Special Report

Statewide Review of Budget Closeout Transactions for Fiscal Year 2011

January 2012

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
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January 18, 2012

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, 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, 2011. 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:

Maryland State Department of Education
Department of Health and Mental Hygiene
Department of Human Resources
Department of Public Safety and Correctional Services
Department of State Police
Department of Veterans Affairs

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, accrued federal fund revenues totaling $25.5 million were identified for which general fund appropriations (or deficiency appropriations) will be needed to eliminate the resulting deficits since federal fund revenues are not available. A summary of our findings, by agency, is included in Exhibit 1.

Three State agencies reported a total of $166.1 million in unprovided for payables as of June 30, 2011 (Exhibit 2). Our review disclosed additional unprovided for payables related to one State agency, totaling $7.5 million, which had not been reported. The expenditures related to these unprovided for payables will have to be funded with subsequent year appropriations (or through a deficiency appropriation). According to an opinion of the Attorney General, this is 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.

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The agencies identified in this report generally agreed with our findings, although for Finding 7 the Department of Public Safety and Correctional Services believes it met the intent of the law. The primary purpose 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. The issues identified during this review, as well as relevant recommendations, will be fully addressed, as appropriate, in our fiscal compliance audit reports on the applicable agencies. 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,

Bruce A. Myers

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

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 closing 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, 2011, applicable to the fiscal year ended June 30, 2011, the firm stated that the State's basic financial statements presented fairly, in all material respects, the respective financial position of the State of Maryland as of June 30, 2011, and the respective changes in the financial position and cash flows, for the year then ended in conformity 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 $990.1 million as of June 30, 2011. This represents an increase of approximately $646.1 million from the balance reported at the preceding fiscal year-end ($344.0 million). The *CAFR* also states that the State Reserve (Revenue Stabilization Account) balance totaled $629.2 million as of June 30, 2011.

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. The net effect of the GAAP adjustments recorded for fiscal year 2011, if they had been recognized on a budgetary basis, would have been to reduce the aforementioned unencumbered budgetary General Fund balance of $990.1 million. For example, year-end GAAP adjustments included $166.1 million recorded for liabilities incurred by State agencies during fiscal year 2011 for which general fund appropriations were not available to finance the expenditures (see Exhibit 2). Other GAAP adjustments that would have reduced the budgetary General Fund balance included an estimated $144.5 million additional liability for the State's share of Medicaid costs for services rendered during fiscal year 2011 and a $228.3 million reduction for State and local income tax collections that were recorded as revenue for fiscal 2011 but were applicable to future fiscal years.

Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2011. 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, 2011, were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies.

Our review consisted of tests of significant year-end transactions for 21 Departments and independent agencies to ascertain if the transactions were properly supported and made in accordance with State budgetary laws, regulations, and accounting policies. We also reviewed, on a limited basis, transactions processed subsequent to June 30, 2011 to determine if the transactions were properly recorded (such as charged or credited to the proper fiscal year). Also, we assessed the status of the findings identified during our review of the budget closeout transactions for the fiscal year ended June 30, 2010, which were reported to the Joint Audit Committee in a special report dated January 24, 2011. 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. Our follow-up review of the four findings from the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2010* determined that none of these findings have been satisfactorily resolved. These findings are presented in three findings in this report.

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. Our fieldwork was conducted during the period from August 2011 to January 2012.

Findings

Closeout Transactions

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 six departments or units thereof were not in compliance primarily because certain year-end transactions were not properly recorded, could not be substantiated, or did not comply with budget law requirements or intent.

Revenue Transactions

Three State agencies recorded accrued federal fund revenues totaling $25.5 million even though related federal funds were not available. In addition, accrued special fund revenues for one State agency, totaling approximately $7.0 million, had been recorded although collection of this revenue appears questionable. Finally, one State agency maintained a special fund deficit balance of $5.2 million as a result of an improper closing transaction recorded in a prior year. The use of general funds will likely be required to eliminate the deficits resulting from these transactions.

Expenditure Transactions

One State agency did not properly report unfunded liabilities totaling $7.5 million to GAD as required.

Other Issues

Two agencies could not support year-end entries that enabled them to retain funds totaling $16.5 million that otherwise would have been reverted to the General Fund. Another State agency did not revert approximately $1.5 million in excess revenues to the General Fund in accordance with budgetary intent. Finally, one State agency could not demonstrate that its use of health insurance appropriations was consistent with budgetary law provisions, which resulted in $700,000 being used for purposes other than health insurance.

A summary of our findings, by agency, is included in Exhibit 1 on page 17 of this report.

Revenue Transactions

Finding 1
Accrued federal fund revenues totaling approximately $25.5 million were recorded even though related federal funds were not available.

