Special Report

Statewide Review of Budget Closeout Transactions for Fiscal Year 2016

January 2017

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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January 25, 2017

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, 2016. 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 Aging
Department of General Services
Department of Labor, Licensing, and Regulation
Department of State Police
State Board of Elections

Additionally, we noted a significant liability pertaining to the Department of Health and Mental Hygiene at June 30, 2016.

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, two State agencies recorded federal fund revenues totaling $10.4 million at fiscal year-end; the recovery of these funds is uncertain. General fund appropriations (or deficiency appropriations) may be needed to eliminate the resulting deficits if the federal funds are not available.

Another agency inappropriately recorded certain fiscal year 2017 expenditures and related federal fund revenues as fiscal year 2016 activity. Furthermore, one agency had special fund receivables of $2.9 million that may not be collected due to insufficient program revenues, and another agency retained $968,000 of special funds that should have been reverted to the General Fund.

Our review noted four state agencies had reported a total of $42.3 million in unprovided for payables or other liabilities as of June 30, 2016 (Exhibit 2). The expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation). For example, one agency reported a federal liability of approximately $34.2 million attributable to the disallowance of certain claims by the federal government. A similar condition was reported in our report on the review of the fiscal year 2015 closeout transactions related to this agency.

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 highlight other liabilities that 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 7, 2016, applicable to the fiscal year ended June 30, 2016, 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, 2016, 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 $384.5 million as of June 30, 2016. This represents an increase of approximately $63.2 million from the balance reported at the preceding fiscal year-end ($321.3 million). The *CAFR* also states that the State Reserve (primarily the Revenue Stabilization Account) balance totaled $871.3 million as of June 30, 2016.

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 $384.5 million. For example, two GAAP adjustments reduced the Fund balance by $814.0 million for income tax collections that that are owed to local jurisdictions as of June 30, 2016. These adjustments were a total of $197.7 million smaller than a similar adjustment made for the fiscal year 2015 *CAFR*. Other GAAP adjustments totaling $42.3 million were made for liabilities incurred by State agencies during fiscal year 2016 for which general fund appropriations were not available to finance the expenditures (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, 2016. This review was conducted under the authority of the State Government Article, Section 2-1221 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, 2016, 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 for 22 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, 2016 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, as well as the independent accounting firm under contract with the State to express an opinion on its financial statements. 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 9 of this report.

We also assessed the status of the six issues (appearing in four findings) identified in our February 2, 2016 report entitled *Statewide Review of Budget Closeout Transactions for Fiscal Year 2015*. We determined that five of the six issues had been resolved. The sixth issue is 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 September 2016 to January 2017.

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 one agency had a significant liability at June 30, 2016 that may require general funds.

Revenue Transactions

Two agencies recorded unsubstantiated revenues to offset federal fund deficits. Specifically, the agencies recorded federal fund revenues totaling approximately $10.4 million to cover expenditures even though the agencies could not document that these funds would be received. To the extent these funds are not received, general funds will likely be required to eliminate the deficits resulting from these transactions.

Expenditure Transactions

Expenditures incurred during the first quarter of State fiscal year 2017 and related federal fund revenues were recorded as fiscal year 2016 activity by one agency.

Special Funds

One State agency had $2.9 million of special fund receivables that may not be collected due to insufficient program revenues, and another agency could not adequately demonstrate that it was entitled to retain special funds totaling $968,000 at fiscal year-end rather than reverting the funds to the General Fund.

Other Liabilities

Four state agencies reported a total of $42.3 million in unprovided for payables or other liabilities as of June 30, 2016. For example, one agency, which had a similar issue in our fiscal year 2015 closeout report, may require general funds of approximately $34.2 million to cover an unfunded federal liability attributable to the disallowance of certain claims. 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
The recovery of recorded federal fund revenues totaling approximately $10.4 million is uncertain.

Analysis
The **Department of Labor, Licensing, and Regulation (DLLR)** and the **State Board of Elections (SBE)** could not substantiate their ability to collect revenues of approximately $9.9 million and $523,000, respectively, as of June 30, 2016. If these agencies are unable to recover these funds, general funds may be needed to eliminate the resulting deficits.

