

**DEPARTMENT OF MINORITY BUSINESS ENTERPRISE
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE PERIOD
JULY 1, 2003 THROUGH JUNE 30, 2004**



AUDIT SUMMARY

This report includes a finding “Consolidate Fiscal and Procurement Operations with Another Agency” that recommends that the Department consider using one of the state’s service bureaus or a larger agency to provide these services. We have recommended, in several prior audit reports, the consolidation of the Department’s fiscal and procurement activity with another large agency. However, the Department’s management did not concur with our recommendation to consolidate operations. We continue to find internal control weaknesses in the Department’s fiscal operations that are inherent given the size of the agency and its inability to retain qualified individuals to perform fiscal duties. These conditions make it difficult for segregation of duties to occur.

We are recommending that the Governor and Secretary of Commerce and Trade consider consolidating the fiscal and procurement functions within a larger agency. Consolidation would enable the Department to focus on its programmatic responsibilities and should be a less costly alternative to hiring a qualified fiscal officer.

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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Our audit of the Department of Minority Business Enterprise found that the Department had several internal control weaknesses related to its fiscal operations. Our specific internal control findings and recommendations are included below. The official response to the internal control findings and recommendations is included on page eleven.

Consolidate Fiscal and Procurement Operations with Another Agency

In our last report, the Auditor's Office recommended the consolidation of the Department's fiscal and procurement activity with another large agency. However, the Department's management did not concur with our recommendation. We continue to find internal control weaknesses in the Department's fiscal operations that are inherent given the size of the agency and its inability to retain qualified individuals to perform fiscal duties. These conditions make it difficult for segregation of duties to occur.

We are recommending that the Secretary of Commerce and Trade and the Governor consider consolidating the fiscal and procurement functions within a larger agency. This consolidation would enable the Department to focus on its programmatic responsibilities and should be a less costly alternative to hiring a qualified fiscal officer. Numerous small agencies have similar arrangements including a central accounting service for the Governor and Cabinet Secretaries.

The Department's fiscal officer position has been vacant for almost eighteen months and the agency is using its engineering coordinator and the administrative staff specialist to perform these duties along with their normal assigned duties. Although both individuals have received some training in how to use the Commonwealth's central accounting system, these employees have limited fiscal experience and knowledge of state accounting rules and regulations. Further, we would not expect that the engineering coordinator and the administrative staff specialist would have either the technical background or previous work experience to perform these functions. At best, the current arrangement will only serve a short term staffing solution in an agency this size.

Many of the internal control weaknesses below may continue to exist even if the Department has experienced fiscal staff since having adequate controls depends on having more than one person processing transactions. Additionally, there appears to exist a misunderstanding that using a service bureau will result in a loss of control over transactions and fiscal information. We believe the opposite will occur and the Department Director and staff can concentrate on their primary functions rather than administrative issues.

- **Inadequate Reconciliation:** The State Comptroller requires a monthly reconciliation of information reported in the Commonwealth Accounting and Reporting System (CARS) to support source documents. Although the Department is preparing a monthly reconciliation, there is insufficient documentation to support that an appropriate reconciliation occurs. Specifically, based on testwork, it appears that the staff are trying to reconcile two separate reports from the system to each other as opposed to the required source documents.
- **Update and Follow Accounting Policies and Procedures:** The Department has not updated many of its internal policies and procedures since November 2000. Many of the policies and procedures reference abolished positions and prior agency directors. In addition, there are no policies and procedures regarding the outside bank account, and the disbursement and purchasing policies do not include sufficient policies and procedures surrounding the use of the Small Purchase Charge Card.

