

Special Report

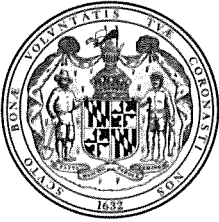
**Statewide Review of
Budget Closeout Transactions for
Fiscal Year 2014**

January 2015



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

January 28, 2015

Thomas J. Barnickel III, CPA
Legislative Auditor

Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2014. Our review of closeout transactions disclosed general compliance with the applicable laws, regulations, and policies. However, we determined that certain transactions pertaining to the following agencies were not in compliance:

Department of Aging
Maryland State Department of Education
Department of Health and Mental Hygiene
Department of Natural Resources
Department of Veterans Affairs

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. Three State agencies recorded federal or reimbursable fund revenues totaling \$6.8 million which could not be substantiated. General fund appropriations (or deficiency appropriations) will be needed to eliminate the resulting deficits if other fund revenues are not available. Similar conditions were noted for two of these agencies in our prior report on the review of fiscal year 2013 closeout transactions.

Two agencies did not report certain liabilities to the Comptroller of Maryland – General Accounting Division during the year-end closeout process. One agency did not report a federal liability of approximately \$13.7 million attributable to the disallowance of certain claims. The other agency did not report unprovided for general fund payables (that is, accounts payable which were not recorded in the budgetary closeout process due to a lack of available appropriation) of \$10.8 million. A summary of our findings, by agency, is included in Exhibit 1.

Three state agencies reported a total of \$49.6 million in unprovided for general fund payables as of June 30, 2014 (Exhibit 2). The expenditures related to these unprovided for payables will have to be funded with subsequent year appropriations (or through a deficiency appropriation). According to an opinion

of the Attorney General, this is not a violation of State law if the General Assembly enacts a budget bill for the subsequent year containing an appropriation that can be used to fund these expenditures.

The primary purpose of this annual review is to alert the Maryland General Assembly to significant financial and budgetary closeout practices that do not comply with applicable laws, regulations, and policies. The issues identified during this review will be fully addressed, as appropriate, in our fiscal compliance audit reports on the applicable agencies, which will include relevant recommendations. We wish to acknowledge the cooperation extended to us during the course of our review by the Comptroller of Maryland's General Accounting Division and by the various State agencies.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Tom J. Barnickel III", with a stylized flourish at the end.

Thomas J. Barnickel III, CPA
Legislative Auditor

Table of Contents

Background Information	5
Introduction, Objectives, and Scope	7
Findings	9
Revenue Transactions	
Finding 1 – The Recovery of Recorded Federal and Reimbursable Fund Revenues Totaling Approximately \$6.8 Million is Uncertain	10
Expenditure Transactions	
Finding 2 – One Agency Had an Unreported Liability For Claims Disallowed by the Federal Government	11
Finding 3 – Unprovided For General Fund Payables Totaling \$10.8 Million at One Agency Were Not Reported to the General Accounting Division as Required	11
Exhibit 1 – Summary of Fiscal Year 2014 Closeout Review Findings by State Agency	12
Exhibit 2 – Schedule of June 30, 2014 Unprovided for General Fund Payables According to the General Accounting Division	13

Background Information

The Comptroller of Maryland – General Accounting Division (GAD) annually provides State agencies with instructions for completing the fiscal year-end budget closeout process. State agencies individually report to GAD their fiscal year-end closeout transactions that have not been previously recorded in the State's accounting records. GAD is responsible for closing the State's accounting records on a statewide basis and for preparing the State's *Comprehensive Annual Financial Report (CAFR)*.

GAD contracts with an independent accounting firm for the purpose of expressing an opinion on the State's basic financial statements contained in the *CAFR*. In its audit report dated December 17, 2014, applicable to the fiscal year ended June 30, 2014, the firm stated that the State's basic financial statements presented fairly, in all material respects, the respective financial position of the State of Maryland as of June 30, 2014, and the respective changes in the financial position and cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America (referred to as GAAP).

The State's *CAFR* states that, on a budgetary basis, the General Fund had an unencumbered balance of approximately \$147.6 million as of June 30, 2014. This represents a decrease of approximately \$354.3 million from the balance reported at the preceding fiscal year-end (\$501.9 million). The *CAFR* also states that the State Reserve (Revenue Stabilization Account) balance totaled \$772.5 million as of June 30, 2014.

