



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Department of
Military Affairs*

*For the Two Fiscal Years Ended
June 30, 2018*

OCTOBER 2019

LEGISLATIVE AUDIT
DIVISION

18-25

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2017, was issued March 23, 2018. The Single Audit Report for the two fiscal years ended June 30, 2019, will be issued by March 31, 2020.

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October 2019

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Military Affairs for the two fiscal years ended June 30, 2018. Included in this report are seven recommendations related to federal grant reimbursements, expenditure accruals, recording fire suppression activity, compliance with federal regulations, and the financial schedule note disclosure preparation process. We also identified noncompliance with state law and determined the department was spending against general fund appropriations when other funding sources were available.

The department's written response to the audit recommendations is included in the audit report at page C-1. We considered the department's conditionally concurring response to Recommendation #1 on page 5. The response notes the department "...is unable to develop additional measures without knowing what specific concern to address..." and "...the audit does not provide specific examples of instances where unallowable expenditures were reimbursed." As outlined on page 6, the documents the department received and reviewed did not demonstrate that the expenditures the department ultimately paid were allowable under the program. The department's response further states the department "...is unable to develop additional measures without knowing...what adequate control measures will pass future state audits." As the independent auditor, we are prohibited from directing the department's corrective action. We believe we provided sufficient information in this report and through conversations throughout the audit process to enable the department to independently complete a corrective action to address the underlying issue.

We also considered the department's conditionally concurring response to Recommendation #2 on page 9. We maintain our position as reported and acknowledge the role of other agencies in part B of the recommendation.

We thank the Adjutant General and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

Department of Military Affairs

Major General Matthew T. Quinn, Adjutant General

Sundi West, Deputy Director, Director's Office

Delila Bruno, Administrator, Disaster and Emergency Services Division

Trent Gibson, Director, Montana Youth Challenge Program (as of June 2018)

Jan Rouse, Director, Montana Youth Challenge Program (through June 2018)

Wendy Fechter, Director, Science and Technology Academies Reinforcing Basic Aviation and Space Exploration Program (STARBASE)

Kelly Ackerman, Administrator, Veterans Affairs Division (as of October 2018)

Joe Foster, Administrator, Veterans Affairs Division (through October 2018)

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MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Department of Military Affairs

For the Two Fiscal Years Ended June 30, 2018

OCTOBER 2019

18-25

REPORT SUMMARY

The Department of Military Affairs (department) coordinated the National Guard activation to assist with fighting the wildfires around the state during the summer of 2017. The department did not comply with state law requiring them to spend nongeneral fund money first when recording the expenditures for this activity. This noncompliance resulted in an expenditure misstatement of approximately \$3,800,000 which contributed to modified opinions on the fiscal year 2018 financial schedules.

Context

The Department of Military Affairs (department) consists of eleven programs: Air National Guard, Army National Guard, Montana Youth Challenge, Director's Office, Disaster & Emergency Services, Disaster Fund, Military Capital Construction, Montana Military Family Relief Fund, Scholarship Program, Montana Science and Technology Academies Reinforcing Basic Aviation and Space Exploration (STARBASE), and Veterans Affairs.

The department, through the Army and Air National Guard, manages a joint federal-state program to maintain trained and equipped military organizations in readiness for state and national mobilizations to active duty. In addition to the National Guard, the department plans for and coordinates state responses in disaster and emergency situations. The department also manages and cooperates with state and federal agencies in providing statewide services for discharged veterans and their families.

The department is funded primarily with federal funds supporting both personal services and operating costs of the Army National Guard, Air National Guard, Montana Youth

Challenge, Disaster & Emergency Services, and Military Capital Construction programs. The department's general fund appropriations support administrative costs in the Director's Office and all funding for the Montana Guard Scholarship Program, which provides scholarships to eligible Montana National Guard personnel enrolled as undergraduate students. State special revenue funds primarily support the Veterans Affairs program with revenue from cemetery plot allowances and sale of veteran license plates.

Results

Our audit efforts focused primarily on federal grants received for the National Guard Military Operations and Maintenance Projects, National Guard Military Construction Projects, Disaster and Emergency Services, and presidentially declared disasters. We also tested transactions related to personal services and operating expenditures. Our work included obtaining an understanding of the department's internal control policies and procedures, performing analytical procedures, and reviewing accounting transactions. We also reviewed and tested compliance with various state and federal laws and regulations.

(continued on back)

The prior audit included four recommendations, two of which the department fully implemented. The remaining two recommendations were not implemented by the department and resulted in further recommendations in this audit report.

During our audit, we identified issues related to federal grant reimbursements, expenditure accruals, recording fire suppression activity, compliance with federal regulations, and the financial schedule note disclosure preparation process. We also identified noncompliance with state law and determined the department was spending against general fund appropriations when other funding sources were available. These issues are discussed in the seven recommendations in the current audit report.

Recommendation Concurrence	
Concur	5
Conditionally Concur	2
Do Not Concur	0
Source: Agency audit response included in final report.	

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Call toll-free 1-800-222-4446, or e-mail LADHotline@mt.gov.

Chapter I – Introduction

Audit Scope

We performed a financial-compliance audit of the Department of Military Affairs (department) for the two fiscal years ended June 30, 2018. The objectives of the audit were to:

1. Determine whether the department's financial schedules present fairly its results of operations and changes in fund equity for each of the two fiscal years ended June 30, 2018 and 2017.
2. Obtain an understanding of the department's internal control structures to the extent necessary to support the audit of its financial schedules and, where necessary, make recommendations for improvement in the department's management and internal controls.
3. Determine the department's compliance with selected, applicable laws and regulations.
4. Follow-up on and determine the implementation status of prior audit recommendations.

We addressed these objectives by focusing our audit efforts primarily on federal grants received for the National Guard Military Operations and Maintenance Projects, National Guard Military Construction Projects, Disaster and Emergency Services, and presidentially declared disasters. We also tested transactions related to personal services and operating expenditures. Our work included obtaining an understanding of the department's internal control policies and procedures, performing analytical procedures, and reviewing accounting transactions. We also reviewed and tested compliance with various state and federal laws and regulations.

Background

The department, through the Army and Air National Guard, manages a joint federal-state program to maintain trained and equipped military organizations in readiness for state and national mobilizations to active duty. The department was authorized 201.75 full-time equivalent (FTE) positions in fiscal year 2018. The following paragraphs discuss the various divisions making up the department, as they appear on the Schedules of Total Expenditures & Transfers-Out on pages A-11 and A-12.

Montana National Guard (86.30 FTE) has a unique dual mission that consists of both federal and state roles. The Governor can call the National Guard into action during local or statewide emergencies, such as storms, fires, earthquakes, or civil disturbances. In addition, the President of the United States can activate the National

Guard for participation in federal missions. The Montana National Guard has two programs—the Army National Guard and the Air National Guard.

- ♦ **Army National Guard** is one component of the Army (which consists of the Active Army, the Army National Guard, and the Army Reserve). The Army National Guard is composed primarily of traditional Guardsmen—civilians who serve their country, state, and community on a part-time basis.
- ♦ **Air National Guard** maintains units available for prompt mobilization during war and provides assistance during national emergencies. During peacetime, the combat-ready units and support units carry out missions compatible with training, mobilization readiness, humanitarian, and contingency operations.

Military Capital Construction (0.0 FTE) is administered by the Montana National Guard and provides support to the Army and Air National Guard for the construction of military facilities, real property improvements, design services, and other projects authorized and directed by Congress or the Department of Defense.

Director's Office (12.32 FTE) is the primary administrative support organization for the department and provides oversight for budgeting, fiscal management, payroll, human resource management, purchasing, property control, policy development and implementation, and assists with interpretation of rules, regulations, and statutes for all programs within the department.

Disaster and Emergency Services Division (DES) (22.89 FTE) works with local, state, and federal officials to prepare, update, and coordinate emergency preparedness, response, and recovery plans. This responsibility includes the administration and disbursement of federal homeland security and emergency management funds to eligible applicants across the state. DES provides technical support and monitoring for civil defense shelters, exercises, and radiological defense. The division also receives, records, and disburses federal funds to eligible government entities.

Disaster Fund Program (0.0 FTE) is administered by DES to provide assistance under an emergency or major disaster declaration. The department works with the Federal Emergency Management Agency and uses the funds to restore its own disaster damaged facilities and to provide subgrants to local governments.

Montana Youth Challenge Academy (53.15 FTE) is a 17-month, voluntary, military-modeled training program targeting unemployed, drug-free, and crime-free youth ages 16 to 18 who have stopped attending secondary school before graduating. The program provides values, skills, education, and self-discipline in a quasi-military modeled training environment. The Residential Phase of the program is a 5-month residential stay on the campus of University of Montana–Western in Dillon focusing

on physical training, classroom instruction, personal development, and life skills. The Mentoring Phase is a year-long mentoring relationship with a specially-trained member of the community where the youth resides to provide a positive role model and to assist the student in gaining employment or enrolling in postsecondary schooling.

