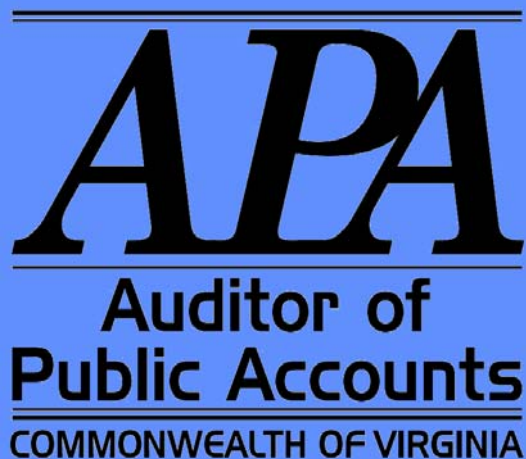


DEPARTMENT OF MINORITY BUSINESS ENTERPRISE

REPORT ON AUDIT

FOR THE PERIOD

FEBRUARY 1, 2007 THROUGH JANUARY 31, 2008



AUDIT SUMMARY

Our audit of the Department of Minority Business Enterprise for the period February 1, 2007, through January 31, 2008, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and
- matters involving compliance and internal control and its operation that we have communicated to management in the Comments to Management section of this report.

Efficiency and Risk Reduction:

We again comment that the Commonwealth is increasing its risk that smaller agencies could have administrative problems with personnel, payroll, procurement, contract management, or other administrative functions, since current service agreements are not providing them sufficient oversight and assistance. The service agreements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls. The Cabinet Secretaries should work with the Secretaries of Administration, Finance, and Technology, as well as the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency to establish a central back office operation to provide information security, managerial oversight, and internal controls for agencies requiring administrative assistance. We discuss this recommendation in greater detail within the section entitled, "Comments to Management".

Status of Prior Findings and Recommendations

The Department of Minority Business Enterprise (Department) has made progress in improving its operations and management has taken a number of actions to address the internal control issues, however, limited resources and the current structure within which management operates restricts their ability to fully resolve the matters. We therefore continue to find many of the same problems with internal controls and compliance during fiscal year 2007 that we discussed in prior reports.

Although we have noted improvements in the Department's fiscal operations within the past year, internal control weaknesses continue to exist. We recommend, as stated above, that the Department work with the Cabinet Secretaries to establish arrangements that outsource the entire fiscal function, rather than simply outsourcing transaction processing.

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COMMENTS TO MANAGEMENT

Risk Alert and Efficiency Issue

We again comment that the Commonwealth is increasing its risk that smaller agencies could have administrative problems with personnel, payroll, procurement, contract management, or other administrative functions, since current service agreements are not providing them sufficient oversight and assistance. The service agreements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls.

We believe that the Commonwealth has made insufficient progress to address the recommendation entitled Increase Efficiencies through Back Office Operations in our last audit and are therefore reissuing the finding and recommendation, but not repeating the detail of the point.

We believe that the Cabinet Secretaries should work with the Secretaries of Administration, Finance, and Technology, as well as the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency to develop and implement an administrative agreement for all back office operations, including information security, managerial oversight and internal controls, for agencies requiring administrative assistance or establish a central back office operation to provide these functions. The current arrangements do not provide a cohesive process which addresses the true operations of an administrative unit. For example, purchasing depends on budget availability, understanding of state contracting practices, contract management, and ultimately the payment and recording of the purchase.

We believe that Secretaries need to address the needs of smaller agencies as an arrangement of outsourcing the entire administrative function rather than the paper processing of groups of transactions. We believe that this approach will improve the operational efficiency of these agencies. However, we do not believe that the Commonwealth will recognize any saving in either personnel or cost, since the smaller agencies are using marginal resources with marginal results.

We also recognize that leaders of the smaller agencies will resist this type of change, however, the Commonwealth will greatly improve its internal controls and gain risk management benefits.

Audit Findings and Recommendations

Update on Prior Year Recommendations

The Department of Minority Business Enterprise has made progress in improving its operations and management has taken a number of actions to address the internal control issues previously reported, however, limited resources and the current structure within which management operates restricts their ability to fully resolve matters reported. As noted above, we believe that this agency and others having limited funding and other administrative resources can not achieve resolution of their internal control findings without resolution of the previously discussed issue.

We therefore continue to find many of the same problems with internal control and compliance that we discussed in prior reports. Internal control is a framework designed to provide reasonable assurance over the reliability of financial resources, effectiveness, and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations.

Although we have noted improvements in the Department's fiscal operations within the past year, internal control weaknesses continue to exist. The Department must work with the Cabinet Secretaries as discussed in the "Risk Alert and Efficiency Issue" section above, to establish arrangements that outsource the entire fiscal function, rather than simply outsourcing transaction processing.

The Department's Director has responsibility for understanding and ensuring the agency's systems, processes, and procedures are sufficient to provide the Department with adequate internal controls. However, the Department, similar to many smaller agencies, does not have resources to provide an appropriate level of administrative assistance; and therefore they outsource their fiscal functions to service providing agencies as necessary. Under this arrangement, the Department shares the responsibility with the service agencies to ensure that adequate oversight and controls over financial transactions exist.

