Audit Report

Department of Natural Resources

April 2011

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

Bruce A. Myers, CPA
Legislative Auditor

April 1, 2011

Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Maryland Department of Natural Resources (DNR) for the period beginning May 1, 2007 and ending March 17, 2010. DNR's primary purpose is to oversee the management and use of the State's living and natural resources for the current and future enjoyment of Maryland's citizens and visitors.

Our audit disclosed that DNR did not analyze a non-budgeted fund clearing account totaling $1.7 million to determine the proper disposition of the funds, including whether any or all should be transferred to the State's General Fund. Furthermore, DNR's supervisory review of the use of corporate purchase cards and the invoice payment process was not always thorough, resulting in questionable purchases made by one employee of over $71,000.

We also identified internal control and record keeping deficiencies with respect to DNR's operations, including public land leases, federal funds, and equipment.

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

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 Department of Natural Resources (DNR) oversees the management and use of the State's living and natural resources for the current and future enjoyment of Maryland's citizens and visitors. These resources include the Chesapeake Bay and its tributaries, state forests and parks, and fisheries and wildlife. According to the State's records, during fiscal year 2010, DNR's expenditures totaled $208 million.

Special Funds

According to DNR records, as of June 30, 2009, DNR had 28 individual special funds, with expenditures totaling $171.5 million during fiscal year 2009. During each fiscal year, DNR records expenditures related to numerous special funds to one particular special fund that supported a unit's operation. At year end, DNR generally allocated these expenditures to other special fund accounts to conform to the amounts appropriated for each fund. For example, during fiscal year 2009, DNR charged expenditures totaling $3,810,588 for the Licensing and Registration Service Unit to the State Boat Act Fund. At the close of the fiscal year, DNR allocated all but $517,300 of these expenditures to other special funds that supported the Unit's operations based on their respective appropriations without determining the actual nature of the expenditures and whether such charges were legally allowed under the applicable statutes.

DNR's special fund accounting policies have been commented upon in a number of our preceding audit reports, due to concerns that DNR was unable to ensure that special funds were being legally spent and interest on related fund balances was being properly allocated. DNR management advised us that it will continue to develop a system to improve its special fund accounting.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the 13 findings contained in our preceding audit report dated August 1, 2008. We determined that DNR satisfactorily addressed 11 of the findings. The remaining 2 findings are repeated in this report.

Findings and Recommendations

Non-Budgeted Fund

Finding 1
DNR did not analyze a non-budgeted fund clearing account balance totaling $1.7 million to determine the composition of the balance and the proper disposition of the funds.

Analysis
DNR did not analyze a non-budgeted fund clearing account, which totaled approximately $1.7 million as of June 30, 2010, to determine the composition of the balance and the proper disposition of the funds. We were advised that, in 2003, Hurricane Isabel caused significant damage to the State's forests and parks. We were further advised that repairs were made by DNR and a portion of the related expenditures were originally charged to various special fund accounts. DNR subsequently received reimbursement from the Maryland Emergency Management Agency and the State's self-insurance program for a majority of the expenditures incurred. These funds were initially deposited into the non-budgeted clearing account and were to be allocated to the applicable special fund accounts where certain of the expenditures were initially recorded. As a result of DNR's inaction, these funds remain in the non-budgeted clearing account and were not available for use by DNR to carry out their mandated responsibilities or transferred to the State's General Fund when the original expenditures were not associated with a special fund account.

The closing instructions issued by the Comptroller of Maryland - General Accounting Division require clearing accounts exceeding $100,000 be analyzed and adjusted to a zero balance.

Recommendation 1
We recommend that DNR

a. **perform an analysis of the aforementioned non-budgeted fund clearing account and determine whether funds should be allocated to its special funds, and**
b. **allocate the funds to the appropriate special fund accounts or transfer the funds to the State's General Fund.**

Questionable Purchases

Finding 2
Purchases made by one employee through the use of corporate purchasing cards and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel, resulting in potential fraudulent transactions by this employee.

Analysis
Purchases made by one employee through the use of corporate purchasing cards (CPC) and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel. The supervisory review of CPC purchases made by this employee was deficient and not conducted in accordance with the Comptroller of Maryland's *Corporate Purchasing Card Program Policy and Procedures Manual*. Even though a supervisor approved the related activity, the monthly cardholder activity logs did not include all of the purchases listed on the related bank statement and purchases were not always supported by vendor invoices. Furthermore, in some instances, the aforementioned cardholder making the purchases also signed the log as one of the approvers. The lack of a thorough supervisory review and the lack of supporting documentation allowed significant potentially fraudulent transactions by this employee without detection by DNR. In addition, this employee also initiated and approved the payment request forms for purchases made through the invoice payment transmittal process, resulting in other questionable transactions.

