Special Report

Statewide Review of Budget Closeout Transactions for Fiscal Year 2018

January 2019

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
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January 15, 2019

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate Shelly L. Hettleman, 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, 2018. 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 Information Technology
Department of Labor, Licensing, and Regulation
Department of State Police
Maryland Department of Health
Maryland Health Benefit Exchange

Additionally, we noted significant reported liabilities pertaining to the Maryland Department of Health at June 30, 2018.

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. Specifically, one State agency recorded federal fund revenues totaling $6.4 million at fiscal year-end which are not likely to be recovered. One other agency recorded reimbursable fund revenues totaling $1.8 million that are not collectable and collectability of an additional $800,000 is uncertain. Lastly, one agency retained $173,000 in funds, without legal authority, in order to reduce an $830,000 special fund deficit. General fund appropriations (or a deficiency appropriation) may be needed to eliminate the resulting deficit if the other funds are not available.

We also noted that four state agencies or departments had reported a total of $110.6 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2018 (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 included in our reports on the review of the fiscal years 2017, 2016, and 2015 closeout transactions related to this agency. In addition, we identified one other agency that had a potential $28.4 million federal liability that was not reported as part of the fiscal year 2018 year-end closing process. The expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

Additionally, one agency had an $821,000 surplus in a non-budgeted fund clearing account for which the disposition of the revenues could not be determined. There had been minimal activity in the clearing account during fiscal years 2015 to 2018; however, the funds were not reverted to the State's General Fund. Although not necessarily within the original scope of our review, we identified one agency that did not make use of $750,000 in general funds restricted by budgetary law for their intended purpose and did not revert or cancel the general fund appropriation at fiscal year-end.

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,

Gregory A. Hook

Gregory A. Hook, 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 14, 2018, applicable to the fiscal year ended June 30, 2018, 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, 2018, 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 $589.6 million as of June 30, 2018. This represents an increase of approximately $331.0 million from the balance reported at the preceding fiscal year-end ($258.6 million). The *CAFR* also states that the State Reserve (primarily the Revenue Stabilization Account) balance totaled $883.6 million as of June 30, 2018.

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 $589.6 million. For example, two GAAP adjustments reduced the Fund balance by $899.7 million for income tax collections that are owed to local jurisdictions as of June 30, 2018. These adjustments were a total of $204.6 million less than similar adjustments made for the fiscal year 2017 *CAFR*. Other GAAP adjustments totaling $110.6 million were made for general fund liabilities incurred by State agencies during fiscal year 2018 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, 2018. 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, 2018, 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, 2018 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 identified in our January 24, 2018 report entitled *Statewide Review of Budget Closeout Transactions for Fiscal Year 2017*. 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 July 2018 to January 2019.

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 five agencies or departments had significant payables or liabilities at June 30, 2018 that may require general funds.

Revenue Transactions

Three agencies reported various improper revenue transactions such as unsubstantiated accruals and retaining funds without proper authority. For example, one agency recorded unsubstantiated revenues to offset federal fund deficits. Specifically, the agency recorded federal fund revenues totaling approximately $6.4 million to cover expenditures even though the revenues are not likely to be recovered. In addition, one State agency had $1.8 million of reimbursable fund receivables that is not collectable and an additional $800,000 may not be collected due to length of reimbursement delays. 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 did not revert or cancel certain unused general fund appropriations in accordance with budgetary law language. Specifically, $750,000 in general funds restricted for the implementation of an opioid risk reduction pilot program was retained by the agency even though the program was not implemented.

Other Liabilities

Four agencies or departments reported a total of $110.6 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2018. For example, one agency, which had a similar issue in our three 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, another agency had a potential $28.4 million liability to the federal government related to certain misallocated expenditures.

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 $6.4 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 $6.4 million. These accrued revenues related to the recovery of past DLLR 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.

The recordation of these unsubstantiated federal fund revenues was previously disclosed in our *Statewide Review of Budget Closeout Transactions for Fiscal Year 2016* and *2017* reports dated January 25, 2017 and January 24, 2018, respectively, and our fiscal compliance audit report on the DLLR's Office of the Secretary dated August 7, 2017. We continue to note that there is no indication of forthcoming federal approval to recover these costs.

Finding 2
Reimbursable fund revenues totaling $1.8 million recorded by one agency at fiscal year-end are not collectable and recovery of an additional $800,000 is uncertain.

