

Audit Report

Department of Natural Resources

August 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

August 1, 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 Maryland Department of Natural Resources (DNR) for the period beginning January 7, 2004 and ending April 30, 2007.

Our audit disclosed that, contrary to recommendations made by a workgroup formed pursuant to the *2002 Joint Chairmen's Report*, DNR did not adequately account for its special funds to ensure that they were used in accordance with enabling laws. In addition, DNR awarded Program Open Space (POS) grants to local jurisdictions for projects which did not appear to be consistent with the statutory restrictions on POS funds. For example, POS grants totaling \$4.1 million were distributed to a local jurisdiction for the land acquisition and development of an indoor aquatic center.

We also noted various internal control deficiencies and noncompliance with State laws relating to certain other special fund programs. For example, our audit disclosed that DNR improperly retained certain funds totaling \$244,117 that should have been reverted to the State's General Fund. Furthermore, DNR loaned \$400,000 from the Land Trust Grant Fund to a private foundation which appears to be in violation of State law, and the loan agreement did not require the foundation to immediately record a conservation easement on the property or to provide legal remedies if the easement was not eventually recorded.

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

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Table of Contents

Executive Summary	5
Background Information	7
Agency Responsibilities	7
Status of Findings From Preceding Audit Report	7
Findings and Recommendations	9
Special Funds	
* Finding 1 – DNR Did Not Adequately Account for Certain Special Funds to Ensure That Funds Were Spent in Accordance with Statutory Requirements	9
Finding 2 – DNR Improperly Retained Funds Totaling \$244,117 That Should Have Been Reverted to the State’s General Fund	10
Program Open Space (POS)	
Finding 3 – DNR Awarded Certain POS Grants to Local Jurisdictions for Indoor Recreation Projects That Did Not Appear to be Consistent with Statutory Restrictions on POS Funds	11
Land Trust Grant Fund	
Finding 4 – DNR Loaned \$400,000 From the Land Trust Grant Fund to a Private Foundation Which Appears to be in Violation of State Law, and Did Not Obtain Required Assurances That the Land Purchased with the Loan Would Be Used as Intended	12
Public Land Leasing	
Finding 5 – DNR’s Public Land Leases Were Not Adequately Monitored to Ensure That Tenants Complied with Lease Terms	14
* Denotes item repeated in full or part from preceding audit report	

Procurements and Disbursements

Finding 6 – DNR Improperly Created Certain Purchase Orders in Violation of State Policies and Procedures 15

* Finding 7 – Proper Internal Controls Were Not Established Over Purchasing and Disbursement Transactions, and FMIS User Security Was Not Properly Monitored 16

Federal Funds

Finding 8 – DNR Did Not Maximize Federal Fund Recoveries to Offset State Expenditures 17

Cash Receipts

* Finding 9 – Adequate Controls Were Not Established Over Cash Receipts 18

State Park Reservation System

Finding 10 – DNR Did Not Obtain Annual Independent Audits of the State Park Reservation System and Did Not Account for Certain Revenues and Expenditures 20

Payroll

Finding 11 – Duties Were Not Adequately Separated Over Certain Payroll Processing Functions 21

Equipment

* Finding 12 – Adequate Procedures and Controls Were Not Maintained Over Equipment 22

Questionable Purchases

Finding 13 – A DNR Employee Purchased Janitorial and Maintenance Supplies at Excessively High Prices From Certain Vendors 23

Audit Scope, Objectives, and Methodology 25

Agency Response Appendix

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

Executive Summary

Legislative Audit Report on Maryland Department of Natural Resources (DNR) August 2008

- **DNR did not adequately account for certain special funds to ensure that funds were spent in accordance with statutory requirements. Specifically, DNR allocated expenditures for its special funds primarily based on the amounts budgeted. As a result, there was a lack of documentation that expenditures charged to the various special funds conformed to the purposes of enabling legislation.**

DNR should implement appropriate accounting policies to ensure that special fund expenditures are properly accounted for and spent in accordance with the funds' enabling laws.

- **DNR improperly retained certain funds totaling \$244,117 that should have been reverted to the State's General Fund.**

DNR should comply with State law and revert the aforementioned funds to the State's General Fund.

- **Certain Program Open Space (POS) grants were awarded to local jurisdictions for indoor recreation projects, such as an indoor aquatic center, which did not appear to be consistent with statutory restrictions.**

DNR should refrain from using POS funds for indoor recreation projects unless an Opinion of the Attorney General is obtained supporting the use of POS funds for indoor projects.

- **DNR loaned \$400,000 from the Land Trust Grant Fund to a private foundation which appears to be in violation of State law, and did not obtain required assurances that the land purchased with the loan would be used as intended.**

DNR should limit loans from the Land Trust Grant Fund to qualified recipients unless an Opinion of the Attorney General is obtained supporting the use of these funds by non-qualified recipients. Additionally, DNR should require the immediate recording of

conservation easements, and include sufficient legal remedies in loan agreements.

- **Proper internal controls were not established over purchases and disbursements to restrict user access and to prevent unauthorized disbursements. Furthermore, DNR created purchase orders in the name of the State of Maryland at the end of fiscal years 2005 through 2007 to avoid reverting unspent appropriations. In the following year, these reserved funds were used to purchase goods or services when a vendor was identified.**

DNR should fully use the available FMIS security features by establishing independent online approval requirements for all critical purchasing and disbursement transactions. DNR should also review the propriety of transactions related to these improperly created purchase orders, take appropriate action, and ensure that only valid purchase orders are created in the future.

