Special Report

Statewide Review of Budget Closeout Transactions for Fiscal Year 2017

January 2018

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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January 24, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2017. Our review of closeout transactions disclosed general compliance with the applicable laws, regulations, and policies. However, we determined that certain transactions pertaining to the following agencies were not in compliance:

Department of General Services
Department of Information Technology
Department of Labor, Licensing, and Regulation
Maryland Department of Aging
Maryland State Department of Education

Additionally, we noted significant liabilities pertaining to the Maryland Department of Health at June 30, 2017.

A summary of our findings, by agency, is included in Exhibit 1.

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, one State agency recorded federal fund revenues totaling $6.8 million at fiscal year-end which are not likely to be recovered. General fund appropriations (or a deficiency appropriation) may be needed to eliminate the resulting deficit if the federal funds are not available.

Two other agencies inappropriately recorded certain fiscal year 2017 expenditures or encumbrances totaling approximately $1.5 million, which allowed the agencies to retain general fund appropriations that should have been cancelled and reverted

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to the State's General Fund. Furthermore, another agency improperly deferred $2.8 million in special fund revenues rather than recording accrued expenditures or encumbrances to retain the funds or reverting the funds to the General Fund.

Our review noted three state agencies or departments had reported a total of $61.7 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2017 (Exhibit 2). For example, one agency reported a liability of approximately $34.2 million attributable to the disallowance of certain claims by the federal government. A similar condition was reported in our reports on the review of the fiscal years 2016 and 2015 closeout transactions related to this agency. In addition, one other department did not report an additional unprovided for general fund payable totaling $2.6 million that related to fiscal year 2017 expenditures for which there was no available funding. The expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

The primary objective of this annual review is to alert the Maryland General Assembly to significant financial and budgetary closeout practices that do not comply with applicable laws, regulations, and policies and to determine if other significant liabilities existed at fiscal year-end. The issues identified during this review will be fully addressed, as appropriate, in our fiscal compliance audit reports on the applicable agencies, which will include relevant recommendations. We wish to acknowledge the cooperation extended to us during the course of our review by the Comptroller of Maryland's General Accounting Division and by the various State agencies.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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Background Information

The Comptroller of Maryland – General Accounting Division (GAD) annually provides State agencies with instructions for completing the fiscal year-end budget closeout process. State agencies individually report to GAD their fiscal year-end closeout transactions that have not been previously recorded in the State's accounting records. GAD is responsible for closing the State's accounting records on a statewide basis and for preparing the State's *Comprehensive Annual Financial Report (CAFR).*

GAD contracts with an independent accounting firm for the purpose of expressing an opinion on the State's basic financial statements contained in the *CAFR*. In its audit report dated December 15, 2017, applicable to the fiscal year ended June 30, 2017, the firm stated that the State's financial statements presented fairly, in all material respects, the respective financial position of the State of Maryland as of June 30, 2017, and the respective changes in the financial position and cash flows, for the year then ended in accordance with accounting principles generally accepted in the United States of America (referred to as GAAP).

The State's *CAFR* states that, on a budgetary basis, the General Fund had an unencumbered balance of approximately $258.6 million as of June 30, 2017. This represents a decrease of approximately $125.9 million from the balance reported at the preceding fiscal year-end ($384.5 million). The *CAFR* also states that the State Reserve (primarily the Revenue Stabilization Account) balance totaled $861.5 million as of June 30, 2017.

The budgetary General Fund balance does not reflect the effect of year-end GAAP adjustments made to the State's financial statements that were prepared on a modified accrual basis of accounting. Certain GAAP adjustments, if recognized on the budgetary basis, would have reduced the unencumbered budgetary General Fund balance of $258.6 million. For example, two GAAP adjustments reduced the Fund balance by $1.1 billion for income tax collections that that are owed to local jurisdictions as of June 30, 2017. These adjustments were a total of $290.3 million greater than similar adjustments made for the fiscal year 2016 *CAFR*. Other GAAP adjustments totaling $61.7 million were made for general fund liabilities incurred by State agencies during fiscal year 2017 for which general fund appropriations were not available to finance the expenditures at the time the adjustments were reported (see Exhibit 2).

Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2017. This review was conducted under the authority of the State Government Article, Section 2-1220 of the Annotated Code of Maryland.

The objective of our review was to determine whether budget closeout transactions, for the fiscal year ended June 30, 2017, were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies and to determine if other significant liabilities existed at fiscal year-end.

