Special Report

# Statewide Review of Budget Closeout Transactions for Fiscal Year 2008

January 2009

**OFFICE OF LEGISLATIVE AUDITS**
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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MARYLAND GENERAL ASSEMBLY

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January 16, 2009

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Verna L. Jones, 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, 2008. 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 Human Resources
Department of State Police

Generally, the non-compliant transactions we identified suggest that additional State funds may be required to eliminate potential deficits. For example, accrued revenues totaling $18.2 million could not be substantiated. If the revenues are not available for these accruals, general fund appropriations (or deficiency appropriations) may ultimately be needed to eliminate the resulting deficits. A summary of our findings, by agency, is included in Exhibit 1.

Six State agencies reported a total of $15.2 million in unprovided for payables as of June 30, 2008 (Exhibit 2). This situation means that the related expenditures will have to be funded with subsequent year appropriations. 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.

The agencies identified in this report generally agreed with our findings. 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 the Treasury – General Accounting Division and by the various State agencies.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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

# Background Information

The Comptroller of the Treasury – 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 12, 2008, applicable to the fiscal year ended June 30, 2008, 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, 2008, 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 the General Fund, on a budgetary basis, had a balance of approximately $1.4 billion as of June 30, 2008. This amount represents a decrease of approximately $700 million from the balance reported at the preceding fiscal year-end ($2.1 billion).

# Introduction, Objectives, and Scope

We conducted a review of the State's budget closeout transactions for the fiscal year ended June 30, 2008. 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, 2008, 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 15 Departments and independent agencies to ascertain if they 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, 2008 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, 2007, which were reported to the Joint Audit Committee in a special report dated January 28, 2008. 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 closeout transactions from the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2007* disclosed that two of the exceptions are repeated in this report, while two findings were satisfactorily addressed by the applicable agencies. The status of Federal audit disallowances of Medicaid expenditures incurred by local education agencies is also repeated and updated.

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 September 2008 to January 2009.

# 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 three departments or units thereof were not in compliance primarily because certain year-end transactions either were not properly recorded or could not be substantiated.

**Revenue Transactions**

Three State agencies could not substantiate certain revenue transactions totaling $18.2 million. That is, the agencies could not provide evidence that they were entitled to receive federal, special, or reimbursable funding for the specific expenditures incurred. To the extent that these funds are not received, the resulting deficits would likely require the use of general funds. In addition, one State agency maintained a deficit special fund balance of $5.5 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 deficit.

A summary of our findings, by agency, is included in Exhibit 1 on page 14 of this report.

## Revenue Transactions

**Finding 1**
**Accrued federal, special, and reimbursable fund revenues totaling approximately $18.2 million could not be substantiated.**

**Analysis**
The **Maryland State Department of Education (MSDE),** the **Department of Human Resources (DHR**), and the **Department of State Police (DSP)** recorded unsubstantiated revenues of approximately $13.3 million, $2.9 million, and $2 million, respectively. 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) may ultimately be needed to eliminate the resulting deficit. These conditions had been commented upon in our five preceding annual budget closeout reports for DHR and were commented upon in our two preceding annual budget closeout reports for MSDE and DSP.

<u>MSDE</u>
MSDE recorded unsubstantiated federal fund revenues totaling $13.3 million at June 30, 2008 related to the federal Temporary Assistance to Needy Families (TANF) grant. This accrued revenue (that is, federal fund receivable) relates to MSDE's failure to recover TANF grant expenditures incurred during fiscal years 2002 and 2003. DHR, which processes the federal fund recoveries, advised that the TANF federal fund grants for those years have already been fully used and are no longer available to reimburse the MSDE expenditures. During our fiscal year 2007 closeout review, we reported that MSDE used $2.1 million in general fund recoveries from MSDE's State aid audit process to reduce the TANF deficit from $15.4 million to $13.3 million. It was also noted that MSDE had accumulated another $2.1 million in recoveries during the first half of fiscal year 2008 to apply to the deficit. In our fiscal year 2007 closeout report, we stated that, because the revenues represented the return of general fund monies, the revenues should have been recorded as general fund revenues. During the current closeout review, we noted that MSDE ceased applying general fund recoveries to the deficit and reverted all recoveries accumulated during fiscal year 2008 to the State's General Fund. MSDE personnel informed us that a deficiency appropriation will be requested to cover the outstanding $13.3 million deficit.

DHR

DHR recorded unsubstantiated federal fund revenues totaling approximately $2.9 million relating to the TANF grant. This condition has been reported upon in our fiscal year closeout reviews since 2003. DHR's records indicated that the TANF unsubstantiated accrued revenues totaled approximately $2.9 million as of June 30, 2008, which is a decrease of $6.4 million from the $9.3 million reported in fiscal year 2007. DHR used fiscal year 2008 general fund appropriations to reduce $6.4 million of the prior years' unfunded liability. DHR was able to use these general fund appropriations to reduce the unfunded receivable by identifying certain fiscal year 2008 expenditures that could be paid by the TANF grant instead of general fund appropriations as originally budgeted.

DSP

DSP recorded unsubstantiated reimbursable and special fund revenues totaling approximately $2 million relating to unattained revenue from the Maryland Emergency Management Agency (MEMA) and from other entities. DSP did not have adequate documentation to support a reimbursable fund accrual of $1.2 million that during our past closeout reviews DSP claimed was due from MEMA. During our current review, DSP personnel acknowledged that MEMA does not owe DSP the $1.2 million and that DSP will be requesting a deficiency appropriation to resolve this issue. This unsubstantiated accrued revenue was reported upon in our two previous closeout reviews. DSP also did not have adequate documentation to support a special fund accrual of $798,000 related to DSP providing services to other entities during fiscal year 2008. Accounting detail records were not available to substantiate this assertion or identify the other entities that owed this amount to DSP. A similar unsubstantiated special fund revenue accrual was reported upon in our fiscal year 2007 closeout review, although the amount of the unsubstantiated accrual increased during fiscal year 2008 (the fiscal year 2007 accrual was $560,000).

