

**REVIEW OF ARMORY FINANCIAL MANAGEMENT
AND
OTHER ISSUES
DEPARTMENT OF MILITARY AFFAIRS**

MARCH 2011

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

SUMMARY

The Department of Military Affairs notified us on January 21, 2011 of a potential fraud involving a custodian at the National Guard Armory in Big Stone Gap, Virginia, who received payment of wages for over ten months after the closing of the armory. We found significant internal control weaknesses and a lack of financial oversight of the management of armories.

We worked with the Virginia State Police in investigating this fraud and included not only a review of the payroll issues, but examined how Military Affairs' staff oversee the fiscal operations of the armories. Generally, we found that operational personnel did not receive information that may have allowed them to detect this loss, and there are not clear lines of responsibility for who must authorize, approve and verify financial information for the armories.

Further, we believe that Military Affairs' management needs to review the information that various operating units need to share and determine if the units have the financial information they need to manage their operations. Also, when management makes decisions affecting operations, all units need to have a system of notifications and verification to ensure all affected units have received the information and can act accordingly.

Military Affairs will receive approximately \$9.3 million in fiscal year 2012 for armory improvements. These funds will be a combination of bond financing, federal funds and special revenue funds. Military Affairs needs to ensure they have adequate internal controls in place to properly manage these funds. This report includes a more detailed discussion of our review of armory financial operations and our findings and recommendations. Some of the recommendations are the result of other audit work, which bears on the need for management to conduct some overall reviews of their internal control systems.

As we discussed these issues with Military Affairs staff during the course of our review, they took steps to begin addressing the issues in this report. Their response at the end of this report details their specific actions.

- TABLE OF CONTENTS -

	<u>Pages</u>
SUMMARY	
INTRODUCTION	1
IMPROPER PAYROLL PAYMENTS	1-2
OVERVIEW OF VIRGINIA NATIONAL GUARD ARMORIES	3-5
<i>Background Information</i>	3
<i>Organizational Structure</i>	3-4
<i>Financial Information</i>	4-5
FINDINGS AND RECOMMENDATIONS	6-7
TRANSMITTAL LETTER	8
AGENCY RESPONSE	9-12
AGENCY OFFICIALS	13

Introduction

The Department of Military Affairs notified us on January 21, 2011 of a potential fraud involving a custodian at the National Guard Armory in Big Stone Gap, Virginia, who received payment of wages for over ten months after the closing of the armory. We worked with the Virginia State Police in investigating this fraud. Our objectives were to review the issues surrounding the potential fraud and to determine the adequacy of the internal controls over the fiscal operations of the armories.

In performing our review, we conducted interviews with the following Department of Military Affairs' personnel:

Human Resources Manager

Director of Fiscal Operations

Facilities Operations and Maintenance Manager

Regional Facilities Operations and Maintenance Manager – West region

Payroll Accountant

We also reviewed documentation and analyzed financial information in the Commonwealth Accounting and Reporting System. We have documented information from our review in this report including several recommendations for improving financial management.

Improper Payroll Payments

In December 2009, Military Affairs decided to move the National Guard unit at the Big Stone Gap armory to another armory. As a result, management determined that there was no need for a custodian at the Big Stone Gap armory. Further, the armory would house only a recruiter. The Regional Manager, therefore, informed the custodian that his job would end effective January 29, 2010.

The custodian determined that he could continue faxing in his timesheets directly to the payroll unit and receive payment. The custodian used a copy of an approved timesheet and Military Affairs continued to pay him until December 2010. In total, the custodian received improper payroll payments totaling \$15,288.

This situation occurred because of a series of breakdowns in Military Affairs' internal controls over armory financial management.

- The Regional Manager did not notify Human Resources of the custodian's termination. As a result, Human Resources did not notify Payroll of the termination and he remained as an active employee on the payroll.