Analysis
The **Maryland State Department of Education (MSDE)**, the **Department of Human Resources (DHR)**, and the **Department of Veterans Affairs (DVA)** recorded federal fund revenues of approximately $12.9 million, $9.6 million, and $3.0 million, respectively, even though federal funds were not available. These revenues related to unreimbursed federal fund expenditures for several federal programs. Since revenues are not available for these accruals, which were recorded to cover federal fund expenditures that had previously been incurred, general fund appropriations in subsequent years (or deficiency appropriations) will be needed to eliminate the resulting deficit.

MSDE
MSDE accrued revenue for a federal fund receivable totaling approximately $12.9 million for which MSDE failed to recover expenditures incurred during fiscal years 2002 and 2003 in relation to the Temporary Assistance to Needy Families (TANF) grant. DHR, which processes the federal fund recoveries, advised us that the TANF federal fund grants for those years have already been fully used and are no longer available to reimburse the MSDE expenditures. MSDE personnel informed us that a deficiency appropriation has been requested to cover the outstanding $12.9 million deficit. This issue has been commented upon in our five preceding annual budget closeout reports.

DHR
DHR accrued revenue for a federal fund receivable totaling approximately $9.6 million related to disallowances by the United States Department of Health and Human Services (DHHS), which DHR was informed of in fiscal year 2009. The disallowances, related to certain Title IV-E grant expenditures from the quarters ended September 30, 2008 and December 31, 2008, were principally based on a lack of a Title IV-E foster care pre-placement provision in DHR's cost allocation plan. DHR appealed the disallowances and, effective October 10, 2010, entered into a settlement agreement with DHHS to resolve all outstanding appeals related to these disallowances. Under the agreement, DHR will not be reimbursed by the federal government for the $9.6 million of disallowances, which will therefore need to be paid with State general funds. This issue has been commented upon in our two preceding annual budget closeout reports.

DVA

The Comptroller of Maryland – General Accounting Division (GAD) accrued federal fund revenues, on behalf of DVA, totaling approximately $3.0 million. According to GAD, these revenues were recorded to eliminate deficit balances at June 30, 2011 that existed in several federal programs due to unreimbursed federal fund expenditures that had been incurred. Officials at DVA and GAD could not provide any documentation supporting that the respective accrued revenues would be received. Furthermore, we were advised by DVA that the $3.0 million would not be collected; therefore, a deficiency appropriation will be needed to eliminate these deficits.

GAD was aware of these unavailable federal fund receivables totaling $25.5 million, which were recorded as a decrease to general fund revenue by GAD in the State's fiscal year 2011 *Comprehensive Annual Financial Report*. Nevertheless, general funds are needed to offset the expenditures incurred.

Finding 2
Accrued special fund revenues totaling approximately $7.0 million could not be substantiated.

Analysis

The **Department of Health and Mental Hygiene (DHMH) – Medical Care Programs Administration (MCPA)** accrued special fund revenues totaling approximately $7.0 million which could not be substantiated. These special funds are generated from quality assessment fees collected from nursing home facilities. If revenues are not available for these accruals, which were recorded to cover expenditures that had been previously incurred, general fund appropriations (or deficiency appropriations) will be needed to eliminate the resulting deficits. According to DHMH, any resulting deficits are generally covered using special fund revenues generated during future years.

Our review of State records disclosed that, as of the 2011 fiscal year-end, MCPA had special fund revenues and expenditures totaling approximately $57.9 million and $89.8 million, respectively. During the fiscal year-end closing, MCPA recorded $31.9 million in accrued special fund revenue, which represented the remaining revenue required to cover the related expenditures that had been incurred. However, DHMH was unable to provide us with adequate supporting documentation to indicate that this amount of revenues would be received. As of December 2011, MCPA had only received approximately $82.8 million in special fund revenues related to the fiscal year 2011 nursing home facility quality assessments, resulting in a deficit of approximately $7.0 million for this program. GAD requires that detailed documentation be maintained to identify the specific sources for all accrued revenues recorded as part of the year-end closing process.

Subsequently, DHMH advised us that it had identified a total of $3.6 million that may be assessed to specific facilities, but indicated that collection of the assessments may be an issue.

Finding 3
A general fund deficiency appropriation may be required to eliminate a special fund deficit balance of $5.2 million.

Analysis
The **Department of State Police (DSP)** may require a general fund deficiency appropriation to eliminate a special fund deficit balance totaling $5.2 million that existed as of June 30, 2011. Specifically, DSP mistakenly recorded certain transactions as both accrued revenue and actual revenue during fiscal year 2005. This resulted in a special fund surplus of $5.6 million being reflected in the records. DSP then transferred what appeared to be excess funds to the general fund during the fiscal year 2005 closeout since it did not have legal authority to retain any remaining balance in this special fund. When this mistake was discovered during fiscal year 2006, DSP was left with a special fund deficit balance of $5.6 million at the end of fiscal year 2006 due to the transfer of the apparent surplus to the general fund and the subsequent automatic reversal of the previously recorded accrued revenue transaction at the beginning of fiscal year 2006. Since fiscal year 2006, excess revenues of $400,000 were retained in the fund, which reduced the negative balance to the current $5.2 million. DSP attempted to obtain a deficiency appropriation in 2011; however, the deficiency appropriation has not been approved. This issue has been commented upon in our five preceding annual budget closeout reports.