Our review consisted of tests of significant year-end transactions, based on our assessment of risk and materiality, for 18 Departments and independent agencies to ascertain if the transactions were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies and to determine if other significant liabilities existed at fiscal year-end. We reviewed, on a limited basis, transactions processed subsequent to June 30, 2017 to determine if the transactions were properly recorded (such as charged or credited to the proper fiscal year).

As part of our current review, we contacted various officials of State agencies. Our review excluded public colleges and universities and transactions processed through the Transportation Trust Fund because the related financial activity does not involve the State's General Fund and/or because agencies have the authority to retain unspent funds at year-end. Our conclusions for the aforementioned objective are contained on page 7 of this report.

We also assessed the status of the six issues (appearing in five findings) identified in our January 25, 2017 report entitled *Statewide Review of Budget Closeout Transactions for Fiscal Year 2016*. We determined four of the six issues were resolved. The remaining two issues are repeated in this report (see Exhibit 1).

Our review was limited to the procedures necessary to accomplish the aforementioned objective. These procedures did not constitute an audit conducted in accordance with generally accepted government auditing standards (GAGAS). Had we conducted an audit in accordance with GAGAS, those standards would require the issuance of recommendations as part of our reporting process. In addition, other matters may have come to our attention that would have been reported. We advised the appropriate agencies of our findings. Formal responses were not requested since this report contains no recommendations. Our fieldwork was conducted during the period from October 2017 to January 2018.

Findings

Conclusion
Our review of State agencies' budget closeout transactions disclosed that such transactions were generally properly supported and made in accordance with State budgetary laws, regulations, and accounting policies. However, we determined that five departments or agencies were not in compliance primarily because certain year-end transactions were not properly recorded, could not be substantiated, or did not comply with budget closeout requirements. Additionally, we determined that three agencies or departments had significant payables or liabilities at June 30, 2017 that may require general funds.

Revenue Transactions
One agency recorded unsubstantiated revenues to offset federal fund deficits. Specifically, the agency recorded federal fund revenues totaling approximately \$6.8 million to cover expenditures even though the revenues are not likely to be recovered. To the extent these funds are not received, general funds will likely be required to eliminate the deficits resulting from these transactions.

Expenditure Transactions
One agency improperly recorded general fund expenditures totaling \$528,000 to retain the related general fund appropriation. Specifically, the expenditures recorded did not represent fiscal year 2017 expenditures that had not been paid as of the fiscal year-end, but were instead recorded to retain appropriations for the future procurement of goods or services.

Encumbrances
One agency improperly encumbered \$931,000 in unused State grant funds that should have been reverted to the General Fund at the close of fiscal year 2017.

Deferred Revenues
One agency improperly deferred special fund revenues totaling \$2.8 million rather than recording accrued expenditures or encumbrances to retain the funds or reverting the funds to the General Fund.

Other Liabilities
Three State agencies or departments reported a total of \$61.7 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2017. For example, one agency, which had a similar issue in our two preceding closeout reports, may require general funds of approximately \$34.2 million to cover an unfunded liability attributable to the disallowance of certain claims. Furthermore, one other department had underreported its unprovided for

general fund payables, as it only reported approximately $900,000, but should have reported an additional $2.6 million.

According to an opinion of the Attorney General, unprovided for payables are not a violation of State law if the General Assembly enacts a budget bill for the subsequent year containing an appropriation that can be used to fund these expenditures.

A summary of our findings, by agency, is included in Exhibit 1.

Revenue Transactions

Finding 1
Federal fund revenues totaling approximately $6.8 million recorded by one agency at fiscal year-end are not likely to be recovered.

Analysis
The **Department of Labor, Licensing, and Regulation (DLLR)** had unsubstantiated accrued federal fund revenues totaling $6.8 million. These accrued revenues related to the recovery of DLLR's indirect costs to administer certain federal programs. Consequently, general funds (such as a deficiency appropriation) may be needed to the extent federal funds are not available for DLLR's indirect costs.

Accrued federal fund revenues totaling $10.1 million were reported by DLLR during the fiscal year 2017 closing process for indirect cost recoveries related to fiscal years 2014 through 2017. However, DLLR could not initially provide documentation supporting how this amount was derived. Subsequent to our inquiries, DLLR researched its grant activity and made correcting accounting entries that increased the amount of accrued federal funds for indirect costs due by $2 million. These correcting entries related to a portion of $3.5 million in federal funds held by DLLR but not yet distributed. DLLR originally believed this $3.5 million related to prior year indirect cost recoveries and reduced the federal funds revenue accrual by that amount. Subsequently, DLLR determined that $2 million of the $3.5 million was unrelated to indirect costs and consequently, the total amount of indirect costs due for reimbursement should have been $12.1 million as of June 30, 2017.

