STATE OF CONNECTICUT

AUDITORS' REPORT
DEPARTMENT OF VETERANS' AFFAIRS
FOR THE FISCAL YEARS ENDED JUNE 30, 1999 AND 2000

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE

Table of Contents

June 11, 2001

AUDITORS' REPORT
DEPARTMENT OF VETERANS' AFFAIRS
FOR THE FISCAL YEARS ENDED JUNE 30, 1999 AND 2000

We have examined the financial records of the Department of Veterans' Affairs for the fiscal years ended June 30, 1999 and 2000. This report on that examination consists of the Comments, Recommendations and Certification which follow.

Financial statement presentation and auditing have been done on a Statewide Single Audit basis to include all State agencies. This audit examination has been limited to assessing compliance with certain provisions of financial related laws, regulations, contracts and grants and evaluating internal control structure policies and procedures established to ensure such compliance

COMMENTS

FOREWORD:

The Department of Veterans' Affairs (DVA) operates under the provisions of Title 27, Chapter 506, Parts I and Ia, Sections 27-102L through 27-137 of the General Statutes and provides comprehensive health, social and rehabilitative services to veterans in the State of Connecticut. The Department of Veterans' Affairs operates the Veterans' Home and Hospital in Rocky Hill that includes a 350 bed hospital and a 519 bed domicile for eligible veterans. Occupancy in the hospital and domicile has been declining for several years, due primarily to residents having to make cost of care payments. Because of this declining occupancy, the hospital is budgeted for 200 beds while the domicile is budgeted for 350 beds. The Agency also operates the Office of Advocacy and Assistance that maintains offices throughout the State and provides advice, assistance and formal representation to veterans and their dependents.

Eugene A. Migliaro, Jr., served as Commissioner throughout the audited period.
Under the provisions of Section 27-102n of the General Statutes, there is a Board of Trustees

established to advise and assist the Commissioner in operating the Agency. The Board consists of the Commissioner and nine members appointed by the governor. The Deputy Commissioner serves as a non voting member of the Board. The Board members are not compensated for their services but may receive reimbursement for reasonable expenses in the performance of their duties. As of June 30, 2000, the following persons served on the Board:

General David D. Boland
John G. Chiarella, Sr.
Clifford R. Wiltshire
William J. Pomfret
John N. Roberto
Linda S. Schwartz
Judith A. Torpey
Stanley F. Zebzda
Robert Wamester

Richard W. Lewis also served during the audited period.

RÉSUMÉ OF OPERATIONS:

Persian Gulf War Information and Relief Commission:

The Commission was created by Public Act 97-144; this Act was codified at Title 27, Chapter 507, Part V of the General Statutes. The Commission advises the Department on (1) medical and social assistance for Gulf War veterans exposed to toxic substances; (2) recommendations for legislation and (3) information that should be provided to Gulf War veterans. As of June 30, 2000, the Commission members were:

Maurice L.Collin, Chairman
Dr. Zygmunt F. Dembek
Michael Donnelly
Allen Wilcoxson
Dr. John Pierce Wise

General Fund Revenues and Receipts:

A comparative summary of General Fund revenues and receipts during the audited period is presented below:

	1998-1999	1999-2000
Medicare reimbursements	$2,093,530	$1,998,698
Federal aid for disabled veterans	4,901,251	5,204,574
Federal aid-miscellaneous	40,650	40,950
Rents for cottages or residences	50,867	51,478
Refunds of expenditures-other than budgeted appropriations (applied to expenditures)	2,563,895	2,786,369
All other revenues and receipts	164,271	135,297
Total Revenues and Receipts	**$9,814,464**	**$10,217,366**

For comparative purposes, total revenues and receipts for the 1997-1998 fiscal year amounted to $9,913,920. The "Refunds of expenditures-other than budgeted appropriations" category consists in large part of transfers from the Institutional General Welfare Fund; these transfers are discussed in the next section.