- Management did not take the appropriate steps to ensure that all administrative offices knew of the closing of the Big Stone Gap armory. Individuals in both the Finance and Human Resources offices stated that they were not aware of the facility closing.
- The Regional Manager did not detect this situation because Military Affairs procedures do not require the managers to review and approve timesheets for part time custodians. Also, employees submit their timesheet to the payroll unit and not their manager.
- The custodian continued to submit timesheets with false approvals and various other alterations until December 2010. While the Payroll Accountant did question several of the timesheets, the Accountant continued to process the timesheets. Part of the reason for the lack of follow through was staffing issues, which we addressed in our most recent audit report.
- The Facilities Operations and Maintenance Manager did not detect that there were continued payroll expenses at the Big Stone Gap armory. The Facilities Operations and Maintenance Manager does not share the expenses information with the Regional Managers; however, they have responsibility for the armories.
- Military Affairs staff did not detect the situation in their monthly monitoring process (i.e. 1,500 hour report) for part time employees. In fact, Military Affairs sent the custodian a letter in October 2010 thanking him for his service and reminding him of the 1,500 hour requirement for hourly employees.

Overview of National Guard Armories

Background Information

The Department of Military Affairs (Military Affairs) administers the Army and Air National Guards of Virginia as well as the Virginia Defense Force. While the Army and Air National Guards are simultaneously state military forces as well as reserve components of the Armed Forces of the United States, the Virginia Defense Force is solely a state reserve militia, composed of community volunteers, trained to augment civil agencies and military forces with trained specialists and specialized teams during emergencies.

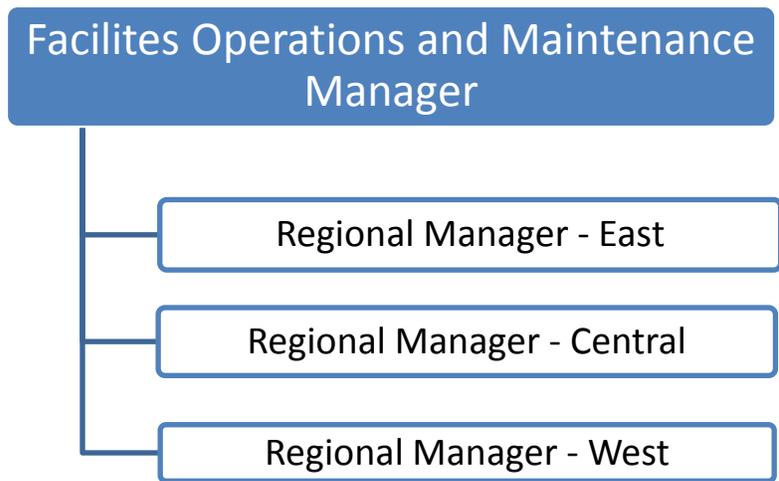
Military Affairs has a dual state and federal mission. Their number one state priority is preparedness to answer the Governor’s call in times of emergency. The agency’s number one federal priority is to answer the President’s call in times of war or during a national emergency.

National Guard armories serve as central locations for training and recruiting of service members into the Virginia National Guard. The Adjutant General is responsible for the general management and care of the armories as set forth in Section 44-134 of the Code of Virginia. The armories also serve as central points for homeland defense and emergency response activities as well as emergency shelters for citizens under current emergency preparedness requirements.

Organizational Structure

Military Affairs operates 46 armories throughout the Commonwealth. The Facilities Operations and Maintenance Division manages these armories. The armories are stand-alone facilities that contain classrooms and training facilities, storage areas for military equipment, parking areas for service members and, in most instances, an arms vault.

For purposes of managing the armories, Military Affairs has separated the 46 armories into three regions in the state, overseen by the Facilities Operations and Maintenance Manager in the Facilities Operations and Maintenance division as shown below.



The listing below shows the armories by region. In addition to armories listed below, there are additional armories that the Federal government completely funds with federal funds; we have not included these armories.

<u>East Region</u>	<u>Central Region</u>	<u>West Region</u>
A.P. Hill	Richmond (Alcott)	Abingdon
Belvoir	Sandston (various facilities)	Allegheny
Charlottesville		Bedford
Emporia		Big Stone Gap
Fairfax		Blackstone
Franklin		Chatham
Fredericksburg		Christiansburg
Hampton		Danville
Harrisonburg		Farmville
Leesburg		Gate City
Manassas		Lexington
Norfolk		Lynchburg
Onancock		Martinsville
Portsmouth		Pennington Gap
Staunton		Petersburg
Suffolk		Powhatan
Virginia Beach		Pulaski
Warrenton		Radford
West Point		Richlands
Winchester		Rocky Mount
Woodstock		South Boston

Financial Information

There are various funding arrangements for the operations and maintenance of the armories. Generally, the state and federal governments share armory operating and maintenance costs. In some localities, the local government also participates in the cost of operating the armory. The following table summarizes state and federal expenses across all armories for fiscal year 2010.