- **Inadequate Expenditure Voucher Documentation:** We noted several expense vouchers with inadequate supporting documentation including the absence of quoted terms for a consultant used by the Department. This consultant received mileage reimbursement for commuting to and from work for an amount greater than the mileage rate allowed for state employees, which could have been avoided had the Department properly negotiated and documented the terms of the services to be provided.
- **Inactive Employees in the Central Payroll System:** The Department did not have inactive employees removed from the state's central payroll and system payroll. One employee remained in the system for all of fiscal year 2004 without receiving a paycheck. The Department indicated that it had contacted the Payroll Service Bureau, who processes the Department's payroll, to request the removal of the employee from the system, but did not follow-up when the employee remained on the system.
- **Inconsistent Authorization Levels:** One employee has authorization to approve expenses per the 2005 Authorized Signatories Form, which the Department is required to annually submit to the Department of Accounts, and to enter transactions in CARS, which implies a lack of segregation of duties. However, a compensating control does exist since the employee's CARS access level prevents the employee from approving transactions in CARS. The 2004 form did not have this inconsistency with user access. The agency should ensure that the Authorized Signatories Form is consistent with the actual operations of the agency and duties of its employees to prevent the potential for segregation of duties issues.
- **Modify CARS Access:** The Director's current level of CARS access allows him to both enter and approve transactions in CARS. As this level of access represents a segregation of duties issue, we recommend modifying his access to more accurately reflect the functionality of his position and to ensure adequate controls are maintained. The Director did not use this access during fiscal year 2004.
- **Limited Use of Small Purchase Charge Card:** The State Comptroller's Quarterly Report on Statewide Financial Management and Compliance cited the Department for underutilization of the small purchase charge card. Specifically, there were 15 instances where the Department made purchases from vendors participating in the small purchase charge card program, but did not use the purchasing card for payment. The Commonwealth instituted the small purchase charge card program to enable agencies to improve prompt payment performance, which has been an issue for the Department in prior years, and to reduce operating costs associated with processing traditional paper checks. Failure to use the Small Purchase Charge Card can result in the agency having to pay to process expenses needlessly.
- **Inadequate Contract Information:** The Director had one of his corporate employees initially assist him on a voluntary basis to address certain accounting issues. This individual has provided assistance to the agency, and to help defray the individual's costs, the Director has elected to pay an annual stipend for these costs. There is no documentation as to whether this stipend is either payroll, contractual, or other cost reimbursement payments to the individual.

In addition to the control issues cited above, the Secretary of Commerce and Trade has approved several transactions of a unique nature that an independent review and recording process would have thoroughly documented. As an example, the Secretary authorized the use and employment of employees of the Director's corporation as both temporary employees and contractors. Additionally, the Director has had a special arrangement with the Secretary and Governor concerning his travel costs and salary. A permanent professional fiscal and procurement staff would have documented these arrangements, and in a small agency, this is not always possible.

Improve Controls Over Outside Bank Account

The Director has sole access to the outside bank account, which the Department uses to deposit all outside donations to pay for a disparity study. The Director makes deposits and is the only person authorized to sign checks, which is a lack of separation of duties. As a compensating control, the Department's administrative staff specialist keeps a check log and reconciles the monthly bank statement. We found untimely deposit of funds and inadequate supporting documentation for the deposit activity. We recommend transferring the remaining balance to the Treasurer of Virginia. Using CARS will ensure that such transactions are subject to the additional controls already inherent in the state's accounting system.

Update Memorandum of Understanding and Funding Plan

The Department receives funding from the Department of Transportation to fund a portion of its activities to help certify and assist minority contractors in doing business with Transportation. During fiscal year 2004, the Department received an appropriation of \$923,302 for these activities, but only incurred actual expenses of \$676,936.

There is a Memorandum of Agreement and Understanding between the Department and Transportation that outlines the objectives of the relationship between the two agencies. This agreement is vague and does not address the total disposition of funds and what activities the agreement intends to address.

The Department recorded a transfer of \$285,274 to its special revenue fund, which reported this as an expense in the Highway Maintenance and Operating Fund causing Transportation to pay additional funds to the Department. During fiscal year 2005 the agency returned \$46,057 of this amount to the Highway Maintenance and Operating Fund, resulting in a net transfer amount of \$239,217.

The \$239,217 remains in the special revenue fund and we recommend the Department restore this funding to the Highway Maintenance and Operating Fund. Further, we recommend the Department and Transportation update its agreement to include funding and appropriate activities.

Improve Controls over Cell Phone Usage

The Department should follow and enforce its policies and procedures concerning the usage of cell phones by its employees. We noted the following issues, of which several are repeat issues from the previous report related to the usage of cell phones by the Department's employees and the lack of oversight over this process.

