



Department of Veterans Affairs

Veterans Health Care Division

Internal Controls and Compliance Audit

July 2014 through February 2017

April 25, 2018
REPORT 18-07

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division

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OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

April 25, 2018

Senator Mary Kiffmeyer, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Larry Shellito, Commissioner
Department of Veterans Affairs

This report presents the results of our internal controls and compliance audit of the Department of Veterans Affairs for the period July 2014 through February 2017. The objectives of this audit were to determine if the department had adequate internal controls over selected financial activities in its Veterans Health Care Division and complied with significant finance-related legal requirements.

This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Director); Tyler Billig, CPA (Auditor-in-Charge); Heather Rodriguez (Senior Auditor); and Erick Olsen (Senior Auditor).

We received the full cooperation of the department's staff while performing this audit.

Sincerely,

A handwritten signature in black ink that reads "Jim Nobles".

James R. Nobles
Legislative Auditor

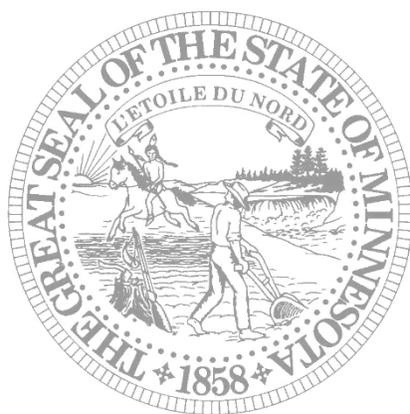
A handwritten signature in black ink that reads "Chris Buse".

Christopher P. Buse
Deputy Legislative Auditor



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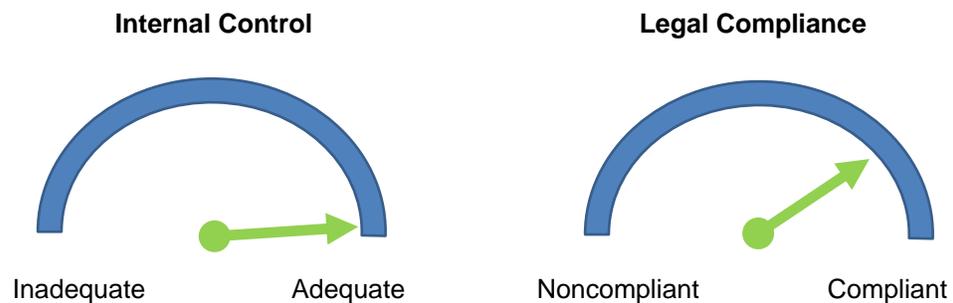
Report Summary

The Minnesota Department of Veterans Affairs is the state agency responsible for the operation of the five state veterans homes, located in Fergus Falls, Hastings, Luverne, Minneapolis, and Silver Bay.

The Office of the Legislative Auditor conducted this selected scope audit to determine whether the department had adequate internal controls and complied with significant finance-related legal requirements for certain activities within its Veterans Health Care Division. The audit scope included payroll expenditures, facility assessments, repair and maintenance expenditures, cost of care calculations, and the operations of the Adult Day Center and the Central Pharmacy. The period under examination went from July 2014 through February 2017.

Conclusion

The Department of Veterans Affairs had adequate internal controls over the financial activities we tested in the Veterans Health Care Division and generally complied with the significant finance-related legal requirements. However, we did find instances of noncompliance related to the Adult Day Center and the Central Pharmacy.



Finding

The Department of Veterans Affairs did not comply with the Administrative Procedures Act when it established guidelines that govern its Adult Day Center and Central Pharmacy.



Audit Overview

This report presents the results of an internal control and compliance audit of selected activities in the Department of Veterans Affairs. Management is responsible for establishing internal controls to safeguard assets and ensure compliance with applicable laws, regulations, and state policies.

A strong system of internal control begins with management's philosophy, operating style, and commitment to ethical values. It also includes processes to continuously assess risks and implement control activities to mitigate risks. Successful internal controls systems include iterative processes to monitor and communicate the effectiveness of control activities.



