

Audit Report

State Archives

December 2007



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

December 5, 2007

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the State Archives for the period beginning February 2, 2004 and ending December 18, 2006.

Our audit disclosed that Archives' billings to the Judiciary for work performed on two information services projects included charges that were not always in compliance with the terms of the related agreement. In addition, the indirect cost rates used for these billings were not periodically recalculated and, therefore, resulted in higher charges.

Our audit also disclosed that the Archives had not entered into an agreement with an affiliated charitable organization that solicited donations on behalf of the Archives. In addition, our audit disclosed that the Archives had not established sufficient controls over information systems and certain equipment.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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Background Information

Agency Responsibilities

The State Archives is an independent unit of the State Government within the Executive Department. The functions of the State Archives include the acquisition, management, custody, and control of artistic property and records of permanent historical, legal, educational, or administrative value. In addition, the Archives is responsible for the compilation, editing, and distribution of the *Maryland Manual*. According to the State's records, during fiscal year 2006, the State Archives' expenditures totaled approximately \$9.9 million.

Current Status of Findings From Preceding Audit Report

We reviewed the current status of the eight findings included in our preceding audit report dated October 27, 2004. We determined that the Archives satisfactorily addressed each of these findings.

Findings and Recommendations

Projects Funded by the Real Property Records Improvement Fund

Background

The State Archives performed work for the Judiciary on two information system projects which involved indexing and digitizing plats and land records stored at the county courthouses, both of which provide the public with electronic access to land and plats records. Both the plats on-line (PLATO) and electronic land records online imaging (MdLandRec and ELROI) projects were funded by the Judiciary's Real Property Records Improvement Fund. The Fund's primary revenue source is a surcharge collected by the Circuit Courts for the recordation of land/title instruments. The Fund's purpose, as stated by law, is to pay the operating expenses of the land record offices and to maintain and modernize equipment at the various Clerk of Circuit Court offices. The Fund is non-lapsing and interest earning and is administered by the Judiciary. The Archives is responsible for operating, servicing, and maintaining PLATO and MdLandRec. A private vendor is responsible for ELROI.

In February 2005, the Archives entered into a Memorandum of Understanding (MOU) with the Judiciary for three years, with the option that the Judiciary could extend the MOU in three-year increments with no limitations. According to the MOU, the Archives was required to invoice the Judiciary on a quarterly basis, based on the annual anticipated expenditures including direct labor, materials, and overhead (that is, indirect costs). The fourth quarter billing to the Judiciary was supposed to represent the difference between actual expenditures for the entire fiscal year and the amount billed for the first three quarters. During fiscal year 2006, the Archives billed the Judiciary approximately \$7 million related to these projects.

Finding 1

Billings to the Judiciary were not in compliance with the terms of the governing MOU.

Analysis

Our review disclosed that billings to the Judiciary were not in compliance with the governing MOU. Specifically, we noted the following conditions:

- Since fiscal year 2005, the Archives has included in the billings to the Judiciary a seven percent Entrepreneurial and Educational Reserve (EER)

service fee which was not specifically provided for under the current MOU with the Judiciary. The fee was computed as a percentage of the direct costs and overhead costs incurred for the projects and, therefore, represented amounts billed in excess of the Archives' costs for its services. Such fees totaled approximately \$883,000 in fiscal years 2005 and 2006. The revenue received from the EER service fee was credited to the Archives Endowment Account, which is an account within the State Archives Fund (a continuing, non-lapsing fund) used for purposes unrelated to the projects. Specifically, the principal of the endowment may not be expended, but earnings from the endowment may be used for certain specific Archives' activities such as research on historical and geographical aspects of Maryland or an outreach program into the schools. These earnings can only be spent pursuant to an appropriation. As of March 2007, the balance in the Endowment Account was \$3.1 million.

Legal advice we obtained regarding this situation indicated that the Archives has statutory authority to receive moneys under the MOU, but it was recommended that the MOU be revised to clarify the nature and amounts of funds provided by the Judiciary.

- The Archives included in the fiscal year 2006 fourth quarter billing to the Judiciary certain commitments totaling approximately \$882,000 for which the related goods or services had not been received. These commitments did not represent actual expenditures incurred by Archives related to the projects. As previously mentioned, the MOU provides that the Archives bill for direct costs and overhead. The Archives should defer billing other commitments until the actual expenditure is incurred.

