Audit Report

Maryland Energy Administration

January 2017

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

Thomas J. Barnickel III, CPA
Legislative Auditor

January 11, 2017

Senator Craig J. Zucker, 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 Maryland Energy Administration (MEA) for the period beginning May 13, 2013 and ending June 30, 2016. MEA manages various programs related to the reduction of energy consumption, the use of renewable energy resources, and the promotion of energy efficiency. MEA also provides grants and loans to governmental units, non-profits, and private entities.

Our audit disclosed that procedures and controls over cash receipts and accounts receivable need to be strengthened.

MEA's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by MEA during the course of this audit.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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Background Information

Agency Responsibilities

The Maryland Energy Administration (MEA) manages programs which help reduce energy consumption in State facilities and operations; encourage the use of renewable energy resources; and promote energy efficiency in the industrial, commercial, and residential sectors. MEA also provides grants and loans for State agencies, local governments, nonprofit organizations, and the commercial sector. MEA advises the Governor's Office on energy policy and managing energy disruptions and emergencies. MEA is the state conduit for federal energy programs from the U.S. Department of Energy. According to the State's records, MEA's total expenditures for fiscal year 2016 were $44.3 million, including grants and loans of $32.2 million.

The majority of MEA's funding comes from the Maryland Strategic Energy Investment Fund (SEIF). In this regard, State law established the Maryland Strategic Energy Investment Program for the purpose of decreasing energy demand and increasing energy supply to promote affordable, reliable, and clean energy to fuel Maryland's future prosperity. By law, MEA administers the Program, as well as SEIF, which was established to implement the Program.

SEIF funds various programs, including the promotion, development, and implementation of cost-effective energy efficiency and conservation programs; renewable and clean energy resources; climate change programs; and demand response programs that are designed to promote changes in electric usage by customers. In addition, SEIF funds are used to supplement funds for low-income energy assistance, to provide rate relief by offsetting electricity rates, to provide grants and loans, and to implement energy-related public education and outreach initiatives. SEIF also provides funding for programs in certain other State agencies, such as the Department of Human Resources. SEIF is funded primarily by quarterly auctions of carbon allowances through the Regional Greenhouse Gas Initiative. According to its annual report, SEIF revenues and expenditures totaled approximately $86.0 million and $76.3 million, respectively, during fiscal year 2015.

Maryland Clean Energy Center

Chapter 138, Laws of Maryland 2008, effective July 1, 2008, created the Maryland Clean Energy Center (MCEC) as an instrumentality of the State. State law requires coordination with MEA in the administration of MCEC programs. MCEC's purpose includes the following Statewide initiatives:

- promote economic development and jobs in the clean energy industry sector
- promote the deployment of clean energy technology
- serve as an incubator for the development of the clean energy industry
- collect, analyze, and disseminate industry data
- provide outreach and technical support to further the clean energy industry

According to MEA's records, since its inception, MCEC has received approximately $6 million in grants and loans from MEA for the purpose of funding start-up and operating costs. However, MCEC has been unable to make current payments on certain loan funds due. Annual payments of $50,000 on a fiscal year 2009 loan of $400,000 were to have begun in fiscal year 2011; however, MEA has deferred the payment due dates multiple times. As of July 2016, only one payment of $50,000 had been made. Additional loans of $140,000 and $760,000 were made to MCEC in fiscal years 2014 and 2015, with repayment on each to begin in July 2017 and January 2018, respectively.

Each year MCEC engages an independent certified public accounting firm to conduct an audit of its financial statements. For the years ended June 30, 2014 and June 30, 2015, the independent auditors reported that MCEC had significant net operating losses and working capital deficits, and that MCEC must depend on a new potential loan or grant from MEA to meet cash flow demands. The auditors stated that these conditions raised substantial doubt about MCEC's ability to continue as a going concern.

State law created a task force in June 2016 to assess certain MCEC programs, to review past and potential future funding operations, and to identify funding choices in order to assist MCEC to become self-sustaining. The task force was to report its findings and recommendations to the Governor and the General Assembly on or before December 1, 2016; however, the task force requested a delay in its submission until January 30, 2017.