Department Overview

The Minnesota Department of Veterans Affairs serves approximately 370,000 Minnesota veterans and their families. In January 2011, Governor Mark Dayton appointed Major General Larry Shellito (retired) as the commissioner of the department. The department has approximately 1,300 employees. The department has two divisions, each managed by a deputy commissioner.

Veterans Health Care Division. This division operates five veterans homes, located in Fergus Falls, Hastings, Luverne, Minneapolis, and Silver Bay. The homes provide services such as skilled nursing care, special care units for dementia and Alzheimer's, domiciliary care, rehabilitation services, recreational therapy, and work therapy. The division operates an Adult Day Center at the Minneapolis facility, which provides daily therapeutic and rehabilitation health care services to clients that live in their own homes. The division also operates centralized pharmacy and facilities management services.

Programs and Services Division. This division provides education, employment, and counseling services. It also helps veterans navigate various federal and state programs to obtain financial assistance.

Financial Activity

To operate the veterans homes, the department receives General Fund appropriations and collects other receipts, such as federal per diems, resident maintenance fees, and insurance reimbursements. Total expenditures for the Veterans Health Care Division to operate the veterans homes are approximately \$100 million annually, as depicted in Table 1.

Table 1: Veterans Health Care Division Expenditures

	Fiscal Years		
	2015	2016	2017 ^a
Beginning Balance	\$12,703,720	\$ 8,951,601	\$ 11,157,455
General Fund Appropriation	46,513,000	52,713,000	57,218,000
Receipts			
Federal Per Diems	29,330,386	29,901,345	30,749,565
Maintenance Fees	15,741,562	15,734,163	16,341,734
Insurance Reimbursements	1,231,346	1,486,554	1,902,596
Other	2,767	0	48
Total Sources	<u>\$92,819,061</u>	<u>\$99,835,062</u>	<u>\$106,211,943</u>
Expenditures			
Payroll	\$75,553,680	\$77,774,885	\$ 82,325,545
Purchased Services	7,645,385	7,359,909	8,658,725
Supplies and Equipment	8,457,485	8,704,306	8,522,517
Other	3,378,380	3,770,141	5,415,017
Encumbrances	0	9,417	120,960
Transfers Out	1,536,250	10,550	32,875
Total Uses	<u>\$96,571,180</u>	<u>\$97,629,208</u>	<u>\$105,075,639</u>
Ending Balance	<u>\$ 8,951,601</u>	<u>\$11,157,455</u>	<u>\$ 12,293,759</u>

^a This table includes all Fiscal Year 2017 financial activity. However, the scope of our audit only included Fiscal Year 2017 activity through February 2017.

Source: State of Minnesota's Accounting System.

Audit Scope and Objectives

This audit reviewed selected activities in the Veterans Health Care Division.

Payroll Expenditures

Payroll accounts for nearly 80 percent of the operating costs of the veterans homes. From July 2014 through February 2017, the department spent about \$206.3 million on payroll.

Facilities Management

The department maintains 56 buildings and structures with over 1,000,000 square feet of space on its five veterans home campuses. Generally, the department uses its operating accounts to pay for repair and maintenance projects that cost \$50,000 or less. From July 2014 through February 2017, the department spent nearly \$3.9 million on repairs and maintenance from its operating accounts.

Cost of Care

State law requires the department to calculate the average daily cost of care at each veterans home for domiciliary and nursing care residents.¹ Each home calculates its own cost of care rate under guidelines established in *Minnesota Administrative Rules*.² The department uses the cost-of-care rates to calculate maintenance fees for residents that have the ability to pay. Those fees generally equal the daily cost of care less any federal per diem collected.

Central Pharmacy

The department operates its Central Pharmacy to provide medication for residents at all five veterans homes.³ For medication provided to residents that have insurance coverage for pharmacy costs (mostly Medicare Part D), the department bills insurance carriers. From July 2014 through February 2017, nonpayroll expenditures for the Central Pharmacy totaled nearly \$4.5 million, and insurance reimbursements were about \$3.4 million.