Summary of Armory Expenses by Funding Source – Fiscal Year 2010

	State Funds	Federal Funds	Total
Operating expenses	\$3,108,077	\$2,490,565	\$5,598,642
Capital expenses	75,785	436,568	512,353
Total expenses	\$3,183,862	\$2,927,133	\$6,110,995

Generally, the majority of expenses at the armories are repair and maintenance expenses. Over two thirds of the armories are over 25 years old, and one third of the armories are over 50 years old. As a result, routine repair and maintenance expenses are the most significant expense. The

following table shows armory expenses by type of expense from the Commonwealth Accounting and Reporting System (CARS) for fiscal year 2010.

Summary of Armory Expenses by Type – Fiscal Year 2010

Type of Expenses	Amount
Contractual Expenses	\$1,976,780
Plant and Improvements	1,966,294
Continuous Charges (e.g. utilities)	806,383
Supplies and Materials	536,641
Personal Services (e.g. payroll and benefits)	453,062
Transfer Payments	222,025
Equipment	93,242
Property and Improvements	56,568
Total expenses	\$6,110,995

The majority of expenses in the Contractual Expenses and Plant and Improvements categories are for repair and maintenance. These costs include lawn services, electrical and equipment repair, and routine maintenance expenses like painting or building repairs. Continuous Charges represent utility costs while Personal Services expenses are for part time custodians at some, but not all of the armories.

While the Regional Managers have responsibility for overseeing their assigned armories, they do not review or approve all the armory expenses. As an example, part time custodians prepare timesheets each pay period. Generally, an individual on site at the armory, who is usually a full time federal employee, approves these timesheets.

The employee sends the timesheets directly to the Finance department and Regional Managers do not review or approve the timesheets. Regional Managers also do not review or approve utility costs. The Facilities Operations and Maintenance Manager, located at headquarters, reviews and processes these bills.

Regional Managers also do not receive periodic financial information so they can review expenses for their assigned armories for reasonableness. Military Affairs uses cost codes in CARS to track expenses by individual armory. The Facilities Operations and Maintenance Manager has access to CARS and he downloads and reviews expenses by armory on a monthly basis; however, he does not share this information with the Regional Managers who have responsibility for the individual armories.

Findings and Recommendations

During our review, we not only reviewed the payroll issues, but examined how Military Affairs' staff oversees the fiscal operations of the armories. Generally, we found that operational personnel did not receive information that may have allowed them to detect this situation. In addition, there does not exist clear lines of responsibility for who must authorize, approve and verify financial and related information. We found the following significant internal control weaknesses.

- Regional Managers have responsibility for the operations of their assigned armories; however, they do not review and approve all expenses, nor do they receive periodic financial information to monitor expenses for their armories. While the Facilities Operations and Maintenance Manager does review monthly financial information, he does not share this information with the Regional Managers.
- Regional Managers have no current inventory of armory equipment. There is no process in place to tag equipment or monitor its location. It is our understanding that Military Affairs recently purchased a maintenance tracking software package that also has the capability to track equipment. Military Affairs' staff intend to use this software to track and monitor armory equipment.
- Military Affairs' management needs to review their process for communicating information that affects multiple departments within the agency. For example, management needs to ensure there is a process in place to communicate changes, such as an armory closing and employee termination, to all the affected areas within the agency.

Recommendation

We recommend that Military Affairs review and implement these recommendations to improve financial management over their armories. Military Affairs will receive approximately \$9.3 million in fiscal year 2012 for armory improvements. These funds will be a combination of bond financing, federal funds and special revenue funds. Military Affairs needs to ensure they have adequate internal controls in place to properly manage these funds.

