

Audit Report

Military Department

March 2010



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

Karl S. Aro
Executive Director

March 23, 2010

Bruce A. Myers, CPA
Legislative Auditor

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 Military Department for the period beginning October 1, 2006 and ending September 16, 2009. The Department maintains the Maryland National Guard within the State of Maryland and, through the Maryland Emergency Management Agency, coordinates Statewide efforts in the event of emergencies and disasters that are beyond the capabilities of local authorities. The Department also administers loan and grant programs that provide funding to volunteer fire companies for facilities and equipment.

Our audit disclosed that the Department procured certain services totaling approximately \$940,000 without a written contract and Board of Public Works approval, and did not recover indirect costs applicable to certain federal grants. Additionally, the Department did not determine whether, according to State law, approximately \$2 million of certain grant awards unexpended by the local jurisdictions should have been reverted to the General Fund. Finally, internal control deficiencies were noted with respect to the Department's cash receipts.

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

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* Denotes item repeated in full or part from preceding audit report

Background Information

Agency Responsibilities

The Military Department maintains the Maryland National Guard within the State of Maryland, including its 37 armories and numerous other facilities used by the Army and Air National Guard. In addition, the Department, through the Maryland Emergency Management Agency, coordinates Statewide efforts in the event of emergencies and disasters that are beyond the capabilities of local authorities. Furthermore, it coordinates disaster preparedness activities with its federal and local counterparts and, through mitigation services, strives to reduce or eliminate the impact of future disasters. The Department also administers loan and grant programs that provide funding to volunteer fire companies for facilities and equipment. According to the State's records, during fiscal year 2009, the Department's operating expenditures totaled approximately \$75.9 million, consisting of federal, general, and special fund expenditures of approximately \$47.3 million, \$ 15.1 million, and \$ 13.5 million, respectively.

Review of Loans to Volunteer Fire Companies

In the April 2008 Joint Chairmen's Report, the budget committees directed the Office of Legislative Audits to review the outstanding loans in the Volunteer Company Assistance Fund (VCAF) and the Fire Truck Revolving Loan Fund (FTRLF), document the fund receivables and balances in each, and track repayment schedules. A report on the review was originally to be submitted to the budget committees by November 1, 2008. In letters dated September 29, 2008 and December 17, 2008, we notified the budget committees that, due to numerous problems (such as incomplete loan records) identified during our initial inquiry with representatives of the Department and the Maryland State Fireman's Association, we planned to conduct our review and report the findings during the 2009 interim.

We performed our review of the fund balances for the VCAF and the FTRLF in conjunction with this fiscal compliance audit of the Department. In a letter to the budget committees dated November 2, 2009, we reported that the Department had substantially reconstructed the loan records (including repayment schedules) for the VCAF and the FTRLF, and had established fund receivables and balances in each fund. As of October 8, 2009, the outstanding loan balances of the VCAF and the FTRLF totaled approximately \$8.5 million and \$710,000, respectively. In addition, the cash balance of the funds (which are combined on the State's accounting records) totaled approximately \$4.5 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the five findings contained in our preceding audit report dated April 17, 2007. We determined that the Department satisfactorily addressed four of these findings. The remaining finding is repeated in this report.

Findings and Recommendations

Procurement of Information Technology Services

Finding 1

The Department made payments totaling approximately \$940,000 to a contractor without a written contract and approval from the Board of Public Works, as required.

Analysis

During the period from November 2006 through October 2009, the Department obtained information technology services (weather data integration services) totaling approximately \$940,000 in violation of State Procurement Regulations. Specifically, these services were not supported by a written contract, and the Department did not obtain Board of Public Works (BPW) approval for these services.

In May 2004, the BPW approved a sole source contract for the procurement of these services from the aforementioned contractor. The initial contract term was for a six-month period with two one-year renewal options. However, upon expiration of the initial contract in November 2006, the Department continued to procure these services from this contractor at six-month intervals using purchase orders, rather than procure a new contract, and did not submit the procurement to the BPW, as required.

State Procurement Regulations generally require that written contracts be prepared for procurements over \$5,000. The Regulations further require that sole source contracts valued in excess of \$100,000, and information technology contracts valued in excess of \$200,000, be approved by the BPW.

Recommendation 1

We recommend that the Department

- a. execute written contracts prior to permitting contractors to provide the related services; and**
- b. disclose the aforementioned procurements to the BPW and, in the future, obtain the approval of the BPW, as required.**

Federal Funds

Finding 2

Indirect costs were not recovered for certain federal grants.