- **Numerous internal control deficiencies were noted with respect to DNR's operations, including public land leases, federal funds, cash receipts, payroll, and equipment.**

DNR should take the recommended actions to improve controls in these areas.

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 2007, DNR's expenditures totaled \$494.6 million and primarily consisted of purchases of land and grants to preserve the State's natural resources.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the 16 findings contained in our preceding audit report dated February 24, 2005. We determined that DNR had satisfactorily resolved 12 findings. The remaining 4 findings are repeated in this report.

Findings and Recommendations

Special Funds

Finding 1

The Department of Natural Resources did not adequately account for certain special funds to ensure that funds were spent in accordance with statutory requirements.

Analysis

The Department of Natural Resources (DNR) did not adequately account for certain special funds to ensure that funds were spent in accordance with statutory requirements. According to its records, as of June 30, 2007, DNR had 28 individual special funds, and related expenditures totaled approximately \$386.8 million during fiscal year 2007. Our review disclosed that, during the fiscal year, DNR recorded all expenditures incurred by certain units to one particular special fund that supported a unit's operations even though the expenditures were related to numerous other special funds. At year-end, DNR generally allocated these expenditures to the other special fund accounts to conform to the amounts appropriated for each fund. For example, during fiscal year 2006, DNR charged expenditures totaling approximately \$3.4 million for its Licensing and Registration Service Unit to one special fund account. At year-end, DNR allocated all but \$287,617 of these expenditures to other special funds that supported the Licensing and Registration Service 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 statutes governing the applicable laws.

The failure to properly account for special funds results in the inability to ensure that funds are being spent, and interest is being allocated, in accordance with State laws. In addition, budget requests submitted to legislative budget committees and indirect cost calculations were not accurate because DNR generally used the appropriated expenditures to compile the budget requests and to calculate the indirect costs allocated to the various funds.

A workgroup established in response to Committee narrative in the *2002 Joint Chairman's Report* had similar findings in its January 29, 2004 report to the legislative budget committees. The report recommended that DNR establish accountability over its special fund expenditures to ensure that expenditures are charged in accordance with the fund's enabling laws.

In legal advice obtained by the Department of Legislative Services in August 2001 on a similar issue pertaining to one of DNR's other special funds, it was

determined, in part, that the relationship between the statute governing a fund and the budget bill is not clear, and that there is still an obligation to submit budget requests that conform with the law.

Deficiencies related to DNR's special fund accounting policies have been cited in a number of preceding audit reports.

Recommendation 1

We again recommend that DNR implement appropriate accounting policies to ensure that special fund expenditures are properly accounted for and to ensure that special funds are spent in accordance with the funds' enabling laws.

Finding 2

DNR improperly retained funds totaling \$244,117 that should have been reverted to the State's General Fund.

Analysis

Our review of the budgetary closeout for fiscal year 2006 disclosed that DNR did not revert security interest filing fees collected during fiscal years 1999 through 2006 totaling \$244,117 to the State's General Fund, as required. DNR personnel advised us that a system coding error prevented the fees from being automatically reverted to the General Fund. This error was discovered by DNR during the fiscal year 2006 closeout process, and we were advised that DNR would revert the aforementioned funds at the close of fiscal year 2008. The Natural Resources Article, Section 8-729 of the Annotated Code of Maryland, established a \$15 security interest filing fee to be collected, under certain circumstances, by DNR during the titling of a vessel, and that \$6 of this fee is to be deposited into the State's General Fund.

Recommendation 2

We recommend that DNR comply with State law and revert the aforementioned funds to the State's General Fund.

Program Open Space

Background

The Natural Resources Article, Section 5-902 of the Annotated Code of Maryland, established Program Open Space (POS) for the State or local jurisdictions to acquire and develop outdoor recreation and open space areas before the escalating cost of land prevents its purchase for public use and before

potential areas are devoted to some other use. DNR is responsible for monitoring local jurisdictions' use of POS funds (such as ensuring that local jurisdictions procured the land in accordance with DNR regulations). DNR is also responsible for approving State procurements of property for open space initiatives which are then appraised and procured by the Maryland Department of General Services. According to the State's records, during fiscal year 2007, expenditures charged to POS totaled approximately \$296.5 million.

Finding 3

DNR awarded certain POS grants to local jurisdictions for indoor recreation projects that did not appear to be consistent with statutory restrictions on the funds.

Analysis

DNR awarded certain POS grants to local jurisdictions for indoor recreation projects that did not appear to be consistent with statutory restrictions on the funds. State law provides that POS funds are to be used to acquire land for outdoor public recreation and open space use and to develop the land for needed outdoor recreation facilities. However, DNR management advised us that open space funds have been used for numerous projects involving indoor facilities (such as community centers and golf course building renovations) over the history of the program. For example, we noted one grant totaling \$1.8 million that was awarded to a local jurisdiction for the development of an indoor aquatic center. This grant represented a portion of the \$4.1 million in POS funds awarded to that local jurisdiction for land acquisition (\$490,000) and development of the aquatic center (\$3.6 million).

DNR management believes that indoor recreation projects fall under the intent of the law because indoor facilities accommodate recreation activities, such as swimming, that are typically conducted outdoors. In addition, DNR management stated that indoor facilities are a better investment of POS funds since the public can enjoy year-round use of the facilities rather than seasonal use of outdoor facilities. However, counsel to the Maryland General Assembly advised us that the use of POS funds for indoor recreational facilities does not appear to be consistent with the aforementioned laws governing the funds.