Analysis
The **Department of Information Technology (DoIT)** had unsubstantiated accrued reimbursable fund revenues totaling $1.8 million that are not collectable and recovery of an additional $800,000 is uncertain. These accrued revenues related to the recovery of costs incurred (accounts receivable) for DoIT's oversight of information technology projects dating back to fiscal year 2011. DoIT recorded revenue accruals totaling $1.4 million for unpaid obligations from other State agencies from fiscal year 2011 to fiscal year 2015 and another $1.2 million for fiscal year 2016. After our inquiries regarding the support for the

collectability of the accruals, DoIT officials informed us that the $1.4 million and a portion of the $1.2 million ($400,000) should be deemed uncollectable. Our review to determine if DoIT had collected any revenues relating to the fiscal year 2016 accrual found that no revenues had been collected as of January 3, 2019. Because of the length of the reimbursement delays, the extent to which the amounts outstanding will be received is uncertain. If DoIT is unable to recover these funds, general funds may be needed to eliminate the resulting deficits.

Finding 3
One agency retained $173,000 in funds without legal authority, in order to reduce an $830,000 special fund deficit.

Analysis
The **Department of State Police (DSP)** retained $173,000 in funds collected for the salvage vehicle inspection program, without legal authority, in order to reduce an $830,000 special fund deficit. After retaining the funds, DSP recorded special fund revenue accruals totaling $657,000 at June 30, 2018 to eliminate a remaining special fund deficit balance without regard to the ultimate collectability of those revenues. We were advised that this deficit was the result of DSP's efforts to address unexplained deficit special fund balances identified in our fiscal compliance audit report dated November 23, 2015.

In fiscal year 2017, DSP began recording salvage vehicle inspection program activity (revenues and expenditures) to this fund, with the intent of using it as a source to eventually eliminate the deficit special fund balance, even though the program activity could not be specifically linked to the special fund. For example, during fiscal year 2018, salvage vehicle inspection program revenues exceeded expenditures by approximately $173,000. DSP applied the $173,000 surplus to the deficit special fund balance, which reduced the June 30, 2018 deficit balance to the aforementioned $657,000. State law does not identify salvage vehicle inspection program revenue as special non-lapsing funds.

Finding 4
One agency did not revert non-budgeted funds totaling $821,000 to the State's General Fund at year-end.

Analysis
DSP did not revert non-budgeted funds totaling $821,000 to the State's General Fund at year-end. Specifically, DSP did not determine the composition of a non-budgeted fund clearing account's June 30, 2018 balance or the proper disposition

of the funds. DSP could not explain the fund's intended purpose, and minimal activity was recorded to the fund during fiscal years 2015 through 2018. If the disposition of the funds cannot be determined, DSP should revert the funds to the State's General Fund, or if determined to be permissible, request an appropriation to use the funds.

The closing instructions issued by the Comptroller of Maryland – General Accounting Division (GAD) require clearing accounts with positive year-end balances to be reported to GAD and that clearing accounts exceeding $100,000 be analyzed and adjusted to a zero balance. As of November 15, 2018, DSP had not reported the balance in the non-budgeted fund clearing account to GAD.

Expenditure Transactions

Finding 5
One agency did not revert or cancel certain unused general fund appropriations in accordance with budgetary law language.

Analysis
The **Maryland Department of Health (MDH)** did not implement an opioid risk reduction pilot program as required by budgetary law language nor revert or cancel the related general fund appropriation. Chapter 150, Laws of Maryland, 2017 provided that $750,000 of the fiscal year 2018 appropriation made for medical care provider reimbursements may not be spent for that purpose and instead shall be expended only to implement an opioid risk reduction pilot program. Funding not used for this restricted purpose may not be transferred or otherwise expended and shall revert to the General Fund and/or be cancelled.

We were advised by MDH that the pilot program was not implemented, and we found that rather than revert or cancel the $750,000 appropriation, during the fiscal year 2018 budgetary closeout process, MDH accrued all of the remaining medical care provider reimbursement general fund appropriations for services provided for in fiscal year 2018 that had not yet been paid. MDH advised us that it intended to revert $750,000 of its year-end accrued appropriation as part of the fiscal year 2019 year-end closeout process.

Other Liabilities

Finding 6
Four agencies or departments reported a total of $110.6 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2018, although there are indications based on subsequent financial reporting that for one agency, the actual unprovided for amount could be lower by several million dollars than reported.

Analysis
Four agencies or departments reported a total of $110.6 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2018 (see Exhibit 2), although there are indications that the amount reported by one agency could be actually lower by several million dollars. The actual expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

For example, at fiscal year-end, **MDH** reported estimated unprovided for payables and other general fund liabilities totaling $104.1 million.[1] Although MDH reported unprovided for payables which totaled $68.7 million to GAD, there are indications based on subsequent financial reporting that the unprovided for payables may be several million dollars less than originally reported (the amount cannot be reasonably determined at this time). Additionally, MDH reported a liability to the federal government of approximately $34.2 million for a disallowed claims related to **Developmental Disabilities Administration (DDA)** residential habilitation add-on services under its Community Pathways waiver program (a Medicaid funded program). The federal Department of Health and Human Services (HHS) – Office of the Inspector General (OIG), in its June 2015 audit report, disallowed these claims and recommended that DDA refund the overbilled amount to the federal HHS Centers for Medicare and Medicaid Services (CMS).

