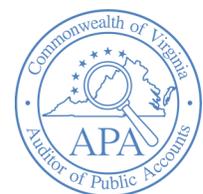




OFFICE OF THE ATTORNEY GENERAL
AND
DEPARTMENT OF LAW

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2014

Auditor of Public Accounts
Martha S. Mavredes, CPA
www.apa.virginia.gov
(804) 225-3350



AUDIT SUMMARY

Our audit of the Office of the Attorney General and Department of Law and the Division of Debt Collection for the fiscal year ended June 30, 2014, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and CollectMax;
- matters involving internal control and its operation necessary to bring to management's attention;
- instances of noncompliance with applicable laws and regulations that are required to be reported; and
- completion of corrective action with respect to the prior audit finding titled "Improve File Transfer Security."

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
AUDIT FINDINGS AND RECOMMENDATIONS	1-2
AGENCY HIGHLIGHTS	3-9
Office of the Attorney General	4-6
Medicaid Fraud Control Unit	6-7
Treasury Equitable Sharing Program	7-8
Division of Debt Collection	8-9
INDEPENDENT AUDITOR'S REPORT	10-12
AGENCY RESPONSE	13
AGENCY OFFICIALS	14

AUDIT FINDINGS AND RECOMMENDATIONS

Strengthen Procedures for Administering Federal Programs

Our review of the Office of the Attorney General's (Office) administration of the Federal Treasury Equitable Sharing Program during fiscal year 2014 identified weaknesses in the agency's internal controls for administering federal programs specifically related to the receipt of settlement funds. The Office's initial failure to identify these funds as a federal grant award created a misperception of how to properly account for the funds in the Commonwealth Accounting and Reporting System (CARS) and created a lack of clarity in the agency's understanding of its requirements under the Office of Management and Budget (OMB) Circular A-133. Inadequate administration of federal awards may result in erroneous accounting, noncompliance with federal guidelines, and misappropriation of federal funds. We determined, however, that the Office properly utilized federal funds during fiscal year 2014 in accordance with guidance provided by the U.S. Department of the Treasury.

During fiscal year 2014, the Office received \$92.9 million from the United States Department of the Treasury's Executive Office for Asset Forfeiture (TEOAF); these funds were part of the 2012 Abbott Laboratories Medicaid fraud settlement and were awarded through the Catalog of Federal Domestic Assistance (CFDA) 21.000 Treasury Equitable Sharing Program. The amount and nature of this award was unprecedented for the Office and the Commonwealth of Virginia. The Office passed through all of the Abbott settlement equitable sharing funds received during fiscal year 2014 to other entities, including other state agencies and local government agencies.

The Commonwealth Accounting Policies and Procedures (CAPP) Manual does not include guidance specific to accounting for equitable sharing funds. Federal equitable sharing funds are considered grant funds. Initially, the Office did not identify these funds as federal grants and erroneously recorded \$65.2 million of federal equitable sharing fund disbursements as revenue refunds in CARS. This is not in accordance with the Commonwealth's policies for federal grants, which requires that federal disbursements be recorded either as expenses or transfers based on the nature of the entity receiving the funds. Improper accounting of funds at this amount could have a material effect on the Commonwealth's Single Audit of federal funds and the Commonwealth's financial statements. By recording the federal grant disbursement as a revenue refund, the Office effectively eliminated these transactions from the Commonwealth's accounting records for financial reporting purposes and, inadvertently, limited the information available regarding the receipt and disbursement of the funds.

Furthermore, weaknesses in the Office's internal controls for administering federal programs resulted in misunderstandings about the agency's compliance requirements in accordance with OMB Circular A-133. Although the Office maintained contact with the TEOAF throughout the award period, the agency did not secure a concrete understanding of its requirements as a federal pass-through entity. Without accurate interpretation and documentation of federal compliance requirements, the Office cannot properly administer its programs in accordance with federal

regulations. As noted above, ultimately we determined the Office had performed all required compliance requirements.

The Office should strengthen its process for administering federal programs to ensure that the agency properly accounts for federal funds and has an accurate understanding of all regulations governing federal programs. We recommend the Office develop procedures to evaluate future federal awards to determine whether OMB Circular A-133 guidelines apply. We also recommend that the Office enhance its communications with applicable federal agencies to determine the relevant compliance requirements and obtain official documentation to support these determinations. In addition, by establishing proactive communication with the Department of Accounts to clarify the nature of unique fund sources and how to account for such funds in accordance with the Commonwealth's guidelines, the Office may eliminate material adjustments and enhance transparency of state spending.

