

VIRGINIA WAR MEMORIAL FOUNDATION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2009**



AUDIT ALERT

RECOMMENDATIONS

- The War Memorial must reexamine its operations in light of available funding. The War Memorial cannot continue to commit future resources of the Commonwealth without ensuring that adequate funding is available for operations.
- We recommend that the Secretary of Public Safety and the War Memorial's Board should work together to review the operational and financial direction of the War Memorial. This review should include an operating direction for the War Memorial including its placement and oversight within the Executive Branch of government. The review should clarify the duties and responsibilities of the Board, Executive Director, and the Secretary of Public Safety providing oversight and resources to aid in the proper management of the War Memorial.
- We have previously recommended that the Department of Veterans Services provide financial management oversight. While Department of Veterans Services' staff have made numerous attempts to assist War Memorial management, these offers of assistance have gone unanswered. This review should provide a framework for assistance and cooperation between the War Memorial and Veterans Services. Additionally, the review should formalize the relationship of the War Memorial to the War Memorial Educational Foundation.

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT ALERT	
BACKGROUND	1
INDIVIDUAL FINDINGS	2-4
PROJECTED DEFICIT	5-6
PROJECT FUNDING CONCERNS	6-7
AUDIT OBJECTIVES	8
AUDIT SCOPE AND METHODOLOGY	8-9
CONCLUSIONS	9
EXIT CONFERENCE AND REPORT DISTRIBUTION	9
AGENCY OFFICIALS	10

BACKGROUND

Over the past several years, this Office has reported on the developing financial difficulties of the Virginia War Memorial Foundation (War Memorial). The issues that we have reported in recent reports included inconsistencies in budgeting its funds, a lack of internal controls over managing public funds, and a lack of internal policies and procedures concerning financial management. Additionally, the relationship of the War Memorial to both the Commonwealth and the Virginia War Memorial Educational Foundation (Foundation) is poorly defined and does not serve the best interest of either the War Memorial or the Commonwealth. We do not believe that the Board and management have adequately addressed any of these issues. In several cases, management has implemented policies that are in conflict with their initial corrective action plan submitted to this Office and the Board.

The Code of Virginia gives the War Memorial Board of Trustees (Board) certain specific duties and responsibilities and clearly states that the War Memorial is a part of the Executive Branch of government. The Board has delegated many matters to management. However, the Boards' lack of written policies and procedures coupled with a lack of formal oversight has not provided management clear objectives to guide the overall direction of the War Memorial. The Board and the Executive Director must work together to ensure that the War Memorial complies with the general provisions of the Appropriation Act, the Code of Virginia, and other central agency oversight requirements.

The War Memorial depends on the Commonwealth for resources for its operations. After the completion of the planned expansion, the War Memorial's dependence on funding from the Commonwealth will grow. The Executive Director envisions increasing the staff and operating cost of the War Memorial, however, with the current constraints on the Commonwealth's General Fund, the expansion of these resources is uncertain.

As an example, the Department of General Services is foregoing the collecting of the rent of approximately \$30,000, it would typically charge for the utilities, care, maintenance, and security of the War Memorial. With the opening of the expansion, General Services believes this rental charge will be approximately \$270,000 and the War Memorial does not have a secure funding source for this rent.

The War Memorial has accepted gifts of historical artifacts, which further commits the Commonwealth to the cost of maintaining and preserving these materials, without the Commonwealth's required approval to accept such materials. The War Memorial does not currently have funding to properly display or even store these artifacts; and therefore has had to rely on other state agencies to store these materials. The acceptance of gifts which commit the future resources of the Commonwealth requires the approval of the Governor as a mechanism of ensuring sufficient future resources to properly maintain and preserve these gifts.

Following are several more specific issues we found during the current audit, which in many cases are repeated issues from prior audits.

