

Audit Report

Maryland Environmental Service

March 2023

Public Notice

In compliance with the requirements of the State Government Article Section 2-1224(i), of the Annotated Code of Maryland, the Office of Legislative Audits has redacted cybersecurity findings and related auditee responses from this public report.



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Victoria L. Gruber
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Gregory A. Hook, CPA
Legislative Auditor

March 10, 2023

Senator Clarence K. Lam, M.D., Senate Chair, Joint Audit and Evaluation Committee
Delegate Jared Solomon, House Chair, Joint Audit and Evaluation Committee
Members of Joint Audit and Evaluation Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Maryland Environmental Service (MES) for the period beginning March 11, 2019 and ending March 31, 2022. MES provides water supply, wastewater treatment, and waste management services to public and private entities. As of July 19, 2022, MES administered 655 projects, of which 271 projects were operated at State-owned facilities.

Our audit disclosed that MES had not established formal written agreements with State agencies to clarify its responsibilities for services it performed for 78 of the 79 reimbursable projects, which includes 76 State-owned water and wastewater facilities, as required by a 1979 Board of Public Works advisory. During fiscal year 2021, MES had collected approximately \$29.9 million from State agencies to operate and maintain these 79 projects.

Additionally, our audit disclosed certain risks in MES' financial management system. However in accordance with the State Government Article, Section 2-1224(i) of the Annotated Code of Maryland, we have redacted the finding from this audit report. Specifically, State law requires the Office of Legislative Audits to redact cybersecurity findings in a manner consistent with auditing best practices before the report is made available to the public. The term "cybersecurity" is defined in the State Finance and Procurement Article, Section 3A-301(b), and using our professional judgment we have determined that the redacted finding falls under the referenced definition. The specifics of the cybersecurity finding were previously communicated to MES as well as those parties responsible for acting on our recommendations.

Our audit also included a review to determine the status of the six findings contained in our preceding audit report. For the non-cybersecurity-related findings, we determined that MES satisfactorily addressed four of those five findings. The remaining finding is repeated in this report.

MES' response to this audit is included as an appendix to this report. We reviewed the response to our findings and related recommendations, and have concluded that the corrective actions identified are sufficient to address all audit issues. Consistent with State law, we have redacted the elements of MES' response related to the cybersecurity audit finding.

We wish to acknowledge the cooperation extended to us during the course of this audit by MES. We also wish to acknowledge MES' willingness to address the audit issues and implement appropriate corrective actions.

Respectfully submitted,

A handwritten signature in black ink that reads "Gregory A. Hook". The signature is written in a cursive, flowing style.

Gregory A. Hook, CPA
Legislative Auditor

Background Information

Agency Responsibilities

The Maryland Environmental Service (MES) was created as an instrumentality of the State and a public corporation to provide water supply, wastewater treatment, and waste management services to public and private entities. MES constructs, operates, and maintains various water, sewer, and solid waste plant facilities under contracts with the State of Maryland, its political subdivisions, and private enterprises.

According to its records, MES administered 655 projects as of July 19, 2022, of which 271 projects were operated at State-owned facilities, including 79 projects that were related to reimbursable State projects. According to its fiscal year 2021 audited financial statements, MES' operating expenditures (including salaries, wages, and fringe benefits) totaled approximately \$186.5 million and MES received revenue totaling approximately \$186.5 million, of which approximately \$175.3 million was received from State and local government entities.

Investigation of the Former Director Resulted in Significant Law Change Impacting MES

During the audit period, the Joint Committee on Fair Practices and State Personnel Oversight (Joint Committee) initiated an investigation and held several hearings concerning a \$233,600 severance payment and certain expense reimbursements made to the former MES director. The former director had resigned to serve as the Governor's Chief of Staff. The Joint Committee subsequently hired a law firm to assist in its investigation, which included testimony from multiple witnesses, interviews with additional individuals, and the analysis of documents.

As a result of the Joint Committee's investigation, the Maryland General Assembly passed Chapter 72, Laws of Maryland 2021, effective July 1, 2021, (known as the Maryland Environmental Service Reform Act) that made significant changes to MES and its operations.