Expenditure Transactions

Finding 4
Unfunded year-end liabilities totaling approximately $7.5 million were not reported to the Comptroller of Maryland – General Accounting Division (GAD).

Analysis
The **Maryland State Department of Education (MSDE)** did not report unfunded year-end general fund liabilities of approximately $7.5 million to GAD, as required. General fund appropriations in subsequent years (or deficiency appropriations) may be needed to eliminate these liabilities.

Of the $7.5 million in unfunded liabilities, $3.1 million related to amounts due to the Department of Health and Mental Hygiene (DHMH) for certain expenditures incurred by DHMH on MSDE's behalf. Specifically, at the end of fiscal year 2011, MSDE had not reimbursed DHMH for payments to medical providers made by DHMH during fiscal year 2011. MSDE did not have sufficient appropriations to fund the entire amount due. In this regard, there were outstanding invoices for $6.2 million, but MSDE's remaining appropriation balance, which it applied towards these expenditures, was only $3.1 million MSDE failed to estimate and report the remaining unfunded liabilities to GAD during the fiscal year 2011 budget closeout process, which totaled approximately $3.1 million ($6.2 million less $3.1 million in accrued expenditures). According to MSDE, this has been a recurring issue and, historically, appropriations from the subsequent fiscal year are used to fund the expenditures of the preceding fiscal year. This issue was also commented upon in our preceding budget closeout report.

The remaining unfunded liabilities totaling $4.4 million related to contractual expenditures for assessment testing performed during fiscal year 2011. Our testing of expenditures recorded during July and August 2011 disclosed six instances where expenditures incurred during fiscal year 2011 were charged against fiscal year 2012 appropriations. According to MSDE, we were informed that sufficient appropriations from fiscal year 2011 were not available to pay for these remaining expenditures. MSDE also failed to report these unfunded liabilities to GAD during the fiscal year 2011 budget closeout process.

Other Issues

Finding 5
Two DHMH agencies could not demonstrate the appropriateness of certain transactions processed at year-end to retain funds that otherwise would have been reverted to the General Fund.

Analysis
The **Department of Health and Mental Hygiene – Developmental Disabilities Administration (DDA)** and **Alcohol and Drug Abuse Administration (ADAA)** could not demonstrate the appropriateness of certain journal entries recorded at the 2011 fiscal year-end, which charged their general fund appropriations for expenditures previously charged to their federal fund appropriations. Furthermore, during the subsequent fiscal year, both agencies processed entries to reverse the initial journal entries, thereby reinstating the amounts as federal fund expenditures. It appears the year-end entries were processed to allow the agencies to retain fiscal year 2011 funds totaling $16.5 million that would have otherwise been reverted at June 30, 2011 as unexpended general fund appropriations.

Specifically, we noted the following conditions:

- During the 2011 fiscal year-end closing, DDA recorded a journal entry to charge approximately $12.6 million, which had originally been charged as federal fund expenditures, to its general fund appropriations. The propriety of this transaction could not be substantiated in that documentation was not available to support, for example, that the original charges against DDA's federal fund appropriation were improper. As a result of these entries, federal fund expenditures on the State's accounting records would not correspond with the amount of federal funds actually received. Our review also disclosed a number of other transfers performed near year-end that reallocated expenditures between federal funds and general funds for which DDA and DHMH were unable to provide adequate supporting documentation to substantiate their propriety.

  DHMH and DDA believe that Chapter 482, 2010 Laws of Maryland, allowed DDA to charge general funds first in cases where federal funds could be carried forward for the purpose of reducing the waiting list for community services for individuals with developmental disabilities. However, DDA had not established a plan as to how the $12.6 million would be used to reduce the waiting list when the transfer was recorded. Furthermore, federal requirements typically require federal expenditures to be recognized to support reimbursements received.

- During the 2011 fiscal year-end closing, ADAA transferred approximately $3.9 million, which had originally been charged as federal fund expenditures to its general funds appropriations. ADAA advised us that since it had not expended all appropriated general funds at fiscal year-end, the entry was recorded to eliminate the remaining general fund appropriation by shifting certain federal fund expenditures to general funds. Chapter 482, 2010 Laws of Maryland generally requires that, when expenditures can be charged to either general or federal fund sources, federal funds should be charged first.