Veterans Affairs Division (25.09 FTE) manages and cooperates with state and federal agencies in providing statewide services for discharged veterans and their families. It promotes the general welfare of veterans and assists Montana's veterans and dependents in obtaining veterans benefits. The program also administers the veterans' cemeteries located in Miles City, Helena, and Missoula.

Montana STARBASE (Science and Technology Academies Reinforcing Basic Aviation and Space Exploration) "Big Sky" Program (2 FTE) is for elementary school-aged children. Its goals include raising interest and improving the knowledge and skills of at-risk youth in math, science, and technology by exposing the students and their teachers to real world applications of math and science. The program uses positive role models found on military bases and installations to implement experimental learning, simulations, and experiments in aviation and space-related fields. The program has two locations in Montana, Helena and Great Falls, as well as summer outreach programs to tribes within the state.

Montana Military Family Relief Fund (0.0 FTE) is administered by the Director's Office and provides monetary grants to families of Montana National Guard and Reserve Component members who meet the grant criteria. The grants are intended to help Montana families defray the costs of food, housing, utilities, medical services, and other expenses that become difficult to afford when a wage-earner has temporarily left civilian employment to be placed on active military duty.

Montana Guard Scholarship Program (0.0 FTE) is administered by the Director's Office and was established to assist in recruiting and retention efforts for the Montana National Guard. The program provides scholarships to eligible Montana National Guard personnel enrolled as undergraduate students at Montana colleges, universities, or in training programs.

Prior Audit Recommendations

The prior audit report for the two fiscal years ended June 30, 2016, contained four recommendations to the department. These recommendations related to federal grant reimbursements, revenue and expenditure accruals, and noncompliance with state law by allowing cash in its federal fund to remain negative for longer than allowed. The

department fully implemented the recommendation related to noncompliance with state law by allowing cash in its federal fund to remain negative for longer than allowed.

The department also implemented the prior audit recommendation related to revenue accruals by implementing a revenue accrual process. However, this prior audit recommendation resulted in several misstatements in the current audit period. The Beginning Fund Equity in fiscal year 2017 is overstated by \$3,006,000 in the federal special revenue fund. State accounting policy requires agencies to correct prior years' errors. The department partially corrected the error by recognizing revenue on the Prior Year Revenues & Transfers-In Adjustments line. However, had the department recognized the revenue correctly in the prior years, beginning fund equity would have been correct and they would not have had to record this prior year revenue. This resulted in an overstatement of approximately \$2,200,000 in fiscal year 2017. The remaining amount of the error should have been corrected through an entry to the Direct Entries to Fund Equity line, but the department did not make this entry; resulting in an overstatement of \$806,000 in fiscal year 2017. These misstatements contributed to the adverse opinion on the fiscal year 2017 Schedule of Changes in Fund Equity. We also determined the department did not remove a revenue accrual of approximately \$1,000,000 from prior years, resulting in an overstatement of Beginning Fund Equity in fiscal year 2017 in the federal special revenue fund. Even though the misstatements just described contributed to an adverse opinion, the department did not have further issues recognizing revenue during the audit period.

The department did not implement the two remaining recommendations. The recommendation related to federal grant reimbursements is discussed in current Recommendation #1, beginning on page 5. The recommendation related to expenditure accruals is discussed in current Recommendation #5, beginning on page 15.

Chapter II – Findings and Recommendations

Nondisaster Grant Reimbursements

The department does not have internal controls in place over its nondisaster related grants to ensure only allowable costs are reimbursed, resulting in noncompliance with federal regulations, federal questioned costs, and expenditure misstatements of approximately \$4,200,000 in each fiscal year of the audit period.

The prior audit included a recommendation for the department to improve internal controls over the grant reimbursement process in the Disaster and Emergency Services Division (DES) to ensure expenditures are allowable under the grant awards. As part of the audit, we followed up on this recommendation and found the department took some steps to address the recommendation, but has a continued need to enhance internal controls.

DES administers and distributes several federal grants to individual local government subrecipients throughout the state, such as Homeland Security Grants, Emergency Management Performance Grants, and Hazard Mitigation Grants (HSGP, EMPG, and HMGP, respectively). The subrecipients expend funds for projects outlined in grant agreements and then request reimbursement from DES. The reimbursement requests for these grants are initially reviewed and approved by various DES staff. During our audit period, subrecipients were reimbursed approximately \$17 million by the department, but we determined the department's procedures did not ensure reimbursements were made only for allowable costs.

During the audit, we intended to review a sample of 78 grant reimbursements in order to audit this activity. However, due to the number of issues we found and the likelihood of encountering more in the remaining sample items, we only reviewed 46 grant reimbursements, totaling approximately \$1,765,000. Our review identified the following issues:

- ◆ Five reimbursements, totaling approximately \$240,000, where a portion of the amount of the reimbursement was unsupported by subrecipient supplied documents.
- ◆ Sixteen reimbursements, totaling approximately \$377,000, where at least a portion of the expenditures were unallowable under the grant award due to inadequate documentation. Eleven of these instances were for EMPG reimbursements.

As outlined in the following two sections, these issues resulted in noncompliance with federal regulations and financial misstatements.

Federal Noncompliance and Questioned Costs

Federal regulations¹ require recipients of federal assistance to establish and maintain effective internal control to provide reasonable assurance the federal award is being administered in compliance with statutes, regulations, and the terms and conditions of the federal award. While the department has developed written procedures for the reimbursement process for each grant, they were not finalized until October 2018 for EMPG and HSGP. The HMGP procedures are still in draft format due to staff turnover at the time of our testing in the spring of 2019. Additionally, these procedures for each grant type do not address the amount and detail of supporting documentation required for each reimbursement. As a result, the department's supporting documentation did not contain enough detail to determine whether the expenditure reimbursements provided to the subrecipients were allowable under the grant for the sixteen instances discussed above.

For an item to be considered an allowable cost for the grant, not only must the activity be something that can be covered by the grant, but the specific expenditures being requested must be allowable under the scope of the grant. For example, personal services expenditures are a common cost for EMPG grants, and are an allowable activity under the grant guidance. However, to be considered an allowable cost and reimbursed by the department, the personal services expenditures need to be for emergency management activities. For example, the emergency manager's salary would be allowable, but the county librarian's salary would not.

Federal regulations² require costs to be adequately documented in order to be considered allowable and paid from federal funds. As the supporting documents provided by the subrecipients for the 21 reimbursements discussed on page 5 were either not sufficient to show all the costs were allowable under the grant or did not support the amount the department ultimately paid, these costs are considered unallowable costs under the federal requirements. The department should not have paid the subrecipients for these unallowable costs. Through our testing, we identified reimbursements made for unallowable costs of \$60,628 and \$54,654 in fiscal year 2017 and fiscal year 2018, respectively. However, due to the pervasiveness of the issues we identified in our sample, there were likely additional reimbursements made for unallowable costs. We used a statistical method to analyze the results of our sample testing. Based on the errors we identified, we are 95 percent confident between 22 percent and 49 percent of the total reimbursements made by the department during the audit period could potentially be for unallowable costs. In quantifying the impact of this analysis, we determined it would be most conservative to consider the maximum potential effect of \$4,192,988

1 2CFR200.303

2 2CFR200.53 and 2CFR200.403

and \$4,202,454 in fiscal years 2017 and 2018, respectively. Thus, as the department did issue the payments for the reimbursements, we question costs of approximately \$8,400,000 for the two fiscal years ended June 30, 2018.

Financial Misstatements

In addition to the federal requirements discussed above, state accounting policy requires all state agencies to implement internal controls to help facilitate statewide compliance with generally accepted accounting principles (GAAP). Policy also requires the internal controls check the accuracy and reliability of financial data and ensure compliance with applicable laws and regulations. As the department did not have adequate supporting documents for the 21 reimbursements discussed on page 5 above at the time they issued the payments, the department should not have paid them. Accordingly, the department's expenditures and federal revenues are overstated in both fiscal years. As mentioned above, we estimate unallowable costs and inappropriately paid expenditures could be as much as \$4,192,988 and \$4,202,454 in fiscal year 2017 and fiscal year 2018, respectively. Because the department requests federal reimbursement based on the expenditure payments they make, the federal revenues corresponding to these inappropriate payments should not have been recorded. The resulting expenditure and federal revenue overstatements contributed to the qualified opinions on the Schedules of Total Expenditures & Transfers-Out and the Schedules of Total Revenues & Transfers-In and the adverse opinions on the Schedules of Changes in Fund Equity & Property Held in Trust for both years in the Independent Auditor's Report beginning on page A-1. This means you cannot rely on the amounts presented for the individual line items on the expenditure and revenue financial schedules affected by these errors and you cannot rely on any amounts presented on the Schedules of Changes in Fund Equity & Property Held In Trust for both fiscal years.