Recommendation 3

We recommend that DNR refrain from using POS funds for indoor facilities unless an Opinion of the Attorney General is obtained supporting the use of the funds for indoor recreation projects.

Land Trust Grant Fund

Finding 4

DNR loaned \$400,000 from the Land Trust Grant Fund to a private foundation which appears to be in violation of State law, and did not obtain required assurances that the land purchased with the loan would be used as intended.

Analysis

DNR loaned \$400,000 from the Land Trust Grant Fund to a private foundation which appears to be in violation of State law, and did not obtain required assurances that the land purchased with the funds would be used as intended. State law established the Grant Fund, which is administered by DNR's Maryland Environmental Trust (MET), to encourage the preservation and protection of open space and natural areas in the State. In December 2004, MET, in conjunction with the Maryland Department of the Environment (MDE), loaned funds totaling \$1.8 million to the foundation (\$400,000 in a reimbursable grant from MET to a nonprofit land trust, which then loaned the funds to a private foundation, and an MDE authorized loan of \$1.4 million from a bank directly to the foundation). The loans were provided to enable the acquisition of certain land for preservation of its natural resources. Our review of the MET loan and related activity disclosed the following conditions:

- The \$400,000 MET reimbursable grant appears to have violated statutory restrictions governing the use of the Grant Fund. Specifically, State law governing the Grant Fund restricts disbursements to qualified land trusts in the State. However, our review disclosed that, although MET awarded the funds to a qualifying land trust, the funds were then directed to a private foundation that did not qualify for the grant. According to MET management, they were aware that the funds were ultimately going to a private foundation but used the aforementioned land trust as an intermediary to comply with the statutory restrictions. Furthermore, MET management believed that this was appropriate because the Board of Public Works' agenda for this transaction disclosed that this project was a joint venture between the land trust and the private foundation and that the private foundation would purchase the

property and resell it to a private buyer. However, it is unclear whether handling the grant in this manner is in accordance with the legislative intent.

- The MET loan agreement did not require the foundation to immediately record a conservation easement at the time the foundation purchased the land. Instead, that agreement permitted the foundation to delay recordation of the easement until the land, or a parcel of the land, was sold to a third party. Furthermore, except for the termination of the agreement and the immediate payment of any outstanding amounts, the loan agreement did not contain a specific performance action clause that outlined the legal remedies available to the State if the easement was not eventually recorded. These findings were also commented upon in the MDE audit report dated January 18, 2008. In that audit report, we also commented that the foundation's current president had previously directed land acquisitions for the aforementioned nonprofit land trust, and that this individual began serving in an advisory capacity to MET's board approximately two months after funds were loaned to the private foundation, providing advice on matters of interest, especially in the solicitation of easements.

As of April 9, 2008, we were advised that the foundation had not sold any of the property (which had been advertised for sale at \$4 million) and no conservation easements had been recorded; consequently, the environmental protection of the property was not restrictively defined in the official land records.

As of July 2007, in accordance with the grant agreement, the foundation had repaid \$150,000 of the \$400,000 MET loan.

Recommendation 4

We recommend that, in the future, DNR limit loans from the Land Trust Grant Fund to qualified land trusts unless an Opinion of the Attorney General is obtained supporting the use of these funds by non-qualified land trusts. We further recommend that DNR, in conjunction with MDE, immediately require the foundation to record a restrictive easement on the property and require the immediate recording of conservation easements for any future loans. Finally, we recommend that DNR include specific performance action clauses in loan agreements that provide sufficient legal remedies in the event that easements are not recorded.

Public Land Leasing

Finding 5

DNR's 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 10 public land leases disclosed that DNR did not verify that the tenants performed certain lease requirements for 3 leases, and did not adequately ensure that all rent payments were received for 2 of the leases.

For example, one tenant's monthly rent was based on a percentage of dump fee revenues collected for a rubble landfill; however, DNR did not audit the tenant's records, as allowed by the lease agreement, to ensure the proper rental payments were submitted. This tenant paid DNR approximately \$192,000 for the last three months of fiscal year 2007.

In another example, DNR entered into a five-year lease to provide land, containing an historical complex, to a nonprofit entity, for which the lessee was to completely renovate and maintain the property (which consisted of a gun factory, a blacksmith shop, two small dwellings, and two residential apartments) in lieu of rent. This lease also provided that all rental payments from the dwellings and apartments should be used to restore and maintain the complex. However, although we were informed that a DNR park manager observed the restorations and maintenance performed, DNR was unable to provide documentation of the work performed, and DNR did not conduct any formal inspections to ensure performance in accordance with the lease agreement. Furthermore, no other data (such as rental fees collected and reinvested in the property, and restorations made) were submitted to and verified by DNR.

According to DNR records, as of June 12, 2007, there were 475 properties (such as croplands and dwellings) which are routinely leased to employees, other governmental entities, nonprofit entities, private companies, and individuals; recorded collections for these public land leases totaled approximately \$1.4 million during fiscal year 2007.

Recommendation 5

We recommend that DNR monitor leases to ensure that tenants are complying with lease terms and the proper amount of rent is collected from tenants.

Purchases and Disbursements**Finding 6**

DNR improperly created certain purchase orders in violation of State policies and procedures.