In MDH's September 24, 2015 response to the audit report and to CMS, MDH disagreed with the OIG's interpretation of waiver requirements and urged CMS to reconsider requiring MDH to refund the $34.2 million in disallowed claims. In a letter dated June 26, 2018, CMS issued a formal disallowance letter requiring the refund of the identified $34.2 million. On August 23, 2018, MDH issued a *Request for Reconsideration* letter to HHS to begin the appeals process related to CMS' determination. The CMS disallowance letter provided that MDH could

[1] MDH reported the potential liabilities of $104.1 million to GAD, and GAD recorded a decrease to the General Fund in the State's fiscal year 2018 Comprehensive Annual Financial Report to recognize these disallowances.

elect to either retain or return the funds in question during the appeals process; however, should HHS confirm CMS' decision, any amount retained by MDH would be subject to interest. MDH's *Request for Reconsideration*, stated that it had elected to retain the funds during the appeals process; therefore, dependent on the HHS' final determination, MDH could be liable to refund the federal government the original $34.2 million in disallowed claims and any accrued interest.

Furthermore, in our DDA fiscal compliance audit report dated November 18, 2016 we disclosed that DDA had improperly instructed providers to collect fees from consumers to contribute to their cost of care, referred to as Contribution to Care, that otherwise would have been paid from State and federal funds. The annual improperly collected fees were estimated to be $4.2 million. In fiscal year 2018, DDA recorded $3.0 million of accrued expenditures to partially cover the refund of one year's fees to consumers. However, the remaining $1.2 million was reported as a liability.

Comments regarding similar federal disallowances were made in our three preceding budgetary closeout reports.

Finding 7
We identified one agency that had a potential $28.4 million liability to the federal government related to certain misallocated expenditures.

Analysis
The Maryland Health Benefit Exchange (MHBE) had a potential liability to the federal government related to certain misallocated expenditures. Specifically, MHBE did not report a potential federal liability totaling approximately $28.4 million to GAD. In March 2015 the federal Department of Health and Human Services – Office of the Inspector General (HHS - OIG) released a report on the audit of establishment grants for Maryland's Health Insurance Marketplace (that is, MHBE) that recommended that MDH refund $28.4 million of misallocated expenditures (MDH was the lead agency responsible for the Maryland marketplace establishment grants and responsible for complying with applicable federal requirements). Since the inception of MHBE, MDH has processed grant allocation and reimbursement requests on its behalf. MDH and MHBE responded to the federal report that the State did not concur with the findings and recommendations to repay the $28.4 million. However, after considering the response, HHS-OIG concluded that all of its findings/recommendations were valid.

In July 2018, the HHS-OIG released an annual report of the top unimplemented HHS-OIG recommendations that would most positively affect HHS programs in terms of cost savings, program effectiveness and efficiency, and public health safety. This report included the outstanding refund due from MHBE of the $28.4 million of misallocated expenses noted in the aforementioned report. At the time of our review, we were unable to obtain any further clarifying documentation from HHS-OIG, MDH, or MHBE on this issue (beyond the July 2018 HHS-OIG report). However, neither MDH nor MHBE reported the $28.4 million liability to GAD, and MHBE advised us that it believes the potential liability will be resolved without the need for State funds. Depending on the resolution of this issue, State general funds may be needed to repay the federal government.

Exhibit 1

Summary of Fiscal Year 2018 Closeout Review
Findings by State Agency

Agency	Finding Number	Finding Description
Department of Labor, Licensing, and Regulation	**1***	Recovery of $6.4 million in recorded federal fund revenues is not likely.
Department of Information Technology	**2**	Reimbursable fund receivables totaling $1.8 million is not collectable and an additional $800,000 may not be collected.
Department of State Police	**3**	Special fund revenues totaling approximately $173,000 were improperly retained in order to reduce an $830,000 special fund deficit.
	4	$821,000 in non-budgeted funds were not reverted to the general fund.
Maryland Department of Health	**5**	$750,000 in revenues were not reverted as intended in the law.
	6*	Unprovided for general fund payables and liabilities of approximately $104.1 million may have to be funded with State general funds.
Maryland Health Benefit Exchange	**7**	A potential federal liability of approximately $28.4 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, 2018 Unprovided for General Fund Payables and Other Liabilities Reported to the General Accounting Division

Agency Reporting	Amount of Reported Unprovided for General Fund Payables / Other Liabilities As of June 30, 2018
Maryland Department of Health	$104,105,000
State Department of Assessment and Taxation	4,036,000
Office of the Public Defender	1,317,000
Department of Information Technology	1,118,000
Total	**$110,576,000**

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