



DEPARTMENT OF EMERGENCY MANAGEMENT AUDIT OF SELECT FEDERAL PROGRAMS

REPORT ON AUDIT FOR THE FISCAL YEAR ENDED JUNE 30, 2018

Auditor of Public Accounts
Martha S. Mavredes, CPA
www.apa.virginia.gov
(804) 225-3350



AUDIT SUMMARY

Our audit of the Emergency Management Preparedness Grant (EMPG) and Homeland Security Grant (HGSP) federal programs, administered by the Department of Emergency Management (Emergency Management) for the fiscal year ended June 30, 2018, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth's accounting and financial reporting submission and in supplemental information submitted to the Department of Accounts;
- five matters involving internal control and its operations necessary to bring to management's attention. Of these findings, three are considered to be material weaknesses; and
- five instances of noncompliance with applicable laws and regulations or other matters that are required to be reported. Of these findings, three are considered to be material non-compliance and will result in a qualified opinion for the EMPG and HGSP federal programs in the Commonwealth's Single Audit report for the year ended June 30, 2018. Compliance with such requirements is necessary, in our opinion, for the Commonwealth to comply with the requirements applicable to these federal programs. The Single Audit report will be available on APA's website at www.apa.virginia.gov in February 2019.

Since 2015, Emergency Management has undergone organizational and operational changes intended to modernize the agency to meet current risks and improve operations. These changes have resulted in a significant increase in the agency's operating expenses. Given Emergency Management's relatively stable funding with no additional resources expected to be available for operations, we have concerns about the agency's ability to sustain this level of spending going forward. We discuss this issue in more detail in this July 2018 report titled "Department of Emergency Management – Audit of Select Cycles – for the period July 1, 2016 through June 30, 2018" found at www.apa.virginia.gov. We believe that some of the findings in this report are due in part to this situation.

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AUDIT FINDINGS AND RECOMMENDATIONS

Since 2015, Emergency Management has undergone organizational and operational changes intended to modernize the agency to meet current risks and improve operations. These changes have resulted in a significant increase in the agency's operating expenses. Emergency Management's operating expenses have increased over \$6 million, or 28 percent, since the beginning of fiscal year 2016. Given Emergency Management's relatively stable funding with no additional resources expected to be available for operations, we have concerns about the agency's ability to sustain this level of spending going forward. We discuss this issue in more detail in this July 2018 report titled "Department of Emergency Management – Audit of Select Cycles – for the period July 1, 2016 through June 30, 2018" found at www.apa.virginia.gov. We believe that some of the findings in this report are due in part to this situation.

Continue to Strengthen Internal Controls over Time and Effort Reporting for Federal Grants

Type of Finding: Internal Control and Compliance

Severity: Material Weakness

Repeat: Yes (first reported in 2016)

Prior Title: Strengthen Internal Controls over Time and Effort Reporting for Federal Grants

Emergency Management needs to continue strengthening its internal controls over time and effort reporting for federal grants to ensure salary allocations are adequately supported. Emergency Management continues to estimate how much of an employee's salary will be supported with federal funds, but does not perform subsequent reviews to confirm the estimates are consistent with the actual work performed by the employee.

Emergency Management recently developed a policy that requires supervisors to certify their employees' time allocations annually to confirm that the amount charged to federal grants is consistent with the effort actually spent on the projects or activities during the period; however, Emergency Management has not incorporated this policy into its current operations.

2 CFR §200.430(I)(1) requires the records supporting charges to federal awards be supported by a system of internal control which provides reasonable assurance that the charges are accurate, allowable, and properly allocated. Further, 2 CFR §200.430(I)(viii) requires the entity's system of internal control to include processes to review after-the-fact interim charges made to a federal awards based on budget estimates and make adjustments to the final amounts charged to the federal award. Without performing after-the-fact reviews of budget estimates, Emergency Management cannot provide these reasonable assurances.