Analysis

The Department's Maryland Emergency Management Agency (MEMA) had not prepared indirect cost recovery plans for fiscal years 2008 and 2009, during which time federal fund expenditures applicable to MEMA grants totaled approximately \$61.9 million. Consequently, a portion of the federal funds received for MEMA grants, which could have been used to cover certain indirect costs of administering these grants, instead was generally used for direct program costs of the grants. The extent of indirect costs, which related to support services provided to MEMA by the Department and various State agencies, could not be readily determined. As commented upon in our four preceding audit reports, the Department has not prepared indirect cost allocation plans and recovered indirect costs since at least 1998.

Department of Budget and Management (DBM) regulations require that all State agencies recover all costs, direct and indirect, associated with the administration of federally funded programs. State agencies are also required to annually prepare an indirect cost allocation plan to distribute all indirect costs within the agency, including any costs allocated through the State cost allocation plan.

We were advised by Department management personnel that it has submitted letters in the past to DBM requesting a waiver from the aforementioned requirements. The most recent waiver request submitted by the Department was dated April 17, 2007. We were advised by Department management personnel that DBM denied that request.

Recommendation 2

We recommend that the Department comply with the aforementioned DBM regulations (repeat).

Cash Receipts

Finding 3

Adequate internal controls had not been established over cash receipts, and certain records were not accurately maintained.

Analysis

The Department had not established adequate internal controls over cash receipts, and certain related records were not accurately maintained. During fiscal year 2009, collections deposited by the Department totaled approximately \$4 million. Specifically, our review disclosed the following conditions:

- One employee had excessive control over certain special fund collections, which totaled approximately \$2 million during fiscal year 2009. These collections primarily represented fire truck loan repayments. Specifically, this employee initially received and recorded the collections, posted the collections to the State's accounting records, and maintained the related accounts receivable records for loan repayments. Additionally, prior to September 2009, this employee also periodically performed the deposit verification for these collections.
- For other collections (such as armory rental fees), which totaled approximately \$2 million during fiscal year 2009, deposit verifications were not always performed in a timely manner. Instead of using the validated deposit slips that the Department received, an employee periodically agreed the initial record of collections to the monthly bank statements to ensure all recorded collections were deposited. Our review disclosed that, at times, this review was not performed for several months following the deposit of the related collections. For example, collections received during the months of May to July 2009 were not verified to the bank statements until September 2009.
- The Department had not established adequate controls to ensure that all armory rental fees were received; during fiscal year 2009, such fees deposited totaled approximately \$354,000. Armory rental fees are generally received for occasional rentals by the public, such as for a party or event. After being executed by the local armory, a copy of the rental agreement and the related collections to be deposited were forwarded to the Department's headquarters unit. While partial payments were accepted, the rental agreement required that the entire amount be paid 10 days prior to the date of the event.

Although the headquarters unit maintained a log to record the prenumbered armory rental agreements issued to the various armory managers, it did not periodically account for the agreements. Additionally, records of executed armory rental agreements were not accurately maintained. Our test of 26 rental agreements entered into during fiscal years 2008 to 2010 disclosed that 8 of the agreements had not been recorded in the records. Additionally, for 13 other rental agreements that had been recorded, the records did not reflect payments totaling \$34,675. Finally, for 3 agreements, no rental agreement amounts were recorded in the records even though related payments totaling \$8,573 were recorded (including one of the aforementioned 13). As a result, there was no assurance that fees had been received and deposited for all rental agreements executed.

Under these conditions, cash receipts could be lost or misappropriated without timely detection. The Comptroller of Maryland's *Accounting Procedures Manual* requires that duties related to the handling of cash receipts and maintaining accounts receivable records be adequately separated, and that an employee independent of the collections process verify that all receipts initially recorded were subsequently deposited.

Recommendation 3

We recommend that the Department

- a. adequately separate duties related to the collection of cash receipts and the maintenance of related accounts receivable records;**
- b. ensure that independent verifications of recorded collections to deposit, using validated deposit slips, are performed timely, such as on a daily basis;**
- c. periodically account for all prenumbered armory rental agreements; and**
- d. maintain accurate records of rental agreements and related payments to ensure all agreements are accounted for and are paid-in-full.**

We advised the Department on accomplishing the necessary separation of duties using existing personnel.

Senator William H. Amoss Fire, Rescue, and Ambulance Fund

Finding 4

The Department did not determine whether Amoss Fund award amounts unexpended by the local jurisdictions should have been reverted to the State's General Fund, as required by law.

