

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

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2007**



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; and
- no matters involving internal control and its operations necessary to bring to management's attention; and
- one instance of noncompliance with applicable laws and regulations that is required to be reported.

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AUDIT FINDING AND RECOMMENDATION

Finalize Information Security Program

The Office of the Attorney General (Office) has made significant progress since our last audit, improving its information security plan, and needs to finalize its completion. The current information security plan does not fully comply with the Virginia Information Technology security standard, SEC501, and the Office must improve its documentation of the following components:

- Risk Assessment
- Business Impact Analysis
- Continuity of Operations Plan
- Disaster Recovery Plan

A finalized agency wide information security program ensures the Office has a plan to effectively respond to emergencies and the proper controls to protect data. The Office should finalize the remaining components in their agency wide information security plan.

AGENCY HIGHLIGHTS

The Attorney General is the chief executive officer of the Commonwealth of Virginia's Department of Law. 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 of the Attorney General and Department of Law (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, and members of the judiciary, state officials, or local constitutional officers.

The Office of the Attorney General's organizational structure is similar to a private law firm, with divisions devoted to legal specialties. The Office has six legal divisions with offices in Abingdon, Fairfax, Norfolk, Richmond, and Roanoke. A Deputy Attorney General heads each division and reports directly to the Chief Deputy Attorney General, an appointee of the 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 – This division includes four sections: Antitrust and Consumer Litigation, Trial, Construction Litigation, and Insurance and Utilities Regulation.

Financial Law and Government Support Division - This division provides legal services to various financial agencies and boards of the Commonwealth within the Secretaries of Finance, Commerce, Public Safety, and Agriculture and Forestry. In addition, the division serves as the Commonwealth's counsel on bond issues involving land.

Public Safety & Enforcement Division - This division includes the Health Care Fraud and Professional Integrity Special Prosecutions Section that includes the Medicaid Fraud Control Unit. The division also includes the Correctional and Criminal Litigation Sections. We have included a separate section in this report to discuss the activities of the Medicaid Fraud Control Unit.

Health, Education, and Social Services Division - This division includes the Education Section, Health Services Section, the Division of Child Support Enforcement, and Medicaid and Social Services Section.

Technology, Real Estate, Environment and Transportation Division - This division includes the Technology and Procurement Section, the Computer Crimes Section, the Real Estate and Land Use Section, the Environmental Section, and the Transportation Section.

Sexual Predators, Tobacco, Alcohol and Gaming (STAG) Division and Division of Debt Collections - This division handles all cases related to Sexual Predators, Alcohol, Tobacco, and Gaming, and includes the Division of Debt Collections.

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 about two thirds 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 also collects and deposits proceeds from fines, forfeitures, court awards, and settlements. In 2007, these funds totaled approximately \$776,000, most of which resulted from a large tobacco settlement. The Office deposits these funds directly into the General Fund and they are not available to the Office to fund its operations.

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 schedules compare the Office's original and final budgets by program with actual expenses for fiscal years 2007 and 2006.

2007 Budgeted and Actual Expenses

<u>Program</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Legal advice	\$24,839,052	\$28,060,195	\$25,566,878
Medical assistance services	\$4,077,799	\$4,182,198	\$3,506,906
Regulation of business practices	<u>\$2,115,481</u>	<u>\$2,146,360</u>	<u>\$2,107,727</u>
Total	<u>\$31,032,332</u>	<u>\$34,388,753</u>	<u>\$31,181,511</u>

2006 Budgeted and Actual Expenses

<u>Program</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Legal advice	\$19,954,342	\$23,870,167	\$22,608,006
Medical assistance services	\$3,895,890	\$3,635,912	\$3,219,507
Regulation of business practices	<u>\$2,038,429</u>	<u>\$2,367,076</u>	<u>\$1,779,316</u>
Total	<u>\$25,888,661</u>	<u>\$29,873,155</u>	<u>\$27,606,829</u>

Overall, the Office's fiscal year 2007 budget increased almost \$5 million from 2006. Most of this increase occurred in the Legal Advice program as a result of 38 new positions in fiscal year 2007 to address workloads. In addition, there were some budget increases during the year due to an additional \$2.4 million received for federal grants not included in the original budget.

