

Audit Report

Office of Administrative Hearings

February 2009



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

February 5, 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 audited the Office of Administrative Hearings (OAH) for the period beginning November 4, 2005 and ending August 17, 2008. OAH was established to provide an unbiased and objective forum for contested cases involving State agencies that regulate certain actions of businesses and citizens.

Our audit disclosed that OAH had not established adequate internal controls over certain disbursement transactions, and did not have assurance that the allocation of its operating costs to State agencies was proper. OAH also improperly recorded accrued expenditures totaling approximately \$150,900 which allowed it to retain funds at the end of fiscal year 2006 that otherwise would have been reverted to the General Fund.

OAH's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by OAH.

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 Office of Administrative Hearings (OAH) was established to provide an unbiased and objective forum for contested cases involving State agencies that regulate certain actions of businesses and citizens. According to OAH's records, during fiscal year 2008, OAH disposed of 48,708 cases. The majority of cases heard by OAH relate to the Motor Vehicle Administration, the Department of Health and Mental Hygiene, and the Department of Human Resources. OAH's fiscal year 2008 appropriation provided for 122 employee positions, including 56 administrative law judges. According to the State's records, during fiscal year 2008, OAH's expenditures totaled approximately \$12.3 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the four findings contained in our preceding audit report dated March 24, 2006. We determined that OAH satisfactorily addressed three of the findings. The remaining finding is repeated in this report.

Findings and Recommendations

Disbursements

Finding 1

Proper internal controls were not established over the processing of certain disbursement transactions.

Analysis

OAH did not fully use the security features available on the State's Financial Management Information System (FMIS) to restrict user access and prevent unauthorized disbursement transactions. Specifically, two employees could process invoices and standard vouchers without independent approvals, and could change vendor information. Additionally, one of these two employees could initiate and approve direct vouchers.

As a result, these employees could process unauthorized transactions which may not be readily detected. Similar conditions were commented upon in our four preceding audit reports dating back to February 1997. According to the State's accounting records, OAH used FMIS to process disbursements totaling approximately \$2.2 million during fiscal year 2008.

Recommendation 1

We again recommend that OAH fully use the available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions.

Cost Allocation

Finding 2

OAH lacked assurance that the allocation of its operating costs to State agencies was proper.

Analysis

OAH lacked assurance that its operating costs were properly allocated to State agencies. OAH conducts administrative hearings on behalf of State agencies and bills its operating costs to those agencies based on an allocation that considers the average time needed to hear a case for each agency and the number of cases heard. Our review disclosed that, although OAH used the most recent data available for the number of cases heard, OAH did not perform periodic reviews to determine the average time to hear a case for each agency. Specifically, we were

advised by OAH management personnel that the average time needed to hear cases used in the fiscal year 2008 cost allocation was based on a review of the case times conducted during the month of July 2003. Consequently, the calculation of the allocation of OAH's operating cost was not based on the most recent data available. As a result, the use of the older data could impact the amount each agency was assessed although any adjustments to the cost allocation would not affect OAH's total operating costs assessed to State agencies. According to OAH records, salaries and operating costs assessed to State agencies in fiscal year 2008 totaled approximately \$12.4 million.

Recommendation 2

We recommend that OAH periodically determine the average time needed to hear a case for each agency by considering case data over a representative period and use the current time to allocate its operating costs to State agencies. This determination should be documented and retained for future reference.

Budgetary Closeout

Finding 3

OAH improperly recorded accrued expenditures totaling approximately \$150,900 at the close of fiscal year 2006.

Analysis

During the budgetary closeout for fiscal year 2006, OAH improperly recorded reimbursable fund accrued expenditures totaling approximately \$150,900 related to a lease payment for equipment. Specifically, we were advised by OAH management personnel that the accrued expenditure related to a partial pre-payment of the fiscal year 2007 and 2008 lease payments owed to the State Treasurer's Office for equipment purchased through the Master Lease Purchase Financing Program. However, under this Program, the fiscal year 2007 and 2008 payments were not due until July 2006, January 2007, July 2007, and January 2008. The existence of a fiscal year-end surplus reimbursable fund balance, which should have been reverted to the General Fund, facilitated this accrual. Additionally, according to the State's annual fiscal year-end closing instructions, accrued expenditures relate to unbilled goods or services that have been received by fiscal year-end. The instructions also specifically prohibit encumbering funds for lease purchase or rental contracts applicable to periods after June 30 (encumbrances represent contracts or commitments for goods or services not yet provided).