Analysis

DNR improperly created certain purchase orders in violation of State policies and procedures. Specifically, our review of DNR records during fiscal years 2005 through 2007 disclosed approximately \$400,000 in purchase orders made to the State of Maryland; however, the corresponding payments were made to multiple non-State vendors. DNR management advised us that, when DNR had remaining funds at year-end and did not have a vendor designated for a particular service, a purchase order in the name of the State of Maryland would be created to avoid reverting unspent appropriations. In the following fiscal year, these reserved funds would then be used to purchase goods or services when a vendor was identified. For example, we noted one purchase order to the State of Maryland created at the end of fiscal year 2004, for \$101,000, which was used in fiscal year 2005 for payments to a construction firm for work on the Western Maryland Rail Trail.

This practice violated the yearly closing instructions of the Comptroller of the Treasury's General Accounting Division since the purchase orders did not represent actual commitments by the State for goods or services and, consequently, would not qualify as valid encumbrances. Accordingly, any remaining funds at fiscal year-end should have been reverted to the State General Fund as required by the State Finance and Procurement Article of the Annotated Code of Maryland.

Recommendation 6

We recommend that DNR identify all improperly created purchase orders, review the propriety of the transactions, and take appropriate corrective action, including reverting any unspent funds to the State's General Fund. We also recommend that, in the future, DNR ensure that only valid purchase orders are created in accordance with the aforementioned State Policy.

Finding 7

Proper internal controls were not established over purchasing and disbursement transactions, and FMIS user security was not properly monitored.

Analysis

DNR did not fully use the available security features of the Financial Management Information System (FMIS) to restrict user access and to prevent unauthorized purchasing and disbursement transactions, and DNR did not properly monitor FMIS user security. Specifically, our review disclosed the following conditions:

- Forty-one employees could process certain purchasing and/or disbursement transactions without independent approvals, one of which could also release disbursement transactions to the Comptroller of the Treasury's General Accounting Division for payment. In addition, five employees could initiate and approve invoices without independent approvals, two of which could also redirect payments to a vendor other than the one named on the related purchase order. This is significant because changing the name of the vendor when processing an invoice could circumvent procurement and/or budgetary requirements, result in erroneous or duplicate payments, prevent the proper tracking of vendor payments, or be used to process fraudulent transactions.
- DNR did not periodically monitor the FMIS security status granted to its employees, as required by the Department of Budget and Management's *Internal Control and Security Policy and Procedures Manual*. Although we were advised that DNR management reviewed periodic reports of its FMIS security profiles during our audit period, such reviews were not documented. In this regard, our review of related online capabilities disclosed that one employee had the capability to modify online approval rules, even though this individual also had the capability to initiate critical purchasing transactions (such as purchase orders).

Because of the aforementioned conditions, employees could process unauthorized disbursement transactions which may not be readily detected. During fiscal year 2006, DNR used FMIS to process approximately \$92 million (\$52 million operating and \$40 million capital) in transactions. A similar condition regarding improper controls over disbursements has been commented upon in our four preceding audit reports.

Recommendation 7

We again recommend that DNR fully use the available FMIS security features by establishing independent online approval requirements for all critical purchasing and disbursement transactions. In addition, we recommend that individuals involved in the invoice payment process not have the ability to redirect payments to vendors other than the vendor on the purchase order. We further recommend that DNR periodically monitor the system security status of its employees and ensure that duties are properly separated.

Federal Funds

Finding 8

DNR did not maximize federal fund recoveries to offset State expenditures and, for one grant, did not document its methodology used to determine costs charged.

Analysis

DNR did not maximize federal fund recoveries to offset State expenditures and, for one grant, did not document its methodology to determine the percentage of program costs charged to federal grant funds. Specifically, we noted the following conditions:

- Our test of expenditures totaling approximately \$2.7 million incurred for three grants disclosed that reimbursement requests were not submitted to the extent possible, or were not submitted timely, for expenditures totaling approximately \$852,000. For one grant, although DNR incurred federal expenditures totaling \$457,472 during June and July 2006, no attempts were made to recover these expenditures. DNR management advised us that it had not attempted to recover the funds because, at least in part, it had exceeded its federal fund appropriation for fiscal year 2006. However, DNR could have requested a budget amendment to increase its federal fund appropriation because, at that time, there were sufficient funds remaining in the grant to cover June and July 2006 expenditures. Furthermore, for this grant, DNR requested and did recover subsequent month's expenditures for fiscal year 2007. The failure to recover these federal funds, as well as to recover other funds tested in a timely manner, resulted in the State losing investment income of at least \$26,535 as of August 2007. State budget law provides that, to the extent consistent with federal requirements, federal funds should be used before State funds are charged.

- For one federal grant, DNR did not have documentation to support the cost allocation methodology used to determine federal expenditures for reimbursement purposes. Specifically, to determine the federal portion, DNR allocated a predetermined percentage of total program costs to this federal grant. For example, for federal fiscal year 2006, DNR charged 12 percent of total program expenditures as the federal portion, and it received federal reimbursements totaling approximately \$2.3 million. This lack of documentation is significant because this rate had not been approved by the federal grantor agency.

According to the State's records, federal fund expenditures totaled approximately \$26.2 million during fiscal year 2007.

Recommendation 8

We recommend that DNR pursue recovery of the aforementioned federal fund expenditures and, in the future, ensure that federal funds are fully recovered in a timely manner. We further recommend that DNR document its methodology used to allocate expenditures to the aforementioned federal grant.

Cash Receipts

Finding 9

Adequate controls were not established over cash receipts.