In January 2010, the Comptroller of Maryland – General Accounting Division, based on its own monitoring of CPC activity, contacted DNR regarding a questionable corporate purchasing card purchase totaling $720 made in December 2009. DNR initiated an investigation of this CPC transaction and expanded it to other selected questionable purchases made with the same card and other purchases made by the cardholder through the invoice payment transmittal process. As a result of this investigation, DNR identified a number of questionable purchases made by the employee and referred the matter to the Office of the Attorney General – Criminal Division for further investigation.

During the course of our audit, we expanded on the previous DNR investigation, with the concurrence of the Criminal Division, and found a pattern of questionable purchases made by this cardholder via both the CPC and transmittal process. We identified over $71,000 in questionable purchases, many of which were delivered to the employee's home address. In many instances, the cardholder made purchases on-line and then prepared an invoice to serve as documentation of the purchase, often using a common product description that misrepresented what was actually purchased. For example, although the invoices may have indicated the purchase of certain office supplies, the actual items purchased included computer games and equipment, clothing, and numerous gift cards. In addition, due to the volume of activity in some months exceeding the employee's card limit, the employee used the CPC assigned to another DNR employee (with that employee's consent) to make additional questionable purchases. DNR terminated this individual's employment in March 2010.

The Comptroller of Maryland's *Corporate Purchasing Card Program Policy and Procedures Manual* requires each cardholder's immediate manager to approve monthly charges, including determining whether the transactions were appropriate. According to the bank's records, as of December 3, 2010, DNR had 912 active CPCs and the related expenditures totaled approximately $9 million during fiscal year 2010.

Recommendation 2
We recommend that DNR

a. **reiterate to all employees that all CPC activity is required to be thoroughly reviewed by a supervisor, who must ensure that the monthly cardholder activity logs include all of the purchases listed on the related bank statement, and ensure that all purchases are supported by vendor invoices and approved;**
b. **ensure that all purchases made through the invoice payment transmittal process are reviewed and approved by supervisory personnel; and**
c. **continue to work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned alleged fraudulent activity.**

Public Land Leasing

Finding 3
Certain public land leases were not adequately monitored to ensure that tenants complied with lease terms.

Analysis
Our review of DNR's public land leases disclosed that certain leases were not adequately monitored to ensure that tenants complied with lease terms. Specifically, our review of 15 public land leases disclosed monitoring issues with 3 leases. For example, two of the three leases permitted the tenant's to rent out certain dwellings or apartments on the properties to others; however, DNR did not verify the propriety of the rental payments or that such payments were used by the tenants in accordance with the respective lease terms. Also, for one lease, DNR

did not verify that the tenant performed certain renovation tasks required by the lease in lieu of rent. In this regard, we were informed that the park manager worked in the leased area and observed the renovation work performed, but DNR was unable to provide documentation of the work performed and did not conduct any formal inspections to ensure performance in accordance with the lease agreement. A similar condition was commented upon in our preceding audit report regarding this lease.

According to DNR records, as of July 14, 2010, there were 468 properties (such as croplands and dwellings) which are routinely leased to employees, other governmental entities, non-profit entities, private companies, and individuals; recorded collections for these public land leases totaled approximately $2.7 million during fiscal year 2010.

Recommendation 3
We recommend that DNR monitor leases to ensure that tenants are complying with lease terms (repeat).

Federal Funds

Finding 4
DNR did not ensure the timely submission of applications for certain federal funds resulting in a loss of interest income of $30,000.

Analysis
DNR did not ensure the timely submission of applications for certain federal funds, resulting in a loss of interest income of approximately $30,000. Before DNR can obtain federal reimbursement for expenditures incurred by the State Recreational Boating Safety Program, formal notification from the federal funding agency must be received and an application for funding must be submitted to, and approved by, the federal government. Payments made from this program are initially funded with State General funds. The formal notification regarding the availability of funding is usually received in December, and DNR has until April of the following year to submit the application for approval; however, earlier submission of applications are allowed. While DNR's applications were filed within the period allowed by the grantor agency, a more timely submission of the application would have allowed a more prompt reimbursement of allowable expenditures and the maximumization of interest income.

Our test of twenty federal fund reimbursement requests totaling $14 million, disclosed that three reimbursement requests totaling $3.7 million pertaining to the State Recreational Boating Safety Program were made from 42 to 132 days after the funds could have been requested had the aforementioned applications been submitted in a timelier manner. For example, in one instance, the application could have been filed as early as January 1, 2009, but was not filed until March 26, 2009 thereby delaying the subsequent reimbursement request for the related expenditures. We estimate that the delay in requesting reimbursement resulted in a loss of interest income of approximately $30,000. According to DNR records, fiscal year 2010 federal fund expenditures totaled approximately $34.3 million, of which approximately $4 million pertained to the State Recreational Boating Safety Program.