Recommendation 1

We recommend that the Archives bill the Judiciary in accordance with the agreed-upon terms in the current MOU. Specifically, we recommend that, unless agreed upon in writing by the Judiciary, the Archives discontinue billing the Judiciary for the EER service fee. We also recommend that the Archives fourth quarter billings to the Judiciary for project costs only include expenditures actually incurred.

Finding 2

The Archives' indirect cost rate assessed on Judiciary billings was not recalculated annually resulting in excessive indirect cost recoveries. In addition, recoveries were not reverted to the General Fund or specifically identified in related budget authorizations.

Analysis

The Archives' indirect cost rate assessed on Judiciary billings was not recalculated annually, resulting in excessive billings. Furthermore, all indirect cost recoveries were not specifically identified in the related budget authorizations. Specifically, we noted the following conditions:

- The indirect cost rate was not recalculated annually and, as a result, we noted that excessive indirect costs were billed to the Judiciary. The Archives calculated an indirect cost rate of 47.79 percent based upon fiscal year 2004 actual expenditures. This rate was applied to the regular and contractual salary expenditures included in the quarterly Judiciary billings beginning in the third quarter of fiscal year 2005 and continuing through fiscal year 2007. Based on the Archives' records, and using the same methodology that Archives had used to calculate the rate for fiscal year 2004, we recalculated the rates for fiscal years 2005 and 2006 to be 44.18 percent and 35.00 percent, respectively. Had these recalculated rates been applied, the billings to the Judiciary would have been significantly less. For example, indirect costs billed for fiscal year 2006 (\$752,695) exceeded amounts that would have been billed based on the recalculated fiscal year 2006 indirect cost rate (\$551,251) by \$201,444.
- The Archives' expenditures for the projects are paid from general and special funds. Although the majority of the Archives' overhead costs were related to expenditures funded by general funds, the applicable portion of the indirect cost recoveries, which were recorded in the State Archives Fund when received by the Archives, was not reverted to the General Fund. A directive previously issued by the Department of Budget and Management (DBM) required that special revenue funds received in reimbursement for indirect costs shall be deposited in the State's General Fund. DBM advised us that this directive was not "operative" and that it needed to be revised and reissued. In addition, Archives budget documents did not specifically provide authorization to spend indirect cost recoveries which remained in the State Archives Fund.

Recommendation 2

We recommend that the indirect cost rate be recalculated and adjusted on an annual basis. We also recommend that the Archives, in conjunction with DBM, determine the proper accounting and use of the indirect cost recoveries that related to general fund expenditures.

Charitable Organization

Finding 3

A formal agreement had not been executed between the Archives and an affiliated charitable organization. Additionally, this charitable organization operated prior to registering its status with the Secretary of State, as required by State law.

Analysis

A written agreement had not been executed between the Archives and its affiliated foundation (that is, a charitable organization). Rather, we were advised by Archives' management that it was their intent to prepare individual agreements for each significant transaction between the two entities. This charitable organization was established, in part, to help the Archives with the acquisition of historical documents, artifacts, and works of art, and to provide funds for certain publications and conservation efforts. In order to clarify the roles and responsibilities of the parties, State agencies should enter into written agreements with affiliated foundations. These agreements should include, but are not limited to:

- A definition of the relationship between the two entities and the purpose of the foundation
- Specifics as to what support the State agency will provide to the foundation (office space, support staff) and how these costs will be reimbursed to the agency
- A statement that the foundation may not make political contributions or participate in any political campaign for or against any candidate for public office

We were advised by Archives management that no office space was provided to the charitable organization and that Archives employees did not provide services to that organization during normal working hours. However, we noted various instances where the Archives' address and Archives' employees were publicly listed as contacts for the charitable organization.

