



# Commonwealth of Virginia

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December 1, 2009

The Honorable Timothy M. Kaine  
Governor of Virginia

The Honorable M. Kirkland Cox  
Chairman, Joint Legislative Audit  
and Review Commission

This communication is provided pursuant to the parameters of the 2009 Office of Management and Budget (OMB) pilot project. Such project requires auditors of entities that volunteer for the project to issue, in writing, an early communication of significant deficiencies and material weaknesses in internal control over compliance for certain federal programs having expenditures of American Recovery and Reinvestment Act of 2009 (ARRA) funding at an interim date, prior to the completion of the compliance audit. Accordingly, this communication is based on our audit procedures performed through November 30, 2009, an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through November 30, 2009 of CFDA #84.397 – State Fiscal Stabilization Fund, we are considering the Compensation Board's compliance with activities allowed or unallowed, allowable costs and cost principles, cash management, period of availability, reporting, and sub-recipient monitoring as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 2009. We are also considering the Compensation Board's internal control over compliance with the requirements previously described that could have a direct and material effect on CFDA#84.394 and #84.397 – State Fiscal Stabilization Fund in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Compensation Board's internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed through November 30, 2009, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency or combination of control

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deficiencies that adversely affect the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance entitled "Improve Sub-recipient Monitoring" to be a significant deficiency. This matter is described in the section entitled "Federal Findings."

*A material weakness* is a significant deficiency or combination of significant deficiencies that result in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not find any deficiencies in internal control over compliance that we consider to be material weaknesses.

The Compensation Board's response to our findings is described in the section "Federal Findings." We did not audit the Compensation Board's response and, accordingly, we express no opinion on it.

This interim communication is intended solely for the information and use the Governor and General Assembly, management, others within the entity, federal awarding agencies, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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## FEDERAL FINDINGS

### U.S. DEPARTMENT OF EDUCATION

#### Improve Sub-recipient Monitoring

The Compensation Board has not previously managed federal funds and consequently does not have detailed processes and policies for disbursing and managing federal funds. For the federal funds received in fiscal year 2009, the Compensation Board did communicate grant requirements and allocation of funds to the localities. However, the Compensation Board has not established a process for monitoring the local entities to ensure appropriate use of federal funds, including requesting and reviewing local entities' federal compliance audit reports (OMB Circular A-133 audit reports).

The Compensation Board has not established for fiscal 2010 the requirements for the localities to appropriately spend and receive reimbursement of the Byrne Justice Assistance Grant (JAG) Program. This program has significantly different recordkeeping and other requirements from the federal funds the Compensation Board disbursed in fiscal year 2009.

As an example of a federal compliance requirement for both grants, the Compensation Board did not communicate the requirement for all entities receiving funds to have a separate Data Universal Numbering System (DUNS) number, as required by the federal government. As a result, the Compensation Board cannot ensure that the localities are appropriately managing and reporting federal pass-through funds.

Compensation Board management has begun working on establishing more detailed processes, policies, and procedures to address federal funds. The Compensation Board should continue to gain more knowledge about federal grant requirements and continue to develop its processes, policies, and procedures for managing and disbursing federal grants. This should include more communication with the localities to ensure that both parties are complying with federal laws and regulations.

#### Management Response:

*Regarding sub-recipient monitoring, Compensation Board staff has reviewed independent auditor federal compliance reports related to OMB Circular A-133 for FY08 for approximately one-third of recipient localities and is in the process of reviewing additional records for remaining localities. Staff is also in discussions with DCJS regarding their ability to meet the sub-recipient monitoring requirements for this grant through a memorandum of understanding between both agencies, as DCJS already has in place a review process for similar grants it administers directly to localities, and the Compensation Board does not have adequate resources to devote to this process.*

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## RISK ALERT

During the course of completing the Compensation Board audit for the statewide single audit of federal funds, we encountered an issue that may require the action of other agencies, the Departments of Accounts and Criminal Justice Services. This matter represents a risk of potential questioned federal grant costs to the Commonwealth.

### Establish Process to Manage Federal Funds

In the past, the Compensation Board primarily received General Fund appropriations to pay for their programs. However, during fiscal year 2009, the Board received approximately \$109 million in one-time federal stimulus funds that it subsequently passed through to local sheriff's offices and regional jails.

