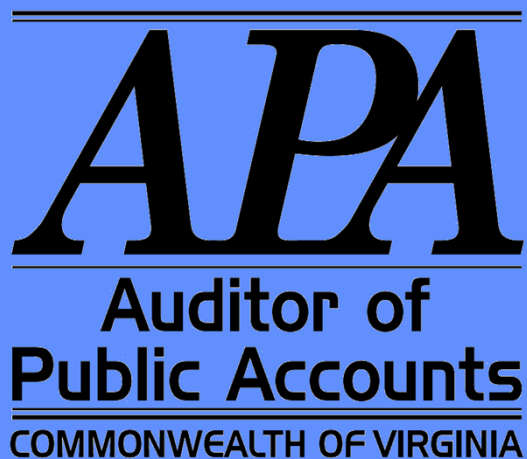


**OFFICE OF THE ATTORNEY GENERAL
AND
THE DEPARTMENT OF LAW**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2011**



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;
- a matter involving internal control and its operation surrounding cash collections, which management brought to our attention and has taken corrective action to address;
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported;
- the Office has completed corrective action with respect to the prior audit finding titled “Improve Policies and Procedures for Accounting Transactions;” and
- the Office has made significant progress on corrective action in response to our prior audit finding titled “Improve Supporting Documentation for Legal Service Billings” by completing policies and procedures for legal service billings during the last quarter of fiscal year 2011.

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AUDIT FINDINGS AND RECOMMENDATIONS

Strengthen Internal Controls Over Cash

Over a period of multiple years, the Office of the Attorney General and Department of Law (Office) collected and held non-state funds, totaling approximately 500 dollars, for a non-state organization. During our fiscal year 2011 audit, management brought to our attention that the Office could not locate these funds. We reviewed the process used to collect and store these funds and found a lack of internal controls over cash, which greatly increases the risk of loss or misappropriation.

Prior Finance staff stored these funds in a safe located in the Deputy Director of Finance's office. There was no authorization or awareness by management that agency personnel were collecting or storing the funds. When the non-state organization contacted the Office in 2011 to retrieve the funds, the Office was unable to locate the cash.

We performed a review of the process used to collect these funds and determined that there were no procedures for the collection, receipting, and deposit of cash collections for outside non-state funds. Although we found evidence that Finance staff receipted these funds, those involved with the funds did not maintain receipts or other documentation to substantiate the funds collected.

The Finance staff left the safe containing these funds unlocked and unattended during business hours, so we could not determine all individuals who may have accessed these funds. Furthermore, the Office also collected cash contributions from employees for donation to charitable organizations, and Finance staff stored these funds in the same safe. Consequently, we could not eliminate the possibility that Finance staff unintentionally commingled the missing funds with other funds in the safe.

Based on the circumstances described above, establishing who lost or took the funds is unlikely. The Office has developed policies and procedures surrounding cash collections of Commonwealth of Virginia funds and prohibiting Finance staff from handling non-state funds. We recommend that the Office communicate these policies and procedures to all staff periodically to ensure compliance.

Status on Prior Year Finding: Improve Supporting Documentation for Legal Service Billings

In the prior year, we found that the Office did not maintain sufficient documentation to substantiate changes made to attorney hours billed to other state agencies. The inability to substantiate billing changes increases the risk that agencies could be over- or under-billed and that there could be questioned costs for legal services charged to Federal funds.

To address the prior year's issues, the Office developed 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 for all hours charged to an agency. The policies and procedures require that the Office appropriately support amounts billed to clients with hours recorded by attorneys and the rate applied and in effect for the fiscal year (or quarter, where appropriate).

Furthermore, the Office will communicate justification for hours charged via the annual legal letters sent to each client agency or Memorandum of Understanding that exists to govern the client relationship.

The Office completed its policies and procedures during the last quarter of fiscal year 2011 and changed the Finance staff responsible for legal billings. Since the fiscal year 2011 billing cycle was already in process prior to these corrective actions occurring, our review of legal billings from fiscal year 2011 identified instances where the Office was unable to substantiate differences between hours billed and hours recorded in the Legal Hours Database. However, exceptions during the current year review were fewer in number, and variances were less significant than those identified during the prior year.

Our current year review of the legal billing process determined that the Office's new policies and procedures over legal billings are sufficient to ensure that attorneys properly record hours, the Office bills agencies according to actual hours recorded, and the Office maintains proper supporting documentation for any modifications. We will review the agency's legal billing process during the fiscal year 2012 audit to ensure that the Office properly implements the policies and procedures and that they properly substantiate any discrepancies between actual hours charged by attorneys and hours billed to an agency.

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 2011.

2011 Budgeted and Actual Expenses

<u>Program</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Legal advice	\$26,510,916	\$28,458,327	\$24,903,231
Medicaid program services	6,142,837	7,849,557	7,661,886
Regulation of business practices	<u>2,241,681</u>	<u>2,241,681</u>	<u>1,748,176</u>
Total	<u>\$34,895,434</u>	<u>\$38,549,565</u>	<u>\$34,313,293</u>

Source: Commonwealth Accounting and Reporting System

The following schedule includes detail relating to adjustments to appropriations during fiscal year 2011.