INDIVIDUAL FINDINGS

Develop and Monitor Budgets

Reductions in appropriations from the Commonwealth over the past two years have required the War Memorial to lay off its two part-time employees and reduce most other operating expenses. Off-setting some of these reductions in funding was the Department of General Services' decision to not bill and collect their annual rent for the War Memorial. However, General Services has indicated that it expects to collect the new annual rental from the War Memorial after the opening of the addition, which is substantially higher than the current rent.

By the end of fiscal year 2010, the War Memorial will exhaust its other resources and be solely dependent on state funding. The Executive Director must work directly with the Board to develop and monitor a long-term plan to address the War Memorial's funding decreases.

The Board does not currently receive periodic budget and actual expense information from the Executive Director. Such information is an important part of the Board's responsibility to manage and direct the operations of the War Memorial. Additionally, the budget plan must include monitoring the progress in developing additional outside resources that will be an essential part of the War Memorial's continued operations. As we recommended in our last report, the Executive Director should accept the assistance of the Department of Veterans Services in developing financial reporting that he and the Board can use to manage the financial operations of the War Memorial.

Review Donations of Historical Artifacts

The War Memorial accepts gifts of various historical artifacts including uniforms, vehicles, and weapons. However, the War Memorial does not have facilities to display or store these donated artifacts and other agencies, including General Services and Capital Police, store and safeguard these historic items. Since the War Memorial does not have sufficient funding to either store these historical artifacts, create displays of these items, or preserve these items, it will increasingly rely on other agencies to store these items.

Additionally, the Appropriations Act requires state agencies obtain the Governor's approval before accepting gifts of this type. The purpose of this restriction is to ensure that any agency committing the Commonwealth to maintaining gifts has the resources to meet that obligation. We noted no approval from the Governor for the War Memorial solicitation or acceptance of the gifts.

We strongly recommend that the Board reconsider its policy on accepting donations of historical artifacts in light of available funding. If the War Memorial wishes to continue to accept donations of historical artifacts, the Board must seek the approval of the Governor and identify a resource to provide for the display, preservation, and maintenance of its collection.

Board Should Develop Policies and Exercise Adequate Oversight

Many of the findings in this report come from the lack of direction from the Board on how management should operate and comply with Commonwealth policies and procedures. As an

example, the Board has not formally set personnel policies relating to its staff. In normal circumstances, the governing body develops and implements policies and procedures governing the conduct, evaluation, and performance standards for its employees, but the Board has not set these policies.

The War Memorial's full time employees receive all state benefits; however, these employees do not meet the definition of a state employee, under the definition as set forth by the Code of Virginia or the Department of Human Resources Management. The Board has not set a pay band for the Executive Director and other staff and the Board has not formally adopted the Commonwealth's personnel policies and procedures. The Code of Virginia sets forth that the Board has certain responsibilities, but does not exempt the Board or its employees from working within the Commonwealth's policies and procedures.

We strongly encourage the Board to develop policies and procedures to governing its operations and to exercise greater oversight of the War Memorial's operations. Board adopted policies should address agency policies and procedures within the context of complying with the Appropriation Act and the Commonwealth's policies and procedures. As part of the Executive Branch of Government, the Board needs to evaluate how it will follow Executive Branch policies and procedures in its agency's operations.

Develop Adequate Internal Controls

The Board must re-examine the operating and financial structure of the War Memorial in order to maintain its financial position, establish sound internal controls, and provide for reliable accounting records. Over the last three years, we have recommended that the Board formally transfer the responsibility for all financial activity to the War Memorial's fiscal agent, the Department of Veterans Services. The internal control issues that we have noted during this current review further support this recommendation.

The lack of staff eliminates any possibility for adequate internal controls. Highlighting this lack of internal control over financial operations is that the Executive Director did not submit a budget to the Board for their approval before the start of the year and did not provide complete and accurate financial information to the Board during the year.

Despite offers of assistance from Veterans Services, the Executive Director did not work with Veterans Services to provide a budget or financial information to allow for proper oversight of the War Memorial operations by the Board. We cannot determine what actions the Board has taken to approve a budget or fiscal plan for the War Memorial. Additionally, the interaction of the Virginia War Memorial Educational Foundation and the War Memorial provides some indication that we cannot determine if we have all the information necessary to accurately complete an audit.

