

Special Report

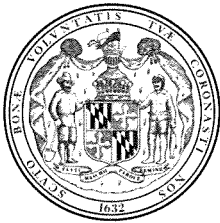
**Statewide Review of
Budget Closeout Transactions for
Fiscal Year 2012**

January 2013



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

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January 22, 2013

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Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, 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, 2012. 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
Executive Department – Governor's Office of Crime Control and Prevention
Department of Human Resources
Military Department
Department of State Police
Department of Veterans Affairs

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, accrued federal fund revenues totaling \$23.9 million were identified for which general fund appropriations (or deficiency appropriations) will be needed to eliminate the resulting deficits since federal fund revenues are not available. A summary of our findings, by agency, is included in Exhibit 1.

Six state agencies reported a total of \$77.4 million in unprovided for payables as of June 30, 2012 (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 "Thomas 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
Closeout Transactions	
Revenue Transactions	
* Finding 1 – Federal Fund Revenues Totaling \$23.9 Million Were Accrued But Related Federal Funds Were Not Available	10
Finding 2 – Recovery of Accrued Federal Fund Revenues Totaling \$8.3 Million Is Uncertain	11
Finding 3 – Accrued Special Fund Revenues Totaling \$11.5 Million Could Not Be Substantiated by One Agency	12
* Finding 4 – A \$5.1 Million General Fund Deficiency Appropriation May Be Needed to Eliminate a Special Fund Deficit Balance	12
Expenditure Transactions	
Finding 5 – Excess General Fund Appropriations Totaling \$446,445 Were Not Cancelled at Fiscal Year-End	13
Exhibit 1 – Summary of Fiscal Year 2012 Closeout Review Findings by State Agency	15
Exhibit 2 – Schedule of Unprovided for General Fund Payables According to the General Accounting Division	16

* 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 12, 2012, applicable to the fiscal year ended June 30, 2012, 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, 2012, 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 \$551.2 million as of June 30, 2012. This represents a decrease of approximately \$438.9 million from the balance reported at the preceding fiscal year-end (\$990.1 million). The *CAFR* also states that the State Reserve (Revenue Stabilization Account) balance totaled \$674.4 million as of June 30, 2012.

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 2012, if they had been recognized on a budgetary basis, would have been to reduce the aforementioned unencumbered budgetary General Fund balance of \$551.2 million. For example, year-end GAAP adjustments included \$77.4 million recorded for liabilities incurred by State agencies during fiscal year 2012 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 \$210 million additional liability for the State's share of Medicaid costs for services rendered during fiscal year 2012 and a \$408 million reduction for State and local income tax collections that were recorded as revenue for fiscal 2012 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, 2012. 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, 2012, 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 30 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, 2012 to determine if the transactions were properly recorded (such as charged or credited to the proper fiscal year). We also reviewed the disposition of selected accrued expenditure and encumbrance transactions from the fiscal year 2011 closing to ensure they were appropriately paid and remaining balances, if any, were cancelled. 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 findings identified during our review of the budget closeout transactions for the fiscal year ended June 30, 2011, which were reported to the Joint Audit Committee in a special report dated January 18, 2012. Our follow-up review of the seven findings from the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2011* determined that two of the seven findings had not been resolved and 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. 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 August 2012 to January 2013.

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 seven 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

Six State agencies recorded accrued federal fund revenues totaling \$32.2 million to cover expenditures even though related federal funds were not available (for \$23.9 million) or it was uncertain that the federal funds would be available (for \$8.3 million). Federal fund revenue can be accrued when agencies have incurred expenditures for federal programs for which funding is still available, but have not yet requested or received reimbursement. In addition, accrued special fund revenues for one State agency had been recorded to cover special fund expenditures totaling approximately \$11.5 million, although collection was questionable. Finally, one State agency maintained a special fund deficit balance of \$5.1 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 deficits resulting from these transactions.

Expenditure Transactions

One State agency inappropriately recorded accrued general fund expenditures totaling \$446,445 at fiscal year-end to avoid reverting unused appropriations.

A summary of our findings, by agency, is included in Exhibit 1 on page 15 of this report.