General Fund Expenditures:

A summary of expenditures for the fiscal years ended June 30, 1999 and 2000, as compared to the preceding fiscal year, is presented below:

	1997-1998	1998-1999	1999-2000
Personal services	$19,404,285	$19,738,756	$20,993,192
Contractual services	4,883,898	4,891,007	4,944,261
Commodities	3,426,207	3,234,873	3,542,029
All other	41,059	102,227	346,154
Total Expenditures	**27,755,449**	**27,966,863**	**29,825,636**
Less: Transfers from other accounts	2,593,249	2,537,140	2,770,850
Net Expenditures per Comptroller	**$25,162,200**	**$25,429,723**	**$27,054,786**

As shown above, total expenditures showed gradual growth throughout the audited period. The increase in personal services expenditures during the audited period was due to an increase in staffing and cost of living increases; paid positions increased from 418 as of June 30, 1998 to 451 at June 30, 2000. Also of significance was the fluctuation in transfers from the Institutional General Welfare and Activity Funds, which is explained below.

Under Section 27-108 of the General Statutes, recoveries for the care and treatment of patients are deposited in the Institutional General Welfare Fund. The Agency, in turn, transfers the monies to a restricted contribution account (Institutional General Welfare Fund, SID 301) within the General Fund. These moneys, categorized as "refunds of expenditures" are used to finance part of the Agency's operating costs. Similar transfers were made from the Activity Fund to the Activity Fund restricted account within the General Fund (SID 303). These transfers are summarized in the following tabulation.

	1998-1999	1999-2000
Institutional General Welfare Fund (SID 301)	$2,510,000	$2,750,000
Activity Fund (SID 303)	27,140	20,850
Total Transfers from Other Accounts	**$2,537,140**	**$2,770,850**

Per Capita Costs:

Annually, the State Comptroller computes the daily per capita cost of maintaining the residents and patients at the Veterans' Home and Hospital. Included in these computations are expenditures of the Institutional General Welfare Fund, which are considered proper costs of maintaining the institution. Per capita daily costs for the domicile and hospital are shown below:

	1998-1999	1999-2000
Domicile (barracks)	$59	$69
Hospital (inpatient)	384	401

Soldiers', Sailors' and Marines' Fund:

Section 27-118 of the General Statutes authorizes the Agency to pay $150 toward burial expenses when any veteran dies not having sufficient estate to pay the necessary expenses of his or her last sickness or burial. In addition, Section 27-119 of the General Statutes provides for payment of expenses related to the transportation and erection of headstones provided by the Federal Government. Funds for headstones and burial expenses of eligible veterans were budgeted through the Soldiers', Sailors' and Marines' Fund (#1115). We address the operations of the Soldiers', Sailors' and Marines' Fund in a separate report.

Only expenditures from appropriations budgeted to the Department of Veterans' Affairs were examined in the course of this audit. A summary of such expenditures follows:

	1998-1999	1999-2000
Burial expenses (SID 604)	$ 4,800	$ 1,200
Headstones (SID 605)	220,690	202,080
Total DVA Expenditures	**$225,490**	**$203,280**

Institutional General Welfare Fund:

The Institutional General Welfare Fund (IGWF) operates under the provisions of subsections (b) and (c) of Section 27-106 and subsection (e) of Section 27-108 of the General Statutes and is available to finance operations of the Veterans Home and Hospital. DVA has been using this Fund to supplement its General Fund appropriations.

Under the provisions of Section 27-108, subsection (c) of the General Statutes, veterans who are able to pay, in whole or in part, for the Department of Veterans' Affairs' services shall receive a monthly bill for such services. The Agency has a patient billing system to collect such monies categorized below as "Patient billings". A finding relating to the patient billing system is presented in the "Condition of Records" section of this report.

As shown below, another significant source of revenue is estate collections. This is permitted under subsection (f) of Section 27-108 of the General Statutes, which states that in the event a veteran dies still owing money for services rendered by the Department of Veterans' Affairs, the Agency may submit a claim against such veteran's estate. Estate collections have been declining steadily; such collections peaked during the 1993 - 1994 fiscal year, amounting to $835,962. We were informed that the decrease is due to improved collection efforts prior to a veteran's death.

A summary of the Institutional General Welfare Fund's revenue and receipts transactions follows:

	1998-1999	1999-2000
Revenues and Interfund Transfers		
Patient billings	$2,943,837	$2,513,402
Estate collections	185,672	119,096
Transfers from other funds	-	-
All other	63,746	104,753
Total Revenues and Transfers	**$ 3,193,255**	**$ 2,737,251**

For comparative purposes, revenues and transfers during the 1997-1998 fiscal year amounted to

$2,598,690. There was a modest increase in "Patient billings" during the 1998-1999 fiscal year.

