLOTMENT CODE

The Department of Veterans Affairs' allotment code is 323.00.