1. **Governance** – The Act changed the composition, appointment process, and qualifications of the Board of Directors. The Act decreased the number of Board members from nine to eight; and removed the MES executive director as the presiding officer of the Board, designating the executive director as a non-voting member. The remaining Board members include the State

Treasurer (or designee) and six members appointed to the Board by the Governor with the advice and consent of the Maryland Senate.

The Board is now required to observe the same standard of care as corporate directors, receive annual training, adopt a conflict of interest policy, and annually evaluate the executive director based on Board approved criteria. The Board also must adopt policies on severance packages, bonuses, tuition reimbursements, expense reimbursements, workforce diversity, whistleblower complaints, travel, and the vehicles and equipment owned by MES.

2. **Administration** – The Act required the MES executive director to appoint a diversity officer to coordinate the development and implementation of a diversity policy for MES and to assist employees in resolving grievances related to alleged violations of the diversity policy or State or federal anti-discrimination law. MES is also required to submit certain contracts with a value of \$250,000 or more to the Board of Public Works for approval. Furthermore, the MES administration is required to notify its Board of any nonemergency expenditure that exceeds \$25,000 and receive Board approval for nonemergency expenditures greater than \$200,000. Finally, MES is required to submit a full and detailed operating and capital budget each year to the Department of Budget and Management, and the budget must specify MES' revenue sources.
3. **Audit** – The Act required MES to obtain an annual audit that focuses on unauthorized spending, misallocated expenses, lack of conformity with State law or Board policies, and other accounting errors. The required annual audit could either be performed by MES' independent accounting firm that audits its financial statements or be performed separately. MES obtained the required audit report dated June 21, 2022 (a draft copy of this report previously had been submitted to the Board on May 26, 2022). The report, which was issued after the conclusion of our audit fieldwork, disclosed that transactions tested were appropriate and adequately documented. The report also disclosed that certain employee expense reimbursements tested were not submitted timely in accordance with MES procedures.

Additionally, the Act required an assessment of the Board's operations by December 31, 2021 and every five years thereafter. MES obtained the required Board assessment and presented it to the Board on December 16, 2021. The report identified opportunities for continued improvement and included recommendations for the Board's consideration, such as developing an onboarding process, requiring cyber awareness training, and self-evaluation

of Board performance. As of September 2022, MES and the Board were in the process of implementing the recommended improvements.

On May 16, 2022, the Joint Committee issued a report to the Legislative Policy Committee on its findings, conclusions, and recommendations regarding MES personnel and Board practices during the tenure of the former director. According to the report, federal and State prosecutors conducted investigations of the former MES director's activities simultaneously with the Committee's investigations. On October 5, 2021 the U.S. Attorney's Office for the District of Maryland indicted the former director, and on the same date the Maryland State Prosecutor's Office filed a criminal information¹ against the former director in the Circuit Court for Anne Arundel County. As of September 2022, the disposition of these criminal charges had not been finalized.

Our audit of MES took into account the aforementioned law changes.

Financial Statement Audits

In accordance with the Natural Resources Article, Section 3-126 of the Annotated Code of Maryland, MES engaged an independent accounting firm to audit its financial statements annually. In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the financial position of MES as of June 30, 2019, 2020, and 2021, and the respective changes in its financial position and, where applicable cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the six findings contained in our preceding audit report dated January 31, 2020. As disclosed in Figure 1 on the following page, for the non-cybersecurity-related findings, we determined that MES satisfactorily addressed four of those five findings. The remaining non-cybersecurity-related finding is repeated in this report.

¹ A filing of a criminal information is similar to an indictment except that it does not require a vote by a grand jury. Instead, the information is presented to a judicial officer who examines it and decides whether there is probable cause that a crime occurred.

Figure 1
Status of Preceding Findings

Preceding Finding	Finding Description	Implementation Status
Finding 1	MES lacked formal written agreements with State agencies for 69 facilities to clarify responsibilities of the services it performed, as required.	Repeated (Current Finding 1)
Finding 2	MES obtained services from two vendors totaling approximately \$8.4 million using a sole source procurement method without necessary MES Board approval to waive its competitive procurement procedures. Furthermore, MES did not have a written contract with one of the vendors.	Not Repeated
Finding 3	MES had not established effective controls over the processing of invoice payments.	Not Repeated
Finding 4	MES check receipt and deposit procedures were inadequate and duties related to cash receipts and accounts receivable were not properly segregated.	Not Repeated
Finding 5	Human resources and payroll system user capabilities were not adequately restricted, and independent documented reviews of personnel and payroll transactions were not performed.	Not Repeated
Finding 6	MES did not ensure that user access capabilities assigned to employees on its financial management systems were adequately restricted.	Status Redacted ²