Analysis

Procedures to control and record cash receipts deposited by DNR, which totaled \$54 million during fiscal year 2006, were not adequate. Our review disclosed the following conditions:

- Adequate verification processes were not always in place to ensure that recorded collections were deposited. Our review of deposit verification procedures at the Finance and Administrative Services Unit (FAS) and at two regional service centers disclosed certain weaknesses regarding such verifications at one location. Specifically, at FAS, employees who performed the verifications did not use the original source documents used to record the collections. FAS receives and processes collections received by mail and collections received by other DNR units that initially record the collections and forward them to FAS for further processing and deposit. According to DNR's records, during fiscal year 2006, cash receipts processed by these three

units totaled approximately \$25.5 million, of which approximately \$7.2 million was processed by FAS.

- DNR did not record cash receipts in FMIS timely or accurately. In this regard, FAS records all cash receipts in FMIS, including those that are deposited by outlying units. Our test of 35 deposits, totaling \$923,761, disclosed that 32 deposits, totaling \$733,936, were entered into FMIS 3 to 33 business days after the dates of deposit. In addition, 26 of the deposits tested had an inaccurate document date recorded in FMIS. The Comptroller of the Treasury's *Accounting Procedures Manual* requires that cash receipts be recorded in FMIS within two business days of the deposit. The *Manual* also requires that the document date entered in FMIS be the actual bank deposit date to facilitate the reconciliation of bank deposit data with FMIS by the State Treasurer's Office. A similar condition was commented upon in our preceding audit report.
- The Licensing and Registration Services Unit lacked adequate controls over voided transactions. Our test of 50 voided transactions totaling \$35,244 processed by DNR's regional service centers (20 voids totaling \$33,567) and approved retail establishments (30 voids totaling \$1,677) disclosed that 24 voided transactions totaling \$18,960 were not properly supported by a copy of the voided license and an explanation for the void. In addition, 13 of these 24 voids were processed by retail establishments that were required to either submit the voided license or to be billed for the cost of the voided transaction. However, neither the voided document nor reimbursement (which totaled \$838 for the 13 voids) was received from the retail establishments.
- Two employees responsible for establishing certain receivables also received the related collections and initiated non-cash credit adjustments. These two employees received collections totaling approximately \$1.6 million during fiscal year 2007. We also noted that independent verifications were not performed to ensure that all recorded non-cash credit adjustments were properly supported and approved by supervisory personnel. Specifically, our test of 15 non-cash credit adjustments, totaling \$655,989, disclosed that 6 non-cash credit adjustments, totaling \$152,293, were approved and processed without adequate supporting documentation. During fiscal year 2007, DNR recorded non-cash credit adjustments totaling approximately \$2.1 million to its accounts receivable records. Similar conditions have been commented upon in two preceding audit reports.

Recommendation 9

We recommend that DNR establish adequate procedures and controls over collections. Specifically, we recommend that FAS employees verify that all

collections are subsequently deposited using original source documents. In addition, we again recommend DNR record collections in FMIS timely and accurately. We also recommend that DNR ensure all voided transactions are properly documented and approved by supervisory personnel. Furthermore, we recommend that DNR obtain reimbursement from agents for any unsupported voided transactions, including the ones noted above. Finally, we again recommend that employees who maintain the accounts receivable records not have access to the related collections, and that DNR independently verify that all non-cash credit adjustments recorded to its accounts receivable records are properly supported and approved by appropriate supervisory personnel. We advised DNR on accomplishing the necessary separation of duties using existing personnel.

State Park Reservation System

Finding 10

DNR did not obtain annual independent audits of the State park reservation system and did not account for certain related revenues and expenditures.

Analysis

DNR did not require the contractor to obtain annual independent audits of the State park reservation system to determine whether the contractor's controls and related policies and procedures were suitably designed and properly operating. Consequently, the system could be vulnerable to a variety of exposures, such as third party access to critical system data (such as credit card numbers). According to information provided by the vendor, reservation fees processed through the system totaled approximately \$5 million during fiscal year 2007.

We further noted that, as of April 9, 2008, DNR had not reconciled its clearing account for park reservation revenues and expenditures since July 2006. Prior to this date, DNR performed monthly reconciliations of the account. All park reservations processed on the park reservation system and paid for via credit card are deposited by the vendor into the clearing account for subsequent allocation by DNR to the applicable parks. The vendor also uses the funds in the account to collect its commissions for the park reservations and cancellations that it processed. In addition, any credit card cancellations and certain chargebacks related to park activity are posted to the clearing account.

Due to the significant activity in and out of the clearing account, and the fact that the vendor has unrestricted access to the account, it is imperative that DNR periodically reconcile the account to ensure the balance is accurate and the related

revenues and expenditures are proper and accounted for. The aforementioned clearing account had a balance of \$788,819 as of July 31, 2007.

Recommendation 10

We recommend that DNR require or obtain annual independent audits of the controls over its park reservation system to ensure that the contractor’s controls and related policies and procedures are suitably designed and properly operating. We also recommend that DNR ensure that any significant deficiencies identified by these audits are corrected and other findings, if any, are appropriately resolved. We further recommend that DNR perform monthly reconciliations of its park reservation clearing account and promptly investigate and resolve any differences.

Payroll

Finding 11
Duties were not adequately separated over certain payroll processing functions.

