Special Report

# Statewide Review of Budget Closeout Transactions for Fiscal Year 2019

January 2020

**Office of Legislative Audits**
Department of Legislative Services
Maryland General Assembly

**Joint Audit and Evaluation Committee**



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## OFFICE OF LEGISLATIVE AUDITS
## MARYLAND GENERAL ASSEMBLY

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January 16, 2020

Senator Clarence K. Lam, M.D., Senate Chair, Joint Audit and Evaluation Committee
Delegate Shelly L. Hettleman, House Chair, Joint Audit and Evaluation Committee
Members of Joint Audit and Evaluation 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, 2019. 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 State Police
Maryland Department of Health
Maryland Department of Labor
Maryland State Department of Education

Additionally, we noted significant potential liabilities pertaining to the Maryland Department of Health and the Maryland Health Benefit Exchange that were reported at June 30, 2019.

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 $6,375,000 at a previous fiscal year-end which we were advised have now been deemed unrecoverable. Another department retained $569,000 in special funds without legal authority and also potentially overspent its fiscal year 2019 appropriation by $1.1 million for one program. Furthermore, one department had a year-end special fund deficit balance totaling approximately $485,000. We also noted that expenditures totaling $420,000 were improperly reported, as related goods or services had not actually been received.

Lastly, four state agencies or departments had reported a total of $92.5 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2019 (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 2018, 2017, 2016, and 2015 closeout transactions related to this agency. In addition, the same agency reported an additional liability to the federal government of approximately $20.9 million; however, GAD did not record this amount as a liability since it is in fact a contingent liability, as federal funds remain available to fund the liability. Furthermore, we identified one other agency that had a potential $28.4 million federal liability. The expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

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

Respectfully submitted,

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 16, 2019, applicable to the fiscal year ended June 30, 2019, 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, 2019, 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 \$974.2 million as of June 30, 2019. This represents an increase of approximately \$384.6 million from the balance reported at the preceding fiscal year-end (\$589.6 million). The *CAFR* also states that the State Reserve (primarily the Revenue Stabilization Account) balance totaled \$890.7 million as of June 30, 2019.

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 \$974.2 million. For example, two GAAP adjustments reduced the Fund balance by \$1.0 billion for income tax collections that are owed to local jurisdictions as of June 30, 2019. These adjustments were a total of \$104.6 million greater than similar adjustments made for the fiscal year 2018 *CAFR*. Four agencies or departments reported a total of \$92.5 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2019 (see Exhibit 2). GAD recorded GAAP adjustments for certain of these liabilities 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, 2019. 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, 2019, 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 15 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, 2019 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 seven issues identified in our January 15, 2019 report entitled *Statewide Review of Budget Closeout Transactions for Fiscal Year 2018*. We determined five of the seven 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 September 2019 to January 2020.

# 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 four 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 four agencies or departments had significant payables or liabilities at June 30, 2019 that may require general funds.

**Revenue Transactions**

In the prior closeout report, we commented that one department had recorded unsubstantiated revenues to offset federal fund deficits. Specifically, the department recorded federal fund revenues totaling approximately $6.4 million to cover certain expenditures. The department has now determined that these revenues are not likely to be recovered. Although the department has advised the Comptroller of Maryland – General Accounting Division of its plan to fund these expenditures using future sources of revenue, to the extent these funds are not received, general funds will be required to eliminate the deficits resulting from these transactions.

**Expenditure Transactions**

One department recorded unsubstantiated accrued expenditures totaling $420,436 for which goods or services had not been received.

**Special Funds**

One department retained $569,000 in special funds without legal authority. Since the department did not have authority to retain the funds, the funds should have been reverted to the State's General Fund. One other department had a year-end special fund deficit balance totaling $485,000.

**Other Liabilities**

Four agencies or departments reported a total of $92.5 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2019. For example, one agency, which had a similar issue in our four preceding closeout reports, may require general funds of approximately $34.2 million to cover an unfunded liability attributable to the disallowance of certain federal reimbursement 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.

**Other Issues**
One department potentially overspent fiscal year 2019 appropriated funding for one program and additional general funds may be needed to eliminate any resultant deficit.

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

## Revenue Transactions

**Finding 1**
**The Maryland Department of Labor has determined that $6,375,000 in previously recorded federal fund revenues have now been deemed unrecoverable.**

**Analysis**
Our January 15, 2019 report on *the Statewide Review of Budget Closeout Transactions for Fiscal Year 2018* noted that the Department of Labor, Licensing, and Regulation, now the **Maryland Department of Labor (MDL)[1]**, had unsubstantiated accrued federal fund revenues totaling $6.4 million. That report further noted that these accrued revenues related to the projected recovery of past indirect costs incurred to administer certain federal programs, but also stated that general funds may be needed to the extent federal funds are not available for these costs.