Based on information received from the U.S. Department of Labor (USDL), $6.8 million of the $12.1 million accrued federal fund indirect cost revenues will likely not be reimbursed (USDL correspondence does indicate that reimbursement for $5.3 million of these costs should be obtained by DLLR).

The recordation of unsubstantiated federal fund revenues was previously disclosed in our *Statewide Review of Budget Closeout Transactions for Fiscal Year 2016* dated January 25, 2017 and our fiscal compliance audit report of the DLLR's Office of the Secretary dated August 7, 2017.

Expenditure Transactions

Finding 2
One agency improperly recorded expenditures totaling $528,000 in order to retain general fund appropriations for the future procurement of goods and services.

Analysis
The **Maryland Department of Aging (MDOA)** improperly recorded general fund expenditure accruals totaling $528,000. This practice violated GAD's yearly closing instructions since the expenditure accruals did not represent actual expenditures for goods or services received during fiscal year 2017 that remained outstanding (or unpaid) as of fiscal year-end. Documentation provided by MDOA management indicated the intended uses for the related appropriations were to procure goods and services in future fiscal years for operational needs, such as a vehicle, office furniture, equipment and software, as well as potential future moving expenses. Consequently, the unspent appropriation should have been cancelled with the related funds being reverted to the State's General Fund.

Encumbrances

Finding 3
One agency improperly encumbered $931,000 in unused State grant funds that should have been reverted to the State's General Fund at year-end.

Analysis
The **Maryland State Department of Education (MSDE)** improperly encumbered unused State grant funds totaling $931,000 that should have been reverted to the General Fund. State grant funds awarded to local school systems that were subsequently returned to MSDE were not properly accounted for and reverted as part of the fiscal year 2017 closing process.

We were advised by MSDE management that these returned funds, which were received prior to the end of the fiscal year, were most likely due to MSDE audit findings and in the past would have been recorded as revenue so the funds would be reverted immediately and not create an available grant balance. However, the funds returned were instead recorded as a reduction of expenditures for the respective grants and improperly increased the grant balance by the amount of funds returned, which were then encumbered at fiscal year-end. These encumbrances were not cancelled prior to the completion of the fiscal year closing process resulting in the related unspent appropriation being improperly retained. Audits are conducted by MSDE to review the propriety of expenditures that were reimbursed with the related grant funds. Grant funds that were paid to reimburse any ineligible expenditures identified through these audits were required to be returned to MSDE.

During fiscal year 2018, MSDE took action to cancel most of these encumbrances but, as of January 4, 2018, the unspent general fund appropriation had not been cancelled.

Deferred Revenues

Finding 4
One agency improperly deferred special fund revenues totaling $2.8 million.

Analysis
The **Department of General Services (DGS)** recorded special fund deferred revenues totaling approximately $2.8 million, but could not provide supporting documentation to justify the recordation as deferred revenue. DGS management was able to provide explanations for some of these funds to be retained at year-end (such as unpaid obligations related to fiscal year 2017); however, none of the explanations justified these amounts being recorded as deferred revenues. GAD fiscal year-end closing instructions state that deferred revenue should be recorded only when revenue has been collected in the fiscal year, but will not be earned and recognized until the next fiscal year. The instructions further require that all fund balances carried over to the next fiscal year be done so in accordance with State statute, regulation, or policy.

Subsequent to our inquiries, DGS determined that certain of these transactions related to the payment of fiscal year 2017 obligations ($1.5 million) which, if true, should have been reported as an accrual or encumbrance, and that certain amounts ($1.3 million) should have been reverted to the General Fund.

For example, $1.6 million of these deferred revenues related to proceeds from its sale of surplus State property. State law does not specify that special fund revenues from these sales proceeds are to be retained in a non-lapsing fund, nor dedicate the revenues collected for any specific purpose. Accordingly, DGS did not have legal authority to retain the sales revenues (in excess of related charges incurred) collected during the year. Instead of reverting these to the General Fund, DGS retained the sales proceeds by classifying them as deferred revenues. DGS management explained the proceeds were recorded as deferred revenue due to the potential refund of some of these proceeds in fiscal year 2018; the transactions were subsequently resolved and approximately $900,000 is to be reverted to the State's General Fund.

Other Liabilities

Finding 5
Three agencies or departments reported a total of $61.7 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2017, although funding appears to be available for $8.9 million of the amount reported by one agency.

