

AUDIT REPORT

Department of Veterans Affairs

March 2009



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Teresa L. Kennedy, CPA
Audit Manager

Sonja Yarbrough, CFE
In-Charge Auditor

Herb Kraycirik, CPA
Jennifer Sidney
Staff Auditors

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-1402
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at
www.comptroller1.state.tn.us/RA_SA/.

For more information about the Comptroller of the Treasury, please visit our website at
www.tn.gov/comptroller/.



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-1402
PHONE (615) 401-7897
FAX (615) 532-2765

March 25, 2009

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 Rosa L. Parks Avenue
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Veterans Affairs for the period February 1, 2005, through February 29, 2008.

We conducted our audit 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. 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 management 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 instances of noncompliance to the Department of Veterans Affairs' management in a separate letter.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA
Director

AAH/cj
08/059

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Veterans Affairs
March 2009

AUDIT SCOPE

We have audited the Department of Veterans Affairs for the period February 1, 2005, through February 29, 2008. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of revenue, expenditures, payment card transactions, and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDING

The Department Has Continued Not to Follow the State's Payment Card Policies and Procedures and Has Not Instituted Proper Controls Over the Use of Payment Cards to Mitigate the Risk of Error or Fraud*

Deficiencies included

- payment card cardholders not attending required training;
- absence of State Payment Card New Account Application & Maintenance Forms;
- wasteful spending for overpriced cleaning supplies;
- purchases of items that are prohibited by payment card policies from being purchased with a payment card such as
 - items available from statewide contracts,
 - computer peripherals,
 - maintenance of leased equipment, and
 - rental purchases;
- credit card statements not signed and dated; and
- late submission of required reports to the Department of Finance and Administration.

* This finding is repeated from the prior audit.

Financial and Compliance Audit Department of Veterans Affairs

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Post-Audit Authority	1
Background	1
AUDIT SCOPE	2
PRIOR AUDIT FINDING	2
Repeated Audit Finding	2
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS	4
Revenue	4
Expenditures	4
Payment Card Transactions	5
Finding - The department has continued not to follow the state's payment card policies and procedures and has not instituted proper controls over the use of payment cards to mitigate the risk of error or fraud	7
Financial Integrity Act	14
OBSERVATIONS AND COMMENTS	15
Management's Responsibility for Risk Assessment	15
Fraud Considerations	15
Title VI of the Civil Rights Act of 1964	16
APPENDIX	17
Allotment Code	17

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, entitlement, 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 Claims 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 12 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.

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 February 1, 2005, through February 29, 2008. Our audit scope included a review of internal control and compliance with laws and regulations, in the areas of revenue, expenditures, payment card transactions, and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

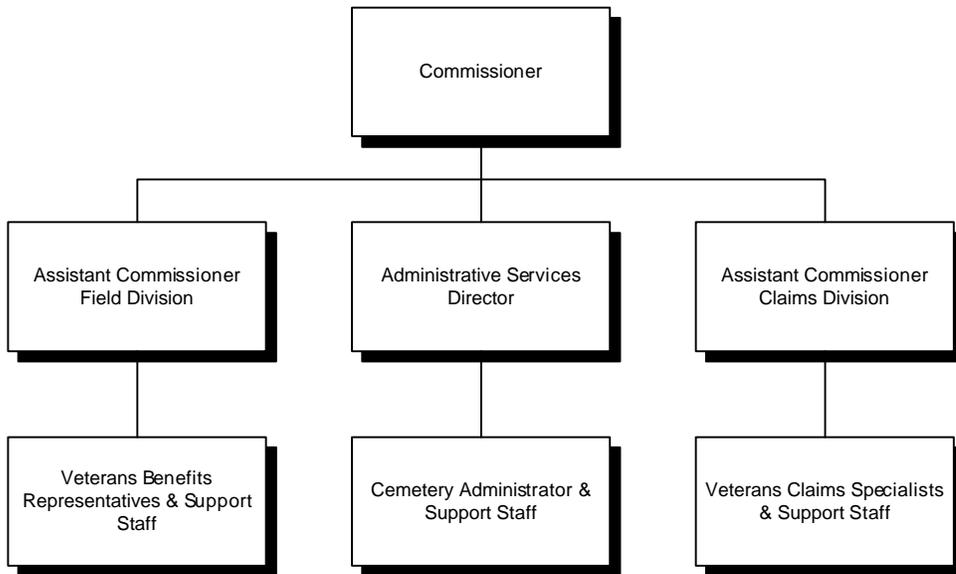
PRIOR AUDIT FINDING

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 January 24, 2008. A follow-up of the prior audit finding was conducted as part of the current audit.

