

Special Report

**Statewide Review of
Budget Closeout Transactions for
Fiscal Year 2010**

January 2011



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
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MARYLAND GENERAL ASSEMBLY

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January 24, 2011

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Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Senator James C. Rosapepe, 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, 2010. 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 Human Resources
Department of Juvenile Services
Department of State Police

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, accrued revenues totaling \$12.9 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 \$37.2 million in unprovided for payables as of June 30, 2010 (Exhibit 2). Our review disclosed additional unprovided for payables related to one State agency, totaling \$4.9 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's General Accounting Division and by the various State agencies.

Respectfully submitted,

Bruce A. Myers, CPA
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* 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 10, 2010, applicable to the fiscal year ended June 30, 2010, 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, 2010, 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 States' *CAFR* states that, on a budgetary basis, the General Fund had an unencumbered balance of approximately \$344.0 million as of June 30, 2010 (\$441.4 million less encumbrances of \$97.4 million). This represents an increase of approximately \$256.8 million from the balance reported at the preceding fiscal year-end (\$87.2 million). The *CAFR* also states that the State Reserve (Revenue Stabilization Account) balance totaled \$614.7 million as of June 30, 2010.

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. The net effect of the GAAP adjustments recorded for fiscal year 2010, if they had been recognized on a budgetary basis, would have been to reduce the aforementioned unencumbered budgetary General Fund balance of \$344 million. For example, year-end GAAP adjustments included \$37.2 million recorded for liabilities incurred by State agencies during fiscal year 2010 for which general fund appropriations were not available to finance the expenditures (see Exhibit 2). Other GAAP adjustments that would have reduced the budgetary General Fund balance included an estimated \$189.6 million additional liability for the State's share of Medicaid costs for services rendered during fiscal year 2010 and a \$450 million reduction for State and local income tax collections that were recorded as revenue for fiscal 2010 but were applicable to future fiscal years.

Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2010. 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, 2010, 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 23 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, 2010 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, 2009, which were reported to the Joint Audit Committee in a special report dated January 15, 2010. 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 seven findings from the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2009* disclosed that three of the seven findings are repeated 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 2010 to January 2011.

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 four 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

One State agency could not substantiate certain revenue transactions totaling \$12.9 million. That is, the agency could not provide evidence that it was entitled to receive federal funding 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, accrued federal revenues of two State agencies, that totaled approximately \$10 million and resulted from the disallowance of federal expenditures, have been recorded and may have to be paid with general funds. Finally, one State agency maintained a deficit special fund balance of \$5.3 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.

Expenditure Transactions

One State agency did not properly report unfunded liabilities totaling \$4.9 million to GAD as required.

A summary of our findings, by agency, is included in Exhibit 1 on page 13 of this report.

Revenue Transactions

Finding 1

Accrued federal fund revenues totaling approximately \$12.9 million could not be substantiated.

Analysis

The **Maryland State Department of Education (MSDE)** recorded unsubstantiated revenues of approximately \$12.9 million at June 30, 2010. These

related to unreimbursed federal fund expenditures for the Temporary Assistance to Needy Families (TANF) grant. Since revenues are not available for these accruals, which were recorded to cover expenditures that had previously been incurred, general fund appropriations in subsequent years (or deficiency appropriations) may be needed to eliminate the resulting deficit.

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 has been requested to cover the outstanding \$12.9 million deficit. This issue has been commented upon in our four preceding annual budget closeout reports.

Finding 2

Accrued Federal revenues relate to disallowances totaling approximately \$10 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. Subsequent to appeals to DHHS and other State agency actions, \$10 million of the disallowance still exists that may need to be paid with State general funds (\$9.6 million related to DHR and \$400,000 related to DJS). This issue was commented upon in our preceding annual budget closeout report.

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. DHR and DJS disagreed with the DHHS' disallowances and appealed DHHS' decisions to the DHHS Departmental Appeals Board. DHR entered into a settlement agreement with DHHS, effective October 10, 2010, to resolve all outstanding appeals related to these federal disallowances. Under the agreement, DHR will not be allowed to recover any portion of its \$9.6 million disallowance which, therefore, may need to be paid with State general funds.