In addition, the organization did not register its status as a charitable organization with the Secretary of the State until after we inquired about this matter (the organization registered on September 5, 2007). The Maryland Solicitations Act requires that a charitable organization register and receive a letter of registration from the Secretary of State before it solicits charitable contributions in the State. Furthermore, State regulations require that private foundations affiliated with State agencies (such as the aforementioned charitable organization) that raise more than \$100,000 in charitable contributions file an annual audit and an agreed-upon procedures report with the Secretary of State. Additionally, Archives' management advised us that it was not until December 2006 that this organization obtained approval as a non-profit organization from the Internal Revenue Service. However, according to the records of the Department of Assessments and Taxation, the organization was formed as a non-profit organization in November 2004.

We noted that the Archives indicated that the charitable organization was instrumental in raising funds and/or acquiring items of historic significance for the Archives. For example, this charitable organization provided \$750,000 in January 2007 to help purchase certain historical documents.

Recommendation 3

We recommend that the Archives enter into a written agreement with the charitable organization to specify each entity's responsibilities and objectives. We also recommend that the Archives ensure that the organization submits the various reports required by State regulations.

Information Systems Security and Control

Finding 4

Backups of critical servers and disaster recovery planning were not adequate.

Analysis

Backups of critical servers and disaster recovery planning were not adequate. Specifically, we noted the following conditions:

- Complete backups of certain critical servers were only performed once a month rather than on a weekly basis. In addition, backups of all critical servers were not taken offsite on a timely basis. We determined that tapes used for complete backups of certain critical servers were not moved offsite until the tapes were full. As a result, we noted instances where backups were

not moved offsite until about 50 days after the respective backups were performed. Accordingly, if the facility which houses both the original data and the backup copies were destroyed by a disaster, the Archives could lose a significant amount of data or system information that it could not readily recreate.

- The Archives did not have a complete or current disaster recovery plan for recovering from disaster scenarios (for example, a fire). The Archives' plan did not adequately address certain requirements of the Department of Budget and Management's *IT Disaster Recovery Guidelines*. Specifically, the plan did not adequately address required detail lists of software components, application inventories prioritized for recovery, and the use of an alternate site. Without a complete and current disaster recovery plan, a disaster could cause significant delays (for an undetermined period of time) in restoring operations above and beyond the expected delays that would exist in a planned recovery scenario.

The Archives is the central depository for Maryland government records and certain private records of permanent value. The Archives serves a diverse group of legal, governmental, commercial, educational, and public customers. Over the last several years, an increasing portion of the Archives' interaction with its customer base has taken place by means of services provided over the Internet.

The Archives also provides Internet access and e-mail service to certain State agencies located in the Annapolis area; it also provides specific network services and web hosting services for many State agencies.

Recommendation 4

We recommend that the Archives perform complete backups of critical servers on a timely basis (weekly) and send backup copies of critical servers to the offsite location as soon as they are created. We also recommend that the Archives develop a complete and current disaster recovery plan that, at a minimum, includes the items specified above.

Equipment

Finding 5

Adequate accountability and control was not established over certain equipment.

Analysis

The Archives had not established adequate accountability and control over its entire equipment inventory. Specifically, we noted that, although the Archives performed annual physical inventory counts of artistic property and information technology equipment, it did not conduct physical inventory counts of general office equipment in the time frames specified in the Department of General Services' (DGS) *Inventory Control Manual*. Specifically, the Archives had not conducted a complete physical inventory count of sensitive and non-sensitive general office equipment items since October 2001. The DGS *Inventory Control Manual* requires that inventories of sensitive capital items be taken at least once each year and that inventories of non-sensitive capital items be taken at least once every three years.

According to the Archives' records, the general office equipment balance as of March 2007 totaled approximately \$1 million.

Recommendation 5

We recommend that the Archives establish proper controls over its entire equipment inventory and comply with the requirements of the DGS *Inventory Control Manual*. Specifically, we recommend that physical inventories counts be conducted in the time frames specified in the *Manual*.

Audit Scope, Objectives, and Methodology

We have audited the State Archives for the period beginning February 2, 2004 and ending December 18, 2006. The audit was conducted in accordance with generally accepted government auditing standards.

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 Archives' financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the current status of the findings contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Archives' operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit scope was limited with respect to the Archives' cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all Archives cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the banks' records.

The Archives' 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.

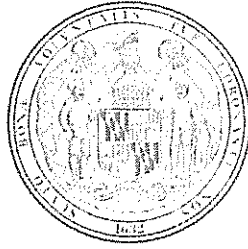
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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 conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the Archives' ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes conditions regarding significant instances of noncompliance with applicable laws, rules, or regulations.