Department staff stated they believe in the existing internal control process because DES has multiple levels of oversight for the reimbursements, and noted the supporting documents are maintained by the subrecipient for some grants. Additionally, department staff noted two on-site monitoring visits are conducted for each subrecipient each year, for each grant. During these visits, staff review general ledgers and supporting documentation including receipts and invoices. Per management, costs that are not substantiated or unable to be verified as eligible costs are followed up on and unsubstantiated costs or costs deemed ineligible are not reimbursed.

Although the department has several levels of review for each reimbursement request, the documentation being reviewed for EMPG reimbursements is not detailed enough to determine the allowability of all costs included in the payment. While the supporting documentation provided for the HSGP and HMGP reimbursements often

contained the correct level of detail, the department's reviews were not sufficient to identify the instances where this was not the case or when the amounts did not match the subrecipient's payment request. Additionally, reviewing the documents during site visits twice per year do not permit the department to identify unallowable costs prior to reimbursement by the state.

Because the department does not have adequate internal controls in place over the DES grant reimbursement process, they are reimbursing subrecipients for unsupported and unallowable costs. Given this and the magnitude of the estimated misstatements detailed above, we consider this internal control deficiency to be a material weakness for financial reporting purposes. This material weakness is reported in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

As mentioned at the beginning of this section on page 5, the department's internal control over these reimbursements was also an issue in the prior audit. During that audit, we identified approximately \$55,200 and \$1,690,000 of known and potential federal questioned costs, respectively, related to this internal control issue. We reported both the internal control issue and the questioned costs to the federal government through the Single Audit report issued in March 2018. As required by federal regulations, the federal awarding agency followed up on the audit report and closed the finding at the federal level after some correspondence with the department. However, under the Single Audit Act, we are required to determine whether the department has complied with federal statutes, regulations, and the terms and conditions of its federal awards; and, if we identify instances when the department is not in compliance, to report this to the federal government, including whether it was an issue in the prior audit. We are also required to report any questioned costs over \$25,000 resulting from the noncompliance. Thus, even if the federal awarding agency closed this finding without requiring the department to pay back any of the costs we questioned, we are still required to report the continuing issue and federal questioned costs we identified during the current audit. We will continue to report this issue, including any effect on the department's financial schedules, when internal control deficiencies or unallowable costs are identified until the federal regulations change.

RECOMMENDATION #1

We recommend the Department of Military Affairs implement internal controls in the Disaster & Emergency Services Division to ensure subrecipient reimbursements are supported and allowable under the grant awards at the time the reimbursement is made.

Nongeneral Fund Money First

Section 17-2-108, MCA, requires agencies to apply expenditures to nongeneral fund appropriations before general fund appropriations, whenever possible. This means if there are resources, such as cash and appropriation authority in a state or federal special revenue fund, the department must record expenditures against that fund before using the general fund as long as the expenditures fit the restrictions on that fund. The following two sections summarize instances when the department did not apply expenditures to nongeneral fund appropriations before general fund appropriations during the audit period.

National Guard Fire Suppression Activities

The department did not comply with state law and charged \$3,800,000 of fire suppression costs to the general fund when other nongeneral funds were available.

When federal, state, and local fire resources are exhausted and still more resources are needed to fight wildfires in the state, the National Guard can be called in to fulfill this need. This occurred during the summer of 2017. Between the operating and personal services costs for the National Guard and the department's DES Division, the department incurred approximately \$6,700,000 of expenditures for these activities during the audit period.

The department's costs for fire suppression activities were initially paid from the general fund under the Governor's Emergency Appropriation established in §10-3-312, MCA. This law establishes a statutory appropriation up to \$16 million per biennium for the governor to use in the event of a declared emergency or disaster. The governor can assign all or a portion of this appropriation to any other state agency as necessary. During the 2018 fiscal year-end closing process, the department moved approximately \$3,900,000 of these costs to the Fire Suppression account in the state special revenue fund, while leaving the remaining approximately \$3,800,000 in the general fund.

Based on our review, there were approximately \$40 million of cash and \$12 million of appropriation authority available in the Fire Suppression account in the state special revenue fund at fiscal year-end 2018. To comply with state law, the department should have moved the entire \$6.7 million, instead of just \$3.9 million. This caused the personal services and operating expenses expenditures to be overstated in the general fund and understated in the state special revenue fund by approximately \$3.8 million on the 2018 Schedule of Total Expenditures & Transfers-Out. These misstatements contributed to the qualified opinion on the fiscal year 2018 Schedule of Total

Expenditures & Transfers-Out and the adverse opinion on the fiscal year 2018 Schedule of Changes in Fund Equity & Property Held in Trust in the Independent Auditor's Report beginning on page A-1. This means you cannot rely on the amounts presented for the individual line items on the expenditure financial schedule affected by this error and you cannot rely on any amounts presented on the Schedule of Changes in Fund Equity & Property Held In Trust for fiscal year 2018. Additionally, given the impact these misstatements had on the financial schedules, we consider the noncompliance with state law to be material noncompliance and have reported it as such in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

Department staff indicated Department of Natural Resources and Conservation (DNRC) staff provided the amount of expenditures to be moved. Staff from DNRC and the Governor's Office of Budget and Program Planning (OBPP) attributed the decision to leave a portion of the expenditures in the general fund to the need to balance the resources available in the fire suppression fund and the emergency appropriation with what they projected could happen with the upcoming fire season. They reported not wanting either the fire suppression fund or emergency appropriation to get too low going into the next fire season in case unforeseen activities were to occur in the future that did not meet the requirements for one source but did for the other. For example, emergency expenditures that are not related to fires, and therefore cannot be paid from the fire suppression fund, or fire expenditures that are not for a declared emergency, and therefore cannot be paid from the general fund emergency appropriation.

We acknowledge the department, DNRC, and OBPP were attempting to balance the available resources in both the fire suppression fund and the emergency appropriation. However, in doing so, the department acted contrary to state law. From discussions with staff, it was clear neither the department, DNRC, nor OBPP staff considered the need to spend nongeneral fund money first when making the decision to leave some costs in the general fund. This indicates the department's internal controls are not ensuring compliance with applicable laws and regulations, as required by state accounting policy. Accordingly, the department should work with DNRC and OBPP to implement internal controls to ensure compliance with state law when paying for emergency National Guard costs.

Given the impact the misstatements had on the financial schedules, we consider the deficiency in internal controls to be a material weakness over financial reporting. This material weakness is reported in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

RECOMMENDATION #2

We recommend the Department of Military Affairs:

- A. *Comply with state law by using nongeneral fund money first whenever possible for fire suppression National Guard costs.*
 - B. *Work with the Department of Natural Resources and Conservation and the Governor's Office of Budget and Program Planning to develop internal controls to ensure nongeneral fund money is used first for future emergency National Guard costs.*
-

National Guard Military Operations and Maintenance Project Costs

The department did not comply with state law and federal regulations to split the costs of the National Guard Military Operations and Maintenance program between federal funds and the general fund.

The department receives federal funding from the National Guard Bureau (NGB) to provide support to the Army and Air National Guard in minor construction, maintenance, repair or operation of facilities, and mission operational support. The state is required to share in the cost of some of these activities as outlined in the Master Cooperative Agreement (MCA) with the NGB, which consists of an Agreement and related Appendices. The Agreement includes the standard terms and conditions applicable to all Appendices, and the Appendices contain the more specific terms and conditions, policy, administrative procedures, scope of work, authorized and unauthorized activities or charges, budget information, and funding limitations. The department's required matching percentage varies by Appendix and is based on the Facilities Inventory and Support Plan (FISP) support code for the facility generating the expenditure. The FISP lists the department's areas and buildings with the support code for the required funding split of federal and state funds. The Army National Guard Facilities Programs, or Appendix 1001, allows 100 percent federal funding for certain expenses for operating and maintaining facilities, 75 percent federal funding of certain expenses for operating and maintaining licensed readiness centers, and 50 percent federal funding of certain expenses for operating and maintaining state-owned readiness centers.

During the audit we tested 44 total operating expenditure transactions from fiscal years 2017 and 2018, and identified 12 instances where the department's funding split

between federal and state funds was not supported. These costs were related to buildings occupied by both federal and state employees. For these buildings, the costs are split between federal and state funds using a percentage derived from the square footage of the space used by either the state or federal employees and the FISP percentages.

We identified seven buildings with these types of square footage splits. The calculations for four of the seven buildings were created before 2006, and department personnel were unable to provide documentation to support the splits. The funding splits for the other three buildings were also not supported, but were created or updated at later dates. For example, the department updated the funding split for one building in June 2017, resulting in an approximate 8 percent change in the split for the building.

Due to the lack of support, the department is not in compliance with a federal regulation³ requiring the department to establish and maintain effective internal controls over the federal award that provide reasonable assurance that the nonfederal entity is managing the federal award in compliance with federal statutes, regulations, and the terms and conditions of the award. Additionally, because the department could not support how the funding splits were determined, they are not in compliance with the matching requirements outlined in the Appendices⁴.