During our current closeout review, MDL advised us that these costs have since been deemed unrecoverable by MDL. In an August 14, 2018 letter to the Comptroller of Maryland – General Accounting Division (GAD) confirming the unrecoverable nature of the costs, MDL indicated that it will offset these unrecovered costs over several years by an indirect cost surcharge to most MDL programs of up to $500,000 per year until recovered. The funding source was anticipated to be split between general funds and special funds from MDL's Special Administrative Expense Fund. During fiscal year 2019, MDL advised us that $25,000 had been applied reducing the unrecoverable amount to $6,375,000.

1 Chapter 91, Laws of Maryland 2019, effective July 1, 2019, renamed the Department of Labor, Licensing and Regulation to the Maryland Department of Labor.

However, during the current closeout review, neither MDL nor GAD were able to specifically identify the remaining debt of $6,375,000 in State records, although MDL management contends that it existed and will be subject to future reduction, using the method previously described.

The recording of these unsubstantiated federal fund revenues was also disclosed in our *Statewide Review of Budget Closeout Transactions for Fiscal Year 2016 and 2017* dated January 25, 2017 and January 24, 2018, respectively, and our fiscal compliance audit report on the Department of Labor, Licensing and Regulation's Office of the Secretary dated August 7, 2017.

## Expenditure Transactions

**Finding 2**
**The Maryland Department of Health improperly recorded certain expenditures on behalf of the Opioid Operational Command Center (OOCC) retaining general fund appropriations for future years.**

**Analysis**
The **Maryland Department of Health (MDH)** improperly recorded certain expenditures at the end of fiscal year 2019, on behalf of OOCC, allowing general fund appropriations to be retained for future years. Specifically, expenditures totaling $420,436 were accrued at year-end although no goods or services had been received. This practice violated GAD's annual closing instructions since the reported expenditures did not represent actual expenditures for goods or services received during fiscal year 2019 that remained outstanding (or unpaid) as of fiscal year-end. GAD's annual closing instructions state that all fund balances carried into the next fiscal year be done so in accordance with State statute, regulation, or policy. *The State Policy on Accounts Payable, Accrued Expenditures, and Encumbrances*, which is included in the closing instructions, states that expenditures should be accrued only when goods or services have been received prior to fiscal year-end, but not invoiced.

## Special Funds

**Finding 3**
**The Maryland State Department of Education retained $569,000 in special funds without legal authority.**

**Analysis**
The **Maryland State Department of Education (MSDE)** retained $569,000 in special funds, primarily collected for Medical Assistance Administration Recoveries, without legal authority. This includes balances carried over from fiscal year 2013 through fiscal year 2019. Although MSDE reported the balance to GAD as exempt from reversion to the State's General Fund, MSDE did not have legal authority to retain the funds (that is, the funds were not exempt from reversion).

**Finding 4**
**The Department of the State Police had a year-end special fund deficit balance totaling $485,000.**

**Analysis**
The **Department of State Police (DSP)** had a special fund deficit totaling approximately $485,000 within its Operations Bureau at June 30, 2019. We were advised that this deficit amount was the remainder after DSP's efforts to address long-standing unexplained deficit special fund balances first identified in our fiscal compliance audit report dated November 23, 2015. Since then, the deficit has been reported in our subsequent budgetary closeout reports and our fiscal compliance audit report dated September 23, 2019. In the June 30, 2018 closeout report (and the September 23, 2019 fiscal compliance report), we noted that the deficit as of June 30, 2018 was $657,000, and that DSP had retained, without legal authority, $173,000 in funds collected for the salvage vehicle inspection program to reduce the deficit from a previous balance of $830,000. At that time, DSP had not consulted with the Department of Budget and Management (DBM) regarding the use of these collections to assist in resolving the deficit, and State law does not identify revenue from the salvage vehicle inspection program as special non-lapsing funds.

For fiscal year 2019, DSP again used funds ($172,000) collected for the salvage vehicle inspection program to reduce the year-end deficit from $657,000 to $485,000. However, during our current review, DBM confirmed to us that it had authorized DSP to use collections for the inspection program to reduce the deficit. DBM also advised DSP that, as part of the fiscal year 2021 budget cycle, it would work with DSP to consider the best way to address the remaining deficit balance going forward.

## Other Liabilities

**Finding 5**
**Four agencies or departments reported a total of $92.5 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2019.**

**Analysis**
Four agencies or departments reported a total of $92.5 million in unprovided for general fund payables or other general fund liabilities as of June 30, 2019 (see Exhibit 2). The actual expenditures related to these liabilities may have to be funded with subsequent year appropriations (or through a deficiency appropriation).