In addition, the aforementioned equipment lease was paid in full by OAH in December 2006 primarily using these accrued reimbursable funds even though OAH's fiscal year 2007 appropriation included approximately \$78,900 to make the lease payments owed for fiscal year 2007. Subsequently, the remainder of this 2007 appropriation was used to fund other OAH expenditures and, thus, was not subject to reversion to the General Fund at the June 30, 2007 fiscal year-end.

The *State Policy on Accounts Payable, Accrued Expenditures, and Encumbrances*, which is included in the fiscal year-end closing instructions, states that expenditures should be accrued only when goods or services have been received prior to fiscal year-end but not invoiced, and that agencies must be careful to accrue only valid expenditures. The *Policy* also requires the reversion of any appropriation balance remaining after recording accounts payable, accrued expenditures, and encumbrances.

Recommendation 3

We recommend that OAH record fiscal year-end accrued expenditures and revert surplus reimbursable fund balances, in accordance with the aforementioned State policies.

Audit Scope, Objectives, and Methodology

We have audited the Office of Administrative Hearings (OAH) for the period beginning November 4, 2005 and ending August 17, 2008. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine OAH's financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

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, inspections of documents and records, and observations of OAH'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.

OAH'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 the 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.

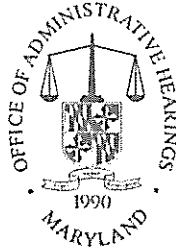
This report includes findings related to conditions that we consider to be a significant deficiencies in the design or operation of internal control that could adversely affect OAH's ability to maintain reliable financial records, operate effectively and efficiently and comply with applicable laws, rules, and regulations. Our report also includes a finding regarding a significant instance of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to OAH that did not warrant inclusion in this report.

OAH's response 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 OAH regarding the results of our review of its response.

APPENDIX

MARTIN O'MALLEY
GOVERNOR

ANTHONY G. BROWN
LT. GOVERNOR



THOMAS E. DEWBERRY
CHIEF ADMINISTRATIVE LAW JUDGE

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January 26, 2009

Bruce A. Myers, CPA
Department of Legislative Services
Office of Legislative Audits
301 West Preston Street – Room 1202
Baltimore, Maryland 21201

Dear Mr. Myers:

Enclosed are the responses to the audit report on the Office of Administrative Hearings for the period beginning November 4, 2005 and ending August 17, 2008.

Sincerely,

Richard E. Norman
Director of Administration

Enclosures

Audit Report

Office of Administrative Hearings

January 2009

Appendix: Agency Responses

Disbursements

Finding 1

Proper internal controls were not established over the processing of certain disbursement transactions.

Recommendation 1

We again recommend that OAH fully use the available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions.

Agency Response: OAH Agrees. The purpose of this ADPICS audit is to ensure that one person does not have authority to control any document from start to finish. One user should never have the authority to create a document, approve it and send it to R*STARS for payment. Cheryl Henson and Patricia Bennett have the capability to create a voucher (using the 1410/1420 screens) and the ability to release the voucher to R*STARS (using interface 05) without anyone else reviewing it. Both users also have access for creating direct vouchers (DV) (using 1800/1810 screens) and the ability to release the direct voucher to R*STARS (using interface 05). Since neither of the users is a final approver of DV removing the 05 interface will remove the violation. In order to be in compliance approval paths must also be established for both DV and voucher payments. With assistance from Ms. Hudson, approval paths were created for both where these documents now are approved in ADPICS by the Director of Administration. In addition FMIS control forms have been forwarded to remove interface 05 which will complete the security issue.