Improve Security Awareness Training

The Office does not enforce its policy that requires all information system users to complete security awareness training on an annual basis nor is a process in place to track completion of training.

The Commonwealth's Information Security Standard (Security Standard), SEC 501-08, Section AT – 2, requires the Office to administer security awareness training to all information system users (employees, managers, executives, and contractors) before gaining system access, and annually or more often, as necessary. Additionally, the Security Standard, Section AT – 4, requires the Office to document, monitor, and store records of individuals' training activities.

A lack of training increases the risk of users being unable to appropriately identify, prevent, and respond to a variety of security threats such as phishing and social engineering, which may result in the compromise of sensitive citizen data. Therefore, we recommend that the Office dedicate the necessary resources to implement a security awareness and training program in accordance with the Security Standard.

Improve Physical and Environmental Security for IT Systems

The Office does not have appropriate physical and environmental security controls in place to protect information technology systems that house sensitive data in accordance with the Security Standard.

Our review noted several areas of weakness that we have communicated in detail to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia, due to their sensitivity and description of security controls.

We recommend that the Office implement the controls discussed in our recommendation in accordance with the current Security Standard.

AGENCY HIGHLIGHTS

The Attorney General is the chief executive officer of the Commonwealth of Virginia's Department of Law. The Attorney General and Department of Law, "Office of the Attorney General," acts as the Commonwealth's law firm. The Attorney General and his staff represent the Commonwealth's interests in all civil cases naming the Commonwealth, or any of its agencies or officials, as a party, and in criminal cases on appeal to the Court of Appeals of Virginia and the Supreme Court of Virginia. In cases involving federal law, the Attorney General represents the Commonwealth's interests in federal court. The Office also enforces consumer protection laws and investigates Medicaid fraud.

The Attorney General is also the legal advisor to the Governor and more than 200 state agencies, boards, commissions, and institutions. The Attorney General renders official opinions on the application of the law upon written request of the Governor, members of the General Assembly, members of the judiciary, state officials, or local constitutional officers. The Office handles criminal convictions on appeal and defends the state when prisoners sue concerning their incarceration. In addition, the Office defends legal challenges of the constitutionality of state laws and supervises the appointment and payment of private attorneys hired by other state agencies for various matters. The Office also administers grants to help reduce crimes involving gangs, drugs, and sex predators.

The Office's organizational structure is similar to a private law firm, with divisions devoted to legal specialties. The Office has five legal divisions with offices in Abingdon, Fairfax, Richmond, and Roanoke. A Deputy Attorney General heads each division and reports directly to the Chief Deputy Attorney General. The Administration Division provides finance, human resources, information systems, and operations support to the legal divisions. The following are the legal divisions.

- Civil Litigation Division (includes the Division of Debt Collection)
- Criminal Justice and Public Safety Division (includes the Medicaid Fraud Control and Tobacco Units)
- Health, Education, and Social Services Division
- Transportation, Real Estate, and Construction Division
- Commerce, Environment, and Technology Division

As of fiscal year 2013, the Office of the Attorney General also includes the Consumer Protection Section, the Division of Human Rights, and complaint-related responsibilities of the former Board for Towing and Recovery Operators.

The Division of Debt Collection is a separate agency within the Office. It provides legal services and advice related to the collection of funds owed to the Commonwealth. The following financial information presents separate information on the Office of the Attorney General and the Division of Debt Collection.

Office of the Attorney General

Historically, the Office receives approximately half of its funding from the General Fund with the remaining funding coming almost equally from special revenue and federal funds. The special revenue funds are primarily from fees charged to agencies and universities for legal services provided by the Office. State law permits the Attorney General to bill agencies for the legal services if the agency receives all or a part of its funding from non-general funds. The Office also receives federal grants supporting Medicaid fraud control activities.

However, in fiscal year 2014, 58 percent of the Office's final appropriation was from federal asset forfeiture funds, which the Office received under the United States Department of the Treasury's Equitable Sharing Program as a result of the 2012 Abbott Laboratories Settlement. The Office disbursed the majority of this funding to other government entities, including other state agencies and local law enforcement agencies, to spend in accordance with the Program guidelines. In fiscal year 2014, the Office received permission to spend \$5 million from the Abbott Laboratories Settlement award for their operations through the Treasury Equitable Sharing Program. This program is discussed in more detail under the report section titled Treasury Equitable Sharing Program.

The Office's activities are budgeted in four programs, the largest of which is the Legal Advice program. Attorneys in the Legal Advice program provide legal services to state agencies. The following schedule compares the Office's original and final budgets by program with actual expenses for fiscal year 2014.

