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• Please address specific inquiries regarding this report to the Audit Manager listed on the inside back cover by telephone at (410) 946-5900.

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• The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at (410) 946-5400 or (301) 970-5400.
June 16, 2004

Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Delegate Van T. Mitchell, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Laboratories Administration of the Department of Health and Mental Hygiene for the period beginning July 1, 2000 and ending August 4, 2003.

Our audit disclosed that the Administration had not established adequate internal control over accounts receivable and certain cash receipts. Additionally, the Administration did not always use proper rates when billing for certain laboratory test services, and such billings were not always prepared in a timely manner.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor
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* Denotes item repeated in full or part from preceding audit report.
Background Information

Agency Responsibilities

The Laboratories Administration is responsible for providing laboratory testing to assist physicians and health officials in the prevention, diagnosis, and control of human disease. During fiscal year 2003, the Administration's central laboratory in Baltimore City and its three regional laboratories conducted approximately 2.8 million laboratory tests.

Current Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the two fiscal/compliance items and the performance audit item contained in our preceding audit report dated January 2, 2001. We determined that the Administration satisfactorily addressed one fiscal/compliance item and the performance audit item. The one remaining fiscal/compliance item is repeated in this report.
Findings and Recommendations

Accounts Receivable

Finding 1
Internal control over the Administration’s accounts receivable record keeping and noncash credit adjustments was not adequate.

Analysis
The Administration had not established adequate internal control over accounts receivable. During fiscal year 2003, billings and collections recorded on the Administration’s automated accounts receivable records totaled approximately $3 million and $2.3 million, respectively. Our review disclosed the following conditions:

- The Administration did not maintain an adequate accounts receivable control account. Specifically, the control account was maintained using summaries of transactions posted to the detail accounts receivable records, instead of from independent source documents. A control account provides a continuous summary of charges, payments, and adjustments and helps ensure that transactions are accurately posted to the detail records.

- Although an output report of noncash credit adjustments posted to the accounts receivable records was generated, supervisory personnel did not use this report to identify adjustments for review. Rather, supervisory personnel only reviewed adjustments forwarded to them by the employees who recorded the adjustments on the accounts receivable records. Consequently, unauthorized adjustments could be processed without detection. Our test of ten noncash credit adjustments processed during fiscal years 2002 to 2004, totaling approximately $86,200, disclosed that eight adjustments, totaling approximately $50,200, had not been reviewed by supervisory personnel. During fiscal years 2002 and 2003, the Administration processed approximately $114,000 in noncash credit adjustments. A similar situation was commented upon in our two preceding audit reports.
Recommendation 1
We recommend that the Administration maintain its accounts receivable control account independent of the detail records, and periodically reconcile the control account balance with the aggregate balance of the detail records. Additionally, we again recommend that the Administration establish procedures to ensure that all noncash credit adjustments recorded on its accounts receivable records are subject to supervisory review.

Finding 2
The Administration did not use the proper billing rate for certain laboratory test services, resulting in an understatement of billings of approximately $336,000. In addition, invoices were not always prepared timely.

Analysis
The Administration used an improper billing rate for newborn screening laboratory tests during the period from February to June 2003. Specifically, in January 2003, the Acting Secretary of the Department of Health and Mental Hygiene approved an increase in the fee for newborn screening tests from $30 to $42, with an effective date of February 1, 2003. However, the Administration continued to bill for tests conducted during the months of February to June 2003 using the $30 rate. As a result, billings for this period, in the aggregate, were approximately $336,000 less than what they would have been had the approved fee been used. We were advised by Administration management that implementation of the new rate was delayed until July 2003 because the Administration had not notified the hospitals of the rate increase until June 2003. However, there is no statutory requirement that the Administration notify hospitals in advance of rate changes. After we brought this issue to the Administration’s attention, the Secretary of the Department of Health and Mental Hygiene retroactively revised the effective date for the rate change to July 1, 2003.

Additionally, the Administration did not prepare invoices totaling approximately $515,000 for newborn screening tests timely. For example, invoices totaling approximately $371,000 for two hospitals were prepared from 2 to 41 months after the related testing services had been performed. As a result of these delays, we estimated that the State lost interest income of approximately $10,000.

During fiscal year 2003, the Administration’s newborn screening test billings totaled approximately $2.4 million.
Recommendation 2
We recommend that the Administration use approved rates when billing for laboratory test services. Furthermore, we recommend that the Administration prepare invoices for laboratory tests timely (that is, within 30 days of the end of the billing month).

