

Audit Report

**Department of Health and Mental Hygiene
Holly Center**

October 2008



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

-
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 West Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
 - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
 - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410- 946-5400 or 301-970-5400.
-



Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

October 23, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Holly Center of the Department of Health and Mental Hygiene for the period beginning August 1, 2005 and ending June 8, 2008. The Center provides comprehensive services for persons of all ages who are developmentally disabled and reside in the nine counties of Maryland's Eastern Shore.

Our audit disclosed that the Center had not established proper internal controls over certain disbursement transactions, materials and supplies inventories, and cash receipts.

The Department of Health and Mental Hygiene's response to this audit, on behalf of the Center, is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by the Center.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Background Information

Agency Responsibilities

Holly Center, which is located in Salisbury, Maryland, provides comprehensive services for persons of all ages who are developmentally disabled and reside in the nine counties of Maryland's Eastern Shore. Additionally, the Center provides certain outpatient services, and coordination and support services to day programs and group homes for the developmentally disabled. As of June 30, 2007, the Center had a licensed capacity of 150 inpatient residents. During fiscal year 2007, the Center had a budgeted average daily population of 98 residents and, according to its records, an actual average daily population of 96 residents. According to the State's records, total Center expenditures were approximately \$19.1 million during fiscal year 2007.

Fraud Investigation

At the beginning of our audit fieldwork, we were advised by the Center's Director that the Department of Health and Mental Hygiene's Office of the Inspector General (OIG) was conducting an investigation of an organization that was located at the Center. This organization was operated as a private, not-for-profit entity, and provided certain services to Center residents and other at-risk adults and children residing on Maryland's Eastern Shore. The organization was awarded State grants totaling approximately \$260,000 from the Center during fiscal years 2006 through 2008. On July 3, 2008, the organization ceased operations at the Center.

In its report issued in August 2008, the OIG identified certain possible illegal or unethical activities of employees who worked for the organization. Many of the organization's board of directors were also paid employees, and one Center employee worked at the organization during normal State working hours. As a result, the report noted several potential conflicts of interest. The OIG also commented that the organization generally lacked internal controls, had limited management oversight of financial and administrative activities, and also noted a number of questionable transactions as well as tax issues. In accordance with a Governor's Executive Order, the OIG advised the Office of the Attorney General and the Chief Counsel to the Governor of the results of its investigation, and was advised by the Office to refer the matter to the Wicomico County Bureau of Investigation. We were advised that the OIG has referred the matter to the Bureau but the investigation has not yet been completed.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the finding contained in our preceding audit report dated September 30, 2005. We determined that the Center satisfactorily addressed this finding.

Findings and Recommendations

Disbursements

Finding 1

Proper internal controls had not been established over the processing of certain disbursement transactions.

Analysis

The Holly Center was not fully using the available security features of the State's Financial Management Information System (FMIS) to restrict user access and prevent unauthorized disbursement transactions. Specifically, we noted that four employees had the capability to initiate and approve invoices without independent approvals, and these employees could also redirect payments to a vendor other than the one named on the related purchase order. Consequently, these employees could process a fictitious invoice on a legitimate purchase order by changing the vendor during the invoice entry process. According to the State's accounting records, the Center used FMIS to process disbursements totaling approximately \$2.2 million during fiscal year 2007.

Recommendation 1

We recommend that the Center fully use the available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions. In addition, we recommend that the Center remove the ability for an employee to change the vendor named on an invoice.

Materials and Supplies

Finding 2

The Center had not established adequate internal controls over its materials and supplies inventories.

Analysis

The Center's internal controls over its materials and supplies inventories were not adequate. According to the State's accounting records, the Center's materials and supplies expenditures during fiscal year 2008 for dietary and medical supplies totaled approximately \$562,000. Specifically, we noted the following conditions:

- The storeroom custodians for dietary and medical supplies forwarded completed requisition forms to the inventory clerks for posting to the perpetual inventory records. As a result, the custodians could alter the requisition forms after the delivery of goods and additional items could be removed from stock without detection.
- The employee responsible for maintaining the perpetual inventory records for the Center's medical supplies also had unrestricted access to the storeroom. Additionally, we observed that, on several occasions during our audit, the dietary storeroom was left open and unsupervised during working hours. Consequently, items could be removed from these storerooms without detection.
- Our test of 10 requisitions for medical supplies completed during fiscal year 2008 disclosed that 9 requisitions were not approved by supervisory personnel.

The Department of General Services *Inventory Control Manual* requires that custodial and recordkeeping duties be separated, and that storerooms be locked when unattended. The *Manual* further requires that requisitions be approved by individuals authorized to approve inventory withdrawals.

Recommendation 2

We recommend that the Center comply with the aforementioned requirements of the *Inventory Control Manual*.

Cash Receipts

Finding 3

Adequate internal controls had not been established over the Center's collections.