The Board needs to evaluate the financial operations of the War Memorial and determine how it is going to develop adequate internal controls in this entity that handles public funds. While we understand that the War Memorial's funding may not constitute a significant amount of the Commonwealth's overall funding, the Executive Director and the Board need to adopt policies and procedures for the handling of public funds that provides for adequate internal controls.

Manage Funds in Compliance with Commonwealth Standards

The Executive Director has state employees performing work for the Virginia War Memorial Educational Foundation, Inc. (Educational Foundation), bills the Educational Foundation, and does not return the recovered funds to the Commonwealth's General Fund. Additionally, the Executive Director requires the Educational Foundation to pay rent for space that the War Memorial receives rent free from the Department of General Services. Further, we have found arrangements that the Executive Director has with the Educational Foundation but we can find no support or approval for these transactions from the Board.

Many state agencies with federal grants and contracts have the practice of billing the cost of employees' services to the federal government and then when they receive the money, they immediately return the funds to the State Treasury. These funds are subject to appropriate oversight and budgetary controls.

We are also concerned about the payment by the Educational Foundation for services for which there are no costs on the part of the War Memorial. Considering the direct relationship between Educational Foundation and War Memorial, if this practice continues or grows, we believe the Educational Foundation may jeopardize its tax-exempt status.

The Executive Director of the War Memorial should immediately pay into the State Treasury \$23,700 of reimbursements from the Educational Foundation for the work and other costs funded by the General Fund of the Commonwealth. Additionally, both the Educational Foundation and War Memorial Foundation should consult with a tax consultant about payment for services, space, and other items for which the War Memorial has no cost.

Enhance Policy to Address Unused Funds from Long-Term Projects

The War Memorial has developed a policy on how they will treat funds remaining from non-operating projects. In the past, the General Assembly has funded non-operating projects such as the production of films and the installation of security cameras and lighting as an addition to the War Memorial's operating funds rather than establishing a separate capital outlay project.

In the prior year, we noted the War Memorial completed at least one of these projects at a cost significantly lower than the budgeted amount. The Board adopted a policy for using unneeded funding from non-operating projects and we commend them for making this effort.

We recommend that the Board review their policy for appropriated funds in excess of the final cost of non-operating projects. The final Board policy should acknowledge that these excess funds come from the Commonwealth, constitute public funds, and consider how the War Memorial will comply with any restrictions on these funds.

PROJECTED DEFICIT

War Memorial continues to exhibit spending patterns which, without additional funding, will result in the War Memorial creating a deficit of nearly \$300 thousand by the end of fiscal year 2011. Below is a chart of the War Memorial's actual and projected funding sources and expenses for fiscal years 2009 through 2011. Also, on the page after the chart is an analysis of funding sources and expenses, which are not included in the Board's budget for the War Memorial, and the effect that these items could have on the Board and the Commonwealth, and these items are *Donation and Payment for Capital Project* and *Rent and Utilities*.

Actual and Projected Funding Sources and Expenses for Fiscal Years 2009 – 2011

	<u>2009 Actual</u>	<u>2010 Projected</u>	<u>2011 Projected</u>
Funding sources			
Cash	\$ 34,839	\$ 41,050	\$ 9,577
General Fund appropriations	247,313	222,107	241,312
Unused project funds	60,000	-	-
Reimbursement of expenses from Educational Foundation	15,900	7,800	-
Donation of payroll expenses	-	15,500	-
Donation for capital project	-	2,000,000	-
Other miscellaneous receipts	<u>6,593</u>	<u>925</u>	<u>-</u>
Total funding sources	<u>364,645</u>	<u>2,287,382</u>	<u>250,889</u>
Expenses			
Payroll	263,040	263,905	263,905
Rent and utilities	34,169	8,008	270,000
Miscellaneous expenses	26,386	5,892	-
Payment for capital project	<u>-</u>	<u>2,000,000</u>	<u>-</u>
Total Expenses	<u>323,595</u>	<u>2,277,805</u>	<u>533,905</u>
Ending cash/ (deficit)	<u>\$ 41,050</u>	<u>\$ 9,577</u>	<u>\$(283,016)</u>