Adult Day Center

The department opened the Adult Day Center on the Minneapolis campus in March 2012. The center offers therapeutic and rehabilitation health care services to veterans and their spouses that live in their own homes. The department collects daily fees from veterans using the center and also collects federal per diems. Although the center's capacity is 35, the average daily attendance was between 16 and 17 during fiscal years 2016 and 2017.

¹ *Minnesota Statutes* 2017, 198.03, subd. 2.

² *Minnesota Administrative Rules* 2017, 9050.0500.

³ The Fergus Falls Veterans Home began using the Central Pharmacy during February 2017.

The objective of our selected scope audit was to answer the following questions for the period from July 2014 through February 2017:

- Did the Department of Veterans Affairs have adequate internal controls over selected financial activities in its Veterans Health Care Division?
- Did the Department of Veterans Affairs comply with significant finance-related legal requirements?

Audit Methodology and Criteria

To answer the objective's questions, we interviewed staff to gain an understanding of financial policies and procedures. We also analyzed accounting data to identify unusual trends or significant changes in financial operations. Finally, we examined samples of financial transactions and reviewed supporting documentation to test whether controls were effective and to determine if transactions complied with finance-related legal provisions.

We conducted the audit in accordance with generally accepted government auditing standards.⁴ 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. Audit standards also require us to consider the risk of errors in accounting records and potential noncompliance when planning and conducting the audit.

We assessed internal controls against the most recent edition of the internal control standards, published by the U.S. Government Accountability Office.⁵ To identify legal compliance criteria for the activity we reviewed, we examined state and federal laws, state administrative rules, state contracts, and policies and procedures established by the departments of Management and Budget, Administration, and Veterans Affairs.

Conclusion

The Department of Veterans Affairs had adequate internal controls over the financial activities we tested in the Veterans Health Care Division and generally complied with the significant finance-related legal requirements we tested. However, we did find an instance of noncompliance related to the Adult Day Center and the Central Pharmacy that we included in this report.

The following *Finding and Recommendation* section provides further explanation about the instance of noncompliance.

⁴ U.S. Government Accountability Office, *Government Auditing Standards*, December 2011.

⁵ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington D.C., September 2014.) In September 2014, the State of Minnesota adopted these standards as its internal control framework for the executive branch.

Finding and Recommendation

The Department of Veterans Affairs did not comply with the *Administrative Procedures Act* when it established guidelines that govern its Adult Day Center and Central Pharmacy.

The department did not use the legally required administrative rulemaking process to establish significant fiscal guidelines for its Adult Day Center and Central Pharmacy. *Minnesota Statutes* 2017, 196.04, subd. 1, states:

The commissioner shall adopt reasonable and proper rules to govern the procedure of the divisions....

Minnesota Statutes 2017, 198.003, subd. 1, further states:

The commissioner shall determine policy and...adopt, amend, and repeal rules for the governance of the homes.

State law requires executive agencies, including the Department of Veterans Affairs, to establish rules by following the requirements of the *Administrative Procedures Act*, *Minnesota Statutes*, Chapter 14. The Act ensures accountability, transparency, and fairness in state government. It requires agencies to justify that the rules they adopt are “needed and reasonable,” and it requires agencies to establish rules in an open process that allow other policy makers and the public to participate.

Agencies cannot avoid the requirement to follow the *Administrative Procedures Act* by calling the rules by another name (policies, guidelines, etc.). According to the law, agencies must follow the process established in the Act when an agency adopts any “statement of general applicability and future effect...to implement or make specific the law enforced or administered by that agency or to govern its organization or procedure.”⁶

Adult Day Center

The department made key decisions about Adult Day Center fees and fee waivers without establishing a rule to govern its decisions. For example, the department charges veterans a \$20 daily co-payment. Spouses also must pay a \$20 daily co-payment and a daily fee equal to the federal per diem rate. The department reduces or waives the co-payment for veterans with incomes below certain thresholds. Furthermore, in an effort to increase attendance, in March 2017, the department began waiving the co-payment for the first two days of attendance each week.

⁶ *Minnesota Statutes* 2017, 14.02, subd. 4.