Finding 6
The Department of State Police did not revert $1.5 million in excess revenues generated from work zone speed camera citations to the General Fund in accordance with budgetary law intent.

Analysis
The **Department of State Police (DSP)** did not revert approximately $1.5 million in excess revenues generated from work zone speed camera citations as directed in the budget law. The collected revenues that were not reverted were being held at June 30, 2011 by the agency that initially receives the revenues, the Department

of Transportation – State Highway Administration (SHA). The interagency responsibilities for this program may have contributed to the revenues not being fully reverted. Chapter 482, 2010 Laws of Maryland, directed that an equivalent amount of general funds be reverted from DSP for any special fund revenues earned from work zone speed camera citations in excess of $5 million. As of June 30, 2011, since the start of the speed camera program, revenues ($19,620,355) have exceeded expenditures ($6,073,228) by $13,547,127. Accordingly, DSP should have reverted $8,547,127 ($13,547,127 less $5 million allowance) to the General Fund. However, DSP had only reverted $7,086,746 to the General Fund for excess revenues from the program. DSP management advised us that the amount reverted was based on DSP's working appropriation at fiscal year-end closing and not actual revenues.

Work zone speed camera revenues are initially collected by SHA. After reimbursement of program costs for all involved State agencies and payments to the vendor that administers the speed cameras, any remaining revenues are distributed to DSP. Under a memorandum of understanding between SHA, DSP, and other related agencies, SHA is required to transfer any remaining balance of revenue under this program to DSP on an annual basis (until October 1, 2012).

Finding 7
The Department of Public Safety and Correctional Services appears to have used health insurance appropriations for other than intended purposes, contrary to budgetary law.

Analysis
The **Department of Public Safety and Correctional Services (DPSCS)** appears to have used health insurance appropriations for other than intended purposes, contrary to budgetary law. Chapter 482, 2010 Laws of Maryland, requires that funds appropriated to various State agency programs and subprograms for State employee and retiree health insurance premiums be used for their intended purposes only and that any unused health insurance appropriations be transferred to the State Employees and Retirees Health and Welfare Benefits Fund (SERHWBF). Furthermore, the law specifies that the use of these appropriations for any purpose other than their intended purpose requires the prior approval of the Secretary of the Department of Budget and Management (DBM) and a budget amendment approved by the Governor, neither of which was obtained.

According to State records, DPSCS as a department had unexpended health insurance appropriations totaling approximately $8.4 million and transferred this amount to the SERHWBF. However, we determined that certain DPSCS units used health insurance appropriations for other purposes. For example, DPSCS' Division of Parole and Probation and Information Technology and

Communications Division had unexpended health insurance appropriations totaling $2.1 million, yet only $1.4 million were transferred to the SERHWBF, indicating that $700,000 was used for something other than health insurance. Other DPSCS agencies transferred additional funds to the SERHWBF to compensate for these agencies not transferring all unexpended health insurance appropriations.

DPSCS management advised us that, according to guidance from DBM and the Comptroller of Maryland – General Accounting Division (GAD), DPSCS was allowed to reallocate unexpended appropriations to eliminate deficits in its other programs as long as it transferred the cumulative amount of unexpended general fund health insurance appropriations for the Department as a whole. However, without a budget amendment, this practice appears contrary to budgetary law intent since it allows DPSCS to use health insurance appropriations for other purposes and use unexpended general fund appropriations that may have otherwise been subject to reversion to the General Fund.

Exhibit 1

Summary of Fiscal Year 2011 Closeout Review Findings by State Agency

Agency	Finding Number	Finding Description
Maryland State Department of Education	**1**	$12.9 million in unsubstantiated federal fund accrued revenues were recorded.
	4	$7.5 million of unfunded year-end liabilities were not reported to GAD as required.
Department of Health and Mental Hygiene	**2**	$7.0 million in unsubstantiated special fund accrued revenues were recorded.
	5	$16.5 million charged to general funds instead of available federal funds.
Department of Human Resources	**1**	$9.6 million in unsubstantiated federal fund accrued revenues were recorded.
Department of Public Safety and Correctional Services	**7**	$700,000 of health insurance appropriations appear to have been used for purposes other than intended under budgetary law.
Department of State Police	**3**	$5.2 million special fund deficit balance exists.
	6	$1.5 million in revenues were not reverted as intended under budget law.
Department of Veterans Affairs	**1**	$3.0 million in unsubstantiated federal fund revenues were recorded.

Exhibit 2

Schedule of Unprovided for General Fund Payables According to the General Accounting Division

Agency	Amount of Reported Unprovided for Payables
Department of Health and Mental Hygiene	$137,349,919
Department of Human Resources	19,452,625
Maryland Higher Education Commission	9,248,945
Total	**$166,051,489**

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