The response from the Archives 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 Archives regarding the results of our review of its response.

Hon. Martin O'Malley
Governor
Hon. Anthony G. Brown
Lt. Governor
Edward C. Papenfuse, Ph.D.
State Archivist and
Commissioner of Land Patents
Timothy D. Baker
Deputy State Archivist
Matthew P. Lalumia
Chairman, Maryland Commission on
Artistic Property



Hall of Records Commission:
Hon. Robert M. Bell, Chair
Chief Judge, Court of Appeals
William R. Brody, Ph.D.
Hon. Michael E. Busch
Alvin C. Collins
Hon. Peter V. R. Franchot
William E. Kirwan, Ph.D.
Hon. Nancy K. Kopp
Hon. Thomas V. Mike Miller, Jr.
Christopher B. Nelson
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December 3, 2007

Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits
Department of Legislative Services
Room 1202
301 West Preston Street
Baltimore MD 21201

Dear Mr. Myers:

Thank you for the opportunity to respond to the draft audit report on the Maryland State Archives for the period beginning February 2, 2004 and ending December 18, 2006. Our response is attached.

Please do not hesitate to contact me if there is anything else you may require.

Sincerely,

Edward C. Papenfuse
State Archivist and
Commissioner of Land Patents

Finding 1 – Billings to the Judiciary were not in compliance with the terms of the governing MOU.

Response:

The State Archives' billings to the Judiciary were in *complete* compliance with the terms of the governing Memorandum of Understanding (MOU).

Appendix B of the Archives' MOU with the Judiciary explicitly recognizes *mdlandrec.net* as a publication of the *Archives of Maryland Online* series. In accord with an opinion of the Attorney General's office and a decision of the Joint Audit Committee, and because *mdlandrec.net* is a publication of the *Archives of Maryland Online*, the Archives is permitted to charge not only for the basic costs of the publication, but also for any overhead and overhead-related charges (such as future research and development) that the Archives deems appropriate.

Both the overhead rate and the indirect rate charges are recognized in the MOU, in two separate paragraphs. The overhead rate is comprised of the Educational and Entrepreneurial Reserve (EER) plus the indirect rate. In sum, the component of the charge to the Judiciary for the on-line publication (*mdlandrec.net*) that constitutes the EER is within the purview of the Archives and is implicit in the existing MOU. That the Judiciary found these charges reasonable is supported by the signed MOU and the purchase orders given the Archives each year, as well as in the clearly supportive language in the Annual Reports of the State Court Administrator to the Legislature on the uses of the monies in the Circuit Court Real Property Records Improvement Fund.

By way of further background, the General Assembly considered, during the 2003 session, a bill, entitled "Circuit Court Real Property Records Improvement Fund - Funding and Duration." The bill later was incorporated into the Budget Reconciliation and Financing Act of 2003. That legislation permitted the Judiciary to increase the amount charged for recordation of land / title instruments in order for the Judiciary and the Archives to partner to pursue the accelerated rollout of ELROI, (Maryland's recordation system), and *mdlandrec.net*. In testimony and supporting documentation, the Archives and the Judiciary jointly proffered that the Archives would be charging the Circuit Court Real Property Records Improvement Fund roughly seven million dollars a year through Fiscal Year 2008 to implement *mdlandrec.net*.

Plats.net and *mdlandrec.net* revenue are recognized in accordance with Section 9-1013 of the State Government Article, entitled "Archives Fund", which allows the Archives to receive funds in the form of public grants for publication of a series known as the *Archives of Maryland*. Section 9-1013 also permits proceeds to be deposited in the Archives' Endowment.

In February 2005, at the request of the courts, the Archives agreed to a new MOU. The new MOU, among other provisions, offered greater transparency with regard to Archives expenditures. It also provided a means by which the Archives could reduce a required grant amount when actual expenditures were less than anticipated. These modifications never changed the fact that these projects were being pursued under Section 9-1013 of the State

Government Article. Indeed, the projects continue to be coded into the State's financial system as an Archives Fund activity.