Emergency Management should promptly operationalize its policy given that federal grants support close to two thirds of payroll costs. While operationalizing its policy, Emergency Management should evaluate the policy to confirm that it is sufficient to address the related requirements. By implementing its policy, Emergency Management will be able to provide assurance that it has adequate internal controls in place to support payroll allocations.

Strengthen Internal Controls over Journal Entries

Type of Finding: Internal Control and Compliance

Severity: Material Weakness

Repeat: Yes (first reported in 2016)

Prior Title: Strengthen Internal Controls over Agency Transaction Vouchers

Emergency Management needs to strengthen internal controls over journal entries. Thirteen of 52 (25%) journal entries tested did not include adequate documentation to support the nature of the entry. The majority of journal entries in question were processed to reallocate payroll costs between various funds and/or federal programs, but did not include adequate information to justify the reason for the change.

While Emergency Management has documented procedures for processing journal entries, their procedures do not include detailed information on what type of documentation needs to support the entry. We believe it is also likely the sheer volume of journal entry activity also contributed to this issue. Emergency Management processes a significant number of journal entries. While some entries are used to correct errors made by newer staff, the majority of exceptions we found were related to transfers of payroll expenses that we believe are related to the agency's strained financial situation.

2 CFR §200.303(a) states that an entity must establish and maintain effective internal control over federal awards that provides reasonable assurance that the entity is managing the award in compliance with the federal statutes, regulations, and terms and conditions of the federal award. The lack of adequate supporting documentation could create questions as to whether the nature of the transaction is permissible and could lead to potential disallowed charges by the federal government. We estimate the known questioned costs for the thirteen journal entries to be approximately \$252,000. Questioned costs are costs that the auditor questions because the entity did not support the costs with adequate documentation at the time of the audit.

Emergency Management should strengthen its procedures over journal entries to ensure they include adequate supporting documentation. Additionally, Emergency Management should identify its significant journal entry types and develop procedures that specify what type of documentation is needed to support the entry. This will help Emergency Management ensure its journal entries are supported by an adequate system of internal control.

Improve Controls over Payroll Adjustments

Type of Finding: Internal Control and Compliance

Severity: Material Weakness

Repeat: No

Emergency Managements needs to improve controls over payroll adjustments in the Commonwealth's accounting and financial reporting system, referred to as "speed type" adjustments. Emergency Management uses speed types as a mechanism to interface transactions between the Commonwealth's payroll system and Commonwealth's accounting and financial reporting system.

Speed types convert unique account values in the payroll system to those generally accepted by the accounting and financial reporting system.

There were several unsupported differences between the Commonwealth's payroll system and the Commonwealth's accounting and financial reporting system that appear to be due to "speed type" adjustments. These differences occurred in 23 of 31 payrolls processed between July 2017 and April 2018 and affected various funds and programs. Due to the lack of documentation for these adjustments, we were not able to determine who approved these adjustments or if they were reasonable.

Emergency Management did not properly identify the risks associated with speed type adjustments and; therefore, did not have any policies and procedures over this process. In addition, we believe there are other factors contributing to the agency's need to process a significant number of payroll adjustments. These factors include the agency's strained financial position as well as the lack of a fully implemented time and effort process.

2 CFR §200.430(I)(1) states that charges to federal awards for salaries and wages must be based on records that accurately reflect the work performed and be supported by a system of internal control which provides reasonable assurance that the charges are accurate, allowable, and properly allocated. The lack of adequate documentation could create questions as to whether the nature of the transaction is permissible and could lead to potential disallowed charges by the federal government and/or any other regulatory agencies. We estimate the known questioned costs for the unsupported differences to be approximately \$464,000. Questioned costs are costs that the auditor questions because the entity did not support the costs with adequate documentation at the time of the audit.

Emergency Management should develop policies and procedures to address the use of speed types that should include what sources of information are necessary to support an adjustment. Additionally, Emergency Management should periodically monitor these adjustments to ensure they are reasonable based on their policy. By doing such, Emergency Management will ensure that they maintain adequate internal controls to support these adjustments and comply with applicable requirements.

