

Audit Report

Military Department

March 2016



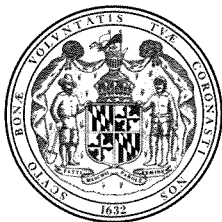
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

March 9, 2016

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Military Department for the period beginning May 14, 2012 and ending June 30, 2015. The Department maintains the Maryland National Guard within the State of Maryland and, through the Maryland Emergency Management Agency, coordinates Statewide efforts in the event of emergencies and disasters that are beyond the capabilities of local authorities. The Department also administers loan and grant programs that provide funding to volunteer fire companies for facilities and equipment.

Our audit disclosed that the Department did not request reimbursement of federal fund expenditures timely resulting in lost interest income to the State. In addition, the Department did not maintain adequate controls and proper records over certain equipment. For example, certain functions were not properly segregated and physical inventories were not conducted as required.

The Department's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by the Department.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "TJ Barnickel III", is written over a horizontal line.

Thomas J. Barnickel III, CPA
Legislative Auditor

Background Information

Agency Responsibilities

The Military Department maintains the Maryland National Guard within the State of Maryland, including its 36 readiness centers and numerous other facilities used by the Army and Air National Guard. In addition, the Department, through its Maryland Emergency Management Agency (MEMA), coordinates Statewide efforts in the event of emergencies and disasters that are beyond the capabilities of local authorities. MEMA also coordinates disaster preparedness activities with its federal and local counterparts and, through mitigation services, strives to reduce or eliminate the impact of future disasters. The Department also administers loan and grant programs that provide funding to volunteer fire companies for facilities and equipment.

According to the State's records, during fiscal year 2015, the Department's operating expenditures totaled approximately \$81 million, consisting of federal fund expenditures of \$47.3 million, general fund expenditures of \$11.7 million, and special fund expenditures of \$22.0 million.

Distributions to Volunteer Company Assistance Fund

State law established the Volunteer Company Assistance Fund (VCAF) to provide loans and grants to volunteer fire companies. Effective fiscal year 2007, State law further provided that the Comptroller of Maryland shall distribute collections each year from a court-imposed surcharge on traffic cases to the VCAF until a total of \$20 million had been distributed. During fiscal year 2014, the Comptroller distributed the final \$4.1 million needed to meet the \$20 million mandate. According to the State's records, as of June 30, 2015, the fund balance totaled approximately \$30 million consisting of notes receivable due from volunteer fire companies totaling \$9.5 million and cash totaling \$20.5 million.

Status of Findings From Preceding Audit Report

Based on our assessment of significance and risk relative to our audit objectives, our audit included a review to determine the status of eight of the nine findings contained in our preceding audit report dated May 30, 2013. We determined that the Department satisfactorily addressed all eight of these findings. We did not follow up on the remaining finding which pertained to State motor vehicles.

Findings and Recommendations

Federal Funds

Finding 1

The Military Department did not submit requests for reimbursement of federal fund expenditures in a timely manner, resulting in lost interest income to the State.

Analysis

The Department did not submit requests for reimbursement of federal fund expenditures related to Maryland Emergency Management Agency (MEMA) and National Guard Bureau (NGB) grants in a timely manner, resulting in lost interest income to the State. Federal guidelines for these grants permit reimbursement to be requested when expenditures are incurred. According to the State's records, during fiscal year 2015, MEMA and NGB grant expenditures totaled \$33.5 million and \$13.8 million, respectively.

Our test of 10 NGB grant reimbursement requests totaling \$2.7 million processed during fiscal years 2013, 2014, and 2015 disclosed that the requests were submitted between 71 and 304 days after the Department spent the funds. For example, one request for reimbursement of \$318,885 that was spent during August 2014 was not submitted until June 2015. Similarly, our test of 10 requests for MEMA grant funds processed during the same period disclosed that 6 requests totaling \$2.9 million were submitted 35 to 193 days after the related expenditures were incurred. The untimely recovery of these funds resulted in lost interest income to the State totaling approximately \$17,000.

Recommendation 1

We recommend that the Department submit federal fund reimbursement requests in a timely manner, such as monthly.

Equipment

Finding 2

Adequate controls and records were not maintained for MEMA equipment.

Analysis

Adequate controls had not been established over MEMA equipment. According to the Department's detail records, the value of MEMA equipment as of June 30,

2015 totaled approximately \$5.1 million, of which \$3.3 million related to sensitive equipment.