The concept of the EER was discussed widely through the budget process and as part of the Archives' general oversight by the Hall of Records Commission. For the *mdlandrec.net* project in particular, the EER was incorporated into the overhead rate at the mutual agreement of the Judiciary and the Archives. As such, the practice was certainly in compliance with terms of the MOU.

The Legislative Auditor's analysis also notes the Archives' practice of billing the Judiciary for encumbrances. After consulting with the Audit team and with the General Accounting Division, the Archives ceased this practice many months ago. The concern of the Archives at the time was that there could be a time when the Archives would create an obligation in one fiscal year and not be able to meet it in a future year should the Judiciary choose unilaterally to cancel the MOU. A better practice would be for the Archives to notify the Judiciary, at the close of the fiscal year, of any substantial outstanding obligations and to ask that the Judiciary encumber the funds to satisfy the requirement when the obligation comes due. We concur with the finding on this point.

Finding 2 - The Archives' indirect cost rate assessed on Judiciary billings was not recalculated annually resulting in excessive indirect cost recoveries. In addition, recoveries were not reverted to the General Fund or specifically identified in related budget authorizations.

Response:

The indirect cost rate was calculated according to standard accounting principles. Both the internal auditors of the Judiciary and the staff of the Office of Legislative Audits deemed the method of calculation to have been correct and reasonable. Our understanding of common accounting practices is for an indirect rate to remain in effect for a period of two to three years. In accord with standard practices, the Archives has recalculated the rate for Fiscal Year 2008, based on numbers from Fiscal Year 2007.

As to the issue of reversions, Section 9-1013 of the State Government Article, entitled "Archives Fund", authorizes the Archives to use moneys in the Fund for publication of series of volumes known as the *Archives of Maryland*. The Archives Fund is a continuous, non-lapsing fund. All monies from it that were used to satisfy expenditures were made pursuant to an appropriation approved by the General Assembly in the annual State Budget. In addition, Section 9-1013 specifically exempts the Archives Fund from Section 7-302 of the State Finance and Procurement Article, which requires the unspent balance of appropriations to revert to the General Fund.

All expenditures of the State Archives are made pursuant to an approved appropriation.

Notwithstanding any of the foregoing, the Archives will renegotiate the MOU with the Judiciary to ameliorate these issues, and henceforth, the Archives will recalculate the indirect rate every year for those interagency agreements that call for the establishment of an indirect rate. In addition, the Archives will consult with the Department of Budget and Management as necessary.

Finding 3 - A formal agreement had not been executed between the Archives and an affiliated charitable organization. Additionally the charitable organization operated prior to registering its status with the Secretary of State as required by law.

Response:

A formal agreement has been executed between the State Archives and the Friends of the Archives group. The group is registered with the Secretary of State's office. An initial delay in registering was the result of a months-long backlog within the Internal Revenue Service in granting 501(c) 3 status to charitable organizations.

Finding 4 - Backups of critical servers and disaster recovery planning were not adequate.

Response:

The State Archives maintains critical data in duplicate sets of storage arrays. Both arrays employ proper RAID (redundant arrays of independent disks) levels and each is housed in different rooms of the Archives. Current technology deployed at the Archives to write off a tertiary tape copy for remote storage is not capable of writing the huge quantity of data in a 7-day back-up window. No data is presently in danger of being lost. In the event of a disaster, data added to the storage arrays during the backup window simply would have to be reprocessed following restoration.

The Archives has redesigned the workflow to ensure that finished tapes are moved off site regularly.

In addition, by the end of December, the Archives will have established an active remote site. Replication appliances will allow the Archives to duplicate critical data and applications to this site. Concurrent with the effort to achieve remote replication, the Archives is inventorying software components and application inventories prioritized for recovery. The Archives' priority is to guarantee the availability of *mdlandrec.net* and *plats.net*. Other applications inventoried and prioritized as second tier may not be considered for emergency restoration if not critical to daily Archives operations.

Finding 5 - Adequate accountability and control over certain equipment was not established.

The Archives concurs with the recommendation.

APPENDIX B

Auditor's Comments on Agency Response

The State Archives disagreed with certain of our comments in its response (Appendix A) to the audit report. We continue to believe that the comments made in the report are valid. In accordance with State law, all areas of disagreement will be addressed through separate correspondence between this Office and Archives.

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