- The Department is not conducting timely reviews of wireless service charges.
- Some employees are not following internal policies and procedures concerning monthly certifications that usage is appropriate.

- Employees appear to be using the cell phones for personal use and in some cases have not reimbursed the agency as required by its policies and procedures.
- The Department pays for two unused cell phones.
- Cell phone plans do not appear appropriate based on usage resulting in additional charges for over use.

Subsequent to the audit period, as part of its annual review process, the Department did update its cell phone plans as recommended by Virginia Information Technologies Agency. However, we caution the Department to not rely solely on prior usage for determining the appropriate plan for its employees as some of that usage appears to be personal in nature.

AGENCY HIGHLIGHTS

The Department of Minority Business Enterprise assists in the establishment and promotion of minority businesses throughout the Commonwealth. A minority business is an enterprise that has one or more socially and economically disadvantaged persons as either the owner or individuals with controlling interest. The agency offers several areas of support, including procurement assistance, marketing, technical guidance, and financial services.

The Department's primary sources of funding are General Fund appropriations, Highway Maintenance and Operating Funds provided by the Virginia Department of Transportation (VDOT), and outside donations received for a disparity study. The funds provided by the VDOT support efforts to increase the participation of disadvantaged and women-owned business enterprises in Virginia's Federal Highway Construction Program. There is a Memorandum of Agreement and Understanding between the Department and VDOT that outlines the objectives of the relationship between the two agencies. According to the Memorandum, the Department will provide support for VDOT's Disadvantaged and Women's Business Enterprise Program including assisting in the certification and prequalification process, providing general management and technical assistance, maintaining a database of certified disadvantaged and women-owned businesses and the services rendered to them by the Department, identifying and facilitating bonding and financial assistance, and increasing community awareness of the opportunities available to disadvantaged and women-owned businesses with the Commonwealth's highway construction program.

Disparity Assessment

Senate Joint Resolution No. 359, which passed during the 2003 General Assembly Session, requested the Department to direct the development of a disparity assessment to determine the status of the participation of minority-owned businesses in the Commonwealth's procurement transactions. The Department requested the assistance of the Departments of General Services and Transportation and the Virginia Employment Commission in directing the assessment. The Department received funding for the study from the Virginia Employment Commission, and the Departments of Transportation, Social Services, Business Assistance, and General Services, and outside donations. In April 2003, the Department contracted with MGT of America, Inc. to perform the disparity assessment at a cost of \$500,000. The contractor completed the disparity study in January 2004, and the report has two findings.

- 1) **Disparity in Minority and Women Business Enterprise Utilization:** Utilization of minority and women-owned businesses by the Commonwealth was very low when compared to other states. A significant portion of the spending related to minority and women-owned businesses was with firms owned by nonminority women. Commonwealth spending with minority businesses, as a percentage of total spending, is one of the lowest recorded in over 100 studies conducted by MGT.
- 2) **Private Sector Utilization and Disparity:** Using records from Reed Construction Data, low levels of utilization of women and minority-owned businesses were found in the private sector commercial construction in Virginia. A statistical analysis of self-employment data for the Commonwealth of Virginia also found disparities in entry into self-employment and earnings from self-employment after using statistical controls for other factors shaping self-employment, such as education, net worth, and age. MGT provided various recommendations to assist the Commonwealth's initiative to improve utilization of minority and women-owned business. Those recommendations covered various areas including purchasing, minority and women business enterprise programs, business development, and the Department's operations.

The Department extended the disparity study contract with MGT of America to allow for reassessments and to obtain disparity studies for local governments. The Department anticipates that funding for the local government studies will come in part from the various local governments with the Department providing additional funding.

FINANCIAL INFORMATION

The schedules below summarize the Department's budgeted revenues and expenses compared with actual results for fiscal year 2004.