- As part of this review, we also found an overall lack of financial management reporting within the agency. Military Affairs budgets and records expenses at the program and service area level, but financial information on budget and actual costs is not consistently generated by the Finance division for review by the individual program areas. While the Finance division did generate some financial management reports in fiscal year 2010, these reports only included General Funds. The Fiscal Operations unit has not prepared or distributed since April 2010 even these basic reports due to workload issues.

- Management needs to also review the administrative operations throughout Military Affairs to determine what information each administrative unit is generating, what information managers need to properly oversee their area of responsibilities, and how often do these managers need the information. Administrative units supporting the operating unit need to understand what operating units are doing and if these functions and oversight provide adequate control over assets.

Recommendation

We recommend that Military Affairs' management conduct an overall review of administrative and operating units to determine if each has the appropriate information to properly oversee and manage their area of responsibilities. This review should determine if the appropriate level of internal controls exists throughout the organization and if operating units are only managing the assets they need to manage.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

March 15, 2011

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have performed a **Review of Armory Financial Management and Other Issues at the Department of Military Affairs** based on a notification we received about a potential fraud. We conducted this 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.

Conclusions

Overall, we found that operational personnel did not receive information that may have allowed them to detect this potential fraud, and there are not clear lines of responsibility for who must authorize, approve, and verify financial information for the armories. We also found some areas for overall improvement in agency wide communication and financial management. We have summarized our specific findings in the section entitled "Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with Military Affairs' management on April 11, 2011. Management's response to the report is included in the section entitled "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

LCW/clj



COMMONWEALTH of VIRGINIA

DEPARTMENT OF MILITARY AFFAIRS

Adjutant General's Office

Virginia National Guard

1100 Bank Street

DANIEL E. LONG, JR.
THE ADJUTANT GENERAL

RICHMOND, VIRGINIA 23219

April 14, 2011

Mr. Walter J. Kucharski
Auditor of Public Accounts
P O Box 1295
Richmond, VA 23218

Dear Mr. Kucharski:

Attached is our response to the draft Auditor of Public Accounts' audit report regarding a fraudulent timesheet issue.

We appreciate your time and efforts in conducting the audit; your recommendations and findings are paramount to improving DMA Fiscal operations. DMA has already implemented many changes and is in the process of reviewing systems and additional quality control measures. Accurate financial management is a top priority to ensure adequate internal controls and efficient communication through the organization.

If you have questions regarding this report, please contact Linda Coleman, Director of Fiscal Operations, at (434) 298-6419.

Respectfully,

A handwritten signature in cursive script that reads "Daniel E. Long, Jr.".

DANIEL E. LONG, JR.
Major General, VaARNG
The Adjutant General

cc: Brig Gen Wayne Wright
COL Daryl Francis
COL Robert McMillin
Mrs. Linda Coleman
Mr. Steve Huxtable
File

**Department of Military Affairs
Response to APA Audit Report on a Fraudulent Timesheet Issue
April 14, 2011**

The Department of Military Affairs (DMA) concurs, in general, with the audit report issued by the Auditor of Public Accounts regarding the fraudulent timesheet issue discovered January 20, 2011.

Since the discovery of the fraudulent timesheets, the agency has taken various steps to improve internal controls. Specifically related to the fraudulent timesheet submissions, DMA has implemented a new time reporting process for all agency P-14 employees. This process requires wage timesheets to be signed electronically by the supervisor at each location, and if the unit is located outside of Fort Pickett, then the supervisor must scan and e-mail the timesheet with the wage employee's signature to the Finance Office. Timesheets for armory custodians are also e-mailed to the respective Regional Manager for informational purposes. Timesheets for P-14 employees located at Fort Pickett can be scanned and e-mailed or hand delivered to the Finance Office, but they cannot be delivered by a wage employee. Any exceptions must be reviewed and approved in writing by either the Director of Fiscal Operations or the Accounting Manager or the timesheet will not be used for payroll processing.