Cash Receipts

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<th>Finding 3</th>
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<td>Internal control over the processing of Controlled Dangerous Substance (CDS) permits and the related cash receipts was not adequate.</td>
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Analysis
The Administration had not established adequate internal control over the processing of CDS permits and the related cash receipts. Although permit application fees were recorded upon receipt, an independent verification was not performed to ensure that recorded fees were deposited. Additionally, two employees who processed and approved CDS permit applications also had access to the related application fees. Finally, there was no supervisory review performed prior to issuing the CDS permits to ensure that permits were issued only to qualified applicants, and that a fee had been received and deposited for each permit.

As a result of these deficiencies, CDS permit fees could be misappropriated and permits could be issued to unqualified individuals without detection. In this regard, the Administration attempted to account for CDS permits used (that is, issued to applicants, voided, etc.) during the period from October 31, 2002 to July 7, 2003 but was unable to account for 142 permits used during this period. Effective November 2003, the Administration implemented a new cash receipt system to facilitate the reconciliation of permits issued to cash receipts received.

According to Administration records, permit fees totaling approximately $840,000 were collected and approximately 14,200 CDS permits were issued during fiscal year 2003.

Recommendation 3
We recommend that an employee independent of the permit fee collection and deposit functions verify that all recorded fees are deposited. We also recommend that an employee independent of the permit processing functions verify that, prior to their issuance, permits are issued only to qualified applicants and that a fee has been received and deposited for each permit issued. Finally, we recommend that the deposit verifications and permit issuance verifications be documented. We advised the Administration on accomplishing the needed separation of duties using existing personnel.
Audit Scope, Objectives, and Methodology

We audited the Laboratories Administration of the Department of Health and Mental Hygiene for the period beginning July 1, 2000 and ending August 4, 2003. The audit was conducted in accordance with generally accepted government auditing standards.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the Administration’s financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings contained in our preceding audit report, including a follow-up review of a previous performance audit finding on the efficiency and effectiveness of the Administration’s laboratory test billing system.

In planning and conducting our audit, we focused on the major financial related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Administration’s operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include certain support services provided to the Administration by the Department’s Office of the Secretary and related units. These support services (for example, payroll, purchasing, maintenance of accounting records, and related fiscal functions) are included within the scope of our audit of the Office of the Secretary. In addition, we did not audit the Administration’s Federal financial assistance programs for compliance with Federal laws and regulations because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies.

Our audit scope was limited with respect to the Administration’s cash transactions because the Office of the State Treasurer was unable to reconcile the State’s main bank accounts during the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all Administration cash transactions were accounted for and properly recorded on the related State accounting records as well as the banks’ records.
The Administration’s management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the Administration’s ability to maintain reliable financial records, operate effectively and efficiently and/or comply with applicable laws, rules, and regulations. Our report also includes conditions regarding significant instances of noncompliance with applicable laws, rules, or regulations.

The Department of Health and Mental Hygiene’s response, on behalf of the Administration, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Department regarding the results of our review of its response.
APPENDIX

STATE OF MARYLAND

DHMH
Maryland Department of Health and Mental Hygiene
201 W. Preston Street • Baltimore, Maryland 21201
Robert L. Erlich, Jr., Governor — Michael S. Steele, Lt. Governor — Nelson J. Sabatini, Secretary

June 15, 2004

Mr. Bruce Myers, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Myers:

This is in response to your May 27, 2004 letter that included the draft audit report for the Laboratories Administration for the period beginning July 1, 2000 and ending August 4, 2003. Attached you will find the Department’s response and plan of correction that addresses each audit recommendation. I will work with the Director of the Laboratories Administration and the Deputy Secretary to promptly address all audit exceptions. In addition, our Division of Internal Audits will follow-up on the recommendations to ensure compliance.

If you have any questions or require additional information, please do not hesitate to contact me at (410) 767-6505 or Ellwood Hall of my staff at (410) 767-5684.