2014 Budgeted and Actual Expenses

Program	Original Budget	Final Budget	Expenses
Legal advice	\$26,840,411	\$ 93,178,159	\$ 86,332,075
Medicaid program services	12,156,148	12,166,148	11,435,978
Regulation of business practices	3,270,910	3,270,910	2,840,906
Personnel management	<u>406,970</u>	<u>406,970</u>	<u>272,934</u>
Total	<u>\$42,674,439</u>	<u>\$109,022,187</u>	<u>\$100,881,893</u>

Source: Commonwealth Accounting and Reporting System

The following schedule includes detail relating to adjustments to appropriations during fiscal year 2014.

Budget Analysis for Fiscal year 2014

Original appropriation per Chapter 806	\$ 42,674,439
Subsequent legislative amendments per Chapter 1	260,000
Adjustments:	
Carry forward of prior year cash balances	505,243
Reimbursement for courthouse renovations and representation for court personnel, in accordance with Chapter 806, Item 59.D	88,475
Increase Indirect Cost Recoveries Appropriation in accordance with cash balance to cover Legal Advice operating expenses	1,000,000
Transfer from central appropriations for salary and benefit changes	949,240
Transfer from Department of Criminal Justice Services for Victim Witness Grants	134,790
Increase for the Office's portion of the Abbott Settlement Treasury Equitable Sharing Program funds	5,000,000
Increase for disbursements to other state agencies and local government agencies from the Abbott Settlement Treasury Equitable Sharing Program funds	<u>58,410,000</u>
Total adjusted appropriations	<u>\$ 109,022,187</u>

Source: Performance Budgeting System

As previously noted, State law permits the Office to bill agencies and universities for legal services if the agency receives all or a part of its funding from non-general funds. For some agencies, the Office calculates the agency's legal service charges for a fiscal year using actual attorney hours worked during the previous fiscal year. At the start of a fiscal year, the Office notifies each agency of their expected charges for the year, and at the beginning of each quarter, the Office bills the agency for that quarter's portion. Other agencies are billed based on a Memorandum of Understanding (MOU) between the Office and that agency. MOUs can be fixed price or non-fixed price. Similar to the process previously explained, the Office bills its fixed price MOUs at the beginning of each quarter. The Office bills its non-fixed price MOUs at the end of each quarter based on the conditions set forth in the MOU or agreed upon by the client agency or entity. The following table provides detail of the Office's legal service revenues for fiscal years 2010 through 2014.

Legal Service Revenues

Fiscal Year	Revenues
2010	\$5,393,597
2011	5,538,162
2012	6,690,691
2013	6,808,348
2014	7,010,088

Source: Commonwealth Accounting and Reporting System

Medicaid Fraud Control Unit

The Virginia Medicaid Fraud Control Unit (MFCU) investigates and prosecutes health care provider insurance fraud against the state and federally funded Medicaid program. The MFCU is also required to investigate allegations of elder abuse and corporate neglect in nursing homes and health care facilities. Federal regulations require the Office establish the MFCU as a separate and distinct entity from the Department of Medical Assistance Services, the state agency that administers the Medicaid program. The U.S. Department of Health and Human Services has certified the MFCU, and it is one of 49 similar state units plus the District of Columbia in the United States. Federal law has expanded the scope of the MFCU to include any state and federal healthcare programs including Medicare, CHAMPUS, and others, in addition to Medicaid. MFCU has a criminal and a civil unit.

Federal grants fund the MFCU operations and require a 25 percent match of General Funds; however, in fiscal year 2008, the MFCU recovered \$39.8 million in the Purdue OxyContin criminal case and will use these funds indefinitely to provide the 25 percent Commonwealth share of the budget, as prescribed in the court order. The MFCU employs a professional staff of 106 criminal investigators, auditors, and several Assistant Attorneys General who are experienced in commercial and financial investigations.

The table below shows the total amount of MFCU recoveries over the last five years as ordered by the courts (fines, penalties, or restitutions). Because the Virginia Medicaid program is 50 percent federally funded and 50 percent state-funded, Virginia receives half of Medicaid program related recoveries. All recoveries go into the Virginia Health Care Fund established by the General Assembly in 2004 and must support health care services.

In fiscal year 2013, a \$1.5 billion settlement with Abbott Laboratories Inc. was approved. Because the MFCU was the lead investigator in this case, approximately \$1 billion of the settlement is included in the 2013 recoveries shown below. The remaining \$500 million is associated with the federal government and other states' share of the Medicaid program related recoveries.