**Finding 2**
**A general fund deficiency appropriation may be required to eliminate a special fund deficit balance of $5.5 million.**

**Analysis**

The **Department of State Police (DSP)** may require a general fund deficiency appropriation to eliminate a special fund deficit balance of $5.5 million that existed as of June 30, 2008. 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 which DSP transferred to the general fund during the fiscal year 2005 closeout because it did not have legal authority to retain any 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 automatic reversal of the previously recorded accrued revenue transaction at the beginning of fiscal year 2006. During fiscal year 2007, excess revenues of $100,000 were retained in the fund, which reduced the negative balance to $5.5 million. There was minimal change to the deficit fund balance during fiscal year 2008. Consequently, a general fund deficiency appropriation may be required to eliminate this deficit. This condition was commented upon in our two preceding annual budget closeout reports.

## Other Issue

## Conclusion

A liability of $32.8 million resulting from federal audit disallowances has been recorded that may have to be paid with general funds.

## Federal Disallowances

**Finding 3**
**Federal audit disallowances totaling approximately $32.8 million may have to be paid with general funds, and the State is attempting to recover $13 million in other federal sanctions.**

**Analysis**
Two federal audits of school-based Medicaid expenditures have resulted in disallowed claims. In one case, potential federal sanctions totaling $32.8 million are under consideration by the United States Department of Health and Human Services and may have to be paid with general funds. In the other case, the federal government has recovered the claimed disallowance from the State, and the State has requested five local education agencies (LEAs) to repay $13 million of the federal disallowance.

The $32.8 million of potential federal sanctions was the result of a federal audit report dated May 2007, which focused on Medicaid expenditures for school-based health services that were claimed in fiscal years 2002 through 2004 by LEAs. The LEAs provide health-related services (such as speech therapy) to special education students in the State as outlined in each child’s Individualized Education Plan. The federal Medicaid program will pay for a percentage of certain of these health-related services and for transportation costs incurred while receiving the covered services.

The sanctions were principally based on the lack of adequate support for the rates claimed for school-based health services. These rates had been established by the Department of Health and Mental Hygiene (DHMH) in conjunction with the Maryland State Department of Education (MSDE) and were uniformly charged by all LEAs, as instructed by MSDE. DHMH and MSDE disagreed with the federal audit report findings and appealed the potential sanctions in June 2007 to the Centers for Medicare and Medicaid Services (CMS). In May 2008, CMS upheld the audit report's findings disallowing the $32.8 million. In June 2008, DHMH appealed the CMS decision to the Department of Health and Human Services Departmental Appeals Board (DAB). During the fiscal year 2008 closing, DHMH reported the $32.8 million to the General Accounting Division (GAD) as a liability with the appeal pending, and the full amount was recorded by GAD in the State's fiscal year 2008 *Comprehensive Annual Financial Report*. If the appeal is denied, the State may also incur considerable interest penalties until the amount due is repaid to the federal government; however, the penalty amount cannot be reasonably estimated until after the appeal process is concluded. As of December 19, 2008, there had been no final determination by DAB on the appeal. To the extent the sanctions are not reduced, the sanctions and any interest penalty accrued during the appeal process may need to be paid with State general funds.

Other sanctions were imposed as a result of a March 2003 federal audit report, which focused on the lack of documentation at certain LEAs to support specific expenditures claimed in fiscal year 2000. DHMH and MSDE disagreed with the federal audit findings and appealed these sanctions. Subsequently, the federal government reduced its claim from $19.9 million to $16.4 million, which was recovered by the federal government in July 2007 by reducing Medicaid reimbursements to DHMH. Of the $16.4 million, DHMH determined that $13.9 million was applicable to five LEAs, and MSDE transferred $900,000 to DHMH that had been withheld from these five LEAs during a previous fiscal year. DHMH has requested the five LEAs to reimburse DHMH the remaining $13 million for their respective portions of the sanctions over the next three years. However, four of the five LEAs have appealed DHMH's request to the Office of Administrative Hearings. DHMH management informed us that the appeal hearing is scheduled in May 2009. Notwithstanding the appeal, in fiscal year 2009 DHMH began withholding a portion of the five LEAs' medical assistance reimbursement payments to fund the $13 million of sanctions.

# Exhibit 1

## Summary of Fiscal Year 2008 Closeout Review
## Findings by State Agency

| Agency | Finding Number | Finding Description |
|---|---|---|
| **Maryland State Department of Education** | **1** | $13.3 million in unsubstantiated federal fund accrued revenues were recorded. |
| **Department of Human Resources** | **1** | $2.9 million in unsubstantiated federal fund accrued revenues were recorded. |
| **Department of State Police** | **1** | $2 million in unsubstantiated reimbursable and special fund accrued revenues were recorded. |
| | **2** | $5.5 million special fund deficit balance exists, which will require a general fund deficiency appropriation to cover. |

# Exhibit 2

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

| Agency | Amount of Reported Unprovided for Payables |
|---|---|
| Maryland Higher Education Commission | $8,953,512 |
| Office of Public Defender | 1,697,944 |
| Department of Health and Mental Hygiene | 1,665,727 |
| Department of Public Safety and Correctional Services | 1,554,814 |
| Department of General Services | 709,181 |
| Department of Human Resources | 661,274 |
| **Total** | **$15,242,452** |

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