

**OFFICE OF THE ATTORNEY GENERAL
AND
THE DEPARTMENT OF LAW**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2010**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Office of the Attorney General and the Department of Law and the Division of Debt Collection found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- two matters involving internal control and its operation necessary to bring to management's attention, which the Office had already identified and begun addressing; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
AUDIT FINDINGS AND RECOMMENDATIONS	1-2
AGENCY HIGHLIGHTS	3-7
Attorney General's Office	4-5
Medicaid Fraud Control Unit	5-6
Division of Debt Collection	6-7
AUDIT OBJECTIVES	8
AUDIT SCOPE AND METHODOLOGY	8-9
CONCLUSIONS	9
EXIT CONFERENCE AND REPORT DISTRIBUTION	9
AGENCY RESPONSE	10
AGENCY OFFICIALS	11

AUDIT FINDINGS AND RECOMMENDATIONS

Improve Policies and Procedures

During our review, we noted some inconsistencies in the recording of certain accounting and billing transactions. Further contributing to our observations is that the staff had not documented their processes for making and recording certain types of transactions which are complex and made infrequently. The lack of documentation slows the closing process and increases the risk that an error could occur due to the staff's lack of knowledge of the process.

Written accounting policies, and more importantly procedures, provide staff a mechanism to follow in determining what needs to happen and decrease the risk of making an error. These documents should not only address the process for year-end, but also entries which do not happen routinely. The following two findings discuss two areas for which the documentation was lacking. The Office of the Attorney General (Office) had already identified and begun addressing these findings.

Accounting Transactions

The Finance Division periodically allocates expenses among accounts in its accounting system. However, the Division did not have sufficient policies and procedures related to the periodic allocation of costs among accounts, including the nature of the items the Division should allocate to the various accounts, its uses, and the time frame in which the Division should record the allocations.

We noted the Division processed many of these allocations at year-end as opposed to throughout the year when the Office incurred the expenses. In addition, we found the Division did not maintain sufficient supporting documentation for all transactions allocating expenses among accounts. We also noted one instance where the Division did not process a recurring expense for fiscal year 2010 prior to year-end.

The lack of sufficient policies and procedures and supporting documentation increased the risk that the Division would incorrectly allocate expenses among its accounts, which could result in inaccuracies in the accounting system, difficulties in the budgeting process, or non-compliance with State or Federal regulations. The Office has developed policies and procedures addressing the periodic allocation of expenses among accounts and year-end closing transactions and reorganized the Finance Division.

These new policies and procedures should address the timing for processing transactions, the nature of the expenses the Division should allocate to its various accounts, the approval process surrounding the transactions, and the documentation the Division should maintain supporting the transactions. In addition, we encourage the Division to create a checklist containing any recurring or year-end transactions to ensure appropriate posting to its accounting system.

Improve Supporting Documentation for Legal Service Billings

The Finance Division determines legal billings based on the number of qualifying hours charged to a specific agency, as recorded in their Legal Hours Database in the previous year, multiplied by the pre-determined billing rate. During our review, we noted several instances in which the Division modified the number of hours recorded related to an agency. The Finance Division made these adjustments based on discussions with the applicable attorney in charge of billing the agency. However, the Division did not maintain sufficient documentation to substantiate all of the changes. The inability to substantiate billing changes increased the risk that agencies could be over or under-billed and that there could be questioned costs for legal services agencies charged to Federal funds.

As a result, the Office has modified its policies and procedures over the billing process to ensure that it is consistent in the process it applies to each agency and that there is sufficient supporting documentation. The new policies and procedures require that attorneys record all hours worked in the Legal Hours Database, which should reduce the number of manual adjustments. We recommend, whenever the Division modifies the hours billed to an agency, that it documents the reason for the modification and maintains any related supporting documentation including correspondence with the agency or applicable attorney.

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 four 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)
- Public Safety and Enforcement Division (includes the Medicaid Fraud Control and Tobacco Units)
- Health, Education, and Social Services Division
- Technology, Real Estate, Environment, Financial Law and Transportation Division

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.

Attorney General's Office

The Office receives the majority 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 and programs to suppress gang activity.

The Office's activities are budgeted in three 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 2010.

2010 Budgeted and Actual Expenses

<u>Program</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Legal advice	\$29,856,133	\$26,895,043	\$24,115,787
Medicaid program services	4,418,047	6,045,702	5,744,840
Regulation of business practices	2,241,681	2,261,802	1,830,395
Executive Management	<u>(2,175,747)</u>	<u>-</u>	<u>-</u>
Total	<u>\$34,340,114</u>	<u>\$35,202,547</u>	<u>\$31,691,022</u>

Source: Commonwealth Accounting and Reporting System

Subsequent to year-end, the Office identified several purchases charged to its federal asset forfeiture fund that did not comply with federal regulations. The Office has performed a detailed analysis of all expenses in the fund during fiscal year 2010 and reimbursed the fund for all non-complying expenses.

The following schedule includes detail relating to adjustments to appropriations during fiscal year 2010.