Central Pharmacy

The department also made key decisions about pharmacy cost recoveries without establishing a rule to govern its decisions. And in some cases, the fiscal practices adopted by the department do not align with state law. For example, *Minnesota Statutes* 2017, 198.003, subd. 7, states:

The commissioner shall maximize the use of Medicare Part D to pay pharmacy costs for eligible veterans residing at the veteran homes. The commissioner shall encourage eligible veterans to participate in the Medicare Part D program and assist veterans in obtaining Medicare Part D coverage.

At the time of our audit, the department identified 74 residents eligible for Medicare Part D that did not have it. From July 2014 through February 2017, we estimated that the department spent about \$843,000 on medication for residents eligible for Medicare Part D, who did not purchase coverage. Federal reimbursements for those medications and the pharmacy costs would have likely exceeded \$1 million.

The department also does not seek reimbursement for pharmacy co-payments and deductibles. From July 2014 through February 2017, the co-payments and deductibles for residents with insurance totaled just over \$1 million. The decision not to attempt to recover these costs contradicts provisions that are currently in *Minnesota Administrative Rules* for cost of care recoveries. For cost of care, the department must recover costs based on a client's ability to pay.

Working through the administrative rulemaking process may not have resulted in decisions or fiscal practices that differ than those implemented by the department. Nonetheless, it is important to follow the external governance provisions that were established by the Legislature.

RECOMMENDATION

The Department of Veterans Affairs should adopt *Minnesota Administrative Rules* to establish guidelines for the operation of its Adult Day Center and its Central Pharmacy.



STATE OF MINNESOTA DEPARTMENT OF VETERANS AFFAIRS

OFFICE OF THE COMMISSIONER, LARRY SHELLITO



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April 20, 2018

Mr. James Nobles, Legislative Auditor
State of Minnesota
Office of the Legislative Auditor
Room 140, Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles,

We appreciate the opportunity to respond to the finding and recommendation included in the Minnesota Department of Veterans Affairs Veterans Health Care Division internal controls and compliance audit for the period of July 2014 through February 2017. We view the audits performed by your Office as valuable opportunities for an independent assessment of our financial processes and a means to evaluate our progress against Department goals and objectives. Additionally, we appreciate the staff resources and professional analysis you dedicated to this review.

MDVA is committed to continuous improvement in all areas, and the one finding identified in your report is no exception. Agency response to the finding in the report is provided on the following page. As illustrated in your report, we have made significant progress over the past several years, and there is always opportunity for continued exploration of procedures and processes consistent with best practices.

Again, we found the information provided helpful and important as we work to fulfill our mission of "serving Minnesota Veterans and their families." Please extend our appreciation to the audit managers and staff responsible.

Sincerely,

/s/ Larry Shellito

Larry Shellito, Commissioner
Minnesota Department of Veterans Affairs

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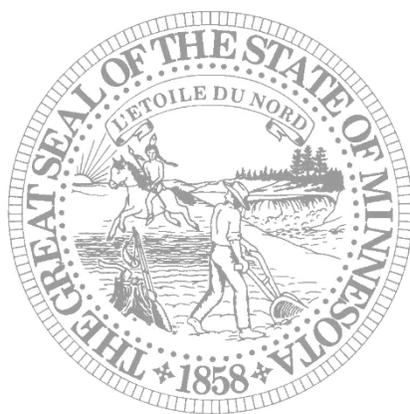
Recommendation #1

The Department of Veterans Affairs should adopt Minnesota Administrative Rules to establish guidelines for the operation of its Adult Day Center and its Central Pharmacy.

The MDVA will seek consultation with interested parties as to the development of administrative rules for its Adult Day Center and Central Pharmacy. As currently authorized by statute, the MDVA began the process of amending the Minnesota Administrative Rule Ch. 9050 in December 2015. The MDVA is considering rule amendments that add new or modify existing definitions, obtain compliance with statutory changes, and make technical corrections. These changes will permit the agency to: update and clarify definitions, clarify program requirements and regulations, establish fiscal guidelines and practices, and other considerations as time allows. The MDVA anticipates completion of the Rule 9050 amendment in December 2018.

Responsible Staff: Douglas Hughes, Deputy Commissioner, Veterans Health Care
Anticipated Completion Date: December 2018





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