During the fieldwork portion of our audit, department personnel stated the supporting documentation for these square footage splits did not exist. Accordingly, we completed an analysis to project the amount of expenditures incorrectly split between federal and state funds during the audit period. Our analysis was based on the department's estimate of upcoming changes in the splits resulting from changes in NGB guidance and usage of the buildings. We used the estimate of approximately \$316,000 and \$374,000 in fiscal years 2017 and 2018, respectively, to consider how these errors affected our opinions on the department's financial schedules.

During the audit reporting process, department management indicated they believed the estimate department personnel initially provided, and we used in our analysis, was too high. They further stated they could recreate the documentation of the split calculations as their computer system contained the underlying information used in the calculation. We performed additional audit procedures over this recreated supporting documentation and found that it did not match the split used during the audit period for six of the buildings. The differences ranged from -2.29 to 1.72 percent, with an aggregate difference of .59 percent. Using this information, we estimate approximately \$48,000 and \$49,000 in fiscal year 2017 and fiscal year 2018, respectively, of costs could have been charged to the federal funding but were not. Instead, the costs were

³ 2CFR200.303

⁴ 2CFR200.403

funded by the state's General Fund, which is contrary to state law. The department had unspent budget authority in the Army National Guard program of approximately \$1.2 million and \$7.9 million in fiscal years 2017 and 2018, respectively, and thus could have paid these expenditures from federal funds.

The department should have an internal control process in place to ensure appropriated nongeneral fund money is used first. These misstatements contributed to the adverse opinions on the Schedules of Changes in Fund Equity & Property Held in Trust in the Independent Auditor's Report beginning on page A-1. These adverse opinions mean a reader cannot rely on any amounts presented on these financial schedules for both fiscal years.

RECOMMENDATION #3

We recommend the Department of Military Affairs:

- A. *Comply with federal requirements to match the percentages as required by the Funding Limitation section of each Master Cooperative Agreement Appendix and the Facilities Inventory and Support Plan,*
 - B. *Establish internal controls to ensure the basis of the splits is supported, and*
 - C. *Comply with state law by using nongeneral fund money first, whenever possible, for National Guard Military Operations and Maintenance program costs.*
-

Disaster Grant Payments

DES administers several federal grants for federally-declared disasters within the state. These grants are based on state and Federal Emergency Management Agency (FEMA) approved projects submitted and completed by individual local government subrecipients throughout the state. The grants include a 25 percent match requirement. If a subrecipient does not have enough resources to pay this match, the department will complete the match using the general fund.

When a subrecipient completes a project, department staff complete a closeout process that entails reviewing supporting documents to verify the following:

- ◆ The subrecipient paid for the costs, and
- ◆ The expenditures were for the project and allowable under the scope of work for the project.

This process takes approximately one month to complete. Once the department has reviewed and approved the project documents, they are sent to FEMA for a final closeout. Once FEMA has completed their closeout, the final payment for the project is issued to the subrecipient. The department paid approximately \$14.7 million to subrecipients for various projects during fiscal years 2017 and 2018 from federal and state funds. The following two sections summarize recommendations related to disaster grants.

Timely Payment

The department did not pay subrecipients timely as required by federal regulations.

Federal regulations⁵ require the department to make payments to subrecipients within 30 days after the department has received the request from the subrecipient and determined all costs included are allowable under the grant award. At the point the department completes their closeout process, the subrecipient has met all their obligations related to the project. The federal program requires subrecipients to make an accounting to the department, which they do as part of the state's project closeout process. The department "approves" this accounting by closing the project at the state level. At this point, because the department has a reasonable estimate of the amount that will be approved by FEMA and paid to the subrecipient, and the subrecipient has fulfilled their responsibilities, the department should make the final payments for the projects. Of the 54 projects with final payments made during fiscal years 2017, 2018, and the first half of 2019, we determined 46 occurred more than 30 days after the department completed their closeout process. The number of days these payments extended beyond the 30 days allowed ranged between 73 and 1,917 days. These payments ranged from \$4,910 to \$218,990.

Department staff stated they believe their process follows FEMA policy and is the best way to avoid requiring the subrecipients to pay back any disallowed costs identified during the FEMA closeout process. Although department personnel stated FEMA policy allows the department to wait until the project has been closed out at the FEMA level to make the final payment, they could not provide, and we were unable to find, an official FEMA policy placing these restrictions on the timing of final payments. Both the FEMA specific federal regulations and general regulations covering all federal programs require timely payments. Additionally, federal regulations⁶ require the department to establish and maintain effective internal controls over the allowability

⁵ 2CFR200.305

⁶ 2CFR200.303

of costs. The department's payment approval process, whether for progress payments or final payments, must include controls intended to identify any unallowable costs prior to issuing payments. Accordingly, the department should not have to rely on FEMA's review to identify unallowable costs.

Additionally, at the time FEMA approves a project initially, the funds are obligated at the federal level and available to the department. The department can draw down these funds and pay subrecipients for progress payments throughout the life of the project based on the work completed by subrecipients. The department frequently makes these progress payments, and there are no prohibitions in federal regulations or FEMA policy preventing the department from drawing down the full amounts of the obligated funds to pay subrecipients for completed work. They could simply treat the final payments as progress payments and pay subrecipients up to the amount that has been approved and obligated by FEMA. By doing so, the department could issue payments timely, in accordance with federal regulations, using the available federal funds.

RECOMMENDATION #4

We recommend the Department of Military Affairs comply with federal regulations by making timely payments to subrecipients once the department has closed out a disaster project.

Expenditure Accruals

The department did not record all valid obligations for disaster grants in accordance with state accounting policy.

The prior audit included a recommendation for the department to record all valid obligations related to disaster grants in accordance with state accounting policy. As part of our audit, we followed up on this recommendation and found the department did not record any of their valid obligations for this activity during fiscal years 2017 and 2018.

State accounting policy requires contractual amounts to be accrued if the performance is complete or virtually complete, as these are valid obligations of the state. The accrual process results in recording a liability and related expenditure in the current year, and the actual cash payment will occur in a subsequent fiscal year. Because the local

government subrecipients have completed the projects outlined in the grant agreements and fulfilled their responsibilities under the federal regulations, the final amounts owed to them are valid obligations of the department and should be recorded on the department's accounting records in the fiscal year they become valid obligations.

However, the department does not include these closed out projects in their accrual process, but rather records the costs as expenses in the year of payment. As a result, the department's accounting records contain misstatements. Table 1 illustrates the impact these errors have on the department's recorded expenditures, reported on the 2017 and 2018 Schedules of Total Expenditures & Transfers-Out.

Table 1
Disaster Grant Expenditure Misstatements
Fiscal Years 2017-2018

Amount Over(Under)stated		
Fiscal Year 2017	General Fund	Federal Special Revenue Fund
Payments issued and recorded as expenditures in FY17 that should have been accrued in prior years.	\$366,744	\$1,043,364
Payments recorded as expenditures in subsequent years that should have been accrued in FY17.	(\$129,245)	(\$528,847)
Net effect on FY17 expenditures	\$237,499	\$514,490
Fiscal Year 2018		
Payments issued and recorded as expenditures in FY18 that should have been accrued in prior years.	\$129,245	\$528,847
Payments recorded as expenditures in subsequent years that should have been accrued in FY18.	(\$14,598)	(\$89,772)
Net effect on FY18 expenditures	\$114,647	\$439,102

Source: Legislative Audit Division.

As the department's expenditures are also presented on the Schedule of Changes in Fund Equity, any overstatements in these expenditures flow through and result in fund equity overstatements on that schedule. This results in the misstatements above contributing to the adverse opinion on the Schedules of Changes in Fund Equity & Property Held in Trust for both fiscal years in the Independent Auditor's Report beginning on page A-1; meaning you cannot rely on any amounts presented on these financial schedules for both fiscal years.

Department staff stated these payments do not need to be accrued as the department has continuing appropriation authority for them. However, having continuing

appropriation authority for these expenditures only means the department does not have to record encumbrances, or reservations of budget authority, for the remaining grant award from FEMA each year to make subrecipient payments in future years. This does not mean actual expenditure accruals for valid obligations of the department that remain unpaid at fiscal year-end do not need to be recorded. We believe this type of error could have been prevented by subject matter expertise in governmental accounting, as discussed in the next recommendation.

RECOMMENDATION #5

We recommend the department of Military Affairs record all valid obligations in accordance with state accounting policy.

Internal Controls Over Expenditure Accruals

The department's internal controls were not sufficient to ensure the accuracy of expenditure accruals recorded on the department's accounting records.