Recommendation 4

We recommend that DNR submit applications for federal funds related to the State Recreational Boating Safety Program in a timely manner and ensure that federal fund reimbursement requests are submitted on a timely basis.

Equipment

Finding 5
Adequate procedures and controls were not maintained over equipment.

Analysis
DNR did not control and account for its equipment in accordance with the Department of General Services' *Inventory Control Manual*. According to DNR's records, the book value of its equipment totaled approximately $72.7 million, as of June 30, 2009. Our review of the procedures and controls over equipment disclosed the following conditions:

- DNR did not ensure that all equipment acquisitions were recorded in the detail records. Our test of eight equipment purchases made during our audit period totaling $198,936 disclosed three purchases totaling $87,319 had not been recorded in the detail equipment records, as of June 30, 2010. Subsequent to our inquiry, all items noted above were recorded in the detail equipment records.

- DNR did not reconcile its equipment records with the State's accounting records for equipment items with a cost of $50,000 or greater. In this regard, as of July 15, 2009, the balance per the State's records ($ 14,057,729) exceeded the balance of the DNR records ($13,569,011) by $488,518. Subsequent to our inquiry, DNR prepared a reconciliation and was able to adequately account for all but $200 of the aforementioned difference.

- An equipment control account was not maintained as required, to provide a continuing summary of transactions and a total dollar value control over amounts in the related detail records.

- A complete physical inventory of equipment was not conducted as required. Our review of 14 units with a total equipment value of $2.4 million, disclosed that documentation of physical inventories of sensitive items for fiscal year 2009 was not available for 6 of the units, with equipment values totaling $256,922. In addition, DNR had not conducted a complete physical inventory of its non-sensitive equipment as required. Our review of 65 locations, with a total non-sensitive equipment value of $18.6 million that were scheduled for a triennial inventory in fiscal year 2009 disclosed that the inventory was not conducted for 28 of the locations with a value of $6.8 million.

The Department of General Services' *Inventory Control Manual* requires that a control account and detail records be maintained to properly reflect all transactions and that the detail records be reconciled to the related control account balance. The *Manual* further requires that physical inventories of sensitive equipment be conducted annually and of non-sensitive equipment be conducted every three years and variances be investigated and resolved, and that adjustments to records and/or any disposals be properly authorized. Similar conditions were commented upon in our preceding audit report.

Recommendation 5

We recommend that DNR comply with the *Inventory Control Manual*. Specifically, we recommend that DNR

a. ensure all equipment acquisitions are recorded in the equipment inventory records (repeat);
b. periodically reconcile its equipment records with the equipment balance per the State's records and that this reconciliation be documented;
c. maintain a control account and periodically reconcile the control account with the aggregate balance of the related detail records (repeat); and
d. conduct physical inventories, as required, and adjust the detail records to reflect the results of the inventories (repeat).

Audit Scope, Objectives, and Methodology

We have audited the Maryland Department of Natural Resources (DNR) for the period beginning May 1, 2007 and ending March 17, 2010. 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 State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DNR's financial transactions, records, and internal controls, 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 special funds, non-budgeted funds, licensing, the environmental trust fund, procurements and disbursements for DNR's operating expenditures, payroll, cash receipts, equipment, and accounts receivable. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of DNR'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 DNR's compliance with federal laws and regulations pertaining to these programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including DNR.

DNR'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 findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DNR'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 DNR that did not warrant inclusion in this report.

DNR'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 DNR regarding the results of our review of its response.

APPENDIX

MARYLAND
DEPARTMENT OF
NATURAL RESOURCES

Martin O'Malley, Governor
Anthony G. Brown, Lt. Governor
John R. Griffin, Secretary
Joseph P. Gill, Deputy Secretary

March 30, 2011

Mr. Bruce A. Myers, CPA
Legislative Auditor
301 West Preston St.
Room 1202
Baltimore, MD 21201

Dear Mr. Myers,

Enclosed is the Department of Natural Resources response to the draft audit report covering the audit period May 1, 2007 to March 17, 2010.

As with every audit, I want to thank you and your staff for the professional manner in which the audit was conducted and for providing us with your comments and recommendations. I can assure you we will work diligently to implement your recommendations so that we can better serve the citizens of the State.

Again, thank you for your professional courtesy and I look forward to continuing to work with you in the future.

Sincerely,

John R. Griffin
Secretary

Enclosures
cc: Greg Cunningham, Director, Audit & Management Review, DNR
Mark Hoffman, Director, Finance and Administrative Support, DNR

Non-Budgeted Fund

Finding 1
DNR did not analyze a non-budgeted fund clearing account balance totaling $1.7 million to determine the composition of the balance and the proper disposition of the funds.