Analysis

The Department did not determine whether unexpended Amoss Fund grant awards reported by the local jurisdictions should have been reverted to the State's General Fund, as required. In that regard, State law provides for the allocation of \$10 million annually to the local jurisdictions for the promotion of fire protection, rescue, and ambulatory services, and requires each local jurisdiction to submit a financial report to the Department each fiscal year disclosing the disposition of the funds. The law further provides that, after two fiscal years, any unexpended and unencumbered award amounts are to be returned to the Department for reversion to the General Fund. Our review of financial reports submitted by five local jurisdictions for the period ending June 30, 2008 disclosed that one local jurisdiction reported approximately \$2 million in unexpended funds relating to amounts awarded during fiscal years 1998 to 2006. However, the Department did not determine whether these funds had been encumbered by the local jurisdiction or require that the jurisdiction return the funds for reversion to the General Fund.

Recommendation 4

We recommend the Department

- a. review the annual financial reports submitted by the local jurisdictions and identify any unexpended and unencumbered funds, and**
- b. recover any Amoss grant funds that have not been expended or encumbered after two fiscal years (including any applicable portion of the aforementioned \$2 million) and revert the funds to the General Fund.**

Audit Scope, Objectives, and Methodology

We have audited the Military Department for the period beginning October 1, 2006, and ending September 16, 2009. 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 Department'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 findings included 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. The areas addressed by the audit included procurements and disbursements, payroll, cash receipts, property and equipment, federal fund reimbursements, and accounts receivable. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Department'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.

Our audit did not include an evaluation of internal controls for federal financial assistance programs and an assessment of the Department's compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including the Department.

The Department'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 the 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 findings related to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the Department's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to the Department that did not warrant inclusion in this report.

The Department's response 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 Department regarding the results of our review of its response.

APPENDIX



MARTIN O'MALLEY
GOVERNOR
COMMANDER-IN-CHIEF

STATE OF MARYLAND
MILITARY DEPARTMENT
FIFTH REGIMENT ARMORY
BALTIMORE, MARYLAND 21201-2288

JAMES A. ADKINS
BRIGADIER GENERAL
THE ADJUTANT GENERAL

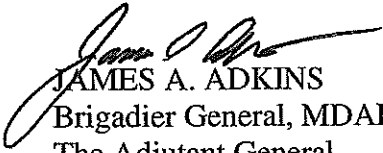
March 18, 2010

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

Dear Mr. Myers:

Please find attached the response to the draft audit report on the Maryland Military Department for the period beginning October 1, 2006 and ending September 16, 2009. The Department has taken corrective actions for the four audit recommendations included in the draft report. In addition, per your request, an electronic version of our response has been e-mailed to response@ola.state.md.us.

If you or your staff have any questions or require additional information, please do not hesitate to contact me or Mr. John S. Nickerson, Director of Finance and Administration at (410) 234-3818.


JAMES A. ADKINS
Brigadier General, MDARNG
The Adjutant General

Enclosures

Cc: Mr. Richard Muth, Director Emergency Management Agency (MEMA)

Procurement of Information Technology Services

Finding 1

The Department made payments totaling approximately \$940,000 to a contractor without a written contract and approval from the Board of Public Works, as required.

Analysis

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In May 2004, the BPW approved a sole source contract for the procurement of these services from the aforementioned contractor. The initial contract term was for a six-month period with two one-year renewal options. However, upon expiration of the initial contract in November 2006, the Department continued to procure these services from this contractor at six-month intervals using purchase orders, rather than procure a new contract, and did not submit the procurement to the BPW, as required.

State Procurement Regulations generally require that written contracts be prepared for procurements over \$5,000. The Regulations further require that sole source contracts valued in excess of \$100,000, and information technology contracts valued in excess of \$200,000, be approved by the BPW.

Recommendation 1

We recommend that the Department

- a. execute written contracts prior to permitting contractors to provide the related services; and**
- b. disclose the aforementioned procurements to the BPW and, in the future, obtain the approval of the BPW, as required.**

AGENCY RESPONSE:

- A. The Department **concurs** with the auditor's recommendation. The aforementioned information technology services contract for weather data integration was procured by the Maryland Emergency Management Agency (MEMA) in May 2004. In February 2008, MEMA's purchasing functions were centralized under the Procurement Office located at the Department's headquarters. The Department's Procurement Office at headquarters has taken action to correct this finding. Effective immediately, the Department will ensure that a written contract is executed for all future contracts

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exceeding \$5,000 as required by State Procurement Regulations. On March 18, 2010, The Adjutant General (agency head) sent a memorandum to all Department managers iterating that written, approved contracts must be executed prior to the Department's accepting any goods or services. The memorandum also noted that administrative action would be taken for failure to comply with State Procurement Regulations.