The following actions have taken place in regards to APA's specific audit findings:

Lack of Financial Information Available to Regional Managers

The Regional Managers primarily work in the field, periodically visiting each facility within their region, and are only in the office one day a week. Most utility invoices are received with such short processing timeframes, that holding these invoices for up to a week for review and approval by the Regional Managers would most often result in non-compliance with the Virginia Prompt Payment Act. Therefore, review and approval of all non-SPCC (Small Purchase Charge Card) bills is assigned to other Facilities Office staff. Since meeting with the APA auditors, the Facilities Operations and Maintenance Manager implemented a new process and now shares financial information with the Regional Managers. This action will be augmented by the publishing of the monthly financial reports indicated as a corrective action for "Lack of Financial Management Reporting" which is detailed below.

Lack of Current Inventory of Armory Equipment Available to Regional Managers

The Finance Office is, and has been for decades, responsible for tagging equipment and monitoring all fixed assets by location in accordance with CAPP Manual requirements. This information is tracked using the state's Fixed Asset Accounting Control System (FAACS) and a physical inventory is conducted every other year as required by CAPP. DMA is in the process of conducting the current biennial inventory. This information is made available to the Regional Managers upon their request.

DMA has purchased software called Asset Works to assist the Facilities Office with keeping track of various facility issues, such as work orders, maintenance

schedules, and warranty expiration dates. One of the modules of Asset Works that we plan to utilize is the one for equipment. This module will be maintained by Facilities staff and compared to FAACS by Finance staff periodically.

In addition, a Logistics expert appointed by DMA will examine current state procedures and Army procedures and incorporate a "best practice" methodology to establish a chain of accountability and responsibility which are flexible and well communicated across the agency.

Lack of Communication of Information That Affects Multiple Agency Departments

DMA has taken several steps to improve communication of information throughout the organization. Changes have been made at the agency level which realigned the reporting structure for several major departments, placing senior leaders closer to the subordinate departments. A weekly Operational Meeting has been established between the Adjutant General and his staff to discuss operational issues in detail. Also, the Adjutant General now meets monthly with the Director of Fiscal Operations and the Director of Facilities to receive updates from each department. These actions should improve organizational communications.

Lack of Financial Management Reporting

The agency has processes in place to provide monthly general fund Budget to Actual Variance reports, but as stated in the APA report, due to workload issues, these reports have not been produced during FY 11. As a result of the APA findings as well as a work center study, DMA will request two additional classified personnel. The additional personnel will allow the monthly publishing and dissemination of the financial reports for all general and non-general funds. The agency will not only consistently produce and distribute these reports to all Program Managers on a monthly basis, but also will be prepared to create them on demand. These reports will be used on a periodic basis to reconcile budget matters between Program Managers in a process which mirrors existing procedures for federal funds managed by the USPFO.

Management Needs to Review Administrative Operations for Availability of Appropriate Information Needed to Manage Each Unit

DMA has appointed the Army Chief of Staff to identify issues and concerns that affect processes and procedures involving multiple departments. Once these issues are identified, subject matter experts from each department will form a working group to design a process that ensures quality control, information sharing, and resource management.

We are also making changes to our Internal Control Program to include the establishment of a Senior Leader Council that will make recommendations to the Adjutant General on audits, investigations, reviews, and self inspections that occur throughout all areas of the organization. The results of each of these data points will be used to make changes to policies and procedures.

Summary

The Adjutant General of Virginia has made fiscal responsibility one of his top priorities, emphasizing the importance of public trust when accounting for taxpayer

dollars. Before this issue arose, DMA directed agency wide process improvement, which is ongoing. The process improvement program identified the shared responsibilities of the Finance Office and Facilities Office as an area of concern and was scheduled to focus on process mapping when the fraudulent timesheet was discovered. When the fraud was uncovered, immediately the existing process was examined and found to have material weakness based on the ability of unapproved personnel to submit pay documents. This was corrected prior to the audit completion and in the course of the corrective action development, other inefficient procedures were discovered and a plan of action to fix them was established.

DEPARTMENT OF MILITARY AFFAIRS

Major General Daniel E. Long, Jr.
Adjutant General

Colonel Donald Sutherland
United States Property and Fiscal Officer

Colonel Daryl Francis
Director of Joint Staff

Linda L. Coleman
Director of Fiscal Operations

Stephen Huxtable
Director of Personnel and Administration