Analysis

The Center had not established adequate internal controls over its collections. Specifically, the verifications of recorded collections to deposit performed by the Center were not independent as the employee who performed the verifications had routine access to collections. Additionally, our test of ten deposits made during fiscal year 2008, totaling approximately \$23,300, disclosed that for four deposits totaling approximately \$17,600, there was no documentation to substantiate that any deposit verification had been performed. Furthermore, for the remaining six deposits tested totaling approximately \$5,700, the deposit verifications were not performed using the document of initial recordation of collections. Rather, deposits were verified to a copy of the initial log retained by a second employee who processed collections. Finally, the employee responsible for recording collections in the State's accounting records was not independent of the cash handling functions.

As a result, the Center lacked assurance that all collections were deposited. According to the State's accounting records, during fiscal year 2007, the Center's collections totaled approximately \$211,000.

Recommendation 3

We recommend that an employee independent of the cash receipt functions verify that all recorded collections were deposited. We also recommend that the initial record of collections be used in the deposit verifications and that such verifications be documented. We further recommend that an employee who does not have access to cash receipts record collections in the State's accounting records. We advised the Center on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have audited the Holly Center of the Department of Health and Mental Hygiene for the period beginning August 1, 2005 and ending June 8, 2008. 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 Center's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the finding 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 Center's 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.

The Center'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.

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

includes a finding regarding a significant instance of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to the Center that did not warrant inclusion in this report.

The response from the Department of Health and Mental Hygiene, on behalf of the Center, 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.



STATE OF MARYLAND

DHMH

APPENDIX

Maryland Department of Health and Mental Hygiene
201 W. Preston Street • Baltimore, Maryland 21201

Martin O'Malley, Governor – Anthony G. Brown, Lt. Governor – John M. Colmers, Secretary

October 20, 2008

Mr. Bruce Myers, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Baltimore, MD 21201


Dear Mr. Myers:

Thank you for your letter regarding the draft audit report of the Holly Center for the period beginning August 1, 2005 and ending June 8, 2008. Enclosed you will find the Department's response and plan of correction that addresses the audit recommendation.

I will work with the appropriate Directors of Administration, Program Directors, and Deputy Secretary to promptly address the audit exception. In addition, the Division of Internal Audits will follow-up on the recommendations to ensure compliance.

If you have any questions or require additional information, please do not hesitate to contact me at 410-767-6505 or Thomas Russell, Inspector General, of my staff at 410-767-5862.

Sincerely,


John M. Colmers
Secretary

Enclosure

cc: Renata J. Henry, Deputy Secretary for Behavioral Health and Disabilities, DHMH
Valerie A. Roddy, Assistant Director to the Deputy, DHMH
Michael S. Chapman, Director, DDA, DHMH
Carrie Phillip, CFO, DDA, DHMH
Thomas Kish, Director, Holly Center DHMH
Ellwood L. Hall, Assistant Inspector General, Audits, DHMH
Thomas Russell, Inspector General, DHMH



**Holly Center
Responses to the Legislative Audit Report
Findings and Recommendations**

Legislative Audit Finding 1:

Proper internal controls had not been established over the processing of certain disbursement transaction.

Legislative Auditor's Recommendation:

We recommend that the Center fully use the available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions. In addition, we recommend that the Center remove the ability for an employee to change the vendor named on an invoice.

Administration's Response:

The Department concurs with the auditor's recommendations. The Center agrees to fully use the available FMIS security features and has established independent online approval requirements for all critical disbursement transactions. On September 10, 2008, the Center mailed a FMIS modification form to the DHMH Functional Coordinator requesting restriction for applicable FMIS users from the ability to change the vendor information. On September 18, 2008, we received notification from the DHMH Functional Coordinator that each of the above employee's security was modified in FMIS.

Legislative Audit Finding 2:

The Center had not established adequate internal controls over its materials and supplies inventories.

Legislative Auditor's Recommendation:

We recommend that the Center comply with the aforementioned requirements of the *Inventory Control Manual*.

Administration's Response:

The Department concurs with the auditor's recommendation. The Center has now incorporated the following corrective actions:

- Separated the custodial and recordkeeping duties
- All requisitions are approved by the requestor's supervisor prior to recording into the perpetual inventory records.
- The employee with unrestricted access to the storeroom no longer is responsible for maintaining the perpetual inventory records.
- Storerooms are locked when unattended.
- Restrict access to the storeroom for employees responsible for maintaining related perpetual inventory records.

Legislative Audit Finding 3:

Adequate internal controls had not been established over the Center's collections.

Legislative Auditor's Recommendation

We recommend that an employee independent of the cash receipt functions verify that all recorded collections were deposited. We also recommend that the initial record of collections be used in the deposit verifications and that such verifications be documented. We further recommend that an employee who does not have access to cash receipts record collections in the State's accounting records. We advised the Center on accomplishing the necessary separation of duties using existing personnel.

Administration's Response:

The Department concurs with the auditor's recommendations. The Center has assigned an employee, independent of the cash receipt handling and recording functions to verify that all recorded collections were deposited. The initial record of collections is now being used in the deposit verification and verification is being documented. The employee verifying recorded collections were deposited no longer has routine access to cash receipts.

AUDIT TEAM

Mark A. Ermer, CPA
Audit Manager

Ken H. Johanning, CFE
Senior Auditor

R. Frank Abel, CPA, CFE
Joseph E. McWilliams
Staff Auditors