Analysis

Duties were not adequately separated over certain payroll processing functions. Specifically, in 6 of DNR’s 14 units, the employees responsible for preparing and submitting required documentation to remove terminated employees from the unit’s payroll records also distributed the related payroll checks. As a result, fictitious timesheets could be prepared for individuals that should have been terminated from the payroll records and the related payroll checks could be misappropriated without detection.

We also noted that DNR lacked adequate controls over changes to payroll information (such as adding employees to and removing employees from the payroll and changing pay rates). Specifically, two employees could both initiate and approve unauthorized payroll transactions, which would not be subject to independent approval and may not be detected. After bringing this issue to their attention, DNR management subsequently restricted the access of the aforementioned employees.

According to DNR’s records, payroll expenditures during fiscal year 2007 totaled approximately \$108 million.

Recommendation 11

We recommend that employees responsible for preparing and/or submitting documentation to remove terminated employees from the DNR payroll

records not have access to related payroll checks. In addition, we recommend that DNR restrict access to critical automated payroll processing functions to prevent the same individual from having access to initiate and approve payroll transactions.

Equipment

Finding 12

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*. For example, an equipment control account was not maintained and a complete physical inventory of equipment was not conducted as required. DNR also did not ensure that all equipment acquisitions were recorded in the detail equipment records. Our test of five equipment purchases during fiscal year 2007 totaling \$267,991 disclosed that three of the purchases totaling \$159,314 had not been recorded in the detail equipment records as of August 7, 2007. We further noted that a September 2002 purchase of radios totaling \$74,302, which we brought to DNR's attention in the prior audit, had still not been recorded in the detail equipment records as of August 7, 2007. Similar conditions were commented upon in our preceding audit report. According to DNR's records, the book value of its equipment totaled approximately \$67.4 million as of June 30, 2007.

Recommendation 12

We again recommend that DNR comply with the *Inventory Control Manual*. In addition, we recommend that DNR ensure that all equipment acquisitions, including the aforementioned ones, are recorded in the equipment inventory records.

Questionable Purchases

Finding 13

A DNR employee purchased janitorial and maintenance supplies at excessively high prices from certain vendors.

Analysis

A DNR employee purchased janitorial and maintenance supplies at excessively high prices from certain vendors. In our special report, dated August 23, 2004, related to the purchases of janitorial and maintenance supplies made with corporate purchasing cards, we reported that employees of several State agencies used their corporate cards to purchase numerous items at exorbitant prices. Our current review of corporate purchasing card transactions disclosed purchases totaling \$28,391, which were made by DNR employees during fiscal years 2005 through 2007 (as of January 25, 2007), from companies which were identified in the aforementioned report for charging exorbitant prices. Furthermore, we noted that 53 percent of these purchases were made by one DNR employee.

Our review of 11 purchases made by this employee, totaling \$1,909, disclosed that, for 10 purchases, DNR paid prices above those offered by competitors, resulting in potential excess costs of \$1,258. For example, hand-sanitizing wipes were purchased for \$179 per case when we determined that an identical product could be purchased from another vendor for \$56 per case.

We were advised by DNR management that bids are generally not obtained when making purchases less than \$2,500. Although State Procurement Regulations do not require formal bids for individual purchases under \$2,500, those Regulations do provide a standard that competition should be sought to the extent practical to foster competition in obtaining needed items in a cost effective manner.

Recommendation 13

We recommend that DNR take immediate action to investigate the propriety of purchases made by the aforementioned employee, including the items noted above. We further recommend that DNR refer all evidence of fraudulent or inappropriate purchases by this employee to the Office of the Attorney General's Criminal Division to determine what actions, if any, should be taken regarding this matter. We also recommend that DNR develop procedures to help ensure that all purchases, including items with individual prices below \$2,500, are made at competitive prices.

Audit Scope, Objectives, and Methodology

We have audited the Maryland Department of Natural Resources (DNR) for the period beginning January 7, 2004 and ending April 30, 2007. 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 DNR'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 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 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 those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including DNR.

Our audit scope was limited with respect to DNR's 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 DNR cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the bank's records.

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



Martin O'Malley, Governor
John R. Griffin, Secretary

July 30, 2008

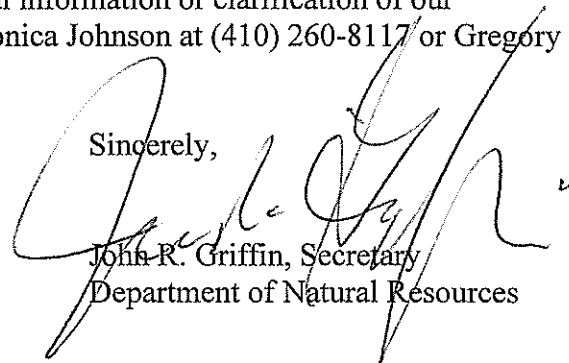
Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits
Room 1202
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Myers,

Thank you for your report and the effort that went into creating it. The report and the underlying discussion notes will be used for the purposes intended, as a means to improve our efficiency and effectiveness in serving the citizens of the State of Maryland.

Thank you also for granting us the two week extension to better prepare our response, which is enclosed. Should you need additional information or clarification of our response, please do not hesitate to contact Monica Johnson at (410) 260-8117 or Gregory Cunningham at (410) 260- 8384.

Sincerely,



John R. Griffin, Secretary
Department of Natural Resources

Special Funds

Finding 1

The Department of Natural Resources did not adequately account for certain special funds to ensure that funds were spent in accordance with statutory requirements.