Budget Analysis for Fiscal year 2010

Original appropriations per Chapter 879	<u>\$34,340,114</u>
Adjustments:	
Additional budget reductions	(919,496)
Appropriation to spend non-general funds recovered from indirect costs for managing grants	676,168
Adjustment to restore the Medicaid Fraud Control Unit's appropriation to 2009 levels	602,180
Adjustment to non-general fund appropriations to offset General Fund reductions	602,180
Adjustment for state employee furlough and suspension of employee benefit and retirement contribution payments	(431,912)
Adjustments for changes in employee benefits costs	(286,595)
Appropriation to spend funds available under the federal asset forfeiture program	204,000
Adjustments for employee compensation and other expenses related to transition of new Attorney General	150,052
Appropriation for payments for private legal services, courthouse renovations and unbudgeted cost for the enforcement of the 1998 Tobacco Master Settlement Agreement	135,006
Re-appropriation of prior year unexpended balances	72,380
Miscellaneous adjustments	<u>58,470</u>
Total adjusted appropriations	<u>\$35,202,547</u>

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. 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 50 similar state units 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 requires 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 approximately 50 criminal investigators, auditors, and several Assistant Attorneys General who are experienced in commercial and financial investigations. The Office transferred multiple staff from the Legal Advice Program to the MFCU in fiscal year 2010 utilizing funds it received in the Purdue OxyContin settlement. These transfers also reduced personal service costs compensated out of the General Fund.

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 recoveries. All recoveries go into the Virginia Health Care Fund established by the General Assembly in 2004 and must support health care services.

MFCU Recoveries by Year

<u>Fiscal Year</u>	<u>Total Recoveries</u>
2006	9,071,737
2007	117,704,812
2008	541,099,617
2009	27,607,670
2010	25,390,468

Source: Medicaid Fraud Case Tracking System

There was a large increase in recoveries in fiscal year 2007 and 2008 due to a significant settlement in the Purdue OxyContin criminal case. The total recoveries from all the defendants in the case were \$634,500,000, which several states shared. The Commonwealth’s recovery was \$105 million of the \$634.5 million, which went to several state agencies and the settlement restricts how the agencies may use these funds. The following agencies received funds under this settlement:

Virginia State Police	\$44 million
MFCU	\$39.8 million
Department of Health Professions	\$20 million
Department of Medical Assistance Services	\$1.2 million

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 2006-2010

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Maximum employment level	23	24	24	24	24
Division budget	\$1,578,689	\$1,665,104	\$1,663,972	\$1,820,469	\$1,820,469
Number of accounts	9,689	10,397	10,774	11,286	12,403
Active accounts (\$ in millions)	\$157	\$132	\$141	\$157	\$166.5
Gross collections (\$ in millions)	\$12.5	\$11.5	\$9.7	\$11.8	\$10.4
General Fund Allocation (\$ in millions)	\$1.1	\$0.5	\$ -	\$ -	\$ -

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 1 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 2010, the Division had a cash balance of \$887,987. The Division requested to keep \$45,000 in addition to the \$400,000 in working capital in order to meet the budget demands of a 3% year-end bonus. The Division transferred \$442,987 to the General Fund on August 31, 2010. The following table details the Division's operating revenues and expenses for the last five fiscal years.

Revenues and Expenses – Fiscal Years 2006 – 2010

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Beginning balance	\$2,689,193	\$2,715,317	\$3,251,192	\$1,849,860	\$1,024,919
Collection fee revenue	1,555,865	2,152,384	1,899,192	2,095,270	2,311,790
Expenses	(1,521,073)	(1,616,509)	(1,699,332)	(1,820,351)	(1,789,415)
Transfers	(8,668)	-	(1,601,192)	(1,099,860)	(659,307)
Ending balance	<u>\$2,715,317</u>	<u>\$3,251,192</u>	<u>\$1,849,860</u>	<u>\$1,024,919</u>	<u>\$ 887,987</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
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October 8, 2010

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
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 Division of Debt Collection** for the year ended June 30, 2010. 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 audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System, review the adequacy of the Office's internal controls, and test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Office of the Attorney General and Department of Law 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 and regulations.

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.

Expenses, including payroll
Revenue collections and distributions
Appropriations

We performed audit tests to determine whether the Office of the Attorney General and Department of Law 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 and regulations. 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 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. The Office of the Attorney General and Department of Law and the Division of Debt Collection records 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.

We noted certain matters involving internal control and its operation that required management's attention and corrective action. The Office was aware of these matters and is taking corrective action as described in the section entitled "Audit Findings and Recommendations."

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on October 12, 2010. 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/alh



COMMONWEALTH of VIRGINIA

Office of the Attorney General

Kenneth T. Cuccinelli, II
Attorney General

October 20, 2010

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Mr. Walter Kucharski
Auditor of Public Accounts
101 N. 14th Street
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Mr. Kucharski:

On behalf of the Attorney General, I would like to thank you for providing us an opportunity to comment on the findings and recommendations in the 2010 audit of the Office of the Attorney General and the Department of Law and the Division of Debt Collection.

As you know, the Office of the Attorney General has undertaken measures to correct operational processes to not only streamline workflow, but also to improve internal controls and documentation. This Office will continue to look for the most cost-effective methods to ensure the proper level of controls without developing operational obstacles. We will also continue to educate staff about the need to ensure compliance with the Commonwealth Accounting Policies and Procedures Manual and the Commonwealth's procurement laws and policies.

Please know that we fully intend to take the actions necessary to adhere to the best practices stated in your audit and make continued improvements in each area mentioned.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles E. James, Jr.", written over a horizontal line.

Charles E James, Jr.
Chief Deputy Attorney General

OFFICE OF THE ATTORNEY GENERAL

As of June 30, 2010

Kenneth T. Cuccinelli
Attorney General

Charles E. James Jr.
Chief Deputy Attorney General

Harrison L. Clark
Director of Administration

Robert T. Lewis
Acting Director of Finance