Expenditures for the 1998-1999 fiscal year amounted to $2,222,607 and $2,769,547 for the 1999-2000 fiscal year. For comparative purposes, IGWF expenditures during the 1997-1998 fiscal year amounted to $2,498,560. These expenditures were made for the general operations of the Veterans' Home and Hospital, primarily out of the IGWF restricted appropriation (SID 301) in the General Fund. The "detail payroll" is paid through the IGWF; elderly residents are paid an allowance of $15 per week in return for performing chores.

In reviewing the financial statements for the Fund, we noted that cash and cash equivalents have improved significantly, as shown in the following tabulation.

June 30, 1998	$647,326
June 30, 1999	$1,633,784
June 30, 2000	$1,609,957

Activity Fund:

The Activity Fund operates under the provisions of Sections 4-52 through 4-55 of the General Statutes for the benefit of residents and patients of the Department of Veterans' Affairs. The major sources of fund receipts were sales at the Winners Circle canteen and vending machine commissions. Revenues for the Activity Fund totaled $18,846 and $21,626 for the fiscal years ended June 30, 1999 and 2000, respectively.

As previously noted, monies from the Activity Fund are transferred and disbursed to a General Fund restricted account (SID 303). Section 4-53 of the General Statutes permits transfers of excess cash to the Welfare Fund; however, there were no such transfers during the audited period. According to the Agency's financial statements, the Activity Fund's cash and cash equivalents balance was $5,054 as of June 30, 2000.

Fitch and Posthumous Funds:

The Fitch and Posthumous Funds are longstanding permanent trust funds whose assets are in the custody of the State Treasurer. The principal balances of these two funds amounted to $11,961 and $23,731, respectively, as of June 30, 2000. Interest earned on these funds is transferred to the Institutional General Welfare Fund and used for the benefit of the Agency's clients. The Posthumous fund is governed by Section 3-38 of the General Statutes.

PROGRAM EVALUATION:

Under the provisions of Section 2-90 of the General Statutes, the Auditors of Public Accounts are authorized to perform audits of programs and activities. We selected the Office of Advocacy and Assistance ("OA&A") in order to assess the effectiveness of this unit.

One of the primary functions of OA&A is to obtain benefits for veterans and their families. Subsection (b) of Section 27-102 L specifies that the Office of Advocacy and Assistance will be headed by the Deputy Commissioner and have a minimum staff of eight (8), with one (1) veteran service officer assigned to each of the State's six (6) Congressional districts. Currently, OA&A has a staff of 18 in addition to the Deputy Commissioner. OA&A maintains six (6) field offices in the Congressional districts; the field office for the First District is co-located on the grounds of the Veterans Home and Hospital in Rocky Hill.

Since processing benefit claims is the primary function of the OA&A , a summary of activity is presented below.

	1998-1999	**1999-2000**
Compensation	403	506
NSC pension	326	355
Death pension	164	180
Dependency compensation	21	17
Burial funds	65	50
Educational benefits	20	41
Military assistance	11	10
Overpayment waivers	22	17
Miscellaneous assistance	272	537
Total Benefit Claims Processed	**1,304**	**1,713**
Value of benefits	$14,439,800	$17,549,400

Finally, *A Guide to Benefits for Connecticut's Veterans* was revised in September 1999. This *Guide* is an important element in fulfilling the statutory requirement of subsection (c)(3) of Section 27-102L to disseminate information about veterans' benefits. In conclusion, the OA&A unit appears to be effective in obtaining benefits for Connecticut veterans and their families.

CONDITION OF RECORDS

Our review of the financial records of the Department of Veterans' Affairs revealed certain areas warranting attention that are discussed in the following findings.

Net Accounts Receivable Misstated:

Background: Accounts receivable balances as of June 30th of each year are required to be reported on GAAP Form #2. Net accounts receivable at the Department of Veterans' Affairs result from charges for room, board and care less those charges estimated to be uncollectable. Net receivable amounts reported should be based on the patient, resident or their family's ability to pay plus any monies which may later be collected from Medicaid or insurance companies. Generally, credit receivable balances occur when more money is recorded as received than is owed.