Findings and Recommendations

State Projects

Background

Maryland Environmental Service (MES) performs project services (such as environmental cleanup and recycling program management) for State agencies. MES enters into a contract with each agency for these projects. During fiscal year 2021, expenditures related to 180 State-related contractual projects totaled approximately \$80.7 million. As provided for in the contracts, MES may require

² Specific information on the current status of this cybersecurity-related finding has been redacted from this publicly available report in accordance with State Government Article, Section 2-1244(i) of the Annotated Code of Maryland.

advance payments from agencies to cover project expenditures. Any interest earned on the advances is credited to the individual projects to offset expenditures. According to MES, the necessity and amount of an advance are based on the duration and size of the project. As of June 30, 2021, MES was holding 54 advances for contractual projects totaling \$5.9 million.

In addition to project services, other MES projects represent long-term operational commitments by MES, in accordance with an Executive Order issued in 1971, to operate and maintain all State-owned water, wastewater, and solid waste management facilities. The funding for these State reimbursable projects is established through the State budgetary process, during which annual estimates of costs for the projects are submitted by MES to the Department of Budget and Management for inclusion in the annual budget request. MES is reimbursed by State agencies on a monthly basis consistent with the annual estimate. During fiscal year 2021, MES collected approximately \$29.9 million from State agencies for 79 reimbursable projects, of which 76 were State-owned water and wastewater facilities and 3 were steam plant facilities.

Finding 1

MES lacked required formal written agreements with State agencies for 78 of the 79 reimbursable projects at State-owned facilities to clarify responsibilities of services it performed.

Analysis

MES lacked formal written agreements with State agencies for 78 of the 79 reimbursable projects at State-owned facilities to clarify responsibilities of services it performed, as required. A 1979 Board of Public Works (BPW) advisory required State agencies to prepare detailed working agreements and descriptions of the scope of responsibility assigned to MES and the other State agency for each project. Our review disclosed that MES only had a written agreement for 1 of the 79 reimbursable projects active during 2021 totaling \$79,839.

A similar condition was noted in our prior audit report. In response to our prior report, MES indicated it would implement formal written agreements by December 2020. However, MES management advised us that they had not made progress on this issue because it was addressing other matters (such as implementing changes resulting from the MES Reform Act) and MES advised us it would execute the required agreements by December 2023.

Recommendation 1

We recommend MES comply with the BPW advisory and enter into formal written agreements with agencies for all reimbursable projects that it operates. The agreements should clarify the various responsibilities of each party (repeat).

Information Systems Security and Control

We determined that the Information Systems Security and Control section, including Finding 2, related to “cybersecurity”, as defined by the State Finance and Procurement Article, Section 3A-301(b) of the Annotated Code of Maryland, and therefore are subject to redaction from the publicly available report in accordance with the State Government Article, Section 2-1224(i). Consequently, the specifics of the cybersecurity-related information as well as the following finding, including the analysis, related recommendations, along with MES’ response, have been redacted from this report copy.

Finding 2

Redacted cybersecurity-related finding.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Maryland Environmental Service (MES) for the period beginning March 11, 2019 and ending March 31, 2022. The audit was conducted 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.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MES’ financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included cash receipts, procurements and disbursements,

payroll, and state projects. We also determined the status of the findings contained in our preceding audit report.

MES engaged an independent accounting firm to audit its financial statements annually. In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the financial position of MES as of June 30, 2019, 2020, and 2021, and the respective changes in its financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We have relied on the work of the independent accounting firm to provide audit coverage of certain aspects of MES' operations (such as, internal controls and testing for debt financing, and certain accounts receivable activities). Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