REPEATED AUDIT FINDING

The prior audit report contained a finding concerning the department not following certain payment card policies and procedures. This finding has not been resolved and is repeated in the applicable section of this report.

Department of Veterans Affairs Organization Chart



OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUE

The primary objectives of our review of revenue were to determine whether

- revenue transactions were adequately supported, deposited intact, and coded and recorded properly and
- records were reconciled with the Department of Finance and Administration's reports.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over revenue. We tested a nonstatistical sample of revenue transactions for the period February 1, 2005, to November 30, 2007, to determine whether they were adequately supported, deposited intact, and coded and recorded properly. In addition, we examined monthly reconciliations to the Department of Finance and Administration's reports for the same time period.

As a result of our testwork, we determined that

- revenue transactions were adequately supported, deposited intact, and coded and recorded properly and
- records were reconciled with the Department of Finance and Administration's reports.

EXPENDITURES

The primary objectives of our review of expenditures were to determine whether

- recorded expenditures were adequately supported and properly approved;
- expenditure documents were canceled to preclude duplicate payments;
- payments were made in a timely manner; and
- payments for travel were in accordance with the Comprehensive Travel Regulations.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over expenditures. We tested a nonstatistical sample of expenditure transactions for the period February 1, 2005, to November 30, 2007, to determine whether the expenditures were adequately supported and properly approved; documents were canceled to preclude duplicate payment; and payments were made in a timely manner. We tested a nonstatistical sample of travel claims for the period February 1,

2005, through November 30, 2007, to determine if payments for travel were in accordance with the Comprehensive Travel Regulations.

As a result of our testwork, we determined that

- expenditures were adequately supported and properly approved;
- documents were canceled to preclude duplicate payments, with one minor exception;
- payments were made in a timely manner; and
- payments for travel were in accordance with the Comprehensive Travel Regulations, with minor exceptions.

PAYMENT CARD TRANSACTIONS

The primary objectives of our review of payment card transactions were to determine whether

- payment card users were eligible and properly approved, and required documentation was on file;
- payment card transactions and transaction logs were adequately supported, approved, reconciled to the monthly credit card statement, and in compliance with the *State of Tennessee State Payment Card Cardholder/Approver Manual*;
- payment card purchases complied with the Department of General Services' purchasing policies and procedures;
- terminated employees' payment card access was revoked timely, and remnants of terminated employees' payment cards were retained;
- only active employees used payment cards;
- payment card transactions were made from authorized vendors, invoices were not split, and users stayed within limits; and
- E-way purchases were proper.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over payment cards and E-way purchases. We reviewed a listing of payment card cardholders as of January 2008 to determine whether payment card users were eligible and properly approved, and required documentation was on file. We tested the payment card transaction logs for the cycles ending February 15, 2007, through January 15, 2008, and a nonstatistical sample of payment card transactions made from February 21, 2005, through October 15, 2007, to determine whether payment card purchases were adequately supported, approved, reconciled to the monthly credit card statement, and in compliance with the *State of Tennessee State Payment Card Cardholder/Approver*

Manual. We also tested the aforementioned sample to determine if payment card purchases complied with Department of General Services' purchasing policies and procedures.

We compared the listings of terminated employees with the listing of active payment card cardholders to determine whether terminated employees' payment cards were revoked in a timely manner, and we ensured remnants of terminated employees' payment cards were retained. We also compared the listing of active payment card cardholders to the listing of suspended employees to determine whether suspended employees used their payment card during the time of their suspension.