The disallowances related to DJS originally 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. DJS applied \$250,000 of other federal funds toward the disallowance and, during fiscal year 2010, used a deficiency appropriation of \$1.8 million of general funds to further reduce the outstanding disallowance to \$2.7 million as of June 30, 2010. Subsequently, under the aforementioned settlement agreement, DJS will be allowed to recover \$2.3 million of the remaining \$2.7 million disallowance. The remaining \$400,000 of the DJS disallowance may need to be paid with State general funds.

The Comptroller of Maryland - General Accounting Division (GAD) was aware of these disallowances and \$12.3 million (\$9.6 million related to DHR and \$2.7 million related to DJS) was recorded as a decrease to general fund revenue by GAD in the State's fiscal year 2010 *Comprehensive Annual Financial Report*. Nevertheless, general funds may be needed to offset the expenditures incurred.

Finding 3

A general fund deficiency appropriation may be required to eliminate a special fund deficit balance of \$5.3 million.

Analysis

The **Department of State Police (DSP)** may require a general fund deficiency appropriation to eliminate a special fund deficit balance of \$5.3 million that existed as of June 30, 2010. 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 \$300,000 were retained in the fund, which reduced the negative balance to \$5.3 million. DSP attempted to obtain a deficiency appropriation in 2010 to resolve this situation; however, the deficiency appropriation was not

approved. This condition has been commented upon in our four preceding annual budget closeout reports.

Expenditure Transactions

Finding 4

Unfunded year-end liabilities totaling approximately \$4.9 million were not reported to the Comptroller of Maryland – General Accounting Division (GAD).

Analysis

The **Maryland State Department of Education (MSDE)** did not report unfunded year-end general fund liabilities of approximately \$4.9 million to GAD, as required. General fund appropriations in subsequent years (or deficiency appropriations) may be needed to eliminate these liabilities.

MSDE's unfunded liabilities related to amounts due to the Department of Health and Mental Hygiene (DHMH) for certain expenditures incurred by DHMH on MSDE's behalf. Specifically, at the end of fiscal year 2010, MSDE had not reimbursed DHMH for payments to medical providers made by DHMH during the third and fourth quarters of fiscal year 2010. MSDE did not have sufficient appropriations to fund the entire amount due. In this regard, MSDE encumbered its remaining appropriation balance of \$360,000 to apply towards the third quarter, but there were no remaining appropriations to pay for the remainder of the \$5.2 million in outstanding invoices. MSDE failed to estimate and report these unfunded liabilities to GAD during the fiscal year 2010 budget closeout process, which ultimately totaled \$4.9 million (\$5.2 million less \$360,000 encumbrance). According to MSDE, this has been a recurring issue where appropriations from the subsequent fiscal year are used to fund the expenditures of the preceding fiscal year.

Exhibit 1

Summary of Fiscal Year 2010 Closeout Review Findings by State Agency

Agency	Finding Number	Finding Description
Maryland State Department of Education	1	\$12.9 million in unsubstantiated federal fund accrued revenues were recorded.
	4	\$4.9 million of unfunded year-end liabilities were not reported to GAD as required.
Department of Human Resources and Department of Juvenile Services	2	\$10 million in federal disallowances were outstanding.
Department of State Police	3	\$5.3 million special fund deficit balance exists.

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	\$21,258,721
Maryland Higher Education Commission ¹	12,809,495
Department of Assessment and Taxation	2,425,398
State Board of Elections ²	699,779
Total	\$37,193,393

¹ During our previous closeout review, we disclosed that the Maryland Higher Education Commission had underreported its unprovided for general fund payables to the General Accounting Division (GAD). During our current closeout review, similar unprovided for payables were reported to the GAD during the closing of fiscal year 2010.

² During our previous closeout review, we disclosed that the State Board of Elections had not reported approximately \$2.0 million in unprovided for payables. During our current closeout review, the unprovided for amount had decreased and was reported to the GAD during the closing of fiscal year 2010.

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