<u>DLLR</u>
DLLR recorded unsubstantiated federal fund revenues totaling approximately $9.9 million. These federal fund revenues related to receivables recorded for indirect costs to be recovered associated with several federal programs administered by DLLR during fiscal years 2014, 2015, and 2016. Officials at DLLR could not provide any documentation supporting how these amounts were determined or what amount of the respective recorded revenues may eventually be received. According to DLLR, it has been experiencing significant delays in obtaining approval from the U.S Department of Labor for these reimbursement rates due to significant turnover at the federal agency. Because of the length of the reimbursement delays, the extent to which the amounts outstanding will be received is uncertain.

As of January 10, 2017, DLLR had received federal approvals for the reimbursement rates for indirect costs through fiscal year 2015 (which was approved by the U.S. Department of Labor on May 9, 2016). However, none of these indirect cost recovery revenues related to these rates had been collected. According to DLLR management, it is in the process of working with the U.S. Department of Labor to recover past costs and obtain approval for the reimbursement rate that is required to recover these indirect costs for 2016. If federal funds are not available for these amounts, general fund appropriations (or deficiency appropriations) may ultimately be needed to eliminate uncollectible indirect costs.

<u>SBE</u>
SBE recorded federal fund revenue totaling $523,000 to offset a deficit balance in a related federal fund source. However, all of these revenues may not be received from the federal government. SBE management explained that these revenues related to funds received in a prior year as part of the Help America Vote Act that

had been recorded as special fund revenues and retained by SBE rather than being recorded as federal funds and used to offset related expenditures. As of June 30, 2016, SBE had a remaining special fund balance of $181,000 under its Help America Vote Act program, and claimed that other funds may be available to help offset the $523,000 receivable. Therefore, general fund appropriations (or deficiency appropriations) may ultimately be needed to eliminate any remaining deficit.

Expenditure Transactions

Finding 2
Expenditures incurred during the first quarter of State fiscal year 2017 and related federal fund revenues were recorded as fiscal year 2016 activity by one agency.

Analysis
The **Maryland Department of Aging (DOA)** improperly recorded expenditures and related federal fund revenues for the first quarter of fiscal year 2017 (that is, July 1, 2016 to September 30, 2016) as State fiscal year 2016 activity. This included actual and projected revenues and expenditures for the first quarter of State fiscal year 2017.

We sighted multiple examples of the payment of invoices from local jurisdictions related to the period from July 1, 2016 to September 30, 2016 that were charged as State fiscal year 2016 expenditures. During the fiscal year 2016 closing, DOA recorded $17.7 million and $19.2 million in federal fund revenues and expenditures, respectively. Based on an analysis prepared by DOA at our request, $6.1 million of the expenditures recorded during the fiscal year closing related to fiscal year 2017 activity.

According to agency management, these revenues and expenditures were recorded to reflect anticipated financial activity related to federal grants that were awarded on a Federal fiscal year basis (which ends on September 30). Management also represented that similar transactions were recorded during the prior fiscal year-end. This practice may result in revenues and expenditures for any given State fiscal year to be misstated for budgetary reporting purposes.

The Comptroller of Maryland – General Accounting Division's closing instructions state that accrued revenues should be recorded only when related goods and services have been provided prior to July 1st; however, billings for the revenue have not been prepared or submitted for collection. Furthermore, the instructions state that accrued expenditures should be recorded only when related goods and services have been received prior to July 1st; however, the related invoices have not been received or paid. Therefore, accrued revenues and accrued expenditures should not include activity related to revenues and expenditures related to goods and services that are provided or received after June 30 since these relate to following fiscal year.

Special Funds

Finding 3
One agency had outstanding special fund accounts receivables totaling $2.9 million that may not be collected due to revenues being less than projected in a certain program.

Analysis
The **Maryland Department of State Police (DSP)** recorded special fund accounts receivable transactions for costs intended to be reimbursed by revenue distributions from the Work Zone Automated Speed Enforcement Program (or SafeZones Program); however, it appears that actual revenues generated by the program were not sufficient to cover these costs resulting in $2.9 million of receivables that may not be collected.