- Certain inventory and recordkeeping functions performed by employees were not properly segregated as required. Specifically, the employee responsible for conducting physical inventories of equipment and investigating the differences between the inventory results and the related detailed records, also maintained the detail records and the control account.
- The Department did not periodically reconcile its control account balance with the total of the detail records as required. As of June 30, 2015, the balance of the detail records (\$5,127,858) exceeded the related control account balance (\$3,777,911) by \$1,349,947.
- The Department did not conduct a physical inventory of sensitive equipment during fiscal years 2014 and 2015 as required.

Under these conditions, errors or other discrepancies could occur without timely detection. The Department of General Services (DGS) *Inventory Control Manual* requires that the duties of record keeping, maintenance of the control account, and conducting physical inventories be segregated. The *Manual* further requires that a control account be maintained on a current basis and be periodically reconciled with the detail records, and that a physical inventory be conducted for sensitive equipment items on an annual basis.

Recommendation 2

We recommend that the Department comply with the requirements of the DGS *Inventory Control Manual*. Specifically, we recommend that the Department

- a. segregate the duties of performing physical inventories, maintaining the equipment detail records, and maintaining the control account;**
- b. periodically reconcile the balance of the control account with the total of the related detail records and investigate any differences; and**
- c. conduct annual physical inventories of sensitive equipment as required.**

We advised the Department on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Military Department for the period beginning May 14, 2012 and ending June 30, 2015. 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 the Department's 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 federal fund reimbursements, cash receipts, payroll, procurements and disbursements, and equipment. We also determined the status of eight of the nine findings contained in our preceding audit report.

Our audit did not include an evaluation of internal controls over compliance with federal laws and regulations for federal financial assistance programs and an assessment of the Department's compliance with those laws and regulations because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including the Department.

To accomplish our objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the Department's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests 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 the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll data), as well as from the contractor administering the State's Corporate Purchasing Card Program (credit

card activity). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these various sources were sufficiently reliable for the purposes the data were used during this 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.

The Department's 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.

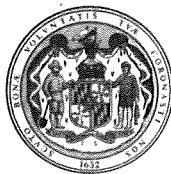
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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

The Department's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Department regarding the results of our review of its response.

APPENDIX



LAWRENCE J. HOGAN, Jr.
GOVERNOR
COMMANDER-IN-CHIEF

STATE OF MARYLAND
MILITARY DEPARTMENT
FIFTH REGIMENT ARMORY
BALTIMORE, MARYLAND 21201-2288

LINDA L. SINGH
MAJOR GENERAL
THE ADJUTANT GENERAL

March 3, 2016

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Office of Legislative Audits
Department of Legislative Services
Room 1202
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Barnickel:

Enclosed please find the Military Department State of Maryland's paper copy response to the draft Legislative Auditor's Report for the period beginning May 14, 2012 and ending June 30, 2015. In addition, an electronic version of our response has been e-mailed to response@ola.state.md.us. As noted in our response, action has been taken by the Department to correct the two (2) audit findings.

If you or your staff have any questions or need additional information, please do not hesitate to contact me or Mr. John S. Nickerson, Director Finance and Administration. Mr. Nickerson can be reached at 410-234-3818.

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

LINDA L. SINGH
Major General (MD), MDARNG
The Adjutant General

Enclosures

Cc: Mr. Russell Strickland, Director, Maryland Emergency Management Agency

**Military Department State of Maryland
Audit Report Responses
Period 5/14/12 to 6/30/15**

FEDERAL FUNDS:

Finding #1 – The Department did not submit requests for reimbursement of federal fund expenditures in a timely manner, resulting in lost interest income to the State.

Response:

The Department concurs with the auditor's recommendation. The Department has taken corrective action. Expenditures related to Maryland Emergency Management Agency (MEMA) and National Guard Bureau (NGB) are now being processed in a timely manner. Due to reviews required to be performed to ensure proper oversight and accountability over grants and cooperative agreements, requests for reimbursements will be processed no later than 90 days after the related expenditure.

EQUIPMENT:

Finding #2 – Adequate controls and records were not maintained for MEMA equipment.

Response:

The Department concurs with the auditor's recommendation. MEMA has taken corrective action. New procedures have been implemented to segregate the duties of performing physical inventories, maintaining the equipment detail records and maintaining the control account. The balance of the control account is periodically reconciled with the total of the related detail records and any differences are investigated. Lastly, designated Accountability Officers are conducting annual physical inventories of sensitive equipment as required.

AUDIT TEAM

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