Criteria: An accounts receivable system should reflect account balances that are valid and collectible. A similar finding has been presented in our last four Department of Veterans' Affairs audit reports.

Conditions: 1. In our review of documentation supporting reported GAAP net receivables, we noted the inclusion of large balances for certain patients or residents. Reported net receivable balances for nine individuals, one as large as $658,000, totaled over $1,550,000 without any consideration of their ability to pay.

2. Reported net receivables also contained over $555,000 of credit receivable balances, the majority of which was not expected to be returned to patients or residents.

Effect: Including receivable balances not expected to be collected or including credit receivable balances not expected to be returned misstated net receivables.

Cause: The Agency did not have a system in place to evaluate whether reported net receivables are valid. Reasons for credit receivable balances varied.

Recommendation: The Agency should develop and implement an integrated patient billing system that would reflect valid collectible receivable balances. This system should include an allowance for bad debts or collectibles based on a resident's or patient's ability to pay. (See Recommendation 1.)

Agency Response: "While the agency's receivable system is not fully complete at this time, we disagree with the notion that net receivables balances should be exclusively a factor of a patient's current and future ability to pay. These amount[s] are, and have been in our experience, considerably speculative due to a variety of factors, including under-reporting, future entitlements not determined at the time of the incurrence of debt, and other "surprises" that tend to be disproportionately high amongst our patient population. We favor a different approach that maintains a gross receivables balance and then discounts; the ability to pay amount and portion of the overall remaining debt, based on a percentage that reflects other unknown sources of collection (usually determined after the patient has deceased). This would also make the computation of this net receivables balance more accurate and easier to maintain."

Auditors' Concluding Comment:

While we acknowledge that the DVA accounts receivable system is used to track lifetime liabilities, which for the most part will never be collected, the system should also be capable of producing accurate information for financial reporting purposes. Further refinements in the system are necessary.

Excess Cash Balances in the Institutional General Welfare Fund Bank Account:

Criteria: The State of Connecticut's *Activity/Welfare Manual* states that any excess monies not needed for the on-going operations should be placed in the State Treasurer's Short Term Investment Fund (STIF). Also, bank account balances are insured by the FDIC only up to $100,000.

Condition: In our review of the Agency's Institutional General Welfare (IGW) Fund checking account, we noted an average daily cash balance of over $500,000 from January 1999 through December 2000.

Effect: Allowing cash balances to remain at such high levels in this bank account not only greatly reduced interest income but also subjected large amounts of these monies to being uninsured.

Cause: We noted a change in staffing around December 1998; after that time, no one seemed to monitor large changes in bank balances to maximize investments in STIF and ensure that bank balances did not exceed $100,000.

Recommendation: The Agency should develop a system to ensure that bank account balances of the IGW Fund do not exceed $100,000 and invest any excess amount in the State Treasurer's STIF account. (See Recommendation 2.)

Agency Response: "The auditor's recommendations are noted and we will be re-implementing a process of monitoring and stripping balances in excess of $100,000. Implementation will be immediate."

Failure to Comply with Section 4-36 of the General Statutes:

Criteria: Each State department is required to establish and maintain an inventory account in accordance with Section 4-36 of the Connecticut General Statutes. A detailed annual inventory of all real or personal property owned by the State and in the custody of the department is to be reported on or before August first as of June thirtieth every year. The State of Connecticut's *Property Control Manual* requires that these reports must be supported by detailed records and that State agencies have policies and procedures in place to ensure that all assets over $1,000 owned or leased will be properly recorded and accounted for in an annual physical inventory. Similar findings were presented in our four prior audit reports.

Conditions: 1. Building improvements amounting to $312,916 were not added to the building cost for the June 30, 1999 annual inventory report.

2. As a result of our inspection of a sample of 40 equipment items shown on the equipment inventory records, we noted that one item with a cost of $6,897, had been sent to State Surplus years earlier but not removed from the inventory records. And a computer was listed as a monitor with a cost of $1.

3. Complete physical inventories were not conducted during either the fiscal year ended June 30, 1999 or the fiscal year ended June 30, 2000.

Effects: 1. The cost of buildings has been understated on the annual inventory reports.