Our assessment of internal controls was based on agency procedures and controls in place at the time of our fieldwork. Our tests of transactions and other auditing procedures were generally focused on the transactions occurring during our audit period of March 11, 2019 and ending March 31, 2022, but may include transactions before or after this period as we considered necessary to achieve our audit objectives.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, tests of transactions, and to the extent practicable, observations of MES' operations. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk, the timing or dollar amount of the transaction, or the significance of the transaction to the area of operation reviewed. As a matter of course, we do not normally use sampling in our tests, so unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, unless sampling is specifically indicated in a finding, the results from any tests conducted or disclosed by us cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from MES' financial management system (such as revenue and expenditure data). We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve

our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

MES' management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records; effectiveness and efficiency of operations, including safeguarding of assets; and compliance with applicable laws, rules, and regulations are achieved. As provided in *Government Auditing Standards*, there are five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. Each of the five components, when significant to the audit objectives, and as applicable to MES, were considered by us during the course of this audit.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be a significant deficiencies in the design or operation of internal control that could adversely affect MES' ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MES that did not warrant inclusion in this report.

State Government Article Section 2-1224(i) requires that we redact in a manner consistent with auditing best practices any cybersecurity findings before a report is made available to the public. This results in the issuance of two different versions of an audit report that contains cybersecurity findings – a redacted version for the public and an unredacted version for government officials responsible for acting on our audit recommendations.

The State Finance and Procurement Article, Section 3A-301(b), states that cybersecurity is defined as “processes or capabilities wherein systems, communications, and information are protected and defended against damage,

unauthorized use or modification, and exploitation”. Based on that definition, and in our professional judgment, we concluded that certain findings in this report fall under that definition. Consequently, for the publicly available audit report all specifics as to the nature of cybersecurity findings and required corrective actions have been redacted. We have determined that such aforementioned practices, and government auditing standards, support the redaction of this information from the public audit report. The specifics of these cybersecurity findings have been communicated to MES and those parties responsible for acting on our recommendations in an unredacted audit report.

MES’ response to our findings and recommendations is included as an appendix to this report. Depending on the version of the audit report, responses to any cybersecurity findings may be redacted in accordance with State law. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise MES regarding the results of our review of its response.

APPENDIX



Wes Moore GOVERNOR

Aruna Miller LT. GOVERNOR

Charles Glass, Ph.D., P.E. EXECUTIVE DIRECTOR

March 2, 2023

Gregory A. Hook, CPA, Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
The Warehouse at Camden Yards
351 West Camden Street, Suite 400
Baltimore, Maryland 21201

RE: Audit of Maryland Environmental Service (MES)
Report Date: February 2023
Audit Period: March 11, 2019 to March 31, 2022

Dear Mr. Hook:

We appreciate your work in conducting a fiscal compliance audit of the Maryland Environmental Service (MES) for the period beginning March 11, 2019 and ending March 31, 2022.

We agree with the two findings and have provided MES's responses in the completed Agency Response Form.

Please feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles C. Glass". The signature is fluid and cursive, with a large initial "C" and a stylized "G".

Charles C. Glass, Ph.D., P.E.
Executive Director

Maryland Environmental Service

Agency Response Form

State Projects

Finding 1

MES lacked required formal written agreements with State agencies for 78 of the 79 reimbursable projects at State-owned facilities to clarify responsibilities of services it performed.

We recommend MES comply with the BPW advisory and enter into formal written agreements with agencies for all reimbursable projects that it operates. The agreements should clarify the various responsibilities of each party (repeat).

Agency Response			
Analysis			
Please provide additional comments as deemed necessary.			
Recommendation 1	Agree	Estimated Completion Date:	12/31/2023
Please provide details of corrective action or explain disagreement.	MES will continue to establish omnibus agreements with additional State agencies where appropriate, and applicable, to ensure there are clearly defined scopes of work. The agreements will include descriptions, responsibilities, and specific services offered by MES for each entity.		

Maryland Environmental Service

Agency Response Form

Information Systems Security and Control

The Office of Legislative Audits (OLA) has determined that Finding 2 related to “cybersecurity”, as defined by the State Finance and Procurement Article, Section 3A-301(b) of the Annotated Code of Maryland, and therefore is subject to redaction from the publicly available audit report in accordance with State Government Article 2-1224(i). Although the specifics of the finding, including the analysis, related recommendations, along with MES’ responses, have been redacted from this report copy, MES’ responses indicated agreement with the finding and recommendations.

Finding 2
Redacted cybersecurity-related finding.

Agency Response has been redacted by OLA.

AUDIT TEAM

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