The department routinely enters into various contracts with vendors for services and supplies, and subrecipients for grant projects throughout the year. Often, these contracts are not complete, or the department has received the goods or service but not issued the payment, by fiscal year-end. In these instances, state accounting policy requires the department to accrue expenditures for commitments related to unperformed legally binding contracts as of the end of the fiscal year. State accounting policy requires expenditure accruals to be supported by documentation and reviewed before they are recorded. State policy also requires the department to have internal controls in place to check the accuracy and reliability of financial data. Based on the results of our audit work, the department's internal controls were not effective at ensuring the expenditure accruals recorded for fiscal years 2017 and 2018 were complete and accurate.

During the fiscal year-end closing process, the Director's Office directs the individual divisions to gather all of their accrual information. Then division staff work with Director's Office staff to create the journal entries. As the Director's Office staff consists of staff performing the accounting functions for the department, they are the ones at the department who have the knowledge of state accounting policy and experience with accruals to identify errors in what the divisions have gathered.

During our audit, we identified the following errors:

- ◆ One instance of an accrual not being reversed and remaining on the books for several fiscal years.
- ◆ One instance of only a portion of the valid obligation being recorded as an accrual. Department staff stated there was not sufficient budget authority available in the fund to record the entire obligation. However, because the department had entered into a contract, and thus created a valid obligation for the state, they should have sought to increase the authority through a Budget Change Document and recorded the full amount. By not recording the full amount of the obligation, the department's financial schedules and records do not reflect the total amount they have expended and the amount of resources remaining for further expenditures.
- ◆ Multiple instances of accruals not being established for valid disaster grant obligations, as discussed in Recommendation #5.

Table 2 illustrates the cumulative impact these errors have on the department's recorded expenditures, reported on the 2017 and 2018 Schedule of Total Expenditures & Transfers-Out.

Fiscal Year	Amount Over(Under)stated	
	General Fund	Federal Special Revenue Fund
2017	(\$129,245)	(\$433,688)
2018	(\$14,598)	(\$101,139)

Source: Legislative Audit Division.

Department accounting staff stated they rely on the individual divisions to gather the appropriate information as the individual divisions are in the best position to know the activity and what needs to be accrued. However, given the errors span multiple divisions within the department and are a recurring issue from the prior audit, it is clear the Director's Office controls need to be enhanced. We believe this type of error could have been prevented by subject matter expertise in governmental accounting.

Given the department's procedures did not prevent and detect and correct the errors in the accruals and the potential for the errors to be material to the financial schedules, we consider the deficiency in internal controls to be a significant deficiency over financial reporting and have included it in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

RECOMMENDATION #6

We recommend the Department of Military Affairs:

- A. *Improve internal controls over the fiscal year-end expenditure accrual process to ensure expenditures are accrued in accordance with state accounting policy, and*
- B. *Record expenditure accruals in accordance with state accounting policy.*

Financial Schedule Note Disclosures**The department did not properly prepare the notes to the financial schedules.**

The notes, beginning on page A-13, are an integral part of the financial schedules and essential to a reader's understanding of the information presented on the financial schedules. These notes should include informative disclosures to help a user of the financial schedules understand the activity presented in those schedules. State policy designates management as responsible for preparing these disclosures based on a template provided by the Department of Administration and for determining what additional disclosures, if any, are required beyond those included in the template. Additionally, state policy requires state agencies to implement internal controls to ensure the notes provided as part of the audit are free from material misstatement prior to the audit process.

There was materially misleading information in the first, second, and third versions of the notes provided for audit by the department. During our review of the first draft of the notes provided by the department, we identified 13 items that needed to be fixed and communicated them to the department. While many of these were small errors, together they made the notes materially misleading to the reader. On the second draft of the notes we identified three items that still needed to be fixed, and on the third draft we identified one item still needing to be fixed. All the items communicated as needing to be corrected in the second and third versions of the notes were items we previously communicated to the department. Examples of these errors include:

- ◆ The department described the Emergency Management Assistance Compact (EMAC) activity in fiscal year 2018 as being recorded in a state special revenue fund instead of an agency fund. Without properly identifying the fund type used to record this activity, a reader would have no information about the activity in the agency fund on the fiscal year 2018 Schedule of Changes in Fund Equity & Property Held In Trust. As this activity is new in fiscal

year 2018, we believe a reader needs to know about it. The department did not update the fund type in this note until the final notes were submitted, resulting in us having to communicate it three separate times.

- ◆ In the template provided by the Department of Administration, each time the agency under audit is mentioned, it lists “department, board, office, council” and the agency is supposed to select the applicable moniker and delete the remaining items. The department did not update this language in multiple places in the first draft of the notes and did not correct all the instances we identified in the second draft, resulting in us having to communicate the same issue multiple times.
- ◆ The department described activity in the private purpose trust fund type in the first draft of the Basis of Presentation note even though the department does not have any private purpose trust funds.

Each time department personnel submitted an updated version of the notes to us, they indicated they understood the errors communicated, why changes were necessary, and they had fixed all items communicated. Based on this, it is clear the department does not have internal control procedures in place to ensure the financial schedule note disclosures are accurate and complete prior to submitting them for audit. Department staff stated although each draft was reviewed, they did not catch the errors. We believe this type of error could have been prevented by subject matter expertise in governmental accounting.

Given the department’s procedures did not prevent and detect and correct material misstatements in the note disclosures, we consider the deficiency in internal controls to be a material weakness. This material weakness is reported in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance With *Government Auditing Standards* on page B-1.

RECOMMENDATION #7

We recommend the Department of Military Affairs strengthen internal controls over the drafting of the financial schedule note disclosures to ensure the information accurately reflects the department’s operations and is not misleading to readers.

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Schedules of Changes in Fund Equity and Property Held In Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Military Affairs for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules.

Management's Responsibility for the Financial Schedules

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our modified audit opinions.

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles

As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets and liabilities.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinions on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles" paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2018, and June 30, 2017, or changes in financial position for the years then ended.

Basis for Adverse Opinions on Regulatory Basis of Accounting

The department did not accrue amounts owed to subrecipients at fiscal year-end for the disaster grants administered by the Disaster and Emergency Services Division. Instead, during fiscal years 2018 and 2017, the department recorded the expenditures when the payments were made, resulting in overstatements of \$439,102 and \$514,490 in the federal special revenue fund and \$114,647 and \$237,499 in the general fund in fiscal years 2018 and 2017, respectively.

In prior fiscal years, the department did not properly recognize approximately \$3,006,000 in federal revenue, resulting in an understatement of Beginning Fund Equity: July 1, 2017 in the federal special revenue fund. In fiscal year 2017, the department recognized revenue related to activities of fiscal year 2016, resulting in an overstatement of approximately \$2,200,000 in fiscal year 2017 on the Prior Year Revenues & Transfers-In Adjustments line in the federal special revenue fund. The department did not make a correcting entry for the remainder of the beginning fund equity adjustment, resulting in an overstatement of approximately \$806,000 in the Direct Entries to Fund Equity line in the federal special revenue fund.

The department did not have sufficient internal controls to ensure they complied with the matching requirements of the National Guard Military Operations and Maintenance Program, resulting in the costs being incorrectly split between the general fund and the federal special revenue fund during fiscal years 2018 and 2017. We estimate additional operating costs of \$48,629 and \$47,987 were eligible for federal reimbursement in fiscal years 2018 and 2017, resulting in misstatements in the federal special revenue fund and general fund.

The department did not have sufficient internal controls in place over the nondisaster related grants administered by the Disaster and Emergency Services Division to ensure only allowable costs are reimbursed. Consequently, the department should not have made approximately one half of the payments it issued during fiscal years 2018 and 2017. This resulted in the Budgeted Revenues & Transfers-In and Budgeted Expenditures & Transfers-Out lines in the federal special revenue fund being overstated by an estimated \$4,202,454 and \$4,192,988 in fiscal years 2018 and 2017, respectively.

The department paid for \$3,805,926 of the National Guard's summer 2017 fire suppression expenditures from the general fund, even though nongeneral fund appropriations were available. This is contrary to state law, which requires the department to apply expenditures against appropriated nongeneral fund money whenever possible before using general fund appropriations. This resulted in the Direct Entries to Fund Equity and Budgeted Expenditures & Transfers-Out lines to be overstated in the general fund and understated in the state special revenue fund by that amount.

The department did not remove a revenue accrual from prior years, resulting in an overstatement of \$999,999 in the fiscal year 2017 Beginning Fund Equity. The department also did not remove an expenditure accrual from prior years, resulting in an understatement of \$95,186 in the fiscal year 2017 Beginning Fund Equity. Both of these errors occurred in the federal special revenue fund.

The issues discussed in the paragraphs above combine to a cumulative impact on the Schedule of Changes in Fund Equity & Property Held In Trust for fiscal year 2018 and the Schedule of Changes in Fund Equity for fiscal year 2017, as summarized in the table below.

