

Special Report

**Statewide Review of
Budget Closeout Transactions for
Fiscal Year 2009**

January 2010



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

Bruce A. Myers, CPA
Legislative Auditor

January 15, 2010

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
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, 2009. 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:

Maryland State Department of Education
Department of State Police
Maryland Higher Education Commission
Comptroller of Maryland – Revenue Administration Division
State Board of Elections

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, accrued revenues totaling \$14.5 million could not be substantiated. If the revenues are not available for these accruals, general fund appropriations (or deficiency appropriations) may be needed to eliminate the resulting deficits. A summary of our findings, by agency, is included in Exhibit 1.

Four State agencies reported a total of \$22.5 million in unprovided for payables as of June 30, 2009 (Exhibit 2). Our review disclosed additional unprovided for payables related to two State agencies, totaling \$6.4 million, which had not been reported. 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 agencies identified in this report generally agreed with our findings. 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, as well as relevant recommendations, will be fully addressed, as appropriate, in our fiscal compliance audit reports on the applicable agencies. We wish to acknowledge the cooperation extended to us during the course of our review by the Comptroller of Maryland – General Accounting Division and by the various State agencies.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Table of Contents

Background Information	5
Introduction, Objectives, and Scope	7
Findings	9
Closeout Transactions	
Revenue Transactions	
* Finding 1 – Accrued Federal and Reimbursable Fund Revenues Totaling \$14.5 Million Could Not Be Substantiated by Two Agencies and One Agency Overstated General Fund Accrued Revenues by \$2.7 Million	10
* Finding 2 – A \$5.4 Million General Fund Deficiency Appropriation May Be Needed to Eliminate a Special Fund Deficit Balance	11
Finding 3 – Fiscal Year-End Special Fund Accounts Receivable of \$2.6 Million Could Not Be Substantiated	11
Expenditure Transactions	
Finding 4 – Unfunded Year-End Liabilities Totaling \$6.4 Million Were Not Reported to GAD as Required	12
Finding 5 – Excess General Fund Appropriations Totaling \$2.4 Million Were Not Cancelled at Fiscal Year-End	13
Other Issues	
Finding 6 – Federal Expenditure Disallowances Totaling \$14.4 Million May Have to Be Paid With General Funds	14
* Finding 7 – Previously Reported Federal Audit Disallowances Totaling \$32.8 Million Will Not Have to Be Paid With General Funds, and the State Is Recovering \$13 Million in Other Federal Sanctions from Local Education Agencies	15
Exhibit 1 – Summary of Fiscal Year 2009 Closeout Review Findings by State Agency	16
Exhibit 2 – Schedule of Unprovided for General Fund Payables According to the General Accounting Division	17
* Denotes item repeated in full or part from preceding report	

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 closing 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 11, 2009, applicable to the fiscal year ended June 30, 2009, 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, 2009, 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 the General Fund, on a budgetary basis, had a balance of approximately \$926 million as of June 30, 2009. This amount represents a decrease of approximately \$461 million from the balance reported at the preceding fiscal year-end (\$1.4 billion).

Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2009. 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, 2009, 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 22 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 also reviewed, on a limited basis, transactions processed subsequent to June 30, 2009 to determine if the transactions were properly recorded (such as charged or credited to the proper fiscal year). Also, we assessed the status of the findings identified during our review of the budget closeout transactions for the fiscal year ended June 30, 2008, which were reported to the Joint Audit Committee in a special report dated January 16, 2009. 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. Our follow-up review of the two closeout transactions from the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2008* disclosed that both exceptions are repeated in this report. Also, the status of the Federal audit disallowances of Medicaid expenditures incurred by local education agencies is updated in this report.

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. Our fieldwork was conducted during the period from September 2009 to January 2010.

Findings

Closeout Transactions

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 either were not properly recorded or could not be substantiated.

Revenue Transactions

Two State agencies could not substantiate certain revenue transactions totaling \$14.5 million. That is, the agencies could not provide evidence that they were entitled to receive federal funding or funding from other sources for the specific expenditures incurred. To the extent that these funds are not received, the resulting deficits may require the use of general funds. In addition, one State agency incorrectly calculated accrued revenue resulting in the overstatement of general fund revenues by \$2.7 million. Also, one State agency maintained a deficit special fund balance of \$5.4 million as a result of an improper closing transaction recorded in a prior year. The use of general funds will likely be required to eliminate the deficit. Finally, one State agency could not substantiate fiscal year-end special fund accounts receivable of \$2.6 million resulting in the potential need for general fund appropriations to cover the uncollected revenues.