Sincerely,

Nelson J. Sabatini
Secretary

Attachment

cc: Ms. Arlene Stephenson, Deputy Secretary for Public Health Services, DHMH
Mr. Thomas Russell, Inspector General, DHMH
Mr. Ellwood Hall, Chief, Division of Internal Audits, Office of the Inspector General, DHMH
Dr. John DeBoy, Dr. P.H., Director, Laboratories Administration, DHMH

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Web Site: www.dh mh.state.md.us
DHMH Laboratories Administration

Findings and Recommendations

Accounts Receivable

Finding 1
Internal control over the Administration’s accounts receivable record keeping and noncash credit adjustments was not adequate.

Recommendation 1
We recommend that the Administration maintain its accounts receivable control account independent of the detail records, and periodically reconcile the control account balance with the aggregate balance of the detail records. Additionally, we again recommend that the Administration establish procedures to ensure that all noncash credit adjustments recorded on its accounts receivable records are subject to supervisory review.

Administration’s Response 1
We concur with the auditor’s finding/recommendation. The number of employees in the Billing Unit has decreased from six to three since the last audit. The billing information we receive from the various labs does not provide the information needed to maintain an independent accounts receivable control account. The Fiscal Accounts Clerk Manager of the Billing Unit will perform 100% verifications of input and output of the accounts receivable system as suggested by the auditor.

The responsibility for reviewing non-cash adjustments will be assigned to the Special Assistant to the Director. The Billing Unit will be advised to submit all non-cash credit adjustments to the Special Assistant to determine if they are properly authorized. She will initial and date the cover memo as well as the source documents to indicate the review and approval of these adjustments. In addition, a copy of the monthly report of all recorded non-cash adjustments will be given to the Special Assistant to select certain adjustments for further review.

Finding 2
The Administration did not use the proper billing rate for certain laboratory test services, resulting in an understatement of billings of approximately $336,000. In addition, invoices were not always prepared timely.
Recommendation 2
We recommend that the Administration use approved rates when billing for laboratory test services. Furthermore, we recommend that the Administration prepare invoices for laboratory tests timely (that is, within 30 days of the end of the billing month).

Administration’s Response 2
We concur with the auditor’s finding/recommendation. The rate increase from $30 to $42 was modified to be effective July 1, 2003. This modification was necessitated due to delayed implementation of performing 23 additional newborn screening tests. Additional time was required to calibrate two new and highly complex instruments (two tandem mass spectrometers), train staff to use the new instruments, validate the tests and develop preliminary cut-off values that identified abnormal results for newborn infants.

Some of the billings were delayed due to a glitch in Newborn Screening Division’s computer system, mainly with premature infants. This problem with the computer system has been fixed. We have an Excel spreadsheet listing the monthly amount billed for each hospital in the State. If a particular hospital has no tests or a low number being billed, we will contact Newborn Screening Division to verify the number of infants to be billed. We will ensure that all billable laboratory tests will be invoiced within 30 days from the end of the billing month.

Cash Receipts

Finding 3
Internal control over the processing of Controlled Dangerous Substance (CDS) permits and the related cash receipts was not adequate.

Recommendation 3
We recommend that an employee independent of the permit fee collection and deposit functions verify that all recorded fees are deposited. We also recommend that an employee independent of the permit processing functions verify that, prior to their issuance, permits are issued only to qualified applicants and that a fee has been received and deposited for each permit issued. Finally, we recommend that the deposit verifications and permit issuance verifications be documented. We advised the Administration on accomplishing the needed separation of duties using existing personnel.
**Administration’s Response 3**

We concur with the auditor’s finding/recommendation. There are only two administrative positions available to process over 12,000 renewal applications for CDS permits. It is an overwhelming task to process these applications in a three to four month period. An ACCESS database system was installed to track the receipts to the applications. Unfortunately, there are still some glitches in the system which need to be resolved. The system does not allow the printing of CDS permits, which makes it difficult to verify that only qualified applicants who have paid the fee are issued these permits.

The Chief of the Division of Drug Control will verify that all recorded fees are deposited. In addition, he will verify on a sample basis that permits are issued only to qualified applicants and that a fee was received and deposited for each permit tested. These sample deposit and permit issuance verifications will be documented by the Chief of the Division of Drug Control.

We are in the process of determining if a new system would be more appropriate which will accommodate all of the recommendations suggested. In addition, we will be proposing legislation next year to allow the staggering of renewal dates more evenly over the year. This will allow verification of deposits and permit issuance to be performed in a timely manner.
AUDIT TEAM

Mark A. Ermer, CPA
Audit Manager

Nelson W. Hopkins, CPA
Senior Auditor