Financial Schedule and Line Item	Over/(Under) Statement		
	General Fund	State Special Revenue Fund	Federal Special Revenue Fund
Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2017.			
Fund Equity, July 1			(\$2,101,187)
Budgeted Revenues & Transfers-In			\$4,659,491
Prior Year Revenues & Transfers-In Adjustments			\$2,200,000
Direct Entries to Fund Equity	\$285,486		\$806,000
Budgeted Expenditures & Transfers-Out	\$285,486		\$4,659,491
Fund Equity, June 30			\$904,813
Schedule of Changes in Fund Equity & Property Held In Trust for the Fiscal Year Ended June 30, 2018			
Fund Equity, July 1			\$904,813
Budgeted Revenues & Transfers-In			\$4,486,374
Direct Entries to Fund Equity	\$3,969,202	(\$3,805,926)	
Budgeted Expenditures & Transfers-Out	\$3,969,202	(\$3,805,926)	\$4,486,374
Fund Equity, June 30			\$904,813

Adverse Opinions on Regulatory Basis of Accounting

In our opinion, because of the significance of the matters discussed in the “Basis for Adverse Opinions” paragraphs, the Schedules of Changes in Fund Equity & Property Held in Trust do not present fairly the changes in fund equity and property held in trust of the Department of Military Affairs for each of the fiscal years ended June 30, 2018, and June 30, 2017, in conformity with the basis of accounting described in Note 1.

Basis for Qualified Opinions on Regulatory Basis of Accounting

The department did not have sufficient internal controls in place over the nondisaster related grants administered by the Disaster and Emergency Services Division to ensure only allowable costs are reimbursed. Consequently, the department should not have made approximately one half of the payments it issued during fiscal years 2018 and 2017. This resulted in the expenditures in the Disaster and Emergency Services column of the Schedules Total Expenditures & Transfers-Out being overstated by an estimated \$4,202,454 and \$4,192,988 in fiscal year 2018 and 2017, respectively.

As these nondisaster grants are reimbursement based, the department requested and received reimbursement from the federal government for these payments. This resulted in the Federal Revenue, Total Revenues & Transfers-In, and Actual Budgeted Revenues & Transfers-In in the Federal Special Revenue Fund column on the Schedules Total Revenues & Transfers-In being overstated by an estimated \$4,202,454 and \$4,192,988 in fiscal year 2018 and 2017, respectively.

The department paid for \$3,805,926 of the National Guard’s summer 2017 fire suppression expenditures from the general fund, even though nongeneral fund appropriations were available. This is contrary to state law, which requires the department to apply expenditures against appropriated nongeneral fund money whenever possible before using general fund appropriations. This resulted in the Expenditures & Transfers-Out by Fund – State Special Revenue Fund and Unspent Budget Authority by Fund – State Special Revenue Fund line items being understated and the Expenditures & Transfers-Out by Fund – General Fund and Unspent Budget Authority by Fund – General Fund line items being overstated by \$3,805,926 in the Disaster and Emergency Services column on the Schedule Total Expenditures & Transfers-Out in fiscal year 2018.

The issues discussed in the paragraphs above combine to a cumulative impact on the Schedules of Total Expenditures & Transfers-Out and Schedules of Total Revenues & Transfers-In for fiscal years 2018 and 2017, as summarized in the following tables (see page A-5).

Financial Schedule and Line Item	Over/(Under) Statement
	Disaster & Emergency Services
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2017.	
Grants From Federal Sources	\$4,192,988
Total Grants	\$4,192,988
Total Expenditures & Transfers-Out	\$4,192,988
Expenditures & Transfers-Out by Fund – Federal Special Revenue Fund	\$4,192,988
Total Expenditures & Transfers-Out by Fund	\$4,192,988
Budgeted Expenditures & Transfers-Out	\$4,192,988
Total Unspent Budget Authority	(\$4,192,988)
Unspent Budget Authority by Fund – Federal Special Revenue Fund	(\$4,192,988)
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2018.	
Grants From Federal Sources	\$4,202,454
Total Grants	\$4,202,454
Total Expenditures & Transfers-Out	\$4,202,454
Expenditures & Transfers-Out by Fund – General Fund	\$3,805,926
Expenditures & Transfers-Out by Fund – State Special Revenue Fund	(\$3,805,926)
Expenditures & Transfers-Out by Fund – Federal Special Revenue Fund	\$4,202,454
Total Expenditures & Transfers-Out by Fund	\$4,202,454
Budgeted Expenditures & Transfers-Out	\$4,202,454
Total Unspent Budget Authority	(\$4,202,454)
Unspent Budget Authority by Fund – General Fund	(\$3,805,926)
Unspent Budget Authority by Fund – State Special Revenue Fund	\$3,805,926
Unspent Budget Authority by Fund – Federal Special Revenue Fund	(\$4,202,454)

Financial Schedule and Line Item	Over/(Under) Statement
	Federal Special Revenue Fund
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2017.	
Federal Revenue	\$4,192,988
Total Revenues & Transfers-In	\$4,192,988
Actual Budgeted Revenues & Transfers-In	\$4,192,988
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2018.	
Federal Revenue	\$4,202,454
Total Revenues & Transfers-In	\$4,202,454
Actual Budgeted Revenues & Transfers-In	\$4,202,454

Qualified Opinions on Regulatory Basis of Accounting

In our opinion, except for the effects of the matters described in the “Basis for Qualified Opinion” paragraphs above, the Schedules of Total Revenues & Transfers-In and Schedules of Total Expenditures & Transfers-Out present fairly, in all material respects, the results of operations of the Department of Military Affairs for each of the fiscal years ended June 30, 2018, and 2017, in conformity with the basis of accounting described in Note 1.

Emphasis of Matter

As discussed in the first Disaster & Emergency Services Footnote, the department incurred approximately \$6,700,000 of expenditures for National Guard firefighting costs during the summer of 2017. Although the full amount of these expenditures is recorded in the Disaster & Emergency Services column on the Schedule of Total Expenditures & Transfers-Out for the fiscal year ended June 30, 2018, the department’s resources were not used to support these activities. The expenditures were paid for by the general fund and the fire suppression state special revenue fund; the revenues for which are not collected by the department. Accordingly, the department’s financial schedules reflect expenditures with no associated revenues in either the general fund or the state special revenue fund. Our opinion is not modified with respect to this matter.

During fiscal year 2017, the department changed how it recorded construction expenditures in the Military Construction Program on the Schedule of Total Expenditures & Transfers-Out to better align with state policy. In prior years, these expenditures were presented in the Capital Outlay line items, but are presented in the Grants From Federal Sources line item during the audit period. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated August 23, 2019, on our consideration of the Department of Military Affairs’ internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department’s internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

August 23, 2019

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND EQUITY & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	<u>General Fund</u>	<u>State Special Revenue Fund</u>	<u>Federal Special Revenue Fund</u>	<u>Agency Fund</u>
FUND EQUITY: July 1, 2017	\$ (739,443)	\$ 2,248,651	\$ (2,939,381)	\$ 0
PROPERTY HELD IN TRUST: July 1, 2017				\$ 0
ADDITIONS				
Budgeted Revenues & Transfers-In	4,754	2,463,852	42,108,757	
Nonbudgeted Revenues & Transfers-In	154	8,947		
Prior Year Revenues & Transfers-In Adjustments	3,617	38,573	(1,593,873)	
Direct Entries to Fund Equity	9,462,874	4,042,483	(459,138)	
Additions to Property Held in Trust				1,460,157
Total Additions	<u>9,471,400</u>	<u>6,553,855</u>	<u>40,055,746</u>	<u>1,460,157</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	9,348,779	6,989,993	38,078,496	
Nonbudgeted Expenditures & Transfers-Out	(10,266)	395,055		
Prior Year Expenditures & Transfers-Out Adjustments	76,818	14,485	(513,132)	
Reductions in Property Held in Trust				1,460,157
Total Reductions	<u>9,415,331</u>	<u>7,399,532</u>	<u>37,565,363</u>	<u>1,460,157</u>
FUND EQUITY: June 30, 2018	\$ (683,375)	\$ 1,402,974	\$ (448,999)	\$ 0
PROPERTY HELD IN TRUST: June 30, 2018				

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-13.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	<u>General Fund</u>	<u>State Special Revenue Fund</u>	<u>Federal Special Revenue Fund</u>	<u>Capital Projects Fund</u>
FUND EQUITY: July 1, 2016	\$ (891,189)	\$ 2,552,962	\$ (5,471,789)	\$ 0
ADDITIONS				
Budgeted Revenues & Transfers-In	5,880	1,308,268	59,936,773	4,840
Nonbudgeted Revenues & Transfers-In	16,105	357		
Prior Year Revenues & Transfers-In Adjustments		49,266	2,699,630	
Direct Entries to Fund Equity	8,530,388	117,343	4,364	
Total Additions	<u>8,552,373</u>	<u>1,475,234</u>	<u>62,640,767</u>	<u>4,840</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	8,371,595	1,763,160	60,689,464	4,840
Nonbudgeted Expenditures & Transfers-Out	(733)	16,249		
Prior Year Expenditures & Transfers-Out Adjustments	29,765	135	(581,104)	
Total Reductions	<u>8,400,627</u>	<u>1,779,545</u>	<u>60,108,360</u>	<u>4,840</u>
FUND EQUITY: June 30, 2017	\$ (739,443)	\$ 2,248,651	\$ (2,939,381)	\$ 0