Prior Year Closing Encumbrances and Accrued Expenditures

Our review of the disposition of selected accrued expenditure and encumbrance transactions totaling \$319 million from the fiscal year 2011 closing disclosed that the transactions were properly liquidated or adequate documentation existed justifying why the transaction had not been liquidated.

Revenue Transactions

Finding 1

Accrued federal fund revenues totaling approximately \$23.9 million were recorded even though related federal funds were not available.

Analysis

The **Maryland State Department of Education (MSDE)**, the **Department of Human Resources (DHR)**, and the **Department of Veterans Affairs (DVA)** recorded federal fund revenues of approximately \$12.9 million, \$9.6 million, and \$1.4 million, respectively, even though federal funds were not available. These revenues related to unreimbursed federal fund expenditures for several federal programs. Since revenues are not available for these accruals, which were recorded to cover federal fund expenditures that had been incurred, general fund appropriations in subsequent years (or deficiency appropriations) will be needed to eliminate the resulting deficit.

MSDE

MSDE recorded accrued revenue totaling approximately \$12.9 million for which MSDE failed to recover federal funds for expenditures incurred during fiscal years 2002 and 2003 in relation to the Temporary Assistance to Needy Families (TANF) grant. DHR, which processes the federal fund recoveries, advised us that the TANF federal fund grants for those years have already been fully used and are no longer available to reimburse the MSDE expenditures. A deficiency appropriation has been requested to eliminate the outstanding \$12.9 million deficit. This issue has been commented upon in our six preceding annual budget closeout reports.

DHR

DHR recorded accrued federal fund revenue totaling approximately \$9.6 million to cover a deficit related to disallowances by the United States Department of Health and Human Services (DHHS), which DHR was informed of in fiscal year 2009. The disallowances, related to certain Title IV-E grant expenditures from the quarters ended September 30, 2008 and December 31, 2008, were principally based on a lack of a Title IV-E foster care pre-placement provision in DHR's cost allocation plan. DHR appealed the disallowances and, effective October 10, 2010, entered into a settlement agreement with DHHS to resolve all outstanding appeals related to these disallowances. Under the agreement, DHR will not be reimbursed by the federal government for the \$9.6 million of disallowances, which will therefore need to be paid with State general funds. A deficiency appropriation has been requested to eliminate the outstanding \$9.6 million deficit. This issue has been commented upon in our three preceding annual budget closeout reports.

DVA

DVA had unsubstantiated federal fund accrued revenues totaling \$1.4 million, which had been recorded on their behalf by the Comptroller of Maryland – General Accounting Division (GAD). These revenues were recorded to eliminate deficit balances that existed in several federal programs as of June 30, 2012. Officials at DVA and GAD could not provide any documentation supporting that federal funds would be received for these accrued revenues. According to GAD, these deficits resulted from federal fund expenditures incurred during prior years. This issue was commented upon in our preceding annual budgetary closeout report.

GAD was aware of the unavailable federal fund receivables for MSDE and DHR totaling \$22.5 million, which were recorded as a decrease to general fund revenue by GAD in the State's fiscal year 2012 *Comprehensive Annual Financial Report*. Nevertheless, general funds are needed to offset the expenditures incurred.

Finding 2

The recovery of accrued federal revenues totaling approximately \$8.3 million is uncertain.

Analysis

The **Maryland State Department of Education (MSDE)**, the **Department of Aging (DOA)**, and the **Military Department** could not substantiate their ability to recover accrued federal fund revenues of approximately \$4.7 million, \$2.9 million, and \$700,000 respectively, as of June 30, 2012. If these agencies are unable to recover these federal grant funds, general funds may be needed to eliminate the resulting deficit.

MSDE

MSDE accrued revenue totaling \$4.7 million related to Library Services Technology Act (LSTA) grant expenditures made during fiscal years 2009 to 2012. MSDE has been unable to satisfy the documentation requirements for reimbursement requests established by the federal grantor agency subsequent to an audit conducted of MSDE's fiscal year 2008 and 2009 LSTA grant expenditures. The report issued by the audit firm engaged by the grantor agency questioned costs previously reimbursed to MSDE totaling \$783,866 due to lack of adequate procedures and/or documentation to support amounts charged to the grant for subgrantees, fringe benefit costs, other direct costs, and administrative costs.