Expenditure Transactions

Two State agencies did not properly report unfunded liabilities totaling \$6.4 million to GAD as required. Also, one State agency improperly encumbered general fund appropriations totaling \$2.4 million, which otherwise would have been cancelled.

A summary of our findings, by agency, is included in Exhibit 1 on page 16 of this report.

Revenue Transactions

Finding 1

Accrued federal and reimbursable fund revenues totaling approximately \$14.5 million could not be substantiated and general fund accrued revenue was overstated by approximately \$2.7 million.

Analysis

The **Maryland State Department of Education (MSDE)** and the **Department of State Police (DSP)** recorded unsubstantiated revenues of approximately \$13.3 million and \$1.2 million, respectively. Since revenues are not available for these accruals, which were recorded to cover expenditures that had been previously incurred, general fund appropriations (or deficiency appropriations) may be needed to eliminate the resulting deficit. Both of these issues have been commented upon in our three preceding annual budget closeout reports. In addition, the **Comptroller of Maryland – Revenue Administration Division (RAD)** overstated its revenue accrual by \$2.7 million.

MSDE

MSDE recorded unsubstantiated federal fund revenues totaling \$13.3 million at June 30, 2009 related to the federal Temporary Assistance to Needy Families (TANF) grant. This accrued revenue (that is, federal fund receivable) relates to MSDE's failure to recover TANF grant expenditures incurred during fiscal years 2002 and 2003. DHR, which processes the federal fund recoveries, advised that the TANF federal fund grants for those years have already been fully used and are no longer available to reimburse the MSDE expenditures. MSDE personnel informed us that a deficiency appropriation will be requested to cover the outstanding \$13.3 million deficit.

DSP

DSP recorded unsubstantiated reimbursable revenues totaling approximately \$1.2 million relating to unattained revenue from the Maryland Emergency Management Agency (MEMA). DSP did not have adequate documentation to support a reimbursable fund accrual of \$1.2 million that during our past closeout reviews DSP claimed was due from MEMA. However, DSP personnel have since acknowledged that MEMA does not owe DSP the \$1.2 million. DSP attempted to obtain a deficiency appropriation in 2009 to resolve this situation; however, the deficiency appropriation was not approved.

RAD

RAD overstated its fiscal year 2009 accrued revenue by \$2.7 million. Specifically, during the calculation of the 2009 fiscal year-end accrual, RAD double counted the \$2.7 million portion of the calculation that related to certain

revenues collected by the Maryland Clerks of the Circuit Court. The double counting of the revenues resulted in the overstatement of general fund revenues for fiscal year 2009.

Finding 2

A general fund deficiency appropriation will be required to eliminate a special fund deficit balance of \$5.4 million.

Analysis

The **Department of State Police (DSP)** may require a general fund deficiency appropriation to eliminate a special fund deficit balance of \$5.4 million that existed as of June 30, 2009. Specifically, DSP mistakenly recorded certain transactions as both accrued revenue and actual revenue during fiscal year 2005. This resulted in a special fund surplus of \$5.6 million being reflected in the records which DSP transferred to the general fund during the fiscal year 2005 closeout because it did not have legal authority to retain any balance in this special fund. When this mistake was discovered during fiscal year 2006, DSP was left with a special fund deficit balance of \$5.6 million at the end of fiscal year 2006 due to the transfer of the apparent surplus to the general fund and the subsequent automatic reversal of the previously recorded accrued revenue transaction at the beginning of fiscal year 2006. Since fiscal year 2006, excess revenues of \$200,000 were retained in the fund, which reduced the negative balance to \$5.4 million. DSP attempted to obtain a deficiency appropriation in 2009 to resolve this situation; however, the deficiency appropriation was not approved. This condition has been commented upon in our three preceding annual budget closeout reports.

Finding 3

Fiscal year-end special fund accounts receivable of \$2.6 million could not be substantiated.

Analysis

The **Department of State Police's (DSP)** fiscal year-end special fund accounts receivable balance could not be substantiated. Specifically, DSP's special fund accounts receivable balance at the close of fiscal year 2009 recorded on the State's general ledger totaled \$5.2 million; however, the unpaid accounts receivable according to DSP's detail records totaled only \$2.6 million. As a result, \$2.6 million of the accounts receivable may never be collected since a record of the individual debts for this amount does not exist. Accordingly, to the extent

these receivables are not collectible, general funds appropriations may be needed to cover the related DSP expenditures recorded in 2009 and prior years related to these receivables.