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Additional information is provided in the notes to the financial schedules beginning on page A-13.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Charges for Services	\$ 4,776	\$ 320,152	\$ 9,380	\$ 334,308
Investment Earnings		7,307		7,307
Sale of Documents, Merchandise and Property	3,530	1,226,183		1,229,713
Grants, Contracts, and Donations		20,670		20,670
Transfers-in	154	935,605	185,597	1,121,356
Federal Indirect Cost Recoveries			8,422	8,422
Miscellaneous	66	1,455	197	1,718
Federal			40,311,287	40,311,287
Total Revenues & Transfers-In	<u>8,525</u>	<u>2,511,372</u>	<u>40,514,884</u>	<u>43,034,781</u>
Less: Nonbudgeted Revenues & Transfers-In	154	8,947		9,101
Prior Year Revenues & Transfers-In Adjustments	<u>3,617</u>	<u>38,573</u>	<u>(1,593,873)</u>	<u>(1,551,683)</u>
Actual Budgeted Revenues & Transfers-In	4,754	2,463,852	42,108,757	44,577,363
Estimated Revenues & Transfers-In	4,754	2,234,669	36,336,607	38,576,030
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 0</u>	<u>\$ 229,183</u>	<u>\$ 5,772,149</u>	<u>\$ 6,001,333</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Charges for Services		\$ 56,069		\$ 56,069
Transfers-in		173,114		173,114
Federal			\$ 5,772,149	\$ 5,772,149
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 0</u>	<u>\$ 229,183</u>	<u>\$ 5,772,149</u>	<u>\$ 6,001,333</u>

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DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	<u>General Fund</u>	<u>State Special Revenue Fund</u>	<u>Federal Special Revenue Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
TOTAL REVENUES & TRANSFERS-IN BY CLASS					
Taxes			\$ 2,275		\$ 2,275
Charges for Services	\$ 2,818	\$ 295,002	1,445		299,265
Investment Earnings		4,022			4,022
Sale of Documents, Merchandise and Property	3,062	3,800	3,279		10,140
Rentals, Leases and Royalties		460			460
Grants, Contracts, and Donations		23,190			23,190
Transfers-in	16,105	1,031,417	152,421	\$ 4,840	1,204,783
Federal Indirect Cost Recoveries			2,907		2,907
Federal			62,474,077		62,474,077
Total Revenues & Transfers-In	<u>21,985</u>	<u>1,357,891</u>	<u>62,636,403</u>	<u>4,840</u>	<u>64,021,118</u>
Less: Nonbudgeted Revenues & Transfers-In	16,105	357			16,462
Prior Year Revenues & Transfers-In Adjustments		49,266	2,699,630		2,748,896
Actual Budgeted Revenues & Transfers-In	<u>5,880</u>	<u>1,308,268</u>	<u>59,936,773</u>	<u>4,840</u>	<u>61,255,761</u>
Estimated Revenues & Transfers-In	<u>5,880</u>	<u>1,130,372</u>	<u>59,936,773</u>	<u>4,840</u>	<u>61,077,865</u>
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 0</u>	<u>\$ 177,896</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 177,896</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS					
Investment Earnings		\$ (7)			\$ (7)
Transfers-in		177,903			177,903
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ 0</u>	<u>\$ 177,896</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 177,896</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-13.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Air National Guard Program	Army National Guard Program	Challenge Program	Director's Office	Disaster & Emergency Services	Disaster Fund	Military Capital Construction	Montana Military Family Relief Fund	Scholarship Program	STARBAS E	Veterans Affairs Program	Total
Personal Services												
Salaries	\$ 2,219,923	\$ 2,452,013	\$ 2,138,787	\$ 766,776	\$ 3,573,595					\$ 157,762	\$ 1,533,400	\$ 12,842,256
Other Compensation			3,826									3,826
Employee Benefits	952,658	899,704	903,154	227,785	677,211					58,160	577,646	4,296,319
Total	<u>3,172,580</u>	<u>3,351,717</u>	<u>3,045,767</u>	<u>994,562</u>	<u>4,250,807</u>					<u>215,922</u>	<u>2,111,046</u>	<u>17,142,401</u>
Operating Expenses												
Other Services	803,517	2,519,494	734,213	26,276	253,178		\$ 744			307,069	48,635	4,693,126
Supplies & Materials	201,381	355,474	265,831	8,857	35,293					149,121	52,783	1,068,740
Communications		151,381	60,860	27,511	55,028		271			2,576	47,528	345,155
Travel	10,449	81,999	41,990	7,878	221,672					17,618	28,986	410,593
Rent		410,743	324,518		4,071,683						54,921	4,861,866
Utilities	581,328	2,051,178	1,744								19,872	2,654,122
Repair & Maintenance	44,511	3,961,191	21,687	250	2,389		8,735			1,665	24,023	4,064,450
Other Expenses	29,647	136,730	84,077	28,597	145,947				\$ 163,708	1,865	2,641	593,212
Goods Purchased For Resale		261		905						3		1,169
Total	<u>1,670,833</u>	<u>9,668,451</u>	<u>1,534,921</u>	<u>100,274</u>	<u>4,785,191</u>		<u>9,750</u>		<u>163,708</u>	<u>479,917</u>	<u>279,389</u>	<u>18,692,433</u>
Equipment & Intangible Assets												
Equipment		44,204									60,146	104,350
Total		<u>44,204</u>									<u>60,146</u>	<u>104,350</u>
Capital Outlay												
Land & Interest In Land		1,573,175					426,411					1,999,586
Buildings							(45,413)				700	(44,713)
Total		<u>1,573,175</u>					<u>380,998</u>				<u>700</u>	<u>1,954,873</u>
Grants												
From State Sources					41,337	\$ 680,376		\$ 25,000				746,713
From Federal Sources					8,536,369	2,865,327	3,159,137					14,560,833
Total					<u>8,577,705</u>	<u>3,545,703</u>	<u>3,159,137</u>	<u>25,000</u>				<u>15,307,545</u>
Transfers-out												
Fund transfers		459,600		32,400	686,625							1,178,625
Total		<u>459,600</u>		<u>32,400</u>	<u>686,625</u>							<u>1,178,625</u>
Total Expenditures & Transfers-Out	<u>\$ 4,843,413</u>	<u>\$ 15,097,146</u>	<u>\$ 4,580,688</u>	<u>\$ 1,127,236</u>	<u>\$ 18,300,327</u>	<u>\$ 3,545,703</u>	<u>\$ 3,549,885</u>	<u>\$ 25,000</u>	<u>\$ 163,708</u>	<u>\$ 695,839</u>	<u>\$ 2,451,281</u>	<u>\$ 54,380,227</u>
EXPENDITURES & TRANSFERS-OUT BY FUND												
General Fund	\$ 368,636	\$ 1,445,297	\$ 1,006,657	\$ 719,719	\$ 3,943,319	\$ 761,817			\$ 163,708		\$ 1,006,179	\$ 9,415,331
State Special Revenue Fund		1,973,175		259	3,955,685	1,011		\$ 25,000			\$ 1,444,402	\$ 7,399,532
Federal Special Revenue Fund	4,474,777	11,678,674	3,574,031	407,259	10,401,323	2,782,874	\$ 3,549,885			\$ 695,839	700	\$ 37,565,363
Total Expenditures & Transfers-Out	4,843,413	15,097,146	4,580,688	1,127,236	18,300,327	3,545,703	3,549,885	25,000	163,708	695,839	2,451,281	54,380,227
Less: Nonbudgeted Expenditures & Transfers-Out	(497)	399,657	(4,983)	(688)	(1,859)						(6,841)	384,789
Prior Year Expenditures & Transfers-Out Adjustments	(7,420)	(272,798)	19,156	(1,461)	(217,957)	38,893			(22,917)	32,854	9,821	(421,829)
Actual Budgeted Expenditures & Transfers-Out	4,851,329	14,970,288	4,566,515	1,129,384	18,520,143	3,506,810	3,549,885	25,000	186,625	662,985	2,448,302	54,417,267
Budget Authority	5,059,533	22,888,570	4,856,589	1,216,080	25,741,852	10,278,680	44,372,317	40,000	186,626	840,528	2,717,301	118,198,075
Unspent Budget Authority	<u>\$ 208,203</u>	<u>\$ 7,918,282</u>	<u>\$ 290,074</u>	<u>\$ 86,696</u>	<u>\$ 7,221,708</u>	<u>\$ 6,771,869</u>	<u>\$ 40,822,432</u>	<u>\$ 15,000</u>	<u>\$ 1</u>	<u>\$ 177,543</u>	<u>\$ 268,999</u>	<u>\$ 63,780,808</u>
UNSPENT BUDGET AUTHORITY BY FUND												
General Fund	\$ 4,403	\$ 7,730	\$ 80,004	\$ 9,705	\$ 240,378	\$ 2,556,736			\$ 1		\$ 25,573	\$ 2,924,529
State Special Revenue Fund		420			115,545			\$ 15,000			\$ 162,459	\$ 293,424
Federal Special Revenue Fund	203,800	7,910,132	210,070	76,991	6,865,785	4,215,133	\$ 33,330,385			\$ 177,543	\$ 50,195	\$ 53,040,035
Capital Projects Fund							7,492,047				\$ 30,773	\$ 7,522,820
Unspent Budget Authority	<u>\$ 208,203</u>	<u>\$ 7,918,282</u>	<u>\$ 290,074</u>	<u>\$ 86,696</u>	<u>\$ 7,221,708</u>	<u>\$ 6,771,869</u>	<u>\$ 40,822,432</u>	<u>\$ 15,000</u>	<u>\$ 1</u>	<u>\$ 177,543</u>	<u>\$ 268,999</u>	<u>\$ 63,780,808</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-13.