DOA

DOA recorded unsubstantiated federal fund accrued revenues of approximately \$2.9 million at June 30, 2012. These accrued revenues relate to unreimbursed federal fund expenditures for the Money Follows the Person grant and Medicaid Waiver that were incurred during fiscal year 2012 and prior years for which requests for reimbursement had never been prepared.

Military

The Military Department recorded unsubstantiated federal fund accrued revenues of \$701,318 at June 30, 2012. These revenues relate to requests for federal reimbursement for National Guard expenditures dating back to fiscal year 2010 that were denied for payment by the federal granting agency. This unsubstantiated accrual revenue was recorded to eliminate a federal fund deficit balance at year-end. We were advised by Department management that it believed that it will ultimately be able to obtain federal funding to cover certain of these accruals.

Finding 3

Accrued special fund revenues related to assistance payments totaling approximately \$11.5 million could not be substantiated.

Analysis

The **Department of Human Resources (DHR)** recorded unsubstantiated special fund accrued revenues of approximately \$11.5 million at June 30, 2012 for Local Department Operations Assistance Payments. DHR's unsubstantiated special fund accrued revenues were recorded to eliminate the deficit balance in the assistance program special funds as of June 30, 2012. The deficit resulted from special fund expenditures that exceeded the available special fund revenues during fiscal years 2010 through 2012 (including \$9,494,672 for 2012). A deficiency appropriation has been requested to eliminate the outstanding deficit.

Finding 4

A general fund deficiency appropriation may be required to eliminate a special fund deficit balance of \$5.1 million.

Analysis

The **Department of State Police (DSP)** may require a general fund deficiency appropriation to eliminate a special fund deficit balance totaling \$5.1 million that existed as of June 30, 2012. 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. DSP then transferred what appeared to be excess funds to the general fund during the fiscal year 2005 closeout since it did not have legal authority to

retain any remaining 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 \$500,000 were retained in the fund, which reduced the negative balance to the current \$5.1 million. A deficiency appropriation has been requested to eliminate the outstanding \$5.1 million deficit. This issue has been commented upon in our six preceding annual budget closeout reports.

Expenditure Transactions

Finding 5

Excess general fund appropriations totaling \$446,445 were not cancelled at fiscal year-end.

Analysis

The **Executive Department - Governor's Office of Crime Control and Prevention (GOCCP)** did not cancel excess general fund appropriations totaling \$446,445 at fiscal year-end. Instead, GOCCP inappropriately recorded accrued expenditures for the unused appropriation so that it could be retained and used in future years. This practice violated the yearly closing instructions of the Comptroller of Maryland - General Accounting Division (GAD) since the accrued expenditures did not represent actual expenditures by the State for goods or services and consequently would not qualify as valid accrued expenditures.

Exhibit 1

Summary of Fiscal Year 2012 Closeout Review Findings by State Agency

Agency	Finding Number	Finding Description
Department of Aging	2	Recovery of \$2.9 million in federal fund accrued revenues is uncertain
Maryland State Department of Education	1	\$12.9 million in federal fund accrued revenues were recorded even though related federal funds are not available
	2	Recovery of \$4.7 million in federal fund accrued revenues is uncertain
Executive Department – Governor’s Office of Crime Control and Prevention	5	Unexpended general fund appropriations of \$446,445 were not cancelled at fiscal year-end
Department of Human Resources	1	\$9.6 million in federal fund accrued revenues were recorded even though related federal funds are not available
	3	\$11.5 million in unsubstantiated special fund accrued revenues were recorded
Military Department	2	Recovery of \$701,318 in federal fund accrued revenues is uncertain
Department of State Police	4	\$5.1 million special fund deficit balance exists
Department of Veterans Affairs	1	\$1.4 million in federal fund accrued revenues were recorded even though related federal funds are not available

Exhibit 2

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

Agency	Amount of Reported Unprovided for Payables
Department of Human Resources	\$52,706,282
Department of Health and Mental Hygiene	10,066,749
Maryland Higher Education Commission	9,621,082
Maryland State Department of Education	3,058,000
Office of the Public Defender	1,328,499
Department of State Police	660,672
Total	\$77,441,284

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