The budgetary General Fund balance does not reflect the effect of year-end GAAP adjustments made to the State's financial statements that were prepared on a modified accrual basis of accounting. Certain GAAP adjustments, if recognized on the budgetary basis, would have reduced the aforementioned unencumbered budgetary General Fund balance of \$147.6 million. For example, one GAAP adjustment reduced the Fund balance by \$443.6 million for State and local income tax collections that were recorded as revenue for fiscal year 2014 but were applicable to future fiscal years. This adjustment was \$202.6 million smaller than a similar adjustment made for the fiscal year 2013 *CAFR*. Other GAAP adjustments totaling \$49.6 million were made for liabilities incurred by State agencies during fiscal year 2014 for which general fund appropriations were not available to finance the expenditures (see Exhibit 2).

Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2014. This review was conducted under the authority of the State Government Article, Section 2-1221 of the Annotated Code of Maryland.

The objective of our review was to determine whether budget closeout transactions, for the fiscal year ended June 30, 2014, were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies.

Our review consisted of tests of significant year-end transactions for 21 Departments and independent agencies to ascertain if the transactions were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies. We reviewed, on a limited basis, transactions processed subsequent to June 30, 2014 to determine if the transactions were properly recorded (such as charged or credited to the proper fiscal year).

As part of our current review, we contacted various officials of State agencies, as well as the independent accounting firm under contract with the State to express an opinion on its financial statements. Our review excluded public colleges and universities and transactions processed through the Transportation Trust Fund because the related financial activity does not involve the State's General Fund and/or because agencies have the authority to retain unspent funds at year-end. Our conclusions for the aforementioned objective are contained on page 9 of this report.

We also assessed the status of the 10 issues (appearing in six findings) identified in our January 13, 2014 report entitled *Statewide Review of Budget Closeout Transactions for Fiscal Year 2013*. We determined that 3 of the 10 issues had not been resolved and are repeated in this report (see Exhibit 1).

Our review was limited to the procedures necessary to accomplish the aforementioned objective. These procedures did not constitute an audit conducted in accordance with generally accepted government auditing standards (GAGAS). Had we conducted an audit in accordance with GAGAS, those standards would require the issuance of recommendations as part of our reporting process. In addition, other matters may have come to our attention that would have been

reported. We advised the appropriate agencies of our findings. Formal responses were not requested since this report contains no recommendations. Our fieldwork was conducted during the period from October 2014 to January 2015.

Findings

Conclusion

Our review of State agencies' budget closeout transactions disclosed that such transactions were generally properly supported and made in accordance with State budgetary laws, regulations, and accounting policies. However, we determined that five departments or units thereof were not in compliance primarily because certain year-end transactions were not properly recorded, could not be substantiated, or did not comply with budget closeout requirements.

Revenue Transactions

Three agencies recorded unsubstantiated revenues to offset various fund deficits. Specifically, the agencies recorded federal fund and reimbursable revenues totaling approximately \$6.8 million to cover expenditures even though there was no indication that these revenues were available. The use of general funds will likely be required to eliminate the deficits resulting from these transactions.

Expenditure Transactions

Two agencies did not report certain liabilities to the Comptroller of Maryland – General Accounting Division (GAD). One agency did not report a federal liability of approximately \$13.7 million attributable to the disallowance of certain claims. The other agency had unprovided for general fund payables of \$10.8 million (that is, accounts payable which were not recorded in the budgetary closeout process due to a lack of available appropriation). GAD requires unprovided for payables to be reported during the year-end closeout process. In addition, three state agencies reported a total of \$49.6 million in unprovided for general fund payables as of June 30, 2014 (Exhibit 2). The expenditures related to these unprovided for payables will have to be funded with subsequent year appropriations (or through a deficiency appropriation).

A summary of our findings, by agency, is included in Exhibit 1.

Revenue Transactions

Finding 1

The recovery of recorded federal and reimbursable fund revenues totaling approximately \$6.8 million is uncertain.

Analysis

The **Department of Aging (DOA)**, the **Department of Veterans Affairs (DVA)** and the **Department of Natural Resources (DNR)** could not substantiate their ability to collect revenues of approximately \$3.8 million, \$1.6 million, and \$1.4 million, respectively, as of June 30, 2014. If these agencies are unable to recover these funds, general funds may be needed to eliminate the resulting deficits.