Recommendation 1
We recommend that DNR

a. perform an analysis of the aforementioned non-budgeted fund clearing account and determine whether funds should be allocated to its special funds, and
b. allocate the funds to the appropriate special fund accounts or transfer the funds to the State's General Fund.

Department Response:
The Department agrees with the finding and related recommendations. The Department has spent a considerable amount of time working on this particular issue, but the fragmentary nature of the accounting records has made resolution difficult. We will continue to pursue it to conclusion as recommended by OLA, with a targeted deadline for resolution of 31 December 2011.

Questionable Purchases

Finding 2
Purchases made by one employee through the use of corporate purchasing cards and the invoice payment transmittal process were not always thoroughly reviewed by supervisory personnel, resulting in potential fraudulent transactions by this employee.

Recommendation 2
We recommend that DNR

a. reiterate to all employees that all CPC activity is required to be thoroughly reviewed by a supervisor, who must ensure that the monthly cardholder activity logs include all of the purchases listed on the related bank statement, and ensure that all purchases are supported by vendor invoices and approved;
b. ensure that all purchases made through the invoice payment transmittal process are reviewed and approved by supervisory personnel; and
c. continue to work in conjunction with the Office of the Attorney General to investigate and resolve the aforementioned alleged fraudulent activity.

Department Response:
The Department agrees with the finding and related recommendations. The current DNR protocol and Comptroller guidelines require supervisory review of

all CPC purchases; appropriate documentation and reconciliation of all purchases, and additional review by a unit administrator and an administrative staff person in FAS. The alleged fraud occurred due to employees not following established procedures; the procedures and protocols were in place.

After immediately alerting the Office of the Attorney General (OAG) and the Office of Legislative Audits of the alleged fraud, the Department: 1) convened its Leadership Team (unit and program directors) to alert them of the potential fraud and to emphasize the importance of following existing procedures for approval of credit card usage; 2) met with unit fiscal officers to review credit card policies and procedures; 3) conducted a study and evaluation of its system of internal controls for credit card purchasing; and 4) analyzed Department-wide credit card usage and reduced the number of cards issued. Going forward, the Department will develop an on line training seminar to share information obtained from DBM's Fraud Committee, including the University of Maryland's Fraud Analysis presentation made in January 2011 and the Risk and Materiality Assessment presented in June 2010.

Purchases paid through the invoice payment transmittal process require a single signature from an approved unit fiscal contact. In cases where the unit fiscal contact is the individual making the purchase, the potential exists that no "supervisory" review will be made. The Department will change its current invoice processing procedures to require an independent level of review and approval from the person submitting the invoice. The Department will continue to assist the OAG as requested in its investigation of the alleged fraudulent activity.

Public Land Leasing

Finding 3
Certain public land leases were not adequately monitored to ensure that tenants complied with lease terms.

Recommendation 3
We recommend that DNR monitor leases to ensure that tenants are complying with lease terms (repeat).

Department Response:
The Department agrees the finding and related recommendation. The Department will by September 30, 2011 develop procedures and policies for insuring its public land leases are properly monitored for compliance with the lease terms and provisions, including the rent payments due DNR.

Federal Funds

Finding 4 DNR did not ensure the timely submission of applications for certain federal funds resulting in a loss of interest income of $30,000.

Recommendation 4

We recommend that DNR submit applications for federal funds related to the State Recreational Boating Safety Program in a timely manner and ensure that federal fund reimbursement requests are submitted on a timely basis.

Department Response:
The Department agrees with the finding and related recommendations. The Department will develop an administrative policy to require units to apply for federal funds in a timely manner, to ensure draw downs can be done as soon as eligible expenditures have been incurred. The targeted date for completion is 30 June 2011.

Equipment

Finding 5 Adequate procedures and controls were not maintained over equipment.

Recommendation 5
We recommend that DNR comply with the *Inventory Control Manual*. Specifically, we recommend that DNR

a. ensure all equipment acquisitions are recorded in the equipment inventory records (repeat);
b. periodically reconcile its equipment records with the equipment balance per the State's records and that this reconciliation be documented;
c. maintain a control account and periodically reconcile the control account with the aggregate balance of the related detail records (repeat); and
d. conduct physical inventories, as required, and adjust the detail records to reflect the results of the inventories (repeat).

Department Response:
The Department agrees with this finding and related recommendations. DNR will continue to strive to maintain its inventory consistent with DGS requirements, including: (1) timely and accurate additions of new items onto inventory; (2) timely and accurate reconciliation of items between DNR's system and FMIS; (3) maintenance of a control account; and (4) physical inventories conducted consistent with DGS requirements and adjustment of records to reflect those inventories. New staff has been put in charge of the inventory function at an

agency-level and a revised policy and procedures on inventory is forthcoming. The targeted date for complete implementation (including physical inventories) is 30 June 2012.

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