The Commonwealth's portion of the settlement includes \$4.2 million for its share of the Medicaid program recoveries and \$1.5 million to cover MFCU investigative costs, both of which it received during fiscal year 2013. In addition, as part of the settlement the Commonwealth will also receive \$115 million from criminal asset forfeiture penalties. The United States Department of the

Treasury awarded these funds through its Equitable Sharing Program. The Commonwealth received \$10.4 million of this amount in fiscal year 2013, \$92.9 million in fiscal year 2014, and will receive the remaining portion over fiscal years 2015 and 2016. The \$103.3 million received by the Commonwealth in fiscal years 2013 and 2014 are not reflected in the MFCU recoveries table, but are discussed in more detail below.

MFCU Recoveries by Year

Fiscal Year	Total Recoveries
2010	\$ 25,390,467
2011	14,573,789
2012	47,212,652
2013	1,028,948,442
2014	32,389,971

Source: Medicaid Fraud Case Tracking System

Treasury Equitable Sharing Program

The United States Department of the Treasury's Executive Office for Asset Forfeiture (TEOAF) guidelines mandate that state or local government organizations must use these funds for law enforcement purposes. The Office disbursed all of the Abbott settlement equitable sharing funds received during fiscal year 2014 to other entities, including other state agencies and local law enforcement agencies, as detailed in the table below. Those entities are responsible for complying with the Equitable Sharing Program guidelines regarding the use of the funds.

Fiscal Year 2014 Equitable Sharing Disbursements

Commonwealth's Attorneys' Services Council	\$ 18,000,000
Virginia Law Officers' Retirement System (VaLORS)	15,000,000
State Police Officers' Retirement System (SPORS)	15,000,000
Department of State Police	6,248,689
Department of Criminal Justice Services	5,506,998
Department of Forensic Science	2,943,000
Virginia Commonwealth University Police	2,081,000
University of Virginia Police	971,167
Thomas Nelson Community College Police	266,558
Division of Capitol Police	145,909
Virginia Polytechnic Institute and State University Police	95,067
J. Sargeant Reynolds Community College Police	40,819
Southwest Virginia Community College Police	<u>77,000</u>
Total Disbursed to State Agencies	<u>\$ 66,376,207</u>
Total Disbursed to Local Law Enforcement Agencies	<u>\$ 26,532,640</u>

Source: Commonwealth Accounting and Reporting System

As stated previously, during fiscal year 2013 the Office received \$10.4 million from the Treasury Equitable Sharing Program for direct use by the Office for law enforcement purposes. The Office received \$5 million in appropriations related to these funds during fiscal year 2014. The Office's fiscal year 2014 expenses from these funds totaled only \$1.9 million. The Office must spend the remaining \$8.5 million during fiscal years 2015 and 2016 unless otherwise permitted by the TEOAF.

Division of Debt Collection

The Division of Debt Collection (Division) is a separate agency within the Office. It collects delinquent accounts for state agencies, state-supported institutions of higher education, and their hospitals. The Division receives delinquent accounts from state agencies and takes appropriate action, including litigation, to collect them.

The 2004 General Assembly passed legislation requiring agencies to forward past due accounts over \$3,000 and 60 days old to the Division. This 2004 legislation also mandated the allocation of collections among the creditor agency, the General Fund, and an amount to fund the Division's operations. The General Assembly removed the General Fund allocation in 2008, and the current allocation of collections is between the creditor agency and the Division.

Division Operating Statistics for 2010-2014

	2010	2011	2012	2013	2014
Maximum employment level	24	24	24	24	24
Division budget	\$1,820,469	\$1,932,884	\$1,899,884	\$1,916,448	\$2,064,183
Number of accounts	12,403	14,818	16,386	18,608	17,798
Active accounts (\$ in millions)	\$166.5	\$193.5	\$215.6	\$256.4	\$274.6
Gross collections (\$ in millions)	\$10.4	\$9.3	\$10.5	\$11.3	\$11.9

Source: Commonwealth Accounting and Reporting System and the Division of Debt Collection

The Division funds operations with a portion of fees retained from their collections. The Appropriation Act allows the Division to keep \$400,000 as operating capital and requires the transfer of any excess collections to the General Fund by September 1st of each year. The Division can request to keep more of the balance, but the Department of Planning and Budget must approve this request. At the end of fiscal year 2014, the Division had a cash balance of \$649,238. The Division transferred the remaining cash balance of \$249,238 to the General Fund in August 2014.