Analysis of Budget and Actual Appropriations and Funding Fiscal Year Ended June 30, 2004

<u>Funding Source</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Funding Received</u>
General fund appropriations	\$ 319,322	\$ 331,964	\$ 331,964
Special revenue fund	-	511,862	265,000
Highway maintenance and Operating	<u>923,302</u>	<u>923,302</u>	<u>962,209</u>
Total resources	<u>\$ 1,242,624</u>	<u>\$ 1,767,128</u>	<u>\$ 1,559,173</u>

Analysis of Budgeted and Actual Expenses

	<u>Program Expenses</u>			<u>Breakdown of Expenses by Funding Source</u>		
	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Highway Maintenance And Operating</u>
Minority Enterprise Industrial Development Services Program						
Fiscal Year 2004	\$1,242,624	\$1,767,128	\$1,409,360	\$288,674	\$443,750	\$676,936

The schedule below summarizes the Department's expenses by program and type for fiscal year 2004.

Fiscal Years Ended June 30, 2004

<u>Minority Enterprise Industrial Development Services Program</u>	<u>Fiscal Year 2004</u>
Personal services	\$ 725,077
Contractual services	582,179
Supplies and materials	8,595
Grant to Virginia Hispanic Chamber of Commerce	10,000
Rent, insurance, and utilities	83,317
Equipment	<u>192</u>
Total expenses	<u>\$ 1,409,360</u>

As with all state agencies, the Department has undergone recent budget reductions in its General Fund and Highway Maintenance and Operating Fund appropriations. The Department addressed these reductions primarily by not filling vacant positions, which contributed to the variance between budgeted and actual expenses.

During fiscal year 2003, the Department used a special revenue fund to account for funding obtained from other state agencies to pay for the cost of the disparity assessment. In addition, the Department has an outside bank account where it deposits private contributions collected to fund this study. Activity in the bank account was under the direct control of the Director of the Department. During fiscal year 2004, the Department received \$240,000 from VDOT to assist in funding the disparity study. In addition, the Director transferred \$25,000 of the \$33,960 collected in the bank account to the special revenue fund to cover the cost of the disparity study and as of June 30, 2004, \$8,960 remains in the account.

Highway Maintenance and Operating Fund

The Department receives funding from the Department of Transportation to fund a portion of its activities to help certify and assist minority contractor in doing business with Transportation. During fiscal 2004, the Department received an appropriation of \$923,302 for these activities, but only incurred actual expenses of \$676,936.

The Department recorded a transfer of \$285,274 to its special revenue fund, which reported this as an expense in the Highway Maintenance and Operating Fund causing Transportation to pay additional funds to the Department. During fiscal year 2005 the agency returned \$46,057 of this amount to the Highway Maintenance and Operating Fund, resulting in a net transfer amount of \$239,217.

The, \$239,217 remains in the special revenue fund and as recommended above, the Department should restore this funding to the Highway Maintenance and Operating Fund.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 14, 2004

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Minority Business Enterprise** for the year ended June 30, 2004. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations. We also reviewed the Department's corrective actions of audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

- Expenditures (including Payroll)
- Appropriations
- Transfers
- Cash

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department'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.

The Department'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.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted certain matters involving internal control and its operation that 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 that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. Reportable conditions are discussed in the section titled "Internal Control Findings and Recommendations."

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards other than those noted in the report.

The Department has not taken adequate corrective action with respect to the previously reported findings "Consolidate Fiscal and Procurement Operations with Another Agency" and "Cell Phone Policies and Procedures." Accordingly, we have included these findings in the section entitled "Internal Control Findings and Recommendations." The Department has taken adequate corrective action with respect to the audit findings reported in the prior year not repeated in this report.

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.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on November 1, 2004 and the agency response is on pages 12.

AUDITOR OF PUBLIC ACCOUNTS

SAH:whb
whb:25

OFFICIAL RESPONSE

Secretary of Commerce and Trade Michael J. Schewel, on November 9, 2004 provided the following response via e-mail.

Upon a closer look at the final Department of Minority Business Enterprise audit report, I realized that the recommendation noted in the Audit Summary and elsewhere in the report with respect to the consolidation of the Department's fiscal and procurement activity is addressed to me and the Governor, rather than the agency. We will undertake to examine that issue with care and will work with the Comptroller's office to prepare our response in timely fashion. Once we do so, we will respond to you in a more formal fashion on this issue.

DEPARTMENT OF MINORITY BUSINESS ENTERPRISE
Richmond, Virginia

OFFICIALS

Edward L. Hamm Jr., Director