2. The amount reported on the annual inventory reports was inaccurate.

3. Equipment items may be obsolete, lost or stolen without the Department's knowledge. Additionally, this will result in overstated balances on the annual inventory reports.

Cause: The reasons for these conditions could not be determined.

Recommendation: Management should comply with the requirements of Section 4-36 of the General Statutes and State of Connecticut's *Property Control Manual*. In addition, management should improve their property control records and conduct physical inventories periodically. (See Recommendation 3.)

Agency Response: "The agency is developing a more comprehensive plan in addressing both the building improvements and the physical inventory. Prior staff shortages, miss-assignment of responsibilities (IT Equipment) and issues with the [C]omptroller's equipment inventory system precluded conducting and maintaining a complete and accurate building improvement and equipment inventory. The sole responsibility now fully rests with the Materials Management department. A complete physical equipment inventory has already begun and is expected to be finished by 6/30/2001 for the next reporting period."

Software Inventory:

Criteria: The State of Connecticut's *Property Control Manual* requires State departments to maintain records of all software installations. A similar finding was presented in our prior report.

Condition: An inventory of software installed on computers still has not been updated.

Effects: The Agency was not in compliance with the requirements of the State of Connecticut's *Property Control Manual.*

Cause: The Agency did not update its software inventory records.

Recommendation: Management should update the software data files and maintain its software inventory in accordance with the State of Connecticut's *Property Control Manual.* (See Recommendation 4.)

Agency Response: "The Agency has shifted the responsibility of conducting and maintaining a Property Control Manual compliant software inventory to the Materials Management Department (from the IT department). The software audit/inventory has begun and is expected to be completed by 6/30/2001, the next reporting due date."

Improper Charges to Capital Equipment Purchase Fund:

Criteria: According to Section 4a-9 of the General Statutes, the Capital Equipment Purchase Fund (CEPF, #1872) shall be used for the purpose of acquiring capital equipment with an anticipated useful life of not less than three years from the date of purchase. The *State Accounting Manual* defines Capital Outlays-Equipment as all items of equipment (machinery, tools, furniture, vehicles, apparatus, etc.) with a value of $1,000 or more and a useful life of one year or more.

Condition: Our review of expenditures disclosed that building and land improvements were financed by the CEPF. A security booth and gate costing $21,959 was charged to the CEPF in the 1998-1999 fiscal year. In the 1999-2000 fiscal year, we noted a fire suppression system costing $5,511 and door replacements costing $6,200 charged to the CEPF. These items appear to be building improvements and land improvements rather than equipment items.

Effect: Land improvements (security booth) and building improvements were financed by the CEPF. Although the money was properly allotted, it was spent for other than equipment acquisitions.

Cause: DVA administrators did not consider the State Comptroller's definition of equipment when making these expenditures.

Recommendation: The Agency should use the Capital Equipment Purchase Fund only for the acquisition of equipment. (See Recommendation 5.)

Agency Response: "The Agency asserts that two CEPF-purchased items noted in this finding; security booth, fire suppression system are equipment items as defined in the State Accounting Manual.

First, the security booth is both valued at over $1,000 and has a useful life of more than 1 year. In addition structural improvements to land are specifically excluded from the comptrollers definition of capital outlays – land. As the security booth and its gate are physically separate from any existing building, it does not meet the definition of capital outlays – buildings and improvements either. In fact, the definition of general agency equipment is the only classification of coding where the actual item is not in conflict with the comptroller's definition.

Second, the fire suppression system is a part of kitchen equipment items (i.e. ovens, grills, etc.) and is not permanently attached to the building. These systems are attached to the equipment items themselves and have the limited purpose of suppressing fire within that item. Therefore, they do not meet the comptroller's definition of capital outlays – buildings and improvements.

Lastly, the doors that were purchased, while technically not fully meeting the definition of equipment and arguably more appropriately coded as a building improvement, were acquired through a situation defined as an emergency by the Commissioner. A large grouping of doors requiring replacement was defined and while a capital project source of funding was being explored, these few doors became inoperable and thus a replacement was sought by whatever means possible.

In the future, the Agency will make every effort to acquire proper funding sources before situations evolve into a[n] emergency status and require extraordinary measures."