Recommendation 1

We again recommend that DNR implement appropriate accounting policies to ensure that special fund expenditures are properly accounted for and to ensure that special funds are spent in accordance with the funds' enabling laws.

Department Response:

The Department agrees with the finding and related recommendation. The Department will work with OLA to determine a special fund accounting system adequate to address statutory requirements, by the adoption of a DNR policy by June 30, 2009.

Finding 2

DNR improperly retained funds totaling \$244,117 that should have been reverted to the State's General Fund.

Recommendation 2

We recommend that DNR comply with State law and revert the aforementioned funds to the State's General Fund.

Department Response:

The Department agrees with this finding and related recommendation. The subject funds were reverted during the financial close-out of fiscal year 2008.

Program Open Space

Finding 3

DNR awarded certain POS grants to local jurisdictions for indoor recreation projects that did not appear to be consistent with statutory restrictions on the funds.

Recommendation 3

We recommend that DNR refrain from using POS funds for indoor facilities unless an Opinion of the Attorney General is obtained supporting the use of the funds for indoor recreation projects.

Department Response:

The Department's counsel advises that while there is some basis in law for the Department's longstanding interpretation, on balance DNR should seek corrective legislation clarifying that the intent of the POS law extends to indoor recreational facilities that accommodate outdoor recreational activities. The Department will seek this corrective change in the 2009 legislative session. In the meantime, because there is a basis in law for the Department's interpretation, and so as not to interfere with local projects currently under development, DNR will continue to award POS grants to local jurisdictions for indoor recreation projects.

Land Trust Grant Fund

Finding 4

DNR loaned \$400,000 from the Land Trust Grant Fund to a private foundation which appears to be in violation of State law, and did not obtain required assurances that the land purchased with the loan would be used as intended.

Recommendation 4

We recommend that, in the future, DNR limit loans from the Land Trust Grant Fund to qualified land trusts unless an Opinion of the Attorney General is obtained supporting the use of these funds by non-qualified land trusts. We further recommend that DNR, in conjunction with MDE, immediately require the foundation to record a restrictive easement on the property and require the immediate recording of conservation easements for any future loans. Finally, we recommend that DNR include specific performance action clauses in loan agreements that provide sufficient legal remedies in the event that easements are not recorded.

Department Response:

As it did with this loan, DNR agrees in the future to limit loans from the Land Trust Grant Fund to qualified land trusts. A restrictive conservation easement is now recorded on the southern portion of the property and will be recorded on the northern part by the end of the year. In the future, MET will record conservation easements immediately unless precluded by financing requirements. As it did here, MET will continue to include clauses in loan agreements that provide sufficient legal remedies in the event easements are not recorded.

Public Land Leasing

Finding 5

DNR's public land leases were not adequately monitored to ensure that tenants complied with lease terms.

Recommendation 5

We recommend that DNR monitor leases to ensure that tenants are complying with lease terms and the proper amount of rent is collected from tenants.

Department Response:

The Department agrees the monitoring of our contractual land agreements has to be documented in order to demonstrate the land leases are being adequately monitored. We will document the monitoring process.

With respect to the audits of lease payments from contingent fee based contracts, the Department currently has nine revenue contingent leases. Of those nine, three are routinely audited by the Department's internal audit program. The internal audit program will re-evaluate the need to audit the other six revenue contingent fee based agreements and based on the risk and materiality associated with each, decide which ones should be added to the list of contingent fee based agreements subject to routine recurring audit. The assessment of risk and materiality will be completed by September 1, 2008 and modify the Annual Audit program accordingly.

Purchases and Disbursements

Finding 6

DNR improperly created certain purchase orders in violation of State policies and procedures.

Recommendation 6

We recommend that the DNR identify all improperly created purchase orders, review the propriety of the transaction, and take appropriate corrective action, including reverting any unspent funds to the State's General Fund. We also recommend that, in the future, DNR ensure that only valid purchase orders are created in accordance with the aforementioned State Policy.

Department Response:

The Department agrees with the finding and related recommendation. During the close-out of the FY 2008 budget, the Department will review prior and current year encumbrances to ensure they were properly created. If improperly created purchase orders are found, they will be cancelled and the associated funds processed in accord with State accounting procedures.

Purchases and Disbursements (continued)

Finding 7

Proper internal controls were not established over purchasing and disbursement transactions, and FMIS user security was not properly monitored.

Recommendation 7

We again recommend that DNR fully use the available FMIS security features by establishing independent online approval requirements for all critical purchasing and disbursement transactions. In addition, we recommend that individuals involved in the invoice payments not have the ability to redirect payments to vendors other than the vendor on the purchase order. We further recommend that DNR periodically monitor the system security status of its employees and ensure that duties are properly separated.

Department Response:

The Department agrees with this finding and related recommendation. We are altering the security of employees to require that initiation and approval of all purchase orders be segregated regardless of dollar amount; this will be completed by the end of 2008. We are participating in the state-wide committee to address the redirection of vendor payments and will implement the outcome of that effort. DNR will continue to periodically monitor FMIS user security and document this review.

Federal Funds

Finding 8

DNR did not maximize federal fund recoveries to offset State expenditures and, for one grant, did not document its methodology used to determine costs charged.

Recommendation 8

We recommend that DNR pursue recovery of the aforementioned federal fund expenditures and, in the future, ensure that federal funds are fully recovered in a timely manner. We further recommend that DNR document its methodology used to allocate expenditures to the aforementioned federal grant.