During the year, the Division performed a review of the rates it charges agencies for collection services. As a result of this review, the Division lowered its rates and processed revenue refunds of \$585,000 to the various agencies that utilized its collection services during the year. This is the third year that the Division has performed this rate review, which has resulted in lower year-end cash balances from previous years. The following table details the Division's operating revenues and expenses for the last five fiscal years.

Revenues and Expenses – Fiscal Years 2010 – 2014

	2010	2011	2012	2013	2014
Beginning balance	\$ 1,024,919	\$ 887,987	\$ 761,709	\$ 403,366	\$ 608,067
Collection fee revenue	2,311,790	2,075,208	2,354,751	2,495,749	2,604,633
Expenses	(1,789,415)	(1,748,728)	(1,842,861)	(1,787,682)	(1,865,395)
Transfers	(659,307)	(452,758)	(375,233)	(3,366)	(113,067)
Revenue Refunds	-	-	(495,000)	(500,000)	(585,000)
Ending balance	<u>\$ 887,987</u>	<u>\$ 761,709</u>	<u>\$ 403,366</u>	<u>\$ 608,067</u>	<u>\$ 649,238</u>

Source: Commonwealth Accounting and Reporting System



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

January 9, 2015

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John C. Watkins
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Office of the Attorney General and Department of Law and the Division of Debt Collection** for the year ended June 30, 2014. We conducted this performance 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.

Audit Objectives

Our primary audit objectives include the following:

- to test compliance for the Statewide Single Audit and ensure the federal schedules submitted to the Department of Accounts are fairly presented relevant to the Equitable Sharing Program;
- evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System and CollectMax and in the Office of the Attorney General and Department of Law's and the Division of Debt Collection's accounting records;
- review the adequacy of the Office of the Attorney General and Department of Law's and the Division of Debt Collection's internal controls;
- test compliance with applicable laws, regulations, contracts, and grant agreements; and
- review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Office of the Attorney General and Department of Law's and the Division of Debt Collection's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Federal grant revenues and expenses
- Other expenses, including payroll
- Legal service revenue
- Medicaid Fraud Control Unit
- Division of Debt Collection
- Information System Security

We performed audit tests to determine whether the Office of the Attorney General and Department of Law's and the Division of Debt Collection's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel; inspection of documents and records including vouchers, reconciliations, deposit certificates, billings, creditor agency collections and distributions, receipts from recoveries, and contracts; and observation of the Office of the Attorney General and Department of Law's and the Division of Debt Collection's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Office of the Attorney General and Department of Law and the Division of Debt Collection properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System, CollectMax, and the federal schedules submitted to the Department of Accounts. The Office of the Attorney General and Department of Law and the Division of Debt Collection record its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and CollectMax.

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations, contracts and grant agreements that require management's attention

and corrective action. These matters are described in the section entitled “Audit Findings and Recommendations.”

The Agency has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this letter.

Exit Conference and Report Distribution

We discussed this report with management on January 13, 2015. Management’s response to the findings identified in our audit is included in the section titled “Agency Response.” We did not audit management’s response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

SAH/clj



COMMONWEALTH of VIRGINIA

Office of the Attorney General

Mark R. Herring
Attorney General

900 East Main Street
Richmond, Virginia 23219
804-786-2071
FAX 804-786-1991
Virginia Relay Services
800-828-1120
7-1-1

January 23, 2015

Ms. Martha Mavredes
Auditor of Public Accounts
101 N. 14th Street 8th Floor
Richmond, VA 23219

Dear Ms. Mavredes:

On behalf of the Attorney General and the Division of Debt Collection, I would like to thank you for providing us an opportunity to comment on the findings and recommendations in the Fiscal Year 2014 audit of the Office of the Attorney General and Division of Debt Collection.

Management recognizes the need to strengthen procedures for administering Federal Programs. We have corrected the internal control weakness(es) and have begun development and/or revisions to the Attorney General Federal Programs Policy, Procedures, and Guidelines. We expect this to be completed by February 27, 2015.

Management recognizes the need for compliance with SEC 501-08. We actively worked and will continue to work towards redressing the concerns noted in the current audit report. As of September 29, 2014, we have corrected one of the two SEC 501-08 findings. We have begun the process to improve and implement the Security Awareness Training. We expect the office wide training to be completed by August 30, 2015.

Sincerely,

A handwritten signature in blue ink that reads "Leigh E. Archer".

Leigh E. Archer
Director of Administration

AGENCY OFFICIALS

Office of the Attorney General and Department of Law

As of June 30, 2014

Mark R. Herring
Attorney General

Cynthia E. Hudson
Chief Deputy Attorney General

Leigh E. Archer
Director of Administration

Christie A. Wells
Director of Finance