We performed analytical procedures on the population of payment card transactions for the period February 21, 2005, through October 15, 2007, to look for unauthorized vendors, split invoices, and spending over the set maximums. We tested a nonstatistical sample of E-way transactions for the period May 31, 2006, through November 30, 2007, to determine whether E-way purchases were proper.

As a result of our testwork, we determined that

- payment card users were eligible and properly approved, with a minor exception, but required documentation was not on file (see the finding below);
- payment card transactions and transaction logs were not adequately supported, approved, reconciled to the monthly credit card statement, and in compliance with the *State of Tennessee State Payment Card Cardholder/Approver Manual* (see the finding below);
- payment card purchases were not in compliance with the Department of General Services' purchasing policies and procedures (see the finding below);
- terminated employees' payment card access was revoked timely, with minor exceptions, and remnants of terminated employees' payment cards were retained;
- only active employees used payment cards;
- payment card transactions were made from authorized vendors, invoices were not split, and users stayed within limits; and
- E-way purchases were proper, with a minor exception noted.

The department has continued not to follow the state's payment card policies and procedures and has not instituted proper controls over the use of payment cards to mitigate the risk of error or fraud

Finding

As stated in the prior audit report, the Department of Veterans Affairs has not followed policies pertaining to payment cards. That finding mentioned improper handling of returned payment cards, the lack of required training for some cardholders, splitting of invoices, unapproved transaction logs, and the lack of documentation of dates necessary to determine the timeliness of submission of reports required by the Department of Finance and Administration (F&A). Management concurred with the prior finding and stated:

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 coordinator. Measures have been taken to ensure payment cards are used properly and not expose the department to fraudulent expenditures.

The department corrected the improper handling of returned payment cards, the splitting of invoices by cardholders, and the lack of documentation of dates necessary to determine the timeliness of submission of reports required by F&A. The department also identified the risk of improper use of payment cards and the controls used to mitigate the risk in its risk assessment. However, the problems noted on this audit and the failure to monitor the controls used to mitigate the risk of fraud make it clear that the measures the department has taken have fallen short of expectations.

The Department of Veterans Affairs has not kept the required documentation on file for its payment card cardholders, has violated state payment card policies, and has not been submitting the required documentation to F&A on time.

The state instituted the payment card program in order to reduce the amount of time and expense needed to process small dollar purchases. The program also improves vendor relations because normally a vendor will receive payment within 48 to 72 hours after the date of sale. However, in order for the program to work effectively, management needs to properly train and supervise the cardholders.

The state payment card manual requires each cardholder and approver to complete a training program about the payment card program. The state's payment card manual includes

two forms that each cardholder is expected to sign and have on file: a “State Payment Card New Account Application & Maintenance Form” and a “State Payment Card Cardholder Agreement.”

At January 31, 2008, there were 22 employees to whom the department had issued payment cards. Four of the 22 employees (18%) did not have documentation to show that they had completed the required training. Sign-in sheets for training were available for the other employees but not for these four. Management stated that it relied on a statement in the cardholder agreement which reads, “I also acknowledge that I have attended a Cardholder/Approver training class. . . .” In addition, 21 of the 22 employees (95%) did not have a “State Payment Card New Account Application & Maintenance Form” on file. The Payment Card Coordinator and Administrative Services Director stated that they could not locate the forms.

We selected for testing a sample of 26 payment card transactions from all 1,244 payment cards transactions (totaling \$228,978) made between February 21, 2005, and October 15, 2007. We also tested all 182 transaction logs and log documentation covering the cycles ending February 15, 2007, through January 15, 2008. We found the following violations of state payment card policies:

- the Cemetery Administrator abused his payment card privileges and made wasteful purchases of cleaning supplies;
- items were purchased that should have been purchased from a statewide contract;
- computer peripherals (i.e., modems, flash drives, etc.) were purchased with payment cards;
- items were purchased for maintenance of equipment being leased from the Division of Motor Vehicle Management of the Department of General Services;
- rental purchases were made with payment cards; and
- the monthly credit card statements were not always signed and dated by the cardholder.

We also found that transaction logs and the related documentation were not submitted timely to F&A.