Personnel expenses of approximately \$25 million are over 80 percent of the Office's total expenses. The Office's personnel expenses increased from 2006 to 2007 due to the additional positions; however, the increase was less than budgeted because the rate of hiring for the additional employees was slower than expected. By the end of fiscal year 2007, the Office's actual employment level was 312 classified employees compared to 314 that the legislature approved.

Medicaid Fraud Control Unit

The Virginia Medicaid Fraud Control Unit (MFCU) investigates and prosecutes health care provider insurance fraud against the federally funded Medicaid program. Federal regulations require the Office establish 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.

A federal grant funds the MFCU operations and requires a 25 percent match of general funds. The MFCU employs a professional staff of approximately 43 criminal investigators, auditors, and several Assistant Attorneys General who are experienced in commercial and financial investigations. MFCU has a criminal and a civil unit.

The civil unit formed in fiscal year 2006, investigates whistle blower cases jointly with the National Association of Medicaid Fraud Control Units (NAMFCU). The civil unit also investigates false claims cases brought by the federal government. The majority of the civil cases relate to pharmaceutical company frauds.

The table below shows the total amount of MFCU recoveries 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>
2000	\$ 1,480,345
2001	37,612
2002	12,081,532
2003	11,848,871
2004	14,358,790
2005	10,578,111
2006	9,071,737
2007	117,704,812

Source: Medicaid Fraud Case Tracking System

In fiscal 2007, MFCU investigations in the Purdue Oxycontin case ended with a significant settlement, which resulted in a large increase in the table above. The Commonwealth recovered about \$105 million with the following organizations receiving a portion of the settlement: MFCU, the Department of Health Professions, and the State Police. MFCU received \$39.8 million in investigative reimbursement from this case. MFCU has requested approval from the federal government to use these funds to cover the state's share of the Unit's operating budget in future years.

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 legislation also mandated the following allocation of collections: 30 percent to the creditor agency, 30 percent to the Division to fund operations, and 40 percent to the General Fund of the Commonwealth with some exceptions. A few agencies have negotiated lower collection fees. In addition, legislation authorizes the Secretary of Finance to grant exceptions to the general fund deposit requirement. The Secretary has granted exceptions that include the five agencies with the largest recoveries: University of Virginia Medical Center, Virginia Commonwealth University Health System, Virginia Employment Commission, and the Departments of Medical Assistance Services and Transportation. The Division distributes 70% or more of the amount collected to those agencies with a general fund deposit exemption depending on the collection fee the agency has contracted with the Division.

From 2002 through 2005, the Division received budget and staffing level increases to keep up with a growing caseload. However, in fiscal year 2006, the number of accounts fell 13%. Growth resumed in fiscal year 2007 and the number of accounts grew seven percent. In fiscal year 2007, the dollar value of active accounts fell \$28.2 million when the Division collected \$1.2 million from a single debtor and placed the remaining \$23 million of the claim in an inactive status. The following table shows selected operating statistics for the last five years for the Division.

Division Operating Statistics for 2003-2007

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Maximum employment level	17	21	23	23	24
Division budget	\$1,126,706	\$1,361,076	\$1,516,385	\$1,578,689	\$1,665,104
Number of accounts	6,322	8,312	11,140	9,689	10,397
Active accounts (\$ in millions)	\$91	\$100	\$159	\$157	\$132
Gross collections (\$ in millions)	\$13	\$13	\$10	\$12.5	\$11.5
Amount returned to the General Fund (\$ in millions)	\$ -	\$1.5	\$1.4	\$1.1	\$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. Over the last several years, the Division has retained fees in excess of their operating expenses. The accumulated cash balance in their operating fund now totals \$3.2 million, the equivalent of two year's worth of operating expenses. Chapter 847 of the Appropriation Act placed a limit on the amount of retained earnings the Division can maintain in its operating account. The Act allows the Division to maintain \$400,000 in working capital and requires the Division return any excess retained earnings in its operating account to the General Fund after paying operating expenses and closing its books for the year. It is our understanding that the Division transferred \$1.4 million to the General Fund at the direction of the Department of Planning and Budget in October 2007. The following table details the Division's operating revenues and expenses for the last five fiscal years.