Findings and Recommendations

Cash Receipts / Accounts Receivable

Finding 1
The Maryland Energy Administration (MEA) did not have adequate procedures to ensure that all collections were deposited and that accounts receivable records were proper.

Analysis
MEA lacked adequate procedures and controls to ensure that all collections were deposited and that the related accounts receivable records were properly maintained. During fiscal year 2016, MEA's collections totaled approximately $3.9 million. Of this total, $3.3 million represented a single check relating to certain proceeds from the Regional Greenhouse Gas Initiative, while the remaining collections of approximately $600,000 related primarily to repayments of energy conservation improvement loans.

Although checks were recorded immediately upon receipt, they were not restrictively endorsed. Specifically, collections were forwarded to a second employee who restrictively endorsed the checks and prepared them for deposit. In addition, there was no independent verification to ensure that all recorded collections were deposited. Rather, the employee who prepared the deposits made copies of the related checks and subsequently compared those copies to the validated deposit slip. According to the Comptroller of Maryland's *Accounting Procedures Manual*, agencies are required to restrictively endorse checks immediately upon receipt, and ensure that the original recordation of collections is compared to deposit documentation by an employee independent of the cash receipts function to verify that collections are deposited intact.

Furthermore, one employee had complete control over the accounts receivable, which were primarily related to energy conservation improvement loans. This employee was solely responsible for recording amounts due, sending invoices and late payment notices, and recording payments on accounts. Although this employee did not have access to collections, based on the aforementioned functions, a payment could be redirected (for example, by altering an invoice to direct payments to an improper address) and the accounts receivable records altered to conceal a misappropriation. As of June 30, 2016, according to MEA's records, accounts receivable totaled $13.9 million.

Based on these conditions, assurance was lacking that all cash receipts had been deposited and that payments posted to the related accounts receivable records were proper.

Recommendation 1
We recommend that MEA

a. restrictively endorse checks immediately upon receipt,

b. ensure that an employee independent of the cash receipts function performs documented verifications that collections initially recorded are subsequently deposited, and

c. ensure that an independent employee reviews the accounts receivable records to verify that all amounts due were recorded and all collections recorded in the accounts receivable records were deposited.

We have advised MEA on accomplishing the necessary segregation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Maryland Energy Administration (MEA) for the period beginning May 13, 2013 and ending June 30, 2016. 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 MEA'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 grant and loan programs, cash receipts, contract procurement, and special funds, including the Strategic Energy Investment Fund.

Our audit did not include certain support services provided to MEA by the Executive Department – Governor. These support services (such as maintenance of FMIS accounting records and related fiscal functions) are included within the scope of our audits of the Executive Department – Governor. Our audit also did not include an evaluation of internal controls over compliance with federal laws and regulations for federal financial assistance programs and an assessment of MEA'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 MEA.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the Administration'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). 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 this source 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.

MEA'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 a finding relating to a condition that we consider to be a significant deficiency in the design or operation of internal control that could adversely affect MEA's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. This finding is also regarded as a significant instance of noncompliance with applicable laws, rules, or regulations. A less significant finding was communicated to MEA that did not warrant inclusion in this report.

MEA's response to our finding 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 MEA regarding the results of our review of its response.

APPENDIX

Maryland Energy
ADMINISTRATION
Powering Maryland's Future

Larry Hogan, ***Governor***
Boyd K. Rutherford, ***Lt. Governor***
Mary Beth Tung, ***Director***

January 6, 2017

Thomas J. Barnickel III, CPA
Legislative Auditor
State of Maryland
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Barnickel:

Attached please find this agency's response to the draft audit report on the Maryland Energy Administration for the period beginning May 13, 2013 and ending June 30, 2016.

I would like to take this opportunity to again thank the members of the Office of Legislative Audits for their professionalism, patience and support extended to our team during this period of high staff turnover.

If you have any questions or need further information, please do not hesitate to contact me directly or my Chief of Staff, Greg Williams, at 410-537-4134.

Sincerely,

Mary Beth Tung

Mary Beth Tung
Director

Attachment

cc: G. Williams
R. Scherini
L. Myers

Attachment for Maryland Energy Administration's final audit report:

Finding 1 – Concur: MEA has adapted its internal procedures to meet the audit team's recommendations.

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