Cleaning Supplies Purchases

When performing our testwork, we found numerous transactions with Florida-based companies for cleaning supplies. As a result, we expanded our testwork and found that between January 4, 2005, and August 7, 2007, the Cemetery Administrator purchased a total of \$13,114 of various types of cleaning supplies from these companies. There were a total of 36 transactions that ranged in price from \$281 to \$484. All of these items were available on statewide contract, available from the Department of General Services’ Central Stores, or available at local retailers. Some of these purchases were ten times more than what would have been paid if purchasing these items through the above means. For example, an invoice dated February 17, 2005, was

\$392 for five gallons of all-purpose cleaner—a cost of \$78 per gallon. All-purpose cleaner was available on statewide contract for \$8 a gallon.

In addition, when reviewing the invoices for these 36 transactions, we found that the vendors did not charge a shipping fee when the total dollar of items purchased was close to \$400, but did charge a shipping fee when there was a larger gap between the total dollar of items purchased and \$400. Up until July 1, 2006, \$400 was the standard maximum single dollar purchase limit. We asked the Cemetery Administrator if he had told the vendors of the \$400 threshold, and he said he did. He said he did not notice that the companies sometimes charged for shipping and sometimes did not.

We further noted that about half of the invoices had inconsistencies in the “ship to” address; Knoxville cemetery’s street address was listed while Nashville was listed as the city, and some had Nashville’s zip code while others had Knoxville’s zip code. When discussing this with the Cemetery Administrator, he stated that all invoices were sent to him, and all cleaning supplies were shipped directly to the three veterans’ cemeteries in Memphis, Nashville, and Knoxville. He also stated that he notified cemetery personnel when he placed an order and always called them when he received an invoice to ensure they received the order. He did not always verify that the cemeteries received the correct quantity of cleaning supplies.

When we asked the Cemetery Administrator why he had first ordered from these out-of-state companies, he stated that he had done so since the sellers contacted him soliciting business. He further stated that he was making purchases that would benefit the cemeteries and felt that these products would work better than those that could be purchased locally. He did not notice that these products were significantly more expensive. The Cemetery Administrator also stated that he was aware of the state’s procurement card rules and that there was adequate training on the restrictions placed on the use of such cards, but he did not check to see if the products were on statewide contract. He stated that he sometimes finds it difficult to determine if a product is on statewide contract but agreed that he should have checked further.

When we questioned the Cemetery Administrator further, he stated that he received multiple gift cards from these companies but destroyed them as he knew it was against state policy to accept them. We attempted to contact the companies, but we were never able to speak to a representative. The phone numbers had either been disconnected or there was a busy signal.

The last purchase from these out-of-state suppliers was made on August 7, 2007, before our audit commenced. We asked the Cemetery Administrator why he stopped purchasing cleaning supplies from the suppliers in Florida, but he stated that he does not remember.

It should also be noted that all of these purchases were required to be reviewed and approved per the state’s procurement card manual. Section 6.0 states, “Approvers are the first and most important line of review for State Payment Card purchases and monitoring Cardholder use.” The person responsible for the review and approval for these purchases was the department’s Fiscal Director, except in the interim period between fiscal directors during which the Commissioner performed this function. We believe these purchases should have been

questioned by them since they were out-of-state transactions; however, the Cemetery Administrator stated that no questions were ever raised about these purchases.

Items on Statewide Contract

Our transaction log and sample testwork also found that payment cards were used to pay for yard maintenance equipment, file folders, coveralls, copier paper, printer cartridges, and toner, which were available on statewide contract. Four of 26 payment card transactions tested (15%) contained items which should have been purchased from statewide contracts. The *State of Tennessee State Payment Card Cardholder/Approver Manual*, Section 4.1, Item 6, states that “Purchases of any supply, material, or equipment covered by a statewide or agency term contract **shall not** be made using the State Payment Card. . . .”

We further performed testwork on all transaction logs for the payment card cycles ending February 15, 2007, through January 15, 2008. During that period of time, cardholders spent the following amounts for items which were available on statewide contracts:

- \$3,598 for yard maintenance equipment;
- \$212 for file folders;
- \$1,056 for coveralls;
- \$215 for copier paper; and
- \$5,956 for printer cartridges and toner.