Auditors' Concluding Comment:

We disagree with the opinion that the security booth is an equipment item. Resources of the Capital Equipment purchase Fund should only be used for equipment acquisitions.

RECOMMENDATIONS

In our prior report, we presented 11 recommendations. Of the 11, eight (8) were implemented or were no longer applicable and three (3) are being repeated as current audit recommendations. And, two (2) new recommendations are being presented as a result of our current audit.

Status of Prior Audit Recommendations:

- The Department should develop a program plan. A study of hospital operations was performed. This recommendation is not being repeated.

- The facility maintenance plan should be revised and updated. A consultant has been selected to perform a facility survey, which should begin during the Spring 2001. This recommendation is not being repeated.

- The petty cash checking account for the Institutional General Welfare Fund should be reconciled to the bank statements. This recommendation has been implemented.

- The Department should implement a computerized accounting system for the Activity and Institutional General Welfare Funds. This recommendation has been implemented.

- The Department should develop an integrated patient billing system. We continued to note deficiencies in the accounts receivable balances and the recommendation is restated below as Recommendation 1.

- Doctors should be trained in completing medical forms, so that Medicare claims can be filed. Representatives from the State's Financial Services Center conducted the training and prepared the claims for past services. This recommendation has been implemented.

- The internal control self-assessment should be completed on time. The assessment for 2000 was completed on time, so the recommendation is not being repeated.

- Obligations should be committed against appropriations. We did not note any instances where obligations were not committed against appropriations, so this recommendation is not being repeated.

- Property control records should be improved and the annual inventory report submitted on time. We noted an improvement in the submission of the annual inventory reports. However, we still noted deficiencies in the property control records and for this reason, the recommendation is repeated below as Recommendation 3.

- The software inventory records should be updated and maintained in accordance with the State Comptroller's guidelines. There has been no progress on updating the software inventory records and the recommendation is repeated as Recommendation 4 below.

- We had recommended that the Department utilize an automated time and attendance system. In May 2000, the Department implemented such a system. Therefore, the recommendation is not being repeated.

Current Audit Recommendations:

1. **The Agency should develop and implement an integrated patient billing system that would reflect valid collectible receivable balances. This system should include an allowance for bad debts or collectibles based on a resident's or patient's ability to pay.**

   Comment:

   We continued to note inaccurate balances in the accounts receivable system.

2. **The Agency should develop a system to ensure that bank account balances of the Institutional General Welfare Fund do not exceed $100,000 and invest any excess amount in the State Treasurer's Short-Term Investment Fund account.**

   Comment:

   We noted that the average daily balance in the Institutional General Welfare Fund checking account exceeded $500,000 from January 1999 through December 2000.

3. **Management should comply with the requirements of Section 4-36 of the General Statutes and State of Connecticut's *Property Control Manual*. In addition, management should improve their property control records and conduct physical inventories periodically.**

   Comment:

   We noted errors in the annual inventory report and that physical inventories of equipment had not been performed.

4. **Management should update the software data files and maintain its software**

inventory in accordance with the State of Connecticut's *Property Control Manual.*

Comment:

The software inventory records had not been updated.

5. **The Agency should use the Capital Equipment Purchase Fund only for the acquisition of equipment.**

   Comment:

   Expenditures were made from the Capital Equipment Purchase Fund for land improvements and building improvements.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Department of Veterans' Affairs for the fiscal years ended June 30, 1999 and 2000. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Veterans' Affairs for the fiscal years ended June 30, 1999 and 2000, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial-related audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Department of Veterans' Affairs complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the Department of Veterans' Affairs is the responsibility of the Department of Veterans' Affairs management. As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts, and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal years ended June 30, 1999 and 2000, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Department of Veterans' Affairs is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Agency's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grants. We believe the following findings represent reportable conditions: net accounts receivable were misstated; there were excess cash balances in the Welfare Fund checking account; the Agency did not comply with the property inventory requirements and there were nonequipment charges to the Capital Equipment Purchase Fund.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants or the requirements to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we believe that none of the reportable conditions described above is a material or significant weakness.

We also noted other matters involving internal control over the Agency's financial operations and over compliance which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program

Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended our representatives by the officials and staff of the Department of Veterans' Affairs during the examination.

Harold L. Colvocoresses
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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