Budget Analysis for Fiscal year 2011

Original appropriations per Chapter 874	<u>\$34,895,434</u>
Adjustments:	
Increase non-general fund appropriation to expand Medicaid Fraud Control Unit	1,612,415
Carry forward FY 2010 general fund cash balance to fund legal support for the 2011 redistricting plan	527,270
Appropriate additional agency indirect cost revenues for agency support services	509,000
Transfer from Central Appropriations for bonuses, benefit changes, and other amounts as required by Items 469 and 473 of Chapter 874	377,053
Transfer from the Department of Criminal Justice Services for the Victim Witness Grants	264,294
Decrease general fund appropriation by keeping vacant the position of Senior Counsel to the Attorney General	(184,000)
Increase non-general fund appropriations to enable payment of December 2010 bonuses	163,530
Increase non-general fund appropriation to sustain the Appropriated Indirect Cost Recoveries Fund until passage of the FY 2011 Budget Bill	141,829
Increase Asset Forfeiture Fund appropriation for law enforcement and prosecution	98,250
Increase non-general fund appropriation to cover two Microsoft license agreement payments	69,149
Carry forward of FY 2010 general fund cash balance to fund internal programs and initiatives deemed necessary by the Attorney General	50,000
Miscellaneous adjustments	<u>25,341</u>
Total adjusted appropriations	<u><u>\$38,549,565</u></u>

As previously noted, State law permits the Office to bill agencies and universities for legal services if the agency receives all or a part of its funding from non-general funds. The Office calculates an agency's legal service charges for a fiscal year using actual attorney hours worked during the previous fiscal year. At the start of a fiscal year, the Office notifies each agency of their expected charges for the year, and at the beginning of each quarter, the Office bills the agency for that quarter's portion. The following table provides detail of the Office's legal service revenues for fiscal years 2007 through 2011.

Legal Service Revenues

<u>Fiscal Year</u>	<u>Revenues</u>
2007	3,093,426
2008	5,090,249
2009	4,545,532
2010	5,393,597
2011	5,538,162

Source: Commonwealth Accounting and Reporting System

Medicaid Fraud Control Unit

The Virginia Medicaid Fraud Control Unit (MFCU) investigates and prosecutes health care provider insurance fraud against the state and federally funded Medicaid program. 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 require a 25 percent match of General Funds; however, in fiscal year 2008, the MFCU recovered \$39.8 million in the Purdue OxyContin criminal case and will use these funds indefinitely to provide the 25 percent Commonwealth share of the budget, as prescribed in the court order. The MFCU employs a professional staff of 81 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. Additionally, in fiscal year 2011, the MFCU expanded in accordance with the court order by adding 25 positions, most of which are investigators.

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>
2007	117,704,812
2008	541,099,617
2009	27,607,670
2010	25,390,467
2011	14,573,789

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 \$634.5 million, 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	\$44.0 million
MFCU	\$39.8 million
Department of Health Professions	\$20.0 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 2007-2011

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Maximum employment level	24	24	24	24	24
Division budget	\$1,665,104	\$1,796,047	\$1,820,469	\$1,820,469	\$1,932,884
Number of accounts	10,397	10,774	11,286	12,403	14,818
Active accounts (\$ in millions)	\$132	\$141	\$157	\$166.5	\$193.5
Gross collections (\$ in millions)	\$11.5	\$9.7	\$11.8	\$10.4	\$9.3
General Fund Allocation (\$ in millions)	\$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 2011, the Division had a cash balance of \$761,709. The Division transferred \$361,709 to the General Fund on August 31, 2011. The following table details the Division's operating revenues and expenses for the last five fiscal years.

Revenues and Expenses – Fiscal Years 2007 – 2011

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Beginning balance	\$2,715,317	\$3,251,192	\$1,849,860	\$1,024,919	\$887,987
Collection fee revenue	2,152,384	1,899,192	2,095,270	2,311,790	2,075,208
Expenses	(1,616,509)	(1,699,332)	(1,820,351)	(1,789,415)	(1,748,727)
Transfers	<u>-</u>	<u>(1,601,192)</u>	<u>(1,099,860)</u>	<u>(659,307)</u>	<u>(452,758)</u>
Ending balance	<u>\$3,251,192</u>	<u>\$1,849,860</u>	<u>\$1,024,919</u>	<u>\$ 887,987</u>	<u>\$761,709</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

October 18, 2011

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, 2011. 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, test compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Office of the Attorney General and Department of Law 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
Legal service revenue
Division of Debt Collection

Medicaid Fraud Control Unit
Information Systems Security

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 a matter involving internal control and its operation that is 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.

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

Exit Conference and Report Distribution

We discussed this report with management on November 1, 2011. 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 27, 2011

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7-1-1

Mr. Walter Kucharski
Auditor of Public Accounts
101 N. 14th Street
Richmond, VA 23219

Dear Mr. Kucharski:

On behalf of the Attorney General, I would like to thank you for providing us an opportunity to respond to the results of the recent audit of our Office. This year, like the last, we recognized a deficiency in our procedures, took corrective action and alerted your staff of the same. We recognize the role we play, in managing this agency and in the audit process is an important one.

Staff changes and the development and implementation of policies and procedures governing accounting transactions, cash collections, and legal billings has enabled us to fulfill the roles and responsibilities expected of us. We are pleased that the results of the audit acknowledge that the administration has already taken corrective actions in these areas.

We will continue to look for ways to improve our operational, financial, and information technology processes while maintaining adequate internal controls and consider you a partner. We welcome the scrutiny of an audit and view it as an opportunity to expose deficiencies and to confirm best practices.

Sincerely,

A handwritten signature in blue ink, appearing to read "Charles E. James, Jr.", written over a circular stamp.

Charles E. James, Jr.
Chief Deputy Attorney General

OFFICE OF THE ATTORNEY GENERAL

As of June 30, 2011

Kenneth T. Cuccinelli, II
Attorney General

Charles E. James Jr.
Chief Deputy Attorney General

Patrice S. Elliott
Director of Finance