In addition, the Department should consider transferring additional responsibilities to service agencies, including the review of cell phones and information technology security responsibilities. This would allow the Department to concentrate more on their primary functions rather than administrative issues.

AGENCY HIGHLIGHTS

The Department of Minority Business Enterprise assists in the establishment and promotion of small, women, and minority-owned (SWAM) businesses throughout the Commonwealth. A SWAM business is an enterprise that has one or more socially and economically-disadvantaged persons as either the owner or individuals with controlling interest. The Department offers several areas of support, including management and technical assistance, as well as educational, training, marketing, and outreach programs.

The Department's primary sources of funding are General Fund and Highway Maintenance and Operating Fund appropriations. In previous years, the Virginia Department of Transportation transferred the Highway Maintenance and Operating Funds to the Department. As of fiscal year 2007, the Department receives a direct appropriation of these funds. The funds provided by Transportation support efforts to increase the participation of disadvantaged owned business enterprises in Virginia's federal transportation and construction industries.

The following table shows the Department's original budget, final budget, and actual expenses for fiscal year 2007. The Department received total resources of approximately \$2.44 million in fiscal year 2007.

Analysis of Budget and Actual Appropriations and Funding Fiscal Year Ended June 30, 2007

Funding source:	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
General Fund	\$ 694,695	\$1,058,854	\$ 888,601
Special revenue Fund	-	1,716	-
Highway Maintenance and Operating Fund	<u>1,380,354</u>	<u>1,380,354</u>	<u>1,380,227</u>
Total Resources	<u>\$2,075,049</u>	<u>\$2,440,924</u>	<u>\$2,268,828</u>

The table below summarizes the Department's expenses by major object for fiscal years 2007. Payroll expenses of \$1,454,994 account for 64 percent of fiscal year 2007 expenses. The Department employs approximately 21 full-time employees. The majority of the remaining expenses are for contractual services, 20 percent.

Analysis of Actual Expenses by Type
Fiscal Year Ended June 30, 2007

Expense type:	
Personal services	\$1,454,994
Contractual services	456,245
Continuous charges	223,989
Equipment	113,078
Supplies and materials	12,150
Transfer payments	<u>8,371</u>
Total expenses	<u>\$2,268,828</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

April 10, 2008

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Department of Minority Business Enterprise** for the period February 1, 2007, through January 31, 2008. We conducted this performance audit in accordance with generally accepted Government Auditing Standards, issued by the Comptroller General of the United States. 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 on the Commonwealth Accounting and Reporting System, review the adequacy of the Department'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 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.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control 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
- Payroll expenses
- Appropriations
- Transfer payments
- Application access

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. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and agreements, and observation of the Department's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

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 and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The Department has not completed corrective action with respect to the previously reported findings "Improve Controls over Cell Phone Usage" and "Document Information Security Program". Accordingly, we have provided an update on the Department's progress in addressing these findings in the section entitled "Internal Control Findings and Recommendations". The Department has taken adequate action with respect to the audit finding reported in the prior year not repeated in this report.

Exit Conference and Report Distribution

We discussed this report with management on April 16, 2008. Management's response has been included at the end of 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.

AUDITOR OF PUBLIC ACCOUNTS



Timothy M. Kaine
Governor

COMMONWEALTH of VIRGINIA

Samuel Hayes, III, PE
Director

Department of Minority Business Enterprise

Viola O. Baskerville
Secretary of Administration

1111 East Main Street, Suite 300
Richmond, Virginia 23219

April 21, 2008

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

Dear Sir:

In my capacity as Director of the Department of Minority Business Enterprise (hereinafter, "DMBE" or the "Agency"), I have reviewed the findings and recommendations provided by the Auditor of Public Accounts in this report. I acknowledge the findings and recommendations included in the audit review for the period of February 1, 2007 through January 31, 2008. The Agency is pleased to report that many operational and internal controls improvements and changes have been implemented since the fiscal year 2007 audit. However, as noted in this Audit, there is a dominant and recurring finding that requires additional work.

The Audit found two things: (1) that the Agency properly recorded and reported its transactions through the Commonwealth Accounting and Reporting System, and, (2) that matters involving compliance and internal control needed to be addressed. More specifically, the Audit noted again that DMBE and other smaller agencies are very challenged by the effective implementation of Agency Service Agreements with larger, service agency providers. The Audit once again recommends a solution at the Secretarial level and a uniform back-office solution.

The Agency will continue to work with the Secretary of Administration and other agencies and Secretariats to develop and implement administrative solutions to improve on operational and internal controls. We are fully committed to doing its part in addressing the recommendations included in this report. We appreciate the work of the APA in helping identify areas in which the Agency can be more efficient and secure.

Respectfully,

A handwritten signature in cursive script that reads "Samuel Hayes, III".

Samuel Hayes, III
Director

DEPARTMENT OF MINORITY BUSINESS ENTERPRISE

DEPARTMENT OFFICIAL

Samuel Hayes, III
Director