Analysis
Three agencies or departments reported a total of $61.7 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2017 (see Exhibit 2), although funding appears to be available for $8.9 million of the amount reported by one agency. With the exception of the $8.9 million, the expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

For example, the **Maryland Department of Health (MDH)** reported unprovided for general fund payables and other general fund liabilities totaling $58.2 million at June 30, 2017, including a liability to the federal government of approximately $34.2 million for disallowed claims related to **Developmental Disabilities Administration (DDA)** residential add-on services. Funding sources to pay this liability have not been identified. MDH reported the potential liability to GAD and, GAD recorded a decrease to the General Fund in the State's fiscal year 2017 *Comprehensive Annual Financial Report* to recognize these disallowances. The claims were disallowed by the federal Department of Health and Human Services – Office of the Inspector General in its June 2015 audit report, which recommended that DDA refund the overbilled amount to the federal government. DDA is disputing the disallowed claims. These disallowed federal fund claims were also commented upon in our two preceding budgetary closeout reports.

MDH also reported a $24.0 million liability to GAD related to estimated unprovided for general fund payables at fiscal year-end. Specifically, MDH indicated that based on its estimates, general fund appropriations would not be sufficient to cover outstanding Medicaid provider reimbursements for claims incurred during fiscal year 2017. The $24.0 million payable consisted of two **Medical Care Programs Administration** programs related to the reimbursement of Medicaid claims for medical providers ($8.9 million) and for behavioral health providers ($15.1 million), which are accounted for separately. Our review disclosed that, based on current Medicaid expenditure projections (as of December 2017), sufficient appropriations were available at year-end to fund any outstanding fiscal year 2017 claims by medical providers and that the $8.9 million unprovided for payable, originally projected, will not occur. This situation has been confirmed by GAD. However, there is still projected to be an unprovided for payable for claims related to the reimbursement of behavioral health providers. Consequently, general funds (such as a deficiency appropriation) may be needed to cover any outstanding fiscal year 2017 claims for this program.

Finding 6
One agency underreported its unprovided for general fund payables to the General Accounting Division by $2.6 million.

Analysis
The **Department of Information Technology (DoIT)** did not report to GAD an unprovided for general fund payable totaling approximately $2.6 million, as required by the GAD fiscal year-end closing instructions. Specifically, DoIT only reported approximately $900,000 in unprovided for payables at year-end; however, we determined that DoIT's actual unprovided for payables were underreported.

The additional $2.6 million in unprovided for general fund payables related to a retroactive compensation payment that was approved by the Board of Public Works (BPW) on July 26, 2017 for services provided in connection with *eMarylandMarketplace*, the State's online procurement system, for the period from January 2016 through July 2017. DoIT management explained that since the compensation to be paid to the vendor was not finalized until July 2017, they considered the payment to be a fiscal year 2018 expenditure. Therefore, it did not consider it necessary to report the unprovided for payable as required by the closing procedures. However, according to our review of available supporting documentation from the vendor, the total payment amount approved by BPW of approximately $3.6 million related to services provided prior to June 30, 2017. Since DoIT had received approximately $1.0 million in related revenues to partially offset the cost of this compensation payment, a general fund appropriation (or a deficiency appropriation) may be required to cover the remaining $2.6 million of these fiscal year 2017 expenditures.

Exhibit 1

Summary of Fiscal Year 2017 Closeout Review
Findings by State Agency

Agency	Finding Number	Finding Description
Department of Labor, Licensing, and Regulation	**1***	Recovery of $6.8 million in recorded federal fund revenues is not likely.
Department of Aging	**2**	Expenditure accruals totaling $528,000 were recorded to retain general fund appropriations for the procurement of future goods and services.
Maryland State Department of Education	**3**	Unused State grant funds totaling $931,000 were improperly encumbered instead of being reverted to the State's General Fund.
Department of General Services	**4**	Special fund revenues totaling approximately $2.8 million were improperly recorded.
Maryland Department of Health	**5***	Unprovided for general fund payables and liabilities of approximately $52.8 million may have to be funded with State general funds.
Department of Information Technology	**6**	An unprovided for general fund payable totaling $2.6 million was not reported, as required.

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

Exhibit 2

Schedule of June 30, 2017 Unprovided for General Fund Payables and Other Liabilities Reported to the General Accounting Division

Agency	Amount of Reported Unprovided for General Fund Payables / Other Liabilities As of June 30, 2017
Maryland Department of Health	$58,214,000
Office of the Public Defender	2,580,000
Department of Information Technology	903,000
Total	**$61,697,000**

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