Computer Peripheral Purchases

We found that payment cards were used to purchase computer peripherals. The *State of Tennessee State Payment Card Cardholder/Approver Manual*, Section 4.1, Item 5, states, “Items that require commodity code approval **shall not** be paid for with the card (i.e., communications, printing, computer-related items).” During the payment card cycles ending February 15, 2007, through January 15, 2008, the department used the payment card to purchase \$1,953 of computer peripherals.

Charges Pertaining to Equipment Leased From Motor Vehicle Management

We found that payment cards were used to purchase maintenance items for equipment leased from Motor Vehicle Management. The *State of Tennessee State Payment Card Cardholder/Approver Manual*, Section 4.1, Item 9, states that “the card is **not** to be used for repairs, maintenance, supplies or any other type charge for any vehicle or equipment leased from the Department of General Services’ Division of Motor Vehicle Management.” During the payment card cycles ending February 15, 2007, through January 15, 2008, cardholders purchased \$3,559 of maintenance and supplies for leased equipment.

Unauthorized Rental Purchases

We found that payment cards were used to pay for rental of equipment. The *State of Tennessee State Payment Card Cardholder/Approver Manual*, Section 4.2, states that the payment card “**cannot** be used for payment of...Rental or lease of property. . . .” During the payment card cycles ending February 15, 2007, to January 15, 2008, cardholders paid \$712 for rental items, which included a satellite dish and the related annual service fee.

Credit Card Statements Not Signed and Dated

Section 5.4 of the *State of Tennessee State Payment Card Cardholder/Approver Manual* states, “. . . the Cardholder must sign and date the cycle statement.” One hundred fifty-three of the 182 cycle credit card statements attached to the transaction logs tested (84%) were either not dated (74 of the 153) or not signed and dated by the cardholder (79 of the 153).

Late Submission of Required Reports to F&A

F&A requires that each department submit its documentation of payment card transactions to F&A on a timely basis. A memorandum dated September 29, 2006, from the Chief of Accounts of F&A states, “Agencies have eight weeks after the cycle end date to submit that cycle’s required State Payment Card documentation to the Division of Accounts. . . .” Of the 12 cycles ending February 15, 2007, to January 15, 2008, we found that the required documentation for 6 (50%) was not submitted to the Division of Accounts within eight weeks after the cycle end date. The business days late ranged from 2 to 14. Of the 182 transaction logs that were completed during the aforementioned time period, 8 (4%) were not approved by the approver until the F&A submission deadline had passed. The department is in violation of F&A guidelines when it fails to submit payment card documentation on time.

Conclusion

When the department does not follow the state’s written payment card policies, the likelihood of error or fraud occurring and going undetected increases. There is also an increased probability that the state’s financial resources will not be spent efficiently, as evidenced by the cleaning supply purchases from companies located in Florida. According to Section 5.0 of the *State of Tennessee State Payment Card Cardholder/Approver Manual* and the state cardholder agreement, the cardholder may be held personally liable for charges and subject to disciplinary actions, up to and including termination, for improper use of the state payment card.

Recommendation

The Commissioner should instruct the payment card coordinator to ensure that all cardholders have completed the state’s training program and that the completion is documented. The Commissioner should require all payment card cardholders to complete a “State Payment Card New Account Application and Maintenance Form” and provide them to the payment card

coordinator. The Commissioner should also remind cardholders that they are accountable for all transactions made on the card assigned to them and remind approvers that they should be monitoring purchases for compliance with the state's payment card policies and procedures and reviewing support for purchases for indications of waste or abuse. The Commissioner should consider taking disciplinary action for noncompliance, waste, and abuse.

Management should continue to evaluate risks and include them in their documented risk assessment activities. Management should ensure staff who are responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely are continually evaluating those controls. Management should ensure staff who are responsible for ongoing monitoring for compliance with all requirements are indeed monitoring and taking prompt action when exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

Cardholder Documentation

We concur. Documentation to show that cardholders completed required training and completed State Payment Card New Account Application & Maintenance Forms and State Payment Cardholders Agreement Forms have been updated and are included in individualized credit card folders for both the credit card holders and approvers.