During fiscal year 2010, the Board will receive new federal stimulus funds, the Byrne Justice Assistance Grant (JAG) Program, and pass these funds to localities under a separate grant award. The federal funds for fiscal 2010 have significantly different recordkeeping and other requirements from the federal funds spent in fiscal year 2009.

The federal grants place a significant additional administrative burden on agencies that receive those funds, especially if the agency passes the funding on to localities. Among other functions, federal grants require additional cash management, sub-recipient monitoring, and reporting processes.

Until fiscal year 2009, the Compensation Board had no prior experience with federal grants. As a result, the Compensation Board has not previously established federal grants management functions and may not have the expertise or resources to appropriately manage federal funds.

This lack of grant management processes poses a significant risk to the Commonwealth and could result in severe penalties for non-compliance with federal laws. Given our experience this year, we are informing the State Comptroller and the Director of Criminal Justice Services that without assistance from other Commonwealth agencies, the Compensation Board may not fully comply with federal laws and regulations, which can result in federal questioned costs.

### Management Response:

*In FY09, general fund dollars were supplanted with federal funds at fiscal year-end, and prior expenditures by the Compensation Board to reimburse localities and regional jail authorities for personnel costs incurred were transferred to federal funds. This allocation of federal funds to localities was done after the end of the fiscal year, during year-end close, and was an allocation of State Fiscal Stabilization Funds – General, utilized for the payment of Commonwealth expenditures to support personnel costs in sheriffs' offices and regional jails, and to support per diem payments to localities for support of jail operational costs. The decision to utilize federal funds in this manner, and budgetary and accounting transactions to effect the supplant, were not decisions or transactions of the Compensation Board but were handled by other Finance agencies. Staff did provide assistance and information to the degree possible to assist these agencies in performing the supplant, and staff did assist in providing notification to Sheriffs, Regional Jails and local governments regarding the supplant action.*

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*While certain assurances, particularly regarding the existence of DUNS numbers in localities where funds were supplanted and reviews of federal single audits to ensure local controls were in place for proper management of federal funds, were not determined in advance of the year-end supplant, policies and procedures are in place governing the reimbursement of expenses budgeted by the Compensation Board and incurred by localities in support of personnel in the sheriff's office or regional jail, and are also in place governing the payment of per diem amounts to localities in support of local/regional jail operational costs. Appropriateness of payment, regardless of fund source, was determined prior to original payment of incurred expenses through the Board's standard budgeting, reimbursement, and per diem payment processes. Appropriateness of use of this stream of federal stimulus funds for the supplant of general funds for these specific payments was confirmed by Finance agencies with the federal governing agency.*

*In FY10, the 2009 General Assembly provided an allocation of \$23.3 million in federal stimulus funds (Edward Byrne Justice Assistance Grant – JAG) to keep whole the budgets set by the Compensation Board for sheriffs' offices and regional jails, restoring a significant portion of a proposed general fund reduction in funding for FY10. Working with the Department of Criminal Justice Services – the prime recipient of the federal JAG funds – the Compensation Board has identified reimbursable salaries and benefits of sworn deputies and regional jail officers in Sheriffs' Offices and Regional Jails as the expense to be covered by the federal funds, and the Board included the federal funds as a funding source in setting level-funded budgets for these offices for FY10 on May 1, 2009.*

*While the Compensation Board is still working with DCJS and the Department of Accounts (DOA) to finalize its detailed plans for distribution of the federal funds in the third quarter of FY10, the general processes have been established and in place for several months and the Compensation Board has communicated to localities preliminary information regarding the grant, its intended use, local distribution amounts and preliminary requirements regarding financial management and reporting. The Compensation Board has also requested and obtained DUNS number information from all localities impacted.*

*At this time, the Compensation Board is awaiting final guidance from DCJS and DOA regarding reporting and cash disbursement requirements prior to communicating final detailed processes and instructions to localities and Sheriffs' Offices and Regional Jails. Compensation Board staff met with staff of DCJS earlier this week, and will be meeting again with DCJS and with DOA at the end of this week to finalize the detailed requirements for cash management and identify detailed reporting requirements. Staff from the Office of the Auditor of Public Accounts has also been included in these meetings. The Compensation Board anticipates that it will be able to provide additional detailed information regarding disbursement processes and reporting requirements to localities and Sheriffs' offices/Regional Jails within the next three weeks.*