Work zone speed camera revenues generated from issued citations are initially collected by the Department of Transportation – State Highway Administration (SHA). After reimbursement of program costs for all involved State agencies and payments to the vendor that administers the speed cameras, any revenues remaining are distributed to DSP in accordance with State law. Specifically, according to Transportation Article, Section 12-118 of the Annotated Code of Maryland, after covering the actual operating costs of both DSP and SHA in administering this program, at least $7 million was to be distributed to DSP during each fiscal year 2016 through 2018 for the replacement of vehicles and related equipment. However, according to DSP agency management, revenues under the program were less than anticipated which resulted in reduced distributions to DSP.

As of January 10, 2017, the total outstanding amount due to DSP as of June 30, 2016 was $4.7 million. Furthermore, DSP management anticipated using revenues generated during subsequent fiscal years to offset this receivable balance; however, there have been no funds distributed for amounts due for fiscal year 2016 from SHA to DSP since May 2016. According to SHA management, in relation to the outstanding amount due for fiscal year 2016, SHA anticipates reimbursing DSP approximately $300,000 for personnel costs related to the program and an additional $1.5 million in revenue distributions pending approval from the Department of Budget and Management. General funds (or deficiency appropriations) may ultimately be needed to eliminate any remaining deficit ($2.9 million).

Finding 4
One agency did not revert special fund revenues totaling approximately $968,000 to the State's General Fund at year-end.

Analysis
The **Department of General Services (DGS)** recorded deferred revenue totaling approximately $968,000 to avoid reverting certain accumulated and unspent special fund revenues.

State law allows for the collection of an administrative fee from bidders for the use of electronic means to conduct procurements with the State if the Board of Public Works approves the fee. In August 2011, DGS received approval from the Board of Public Works to collect fees on these types of procurements to pay for the costs incurred to operate the *eMaryland Marketplace* system. However, the law does not specify that the special fund revenues from these fees are to be retained in a nonlapsing fund, nor dedicate the fees collected for any specific purpose. Accordingly, DGS did not have legal authority to retain the excess fees collected during the year. Instead of reverting to the general fund fees collected in excess of costs incurred, DGS retained the excess funds by classifying them as deferred revenues to offset future years' costs.

The Comptroller of Maryland – General Accounting Division's 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. However, DGS could not document that these deferred revenues were being carried forward in accordance with State statute, regulation, or policy. Furthermore, DGS could not document that these funds were necessary to pay specific costs and expenditures associated with *eMaryland Marketplace* for fiscal year 2016. In addition, the Department of Budget and Management advised us that DGS should have reverted these year-end balances to the General Fund, rather than recording deferred revenue.

Other Liabilities

Finding 5
Four agencies reported a total of $42.3 million in unprovided for payables or other liabilities as of June 30, 2016.

Analysis
Four agencies had a total of $42.3 million in unprovided for payables or other liabilities as of June 30, 2016 (see Exhibit 2). The expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

For example, the **Department of Health and Mental Hygiene (DHMH)** had unprovided for payables and other liabilities totaling $34.7 million at June 30, 2016 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. DHMH reported the potential liability to GAD and, GAD recorded a decrease to the General Fund in the State's fiscal year 2016 *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. Disallowed federal fund claims were also commented upon in our preceding budgetary closeout report.

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.

Exhibit 1

Summary of Fiscal Year 2016 Closeout Review
Findings by State Agency

Agency	Finding Number	Finding Description
Department of Labor, Licensing, and Regulation	**1**	Recovery of $9.9 million in recorded federal fund revenues is uncertain
State Board of Elections	**1**	$523,000 in federal fund revenues were recorded even though related federal funds may not be available
Maryland Department of Aging	**2**	Certain fiscal year 2017 expenditures and related federal fund revenues were recorded as fiscal year 2016 activity
Maryland Department of State Police	**3**	Special fund receivables totaling $2.9 million may not be collected due to insufficient program revenue
Department of General Services	**4**	Special fund revenues totaling approximately $968,000 were not reverted to the State's General Fund at year-end
Department of Health and Mental Hygiene	**5***	A federal liability of approximately $34.2 million may have to be funded with State general funds

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

Exhibit 2

Schedule of June 30, 2016 Unprovided for General Fund Payables and Other Liabilities Reported to the General Accounting Division

Agency	Amount of Reported Unprovided for Payables / Other Liabilities As of June 30, 2016
Department of Health and Mental Hygiene	$34,661,369
Office of the Public Defender	5,216,698
Maryland Health Benefit Exchange	1,533,761
Department of State Police	925,582
Total	**$42,337,410**

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