DSP unsubstantiated receivables were commented upon in our two preceding annual budget closeout reports. Specifically, DSP recorded fiscal year 2008 and 2007 year-end special fund revenue accruals (which resulted in establishing accounts receivable) of \$798,000 and \$560,000, respectively, for services DSP provided to other entities. However, for both these years, DSP was not able to substantiate the accruals or identify the other entities who owed the amounts to DSP, and these accruals have contributed to the unsubstantiated receivable that existed at the end of fiscal year 2009.

DSP acknowledged that issues exist with their accounts receivable balance and corresponding detail records and advised that it was attempting to rectify the issues. DSP intended to offset part of the uncollectible accounts receivable using the improperly encumbered general fund appropriations identified in Finding 5 of this report.

The Comptroller of Maryland – General Accounting Division’s (GAD) accounting procedures manual requires that adequate records be maintained to account for billings and related collections.

Expenditure Transactions

Finding 4

Unfunded year-end liabilities totaling approximately \$6.4 million were not reported to the Comptroller of Maryland – General Accounting Division (GAD).

Analysis

The **Maryland Higher Education Commission (MHEC)** and the **State Board of Elections (SBE)** did not report unfunded year-end liabilities of approximately \$4.4 million and \$2 million, respectively, to GAD as required. General fund appropriations in subsequent years (or deficiency appropriations) may be needed to eliminate these liabilities.

MHEC

MHEC failed to report unfunded liabilities to GAD totaling \$4.4 million during the fiscal year 2009 budget closeout process. MHEC’s unfunded liabilities related to amounts due to community colleges for employer retirement contributions and fees for non-resident students (that is, the fee paid by the State for certain students

attending a community college in a county other than their county of residence). However, MHEC did not have sufficient appropriations to fund certain of these fiscal year 2009 expenditures. Although MHEC reported unfunded liabilities totaling \$6.8 million to GAD at the close of fiscal year 2009 related to employer retirement contributions (see Exhibit 2), the amount reported was incomplete. MHEC did not report an additional \$200,000 unfunded liability in employer retirement contribution costs incurred in June 2009. Furthermore, MHEC did not report \$4.2 million in expenditures incurred by community colleges for non-resident students.

SBE

SBE failed to report unfunded liabilities to GAD totaling \$2 million during the fiscal year 2009 budget closeout process. SBE's unfunded liabilities related to unpaid vendor invoices. Specifically, at the end of fiscal year 2009, SBE had unpaid vendor invoices totaling \$5.1 million¹. However, SBE did not have sufficient appropriations to fund the entire amount due. In this regard, SBE encumbered \$3.1 million, but there were no remaining appropriations to pay for the final \$2 million of outstanding invoices.

Finding 5

Excess general fund appropriations totaling \$2.4 million were not cancelled at fiscal year-end.

Analysis

The **Department of State Police (DSP)** did not cancel excess general fund appropriations totaling approximately \$2.4 million at fiscal year-end. Instead, DSP inappropriately encumbered the unused appropriation so that it could be retained and used in future years (specifically, DSP intended to use these appropriations to offset uncollectible accounts receivable previously noted in Finding 3). DSP did not have expenditure obligations such as purchase orders or contracts to support the encumbrance of these appropriations. This practice violated the yearly closing instructions of the Comptroller of Maryland - General Accounting Division (GAD) since the encumbrances did not represent actual commitments by the State for goods or services and consequently would not qualify as valid encumbrances.

¹ After consultation with the Office of the Attorney General, SBE decided not pay the \$5.1 million of invoices due to a pending legal claim against the vendor.

Other Issues

Conclusion

Liabilities totaling approximately \$14.4 million resulting from the disallowance of federal expenditures have been recorded and may have to be paid with general funds. A liability of \$32.8 million reported upon in previous closeout reports resulting from federal audit disallowances will no longer need to be repaid.

Federal Disallowances

Finding 6

Federal expenditure disallowances totaling approximately \$14.4 million may have to be paid with general funds.

Analysis

In fiscal year 2009 the **Department of Human Resources (DHR)** and the **Department of Juvenile Services (DJS)** were informed by the United States Department of Health and Human Services (DHHS) that certain Title IV-E grant expenditures totaling \$14.4 million were disallowed. To the extent that the disallowances are not recovered, the Title IV-E expenditures in question will need to be paid with State general funds.

The disallowances related to DHR totaled \$9.6 million and were principally based on the lack of a Title IV-E foster care pre-placement provision in DHR's cost allocation plan. Consequently, DHHS did not pay for foster care pre-placement costs claimed on DHR's Title IV-E reports for the quarters ending September 30, 2008 and December 31, 2008.