DOA

DOA recorded federal fund and reimbursable fund revenue transactions of approximately \$2.9 million and \$900,000, respectively, at June 30, 2014. These revenue transactions (that is, federal fund receivables and receivables from another State agency) related to federal fund expenditures for the Medicaid Waiver and the Money Follows the Person grant that were incurred during fiscal year 2014 and prior years. However, as of January 12, 2015, requests for reimbursement of these expenditures had not been prepared. This issue, as related to federal fund revenues, has been commented upon in our two preceding budgetary closeout reports. In this regard, at June 30, 2013, DOA recorded unsubstantiated federal fund revenues of \$3.7 million related to similar federal fund expenditures.

DVA

Federal fund revenue transactions totaling approximately \$1.6 million were primarily recorded on DVA's behalf by the Comptroller of Maryland – General Accounting Division (GAD) to eliminate deficit balances that existed in several federal programs as of June 30, 2014. Officials at DVA and GAD could not provide any documentation supporting that the year-end recorded revenues would be received. According to GAD, these deficits resulted from federal fund expenditures incurred during prior years. This issue has been commented upon in our three preceding budgetary closeout reports.

DNR

DNR recorded year-end federal fund revenue transactions totaling approximately \$1.4 million, related to federal fund grant expenditures, which will not be received. Officials at DNR explained that the related grants had closed prior to DNR requesting reimbursement and that no extension requests can be submitted; therefore, DNR does not anticipate collecting these funds. Since federal funds are

not available to cover federal fund expenditures that had been previously recorded, other funds will be needed to eliminate these resulting deficits.

Expenditure Transactions

Finding 2

The Department of Health and Mental Hygiene had an unreported liability to the federal government related to certain disallowed claims.

Analysis

The **Department of Health and Mental Hygiene** has a liability to the federal government of approximately \$20.6 million for disallowed claims related to **Developmental Disabilities Administration (DDA)** residential service. During the closeout process, DDA encumbered, with the approval of the Department of Budget and Management, \$6.9 million of fiscal year 2014 general funds to make the first of three annual payments to return funds for the disallowed claims. The remaining liability of \$13.7 million was not reported as part of the budget closeout process. However, GAD recorded a decrease to the General Fund in the State's fiscal year 2014 *Comprehensive Annual Financial Report* to recognize these disallowances.

As disclosed in our October 2, 2013 fiscal compliance audit report on DDA, DDA residential service costs totaling approximately \$20.6 million were disallowed by the federal Department of Health and Human Services – Office of the Inspector General in its September 2013 audit report which recommended that DDA refund the overbilled amount to the federal government. DDA intends to repay the disallowed claims over three years using general funds. This issue was commented upon in our preceding budgetary closeout report.

Finding 3

The Maryland State Department of Education did not report unprovided for general fund payables of \$10.8 million.

Analysis

The **Maryland State Department of Education (MSDE)** failed to report unprovided for general fund payables totaling approximately \$10.8 million to GAD, as required by the State's year-end closeout procedures. According to MSDE, fiscal year 2014 general fund expenditures for nonpublic placements in its Students With Disabilities – Aid to Education program totaled \$120.6 million while the related appropriation was only \$109.8 million.

Exhibit 1

Summary of Fiscal Year 2014 Closeout Review Findings by State Agency

Agency	Finding Number	Finding Description
Department of Aging	1*	Recovery of \$3.8 million in recorded federal and reimbursable fund revenues is uncertain
Department of Veterans Affairs	1*	\$1.6 million in federal fund revenues were recorded even though related federal funds are not available
Department of Natural Resources	1	\$1.4 million in federal fund revenues were recorded even though related federal funds are not available
Department of Health and Mental Hygiene	2*	An unreported federal liability of approximately \$13.7 million may have to be funded with State general funds
Maryland State Department of Education	3	Unprovided for general fund payables of \$10.8 million were not reported at year end as required

*** Denotes item repeated in full or part from preceding report**

Exhibit 2

Schedule of June 30, 2014 Unprovided for General Fund Payables According to the General Accounting Division

Agency	Amount of Reported Unprovided for Payables As of June 30, 2014
Department of Health and Mental Hygiene	\$44,380,937
Maryland Higher Education Commission	3,370,038
Office of the Public Defender	1,867,341
Total	\$49,618,316

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