- B. The Department **concurs** with the auditor's recommendation. On March 18, 2010, The Adjutant General (agency head) sent a memorandum to BPW disclosing the aforementioned IT procurement and recommending the following two actions:
- a. Begin immediately an open and competitive procurement of validated requirements; and
 - b. Obtain BPW approval for an Emergency Procurement to continue receiving the current services until the procurement action is complete. The Department will also request Board ratification of the actions under the IT contract that were previously executed in violation of State Procurement Law.

In addition, the Department's letter advises BPW that all future contracts that require BPW approval will be submitted as required by State Procurement Regulations.

Federal Funds

Finding 2

Indirect costs were not recovered for certain federal grants.

Recommendation 2

We recommend that the Department comply with the aforementioned DBM regulations (repeat).

AGENCY RESPONSE:

The Department **concurs** with the auditor's recommendation. The Department will work with the DBM to develop a plan to recover the indirect costs associated with the administration of MEMA's federally funded programs. It is anticipated that this action will be implemented for fiscal year 2011.

Cash Receipts

Finding 3

Adequate internal controls had not been established over cash receipts, and certain records were not accurately maintained.

Recommendation 3

We recommend that the Department

- a. adequately separate duties related to the collection of cash receipts and the maintenance of related accounts receivable records;**
- b. ensure that independent verifications of recorded collections to deposit, using validated deposit slips, are performed timely, such as on a daily basis;**
- c. periodically account for all prenumbered armory rental agreements; and**
- d. maintain accurate records of rental agreements and related payments to ensure all agreements are accounted for and are paid-in-full.**

We advised the Department on accomplishing the necessary separation of duties using existing personnel.

AGENCY RESPONSE:

- A. The Department **concurs** with the auditor's recommendation. Effective October 19, 2009 the Department implemented a new cash receipt procedure which adequately separates duties related to the collection of cash receipts. Specifically, the employee who maintains the accounts receivable records for special fund collections no longer has access to the related cash receipts.
- B. The Department **concurs** with the auditor's recommendation. Effective October 19, 2009, the Department implemented a new cash receipt procedure that will ensure that independent verifications of recorded collections to deposit, using validated deposit slips, are performed timely on a daily basis.
- C. The Department **concurs** with the auditor's recommendation. Effective immediately, the Department will use its computerized armory rental data base to account for all pre-numbered armory rental agreements as to being issued, voided, or on hand.
- D. The Department **concurs** with the auditor's recommendation. Effective immediately, the Department will use the computerized rental agreement database to maintain accurate records of rental agreements and related payments to ensure all agreements are accounted for and paid-in-full.

Senator William H. Amoss Fire, Rescue, and Ambulance Fund

Finding 4

The Department did not determine whether Amoss Fund award amounts unexpended by the local jurisdictions should have been reverted to the State's General Fund, as required by law.

Recommendation 4

We recommend the Department

- a. review the annual financial reports submitted by the local jurisdictions and identify any unexpended and unencumbered funds, and
- b. recover any Amoss grant funds that have not been expended or encumbered after two fiscal years (including any applicable portion of the aforementioned \$2 million) and revert the funds to the General Fund.

AGENCY RESPONSE:

- A. The Department **concurs** with the auditor's recommendation. Effective immediately, the Department will review the annual financial reports submitted by all local jurisdictions and identify any unexpended and unencumbered funds. In addition, letters will be sent to the local jurisdictions requesting documentation that provides proof that unexpended funds that are over two years old have been encumbered. The Department has sent a letter to the one local jurisdiction identified in the draft audit report as having approximately \$2 million in unexpended funds to request documentation that the funds have been expended. The jurisdiction has responded and is working with the Department and State Attorney General's office to ensure the requirements of the law are met.
- B. The Department **concurs** with the auditor's recommendation. Effective immediately, the Department will recover any funds that have not been expended or encumbered after two fiscal years and revert the funds to the General Fund.

AUDIT TEAM

Mark A. Ermer, CPA
Audit Manager

Edward J. Welsh
Senior Auditor

Chiaka N. Opara
A'knea K. Smith
Staff Auditors