Revenues and Expenses – Fiscal Years 2003 – 2007

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Beginning balance	\$ 876,937	\$1,352,947	\$2,278,366	\$2,689,193	\$2,715,318
Collection fee revenue	1,579,304	1,964,690	1,705,269	1,555,866	2,152,384
Expenses	(1,056,470)	(1,024,534)	(1,285,932)	(1,521,073)	(1,616,509)
Transfers	<u>(46,824)</u>	<u>(14,737)</u>	<u>(8,510)</u>	<u>(8,668)</u>	<u>0</u>
Ending balance	<u>\$1,352,947</u>	<u>\$2,278,366</u>	<u>\$2,689,193</u>	<u>\$2,715,318</u>	<u>\$3,251,193</u>



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 15, 2007

The Honorable Timothy M. Kaine
Governor of Virginia
State Capitol
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 **Office of the Attorney General and the Department of Law and the Division of Debt Collection** for the year ended June 30, 2007. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

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 **Office and the Division's** internal control, test compliance with applicable laws and regulations, and review corrective actions of audit findings from the prior year's report.

Audit Scope and Methodology

The **Office of the Attorney General and the 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, 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, including Payroll
Revenue Collections and Distributions
Appropriations
General Controls over Information Systems

We performed audit tests to determine whether the **Office of the Attorney General and the 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, audit adjustments, and observation of the operations. We reviewed the applicable sections of the Code of Virginia and the 2007 Virginia Acts of Assembly. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the **Office of the Attorney General and the 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 and the Division record their 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 no matters involving internal control and its operation that we consider necessary to be reported to management. We noted an instance involving compliance with applicable laws and regulations that require management's attention and corrective action. This matter is described in the section entitled "Audit Findings and Recommendations."

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 19, 2007. 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

LCW:clj



COMMONWEALTH of VIRGINIA
Office of the Attorney General

Robert F. McDonnell
Attorney General

900 East Main Street
Richmond, Virginia 23219

November 27, 2007

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

Dear Mr. Kucharski,

Thank you for providing the Office of the Attorney General with the opportunity to respond to the recommendations in your recent audit. We are especially pleased that the office continues on its track to consistently employ sound financial controls that effectively safeguard public assets.

Since last year's audit, the Finance Section continues to review internal processes that streamline operations and improve internal controls. The Director of Finance continues to stress the importance of proper documentation when recording transactions and continues to educate Agency staff about the need to ensure compliance with the Commonwealth Accounting Policies and Procedures Manual and the Commonwealth's procurement laws and policies.

The OAG also recognizes the importance of strong system control measures and aggressively continues on our course to achieve compliance with ITRM Standard SEC 501-01 which took effect on July 1, 2007. The appointment of a Chief Security Officer has established a strong foundational plan to make further improvements in this area. Under separate cover we will detail our plans in this effort.

As always, the Attorney General is appreciative of the Auditor of Public Accounts for bringing this matter to our attention.

Sincerely,

A handwritten signature in black ink, appearing to read "Wm C Mims", written over a horizontal line.

William C. Mims
Chief Deputy Attorney General

c: David A. Von Moll, State Comptroller

OFFICE OF THE ATTORNEY GENERAL

As of June 30, 2007

Robert F. McDonnell
Attorney General

William C. Mims
Chief Deputy Attorney General

Jasen Eige
Chief of Staff and Counsel

Thomas A. Gelozin
Director of Finance