Cleaning Supplies Purchases

We concur. Cleaning supplies should have been purchased from the Department of General Services' Central Stores or local retailers. Cleaning supplies are now purchased from a statewide contract. The Cemetery Administrator is no longer with the department. Credit card purchases are reviewed by the Fiscal Director for validity and accuracy.

Items on Statewide Contract

We concur. Copier paper, printer cartridges and toner are now purchased from a statewide contract. The buyer in the Department of General Service has been contacted regarding the inadequacy of existing coveralls on statewide contract for this department's use. We requested that coveralls to meet our needs be included in a statewide contract.

Computer Peripheral Purchases

We concur. Items that require commodity code approval are no longer purchased using the payment card.

Charges Pertaining to Equipment Leased From Motor Vehicle Management

We concur. The payment card is no longer used for repairs, maintenance, supplies or any other type charge for any vehicle or equipment leased from the Department of General Services' Division of Motor Vehicle Management.

Unauthorized Rental Purchases

We concur. The payment card is no longer used for rental items.

Credit Card Statements Not Signed and Dated

We concur. Controls are in place to assure that credit card statements attached to the transaction logs are reviewed, validated, signed, and dated by the cardholder.

Late Submission of Required Reports to F&A

We concur. Controls are in place to assure that documentation is submitted to the Division of Accounts, F&A within the required timeframe. These controls are now included in the department's updated Risk Assessment Plan.

Conclusion

We concur and appreciate the comprehensive review of this department's administrative operations. The findings as discussed during the audit were implemented during the audit and will be continued. The audit showed that the department had not followed policies pertaining to payment cards. 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.

Risk assessment activities regarding payment cards will be continually evaluated and documented in the department's risk assessment plan. Internal controls documented in the risk assessment plan are designed to mitigate risk and to prevent and detect exceptions in a timely manner.

All current cardholders have completed the state's training program and the completion of that training is documented in individual folders. The folders also contain a completed State Payment Card New Account Application and Maintenance Form for both the cardholder and approvers. These folders will be maintained by the payment card coordinator. Cardholders are reminded that they are accountable for all transactions made on the card assigned to them and will be personally responsible financially for any violations. Card purchases are reviewed by the Fiscal Director for validity and accuracy.

The payment card is no longer used for repairs, maintenance, supplies or any other type of charge for any vehicle or equipment leased from the Department of General Services' Division of Motor Vehicle Management. The card is not used for items which are on statewide contract,

rental, or require commodity code approval. In the event an operationally unique item is needed, a request for an exception or inclusion to a statewide contract will be requested.

Controls are in place to assure that credit card statements attached to the transaction logs are reviewed, validated, signed, and dated by the cardholder. Documentation is now submitted to the Division of Accounts, F&A within the required timeframe. Controls to assure timely submissions are now included in the department's updated Risk Assessment Plan.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, required 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 was 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' June 30, 2007; June 30, 2006; and June 30, 2005, responsibility letters and December 31, 2007, 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 reviewed the June 30, 2007; June 30, 2006; and June 30, 2005, responsibility letters and the December 31, 2007, 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 reviewed the supporting documentation for the Department of Veterans Affairs' evaluation of its internal accounting and administrative control.

We determined that the Financial Integrity Act responsibility letters were submitted on time for June 30, 2005, and June 30, 2006, but the letter for June 30, 2007, was not submitted until July 19, 2007. The internal accounting and administrative control report for December 31, 2007, was also filed late. It was not submitted until January 14, 2008. An exception was noted

for the department's late submittal. Support for the internal accounting and administrative control report was properly maintained, and the procedures used were in compliance with *Tennessee Code Annotated*.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, 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, 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 October 1 each year beginning with the Title VI compliance report and implementation plan due in 2007. Prior to 2007, the Title VI compliance report and implementation plan were due by June 30 each year. The Department of Veterans Affairs filed its compliance reports and implementation plans on June 30, 2005; July 13, 2006; and July 13, 2007. An exception was noted for the department's late submission.

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

323.00 Department of Veterans Affairs