Strengthen Internal Controls over Procurement to Ensure that Procurement Records are Complete

Type of Finding: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: No

Emergency Management needs to strengthen its internal controls over procurement to ensure its procurement records are complete. The procurement records, for two major contracts supported by federal funding from the EMPG and HSGP programs, did not contain critical documentation supporting its procurement or renewal. These contracts comprise nearly 34 percent of the procurement spending occurring within the EMPG and HSGP programs during the period under review. Missing pieces of procurement documentation include, but were not limited to:

- Written approval to expend funds as required by Annex 7-E of the Department of General Services Agency Procurement and Surplus Property Manual (Manual). When Emergency

Management identifies the need for a procurement transaction, the requesting party completes an Internal Procurement Requisition form that executive management and the finance department are required to sign. This form was not included within the procurement record. This deficiency was applicable to both contracts tested during the audit.

- Identification of the contract administrator and his or her responsibilities as required by Annex 7-E of the Manual. This deficiency was applicable to one of the contracts tested during the audit.
- Contractor performance reports as required by Section 10.3 of the Manual. This deficiency was applicable to both contracts tested during the audit.

Section 10.3 of the Manual requires agencies to maintain a complete file in one place for each purchase transaction, containing all the information necessary to understand the why, who, what, when, where, and how of the transaction. It must contain as a minimum, as applicable, the description of requirements, sources solicited, a copy of the Virginia Business Opportunities (VBO) receipt, cancellation notices, the method of evaluation and award, a signed copy of the contract or purchase order, contractor performance report submitted by the administrator, modifications or change orders, vendor complaint forms, cure letters, usage data such as release or obligation registers, and any other actions relating to the procurement. Without maintaining complete files, it is difficult for Emergency Management to substantiate the legitimacy of the procurement transaction. Emergency Management did not maintain complete files because it experienced significant turnover within its procurement office over the last several years and did not maintain adequate policies and procedures for procurement transactions.

Emergency Management has recently filled the vacant procurement positions and is in the process of revising its policies and procedures in this area. Additionally, Emergency Management is evaluating the structure of its existing contract agreements and making modifications as contracts are up for renewal. Emergency Management should continue with its efforts in this area to ensure procurement records are complete and consider using the checklists included within the Manual as a reference. By doing such, Emergency Management will be able to adequately support its procurement and prevent questions regarding the legitimacy of procurement transactions.

Improve Process for Allocating Overhead Costs

Type of Finding: Internal Control and Compliance

Severity: Significant Deficiency

Repeat: No

Emergency Management needs to improve their process for allocating overhead expenses within the agency. Emergency Management changed their overhead allocation methodology in November 2017, which caused overhead costs to be incorrectly allocated amongst various funds and grants for at least six months in fiscal year 2018.

This issue was the result of an error in their internal allocation calculator. As a result, the Radiological Emergency Preparedness Fund was overcharged approximately \$250,000 in overhead costs.

This error also resulted in the Emergency Management Performance Grant being overcharged by approximately \$450,000. 2 CFR §200.303(a) states that an entity must establish and maintain effective internal control over federal awards that provides reasonable assurance that the non-federal entity is managing the award in compliance with the federal statutes, regulations, and terms and conditions of the federal award. Improperly allocating costs to certain funds and/or federal programs limits the agency's available financial resources that funds certain programmatic expenses such as emergency management training and pass-through payments to local governments.

Although the agency corrected this error by the end of fiscal year 2018, it went undetected for six months and affected Emergency Management's ability to properly monitor costs charged to various federal grants. Emergency Management needs to strengthen controls over this process to ensure the allocation process accurately allocates overhead costs within the agency and complies with applicable requirements.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

September 26, 2018

The Honorable Ralph S. Northam
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Emergency Management Performance Grant (EMPG) and Homeland Security Grant Program (HGSP)**, administered by the Department of Emergency Management (Emergency Management), for the year ended June 30, 2018. We conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, in support of the Commonwealth's Single Audit. 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. 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 objective was to audit the EMPG and HGSP federal programs in support of the Commonwealth's Single Audit. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth's accounting and financial reporting system and in supplemental information submitted to the Department of Accounts; reviewed the adequacy of the Emergency Management's internal controls over the federal programs; and tested for compliance with applicable laws, regulations, contracts, and grant agreements.