The largest amount of fiscal year-end unprovided for payables related to **MDH,** which reported estimated unprovided for payables and other general fund liabilities totaling $58.8 million. This amount consists of three different components, including a liability to the federal government of approximately $34.2 million for 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 DDA 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 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, depending on HHS' final determination, MDH could be required to pay the federal government the original $34.2 million in disallowed claims and any accrued interest. Since the

August 2018 *Request for Reconsideration* letter, there has been no further action or correspondence regarding HHS' final determination.

Comments regarding similar federal claims disallowances were made in our four preceding *Statewide Review of Budget Closeout Transactions* reports.

Furthermore, MDH also reported an additional liability to the federal government of approximately $20.9 million for an obligation relating to the Rebalancing Fund Demonstration which is associated with the **Medical Care Programs Administration** Money Follows the Person (MFP) program. The MFP Rebalancing Fund Demonstration is a part of a comprehensive, coordinated strategy by CMS to assist States, in collaboration with stakeholders, to make widespread changes to their long-term care support systems. A major objective of the MFP Rebalancing Fund Demonstration is to increase the use of home and community-based services rather than institutional, long-term care services.

By participating in the Rebalancing Fund Demonstration, the State agreed to accept federal funds covering 75 percent of its MFP program expenditures, with the remaining 25 percent supported by State funds, instead of the more traditional 50/50 funding split used in many other federal programs. However, the 25 percent savings that the State realized from the enhanced federal reimbursement rate is required to be spent on additional MFP program expenditures and not used for other purposes. The aforementioned $20.9 million represents this enhanced funding for which the required additional MFP expenditures had not been made as of June 30, 2019.

The Rebalancing Fund Demonstration was to end June 30, 2019, however CMS extended the program until September 30, 2020. As of December 19, 2019, MDH had no further updates on whether the Rebalancing Fund Demonstration program would be extended beyond its current end date of September 30, 2020, nor could MDH provide guidance on what, if any, actions the federal government may take if MDH has not satisfied the aforementioned program requirements by that date. However, GAD did not record this amount as a liability since it is in fact a contingent liability, as federal funds remain available to fund the liability. Specifically, MDH continues to have an opportunity to expend the grant funds through September 30, 2020. The actual liability, if any, will not be determined until after the close of the project period.

Another agency, the **Maryland Health Benefit Exchange (MHBE)**, had a $28.4 million potential liability to the federal government related to an audit finding by the HHS – OIG of certain misallocated expenditures. This issue was detailed further in finding seven of our January 15, 2019 report on *the Statewide Review of*

*Budget Closeout Transactions for Fiscal Year 2018*. In a letter dated September 1, 2019 to the Chairs of the Senate Budget and Taxation and House Appropriations Committees, MHBE noted that the HHS – Office of General Counsel had recommended that MHBE rely on a previous determination by HHS' CMS that MHBE followed CMS' guidance when allocating establishment grant expenditures. However the letter also stated that, in response to MHBE's inquiries regarding the status of this matter, MHBE was advised that no formal resolution was yet available.

## Other Issues

**Finding 6**
**MSDE potentially overspent fiscal year 2019 appropriated funding for its Students with Disabilities – Aid to Education program.**

**Analysis**
**MSDE** potentially overspent fiscal year 2019 appropriated funding for its Students with Disabilities – Aid to Education program. During the year-end closeout process, after allowing for certain recorded encumbrances related to the program, MSDE anticipated sufficient appropriated funds to cover the related expenditures in the program that had been incurred but not paid as of June 30, 2019. However, subsequent to the year-end close process and over the intervening six months, funding now appears to be inadequate, as our review determined that as of January 14, 2020, MSDE has obligated funds that exceeded its fiscal year 2019 appropriations by approximately $1.1 million. Consequentially, depending on the action taken and dollar activity involved, additional State general funds may be needed to eliminate any resultant deficit.

# Exhibit 1

## Summary of Fiscal Year 2019 Closeout Review
## Findings by State Agency

| Agency | Finding Number | Finding Description |
|---|---|---|
| **Maryland Department of Labor** | **1*** | $6,375,000 in recorded federal fund revenues have been deemed unrecoverable. |
| **Maryland Department of Health** | **2** | Expenditure accruals totaling $420,436 were improperly recorded, as no services or goods had been provided. |
| | **5*** | Unprovided for general fund payables and liabilities of approximately $58.8 million may have to be funded with State general funds. |
| **Maryland State Department of Education** | **3** | Special fund revenues totaling $569,000 were improperly retained. |
| | **6** | MSDE potentially overspent the appropriated funding for one program by $1.1 million. |
| **Department of State Police** | **4** | DSP had a year-end special fund deficit balance totaling $485,000. |
| **Maryland Health Benefit Exchange** | **5** | 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, 2019 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, 2019 |
|---|---|
| Maryland Department of Health | $58,738,000 |
| Maryland Heath Benefit Exchange | 28,400,000 |
| Office of the Public Defender | 3,637,000 |
| Department of State Police | 1,752,000 |
| **Total** | **$92,527,000** |

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