Source: War Memorial Financial Records, Appropriation Act, Budget Bill, Board Documents, General Services

Donation and Payment for Capital Project

To secure state funding of close to \$8 million, the Board certified to General Services that it would provide \$2 million of the \$10 million budgeted to construct a new wing of the building used by War Memorial. While General Services anticipates needing the \$2 million from War Memorial in May of 2010 to complete construction, as of February 2010 War Memorial has not received any of the \$2 million. According to War Memorial's Executive Director, the War Memorial expects to receive the \$2 million from the Educational Foundation, the non-profit sister organization of the War Memorial that shares many of the same Board Members.

The Educational Foundation has certified to us that these funds are available in the form of cash, pledges and a line of credit with a local commercial bank; however, the Educational Foundation has not provided us with any documentation supporting this certification, we therefore are unable to determine if these funds are available.

Rent and Utilities

With the opening of the new space, the square footage of the War Memorial will increase by three times; as a result, General Services informed the War Memorial that its annual rent should increase to \$270 thousand annually. Currently the recommended funding for War Memorial in fiscal 2011 is insufficient to cover either its payroll or rent.

If War Memorial cannot generate its own funding sufficient to cover these expenses, the Commonwealth may need to take appropriate measures to control the cost of the War Memorial. One option may include continuing to forgo the collection of rent. However, even if the Commonwealth forgoes the rent, War Memorial will still have to decrease staffing in order to reduce expenses to the proposed level of funding.

PROJECT FUNDING CONCERNS

We previously recommended that the Board develop a policy for unused project funds because of concerns about the way those funds were being treated. We again this year have concerns related to the treatment of project funds.

According to the 2010 Budget Bill, the projected total cost of the War Memorial addition is \$10,013,000. General Services has spent the General Funds appropriated to date for this project and plans to exhaust the bond proceeds before requesting the private funds from War Memorial.

However, as shown in the table below, the War Memorial has requested an additional \$913,000 for purchase of equipment from the General Funds for fiscal year 2011. The Board is under the impression that the additional General Funds will reduce the War Memorial's financial obligation. However, the Budget Bill's language is not reducing the War Memorial's obligation but is expanding the project.

The final award language of any additional funding will need to clarify the intent of the funding. In addition should General Services complete this project under budget, since the funding involves bond proceeds, they will need to return the unspent funds to the State Treasurer.

Project Funding Sources

General Funds	\$ 550,000
Bond Proceeds	6,500,000
Private Funds, Obligated by War Memorial	<u>2,050,000</u>
Total Current Funds Available	<u>9,100,000</u>
Additional Proposed General Funds for 2011	<u>913,000</u>
Total Project	<u>\$10,013,000</u>



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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February 22, 2010

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Virginia War Memorial Foundation** for the year ended June 30, 2009. 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 on the Commonwealth Accounting and Reporting System, review the adequacy of the War Memorial'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

War Memorial'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.

Revenues
Expenses
Payroll Expenses
Appropriations
Capital Projects

We performed audit tests to determine whether the War Memorial'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 observation of the War Memorial's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the War Memorial properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The War Memorial 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 "Individual Findings."

The War Memorial has not completed corrective action with respect to the previously reported findings entitled "Consolidate Accounting Processes and Internal Controls" and "Adopt a Formal Budget Development and Execution Process". Accordingly, we have provided an update on the War Memorial's progress in addressing these findings in the section entitled "Individual Findings".

Exit Conference and Report Distribution

We discussed this report with management on March 11, 2010. Management accepts the report and will respond in the future.

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

WJK/clj

VIRGINIA WAR MEMORIAL FOUNDATION

DEPARTMENT OFFICIALS

Jon Hatfield
Executive Director

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