Audit Scope and Methodology

Emergency Management'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, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the EMPG and HGSP federal programs.

We performed audit tests to determine whether Emergency Management'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, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, contracts, and observation of Emergency Management's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We have explicitly identified three findings in the section titled "Audit Findings and Recommendations" that we consider to be material weaknesses in internal control over compliance. These findings, considered collectively, will result in the EMPG and HGSP federal programs receiving qualified opinions on compliance.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We have explicitly identified two findings in the section titled "Audit Findings and Recommendations" that we consider to be significant deficiencies in internal control over compliance.

As the findings noted above have been identified as material weaknesses or significant deficiencies for the Commonwealth, they will be reported as such in the "Independent Auditor's Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by Uniform Guidance," which is included in the Commonwealth's Single Audit Report for the year ended June 30, 2018.

Additionally, as described in the "Audit Findings and Recommendations" section of this report, Emergency Management did not comply with requirements regarding the EMPG and HGSP federal programs, as described in the findings titled "Continue to Strengthen Internal Controls over Time and Effort Reporting for Federal Grants," "Strengthen Internal Controls over Journal Entries," and "Improve Controls over Payroll Adjustments," for the allowable costs and costs principles compliance requirement. Compliance with such requirements is necessary, in our opinion, for the Commonwealth to comply with the requirements applicable to these federal programs. These findings will result in a qualified opinion on the EMPG and HGSP federal programs included in the "Independent Auditor's Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by Uniform Guidance" of the Commonwealth's Single Audit report for the year ended June 30, 2018.

The Single Audit will be available on APA's website at www.apa.virginia.gov in February 2019.

Conclusions

We found that Emergency Management properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's accounting and financial reporting system, and in supplemental information submitted to the Department of Accounts for the EMPG and HGSP federal programs.

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations, contracts and grant agreements that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with management on October 9, 2018. 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

LCW/vks

JEFFREY D. STERN, Ph.D.
State Coordinator

CURTIS C. BROWN
Chief Deputy Coordinator/
Acting Deputy Coordinator – Mission Support



JOHN SCRIVANI
Deputy Coordinator – Disaster Services

COMMONWEALTH of VIRGINIA
Department of Emergency Management

10501 Trade Court
North Chesterfield, Virginia 23236-3713
Tel: (804) 897-6500 TDD (804) 674-2417 FAX (804) 897-6506

November 15, 2018

Ms. Martha Mavredes
Auditors of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

RE: APA Audit Report on the Virginia Department of Emergency Management

Dear Ms. Mavredes:

The Virginia Department of Emergency Management (VDEM) has reviewed the Auditor of Public Accounts (APA) report pertaining to VDEM for the fiscal year 2018. We understand the findings and appreciate the opportunity to respond to the recommendations.

VDEM will provide viable responses to the findings accompanied by plans to address the issues appropriately and specifically raised by the APA. Combined with actions already taken and currently under way, the VDEM's objective to comply with applicable laws and regulations will serve to strengthen and control our operations and financial records.

Please let me know if you have any questions regarding this response.

Sincerely,

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

Curtis C. Brown

Cc: Jeffrey D. Stern, State Coordinator
Cheryl Lee, Chief Financial Officer

*Saving lives through effective emergency management and homeland security.
"A Ready Virginia is a Resilient Virginia."*

VIRGINIA DEPARTMENT OF EMERGENCY MANAGEMENT

As of June 30, 2018

Jeffrey D. Stern, Ph.D.
State Coordinator

Curtis Brown
Chief Deputy State Coordinator