Department Response:

The Department agrees with this finding as related recommendation. The Department has already recovered the aforementioned federal funds. The Department will continue to attempt to bill federal grants within 30 days of monthly close-out. DNR will review its cost mythology with the subject federal agency.

Cash Receipts

Finding 9

Adequate controls were not established over cash receipts.

Recommendation 9

We recommend that DNR establish adequate procedures and controls over collections. Specifically, we recommend FAS employees verify that all collections are subsequently deposited using original source documents. In addition, we again recommend DNR record collections in FMIS timely and accurately. We also recommend that DNR ensure all voided transactions are properly documented and approved by supervisory personnel. Furthermore, we recommend that DNR obtain reimbursement from agents for any unsupported voided transactions, including the ones noted above. Finally, we again recommend that employees who maintain the accounts receivable records not have access to the related collections, and that DNR independently verify that all non-cash credit adjustments recorded to its accounts receivable records are properly supported and approved by appropriate supervisory personnel. We advised DNR on accomplishing the necessary separation of duties using existing personnel.

Department Response:

The Department agrees with the finding and related recommendations. FAS will create a check logging system for receipts from the units. This original source document will be used to verify all deposits. The DNR has implemented procedures to be used within the units to create check logs and verification of receipts. The Department will seek a formal exception from the Comptroller's policy to address the 2-day requirement. The Department will continue to independently verify all non-cash credit adjustments in its accounts receivable system.

With respect to the voided transactions and recovery of the funds from the license agents, we believe it would not be appropriate or cost effective to pursue the eleven agents involved for payment given: the error emanated from within the Department; the time that has lapsed since the error occurred, two years; and, the dollar amount, less than \$600. Further, to prevent a recurrence of this situation, in September 2006 the Department took corrective action to insure all voided transactions are properly documented and approved by supervisory personnel.

State Park Reservation System

Finding 10

DNR did not obtain annual independent audits of the State park reservation system and did not account for certain related revenues and expenditures.

Recommendation 10

We recommend that DNR require or obtain annual independent audits of the controls over its park reservation system to ensure that the contractor's controls and related policies and procedures are suitably designed and properly operating. We also recommend that DNR ensure that any significant deficiencies identified by

□

these audits are corrected and other findings, if any, are appropriately resolved. We further recommend that DNR perform monthly reconciliations of its park reservation clearing account and promptly investigate and resolve any differences.

Department Response:

The Department will contract an SAS 70 review for its State Park Reservation system and ensure any significant deficiencies are corrected and other findings appropriately resolved. Further, the Department will perform monthly reconciliations of its park reservation clearing account and promptly investigate and resolve any differences.

Payroll

Finding 11

Duties were not adequately separated over certain payroll processing functions.

Recommendation 11

We recommend that employees responsible for preparing and/or submitting documentation to remove terminated employees from the DNR payroll records not have access to related payroll checks. In addition, we recommend that DNR restrict access to critical automated payroll processing functions to prevent an individual from having access to initiate and approve payroll transactions.

Department Response:

The Department agrees with the finding and related recommendation. The Department will segregate duties between individuals processing employee cut-offs at the unit level and the pick-up and distribution of paychecks. The Department has already altered procedures for the initiation and approval of personnel transactions to address the second item.

Equipment

Finding 12

Adequate procedures and controls were not maintained over equipment.

Recommendation 12

We again recommend that DNR comply with the *Inventory Control Manual*. In addition, we recommend that DNR ensure that all equipment acquisitions, including the aforementioned ones, are recorded in the equipment inventory records.

Department Response:

The Department agrees with this finding and related recommendation. 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; (4) a review level over all disposals and deletions; and (5) physical inventories conducted consistent with DGS requirements and adjustment of records to reflect those inventories.

Questionable Purchases

Finding 13

A DNR employee purchased janitorial and maintenance supplies at excessively high prices from certain vendors.

Recommendation 13

We recommend that DNR take immediate action to investigate the propriety of purchases made by the aforementioned employee, including the items noted above. We further recommend that DNR refer all evidence of fraudulent or inappropriate purchases by this employee to the Office of the Attorney General's Criminal Division to determine what actions, if any, should be taken regarding this matter. We also recommend that DNR develop procedures to help ensure that all purchases, including items with individual prices below \$2,500, are made at competitive prices.

Department Response:

The Department agrees to audit for propriety the purchases identified by the auditors as excessively priced and take the appropriate corrective action, up to and including referring the matter to the Attorney General's Criminal Investigation Division, if warranted. To date the Department's internal audit manager notified the CID of the discussion note finding and advised them we would initiate an examination of the questionable expenditures and advise them accordingly. This audit is expected to be completed by September 1, 2008.

Lastly, as evidenced by the Department's website on the Intranet, our procurement procedures require competitive prices be obtained to the extent practical. The Department will look for other means to encourage compliance with these procedures.

AUDIT TEAM

Brian S. Tanen, CPA, CFE
Audit Manager

A. Jerome Sokol, CPA
Information Systems Audit Manager

Karen J. Howes
Senior Auditor

Catherine M. Clarke
MaryAnn F. Davenport
Terry S. Gibson
Michael A. Horvath
Yusef Ibrahim
Britta M. Street
Marva M. Sutherland
Keonna M. Wiley
Anthony M. Yancy
Staff Auditors

Amanda L. Trythall
Information Systems Staff Auditor

OTHER STAFF WHO CONTRIBUTED TO THIS REPORT

Richard L. Carter, CISA
David R. Fahnstock