The disallowances related to DJS totaled \$4.8 million and were principally based on DHHS claiming that DJS and DHR violated Maryland State law by operating separate Title IV-E programs and that a proposed agreement between DHR and DJS permitting DJS to perform certain Title IV-E activities was deemed by DHHS to be inconsistent with applicable laws. Consequently, DHHS did not pay for DJS' Title IV-E costs claimed on the DHR Title IV-E reports for the quarters ending June 30, 2008, September 30, 2008, and December 31, 2008.

DHR and DJS disagreed with the DHHS' disallowances and on December 19, 2008; March 19, 2009; and May 19, 2009 appealed DHHS' decisions to the DHHS Departmental Appeals Board (DAB). During the fiscal year 2009 closing, DHR and DJS reported the \$9.6 million and \$4.8 million to the Comptroller of Maryland - General Accounting Division (GAD) as liabilities with the appeal pending, and the total amount was recorded as a decrease to general fund revenue by GAD in the State's fiscal year 2009 *Comprehensive Annual Financial Report*.

As of December 31, 2009, there had been no final determination by DAB on the appeal.

Finding 7

Previously reported federal audit disallowances totaling approximately \$32.8 million will not have to be repaid, and the State is recovering \$13 million in other federal sanctions from local education agencies (LEAs).

Analysis

In our two previous closeout reports we disclosed two federal audits of school-based Medicaid expenditures, which resulted in disallowed claims totaling approximately \$45.8 million. The federal sanctions from an audit report dated May 2007 totaled \$32.8 million and was appealed by the Department of Health and Mental Hygiene (DHMH) and the Maryland State Department of Education (MSDE) in June 2008. During the fiscal year 2009 closing, DHMH reported the \$32.8 million to the Comptroller of Maryland – General Accounting Division (GAD) as a liability with the appeal pending, and the full amount was recorded by GAD in the State’s fiscal year 2009 *Comprehensive Annual Financial Report*. In November 2009 the United States Department of Health and Human Services (DHHS) and DHMH, acting for the State, entered into a settlement agreement, which resulted in DHHS withdrawing its \$32.8 million disallowance. The settlement agreement required DHMH to submit certain documentation and take certain actions to address DHHS’ concerns in the future.

Other sanctions were imposed as a result of a March 2003 federal audit report. DHMH and MSDE disagreed with the audit findings and appealed these sanctions. Subsequently, the federal government reduced its claim from \$19.9 million to \$16.4 million, which was recovered by the federal government in July 2007 by reducing Medicaid reimbursements to DHMH. DHMH requested the five applicable LEAs to reimburse DHMH \$13 million for their respective portions of the sanctions over a three-year period beginning in fiscal year 2009. However, four of the five LEAs appealed DHMH’s request to the Office of Administrative Hearings (OAH). Notwithstanding the appeal, DHMH began to withhold a portion of the five LEAs’ medical assistance reimbursement payments to fund the \$13 million of sanctions. In March 2009, OAH ruled that DHMH and MSDE had the legal authority to recover the overpayments from the LEAs.

Exhibit 1

Summary of Fiscal Year 2009 Closeout Review Findings by State Agency

Agency	Finding Number	Finding Description
Maryland State Department of Education	1	\$13.3 million in unsubstantiated federal fund accrued revenues were recorded.
Department of State Police	1	\$1.2 million in unsubstantiated reimbursable fund accrued revenues were recorded.
	2	\$5.4 million special fund deficit balance exists, which may require a general fund deficiency appropriation to cover.
	3	\$2.6 million of special fund accounts receivable at fiscal year-end could not be substantiated.
	5	\$2.4 million of excess general fund appropriations were not cancelled at fiscal year-end.
Comptroller of Maryland – Revenue Administration Division	1	\$2.7 million of general fund accrued revenue was overstated.
Maryland Higher Education Commission	4	\$4.4 million of unfunded year-end liabilities were not reported to GAD as required.
State Board of Elections	4	\$2 million of unfunded year-end liabilities were not reported to GAD as required.

Exhibit 2

Schedule of Unprovided for General Fund Payables According to the General Accounting Division

Agency	Amount of Reported Unprovided for Payables
Department of Health and Mental Hygiene	\$7,883,240
Maryland Higher Education Commission ²	6,799,269
Department of Assessment and Taxation	5,958,347
Department of Juvenile Services	1,836,449
Total	\$22,477,305

² As previously noted in Finding 4, the Maryland Higher Education Commission underreported its unprovided for general fund payables to the General Accounting Division by \$4.4 million. We also noted that SBE did not report unprovided for payables of \$2 million.

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