As per the R*STARS audit, one user should never have the authority to create a document, approve it and send it through R*STARS for payment. At this time, Ms. Bennett has the ability to do that as she may enter or change a disbursement transaction using user classes 01 and 99 and a release flag=1 (these user classes have an accounting trans > 0 which allow an individual to create and the release flag allows the release of the batch). Once the batch is released, user class 89 will allow the user to apply the action code 123 to the document and send it to the 32 screen. A solution would be to remove Ms. Bennett from user class 01 and add user classes 04; 07; and 08. In addition, OAH could change the release flag from 1 in user class 09 to release flag 0. Forms making these changes have been completed and forwarded to FMIS security.

As of the last FMIS Security report, OAH is in compliance.

Cost Allocation

Finding 2

OAH lacked assurance that the allocation of its operating costs to State agencies was proper.

Recommendation 2

We recommend that OAH periodically determine the average time needed to hear a case for each agency by considering case data over a representative period and use the current time to allocate its operating costs to State agencies. This determination should be documented and retained for future reference.

Agency Response: OAH agrees with this recommendation.

Budgetary Closeout

Finding 3

OAH improperly recorded accrued expenditures totaling approximately \$150,900 at the close of fiscal year 2006.

Recommendation 3

We recommend that OAH record fiscal year-end accrued expenditures and revert surplus reimbursable fund balances, in accordance with the aforementioned State policies.

Agency Response: OAH disagrees with this finding. As per the State of Maryland Policy, the goods and services at issue were received in fiscal year 2005. Therefore, the accrued expenditures in fiscal year 2006 were valid. Policy also requires the reversion of any appropriation balance remaining after the accrued expenditures. In this situation there were no balances remaining after the proper accrued expenditures.

In fiscal year 2005 OAH purchased approximately \$220,000 in computer equipment. Working through the Treasurer's Office for a lease payment option, OAH estimated having lease payments in FY2006; FY2007; and FY2008. The original lease payment scheduled in FY2006 totaled approximately \$78,000. OAH's budget, however, contained only \$35,000 appropriated. This was because the budgeted figure was prepared and submitted in advance of the lease payment schedule generated by the Treasurer's Office. Realizing that funds were not appropriated to cover the FY2006 lease payment, OAH accrued a payment in FY2005 to ease the burden on the FY2006 budget. In FY2006, OAH again, through proper management, was able to make not only the required FY2006 payments but was able to accrue the FY2007 payments, thus alleviating the need to budget the remaining lease payment due in FY2008. Prepaying out years lease payments

are not uncommon and are done to save money (on accrued interest) and to aid the Executive Department in preparing budgets in fiscally challenging times.

Office of Legislative Services recommends reverting appropriated funds not expended for lease payments to the general fund. In actuality, there were no funds to revert. The total appropriation received for the lease payments was approximately \$114,000. The total payments to the Treasurer's Office were approximately \$223,000. OAH through sound fiscal management was able to identify funds to prepay the lease payments. In addition, OAH works with the Department of Budget and Management, Office of Budget Analysis at year end prior to incurring expenditures beyond budgeted amounts.¹

Table Summary

	Lease Payment and/or (Accrual)	Appropriation	Difference funded by OAH
FY2005	\$ 49,314.00	\$ 0.00	\$ 49,314.00
FY2006	168,435.93	35,000.00	133,435.93
FY2007	5,354.77	78.854.00	(73,499.23)
FY2008	0.00	0.00	0.00
Totals	\$ 223,104.70	\$ 113,854.00	\$ 109,250.70

¹ Auditor's Comment: As noted in our analysis, the encumbering or accruing of future lease/purchase payments under this scenario are prohibited by the Comptroller of the Treasury's annual fiscal year-end closing instructions. OAH's accrual of future lease payments is clearly improper, regardless of OAH's assertion that this was done to save money on accrued interest charges. Additionally, OAH states that we recommended that appropriated funds not expended for lease payments be reverted to the General Fund, but that there were no funds to revert. Our recommendation concerning the reversion of surplus reimbursable fund balances is prospective in nature. Furthermore, although OAH indicates that it works with the Department of Budget and Management (DBM) at year-end, there is no indication that DBM approved these transactions.

AUDIT TEAM

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