DEPARTMENT OF MILITARY AFFAIRS
 SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
 FOR THE FISCAL YEAR ENDED JUNE 30, 2017

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Air National Guard Program	Army National Guard Program	Challenge Program	Director's Office	Disaster & Emergency Services	Disaster Fund	Military Capital Construction	Montana Military Family Relief Fund	Scholarship Program	STARBASE	Veterans Affairs Program	Total
Personal Services												
Salaries	\$ 2,206,569	\$ 2,327,256	\$ 2,123,342	\$ 802,806	\$ 1,461,095					\$ 160,049	\$ 1,515,652	\$ 10,596,769
Other Compensation			3,062									3,062
Employee Benefits	1,035,212	924,090	1,016,044	312,201	536,644					63,516	639,967	4,527,675
Total	3,241,780	3,251,346	3,142,448	1,115,008	1,997,739					223,565	2,155,620	15,127,505
Operating Expenses												
Other Services	761,801	6,451,056	631,546	33,962	172,397					286,431	31,319	8,368,513
Supplies & Materials	197,807	327,672	218,402	10,957	45,781					101,263	109,611	1,011,493
Communications	322	176,273	59,149	25,998	51,825					2,954	41,074	357,597
Travel	9,309	61,276	53,834	6,819	83,123					13,749	37,132	265,243
Rent	540	495,137	332,187		57,675						54,990	940,529
Utilities	607,824	1,906,299	2,026								22,732	2,538,881
Repair & Maintenance	88,625	4,849,431	6,046	9,854	8,197		\$ 3,781			5,361	36,669	5,007,964
Other Expenses	20,510	61,863	85,933	28,939	81,161				\$ 240,417	1,502	9,260	529,585
Goods Purchased For Resale		1,300										1,300
Total	1,686,739	14,330,308	1,389,123	116,530	500,158		3,781		240,417	411,261	342,788	19,021,105
Equipment & Intangible Assets												
Equipment		76,231										76,231
Total		76,231										76,231
Capital Outlay												
Land & Interest In Land		106,928					846,178					953,106
Buildings							807,638				58,330	865,968
Total		106,928					1,653,815				58,330	1,819,073
Grants												
From State Sources					141,685	\$ 1,778,287		\$ 42,000				1,961,971
From Federal Sources					8,517,139	9,335,780	13,692,849					31,545,768
Total					8,658,824	11,114,067	13,692,849	42,000				33,507,740
Transfers-out												
Fund transfers		46,515	787	25,007	532,728	118,879	4,840				12,960	741,717
Total		46,515	787	25,007	532,728	118,879	4,840				12,960	741,717
Total Expenditures & Transfers-Out	\$ 4,928,520	\$ 17,811,328	\$ 4,532,358	\$ 1,256,545	\$ 11,689,448	\$ 11,232,946	\$ 15,355,285	\$ 42,000	\$ 240,417	\$ 634,826	\$ 2,569,698	\$ 70,293,372
EXPENDITURES & TRANSFERS-OUT BY FUND												
General Fund	\$ 422,209	\$ 1,617,813	\$ 1,039,883	\$ 862,745	\$ 1,327,001	\$ 1,778,287			\$ 240,417		\$ 1,112,272	\$ 8,400,627
State Special Revenue Fund		107,388	787	353	171,590			\$ 42,000			1,457,426	1,779,545
Federal Special Revenue Fund	4,506,310	16,086,127	3,491,688	393,446	10,190,857	9,454,659	15,350,445			\$ 634,826		60,108,360
Capital Projects Fund							4,840					4,840
Total Expenditures & Transfers-Out	4,928,520	17,811,328	4,532,358	1,256,545	11,689,448	11,232,946	15,355,285	42,000	240,417	634,826	2,569,698	70,293,372
Less: Nonbudgeted Expenditures & Transfers-Out			787	400	14,328							15,516
Prior Year Expenditures & Transfers-Out Adjustments	236	(445,902)	(428)	19,273	(115,126)					(9,879)	623	(551,203)
Actual Budgeted Expenditures & Transfers-Out	4,928,284	18,257,230	4,531,999	1,236,871	11,790,246	11,232,946	15,355,285	42,000	240,417	644,706	2,569,074	70,829,059
Budget Authority	5,742,275	19,440,061	4,650,577	1,377,360	21,618,969	18,393,153	43,697,602	90,000	240,418	700,000	2,858,243	118,808,658
Unspent Budget Authority	\$ 813,991	\$ 1,182,830	\$ 118,578	\$ 140,489	\$ 9,828,723	\$ 7,160,207	\$ 28,342,317	\$ 48,000	\$ 1	\$ 55,294	\$ 289,169	\$ 47,979,600
UNSPENT BUDGET AUTHORITY BY FUND												
General Fund	\$ 12,778	\$ 113,150	\$ 35,724	\$ 10,576	\$ 317,664	\$ 2,415,902			\$ 1		\$ 2,940	\$ 2,908,734
State Special Revenue Fund		5,215			15,559			\$ 48,000			204,562	273,335
Federal Special Revenue Fund	801,213	1,064,466	82,854	129,913	9,495,501	4,744,305	27,865,270			\$ 55,294	50,895	44,289,710
Capital Projects Fund							477,047				30,773	507,820
Unspent Budget Authority	\$ 813,991	\$ 1,182,830	\$ 118,578	\$ 140,489	\$ 9,828,723	\$ 7,160,207	\$ 28,342,317	\$ 48,000	\$ 1	\$ 55,294	\$ 289,169	\$ 47,979,600

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-13.

Department of Military Affairs Notes to the Financial Schedules For the Two Fiscal Years Ended June 30, 2018

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Capital Projects). In applying the modified accrual basis, the department records:

- ◆ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ◆ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- ◆ **General Fund** – to account for all financial resources except those required to be accounted for in another fund.
- ◆ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include: Radioactive Waste Transport, Environmental Contingency, Honor and Remember medal, Search and Rescue (SAR), Emergency Preparedness Summit, Veterans Affairs Cemeteries, Patriotic License Plate Fees, Military Family Relief Fund, DES Training Conference, Armory Rental Funds, Veterans Affairs SB401,

Montana Army National Guard Land Purchase fund, MT Valorous Medal, VA Private Funds, Army Special Projects, DES Private Travel, EXXON OIL SPILL, Long Range Const Private and ARNG Billeting and Lodging.

- ◆ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds include FUNDS FOR: DES Disaster Grants CFDA 97.036, Military Capital Construction, National Guard, DES Emergency Mgmt Perf CFDA 97.042, DES Homeland Security CFDA 97.067, DES Hazard Mitigation CFDA 97.039, DES Pre-Disaster Mitigation CFDA 97.047, DES Hazardous Materials CFDA 20.703, DES Flood Mitigation CFDA 97.029, Long Range Building, Veterans Cemetery and the Air National Guard.
- ◆ **Capital Projects Fund** – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department uses this fund for Army NG Construction.
- ◆ **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The department agency funds include, EMAC,.

2. General Fund Equity Balance (negative balances)

The negative fund equity balance in the General Fund does not indicate overspent appropriation authority. The department and the board of Veterans Affairs has authority to pay obligations from the statewide General Fund within its appropriation limits. The department and the board of Veterans Affairs expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund equity balances for each of the fiscal years ended June 30, 2017 and June 30, 2018.

3. Direct Entries to Fund Equity

Direct entries to fund equity in the (General, Special Revenue, Federal Special Revenue Fund) fund(s) include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

FOOTNOTES:

Army National Guard PGM

The special session of the Legislature in the Fall of 2017 passed HB6 which required a transfer of \$400,000.00 from the state special Army Land Purchase Fund to the General Fund.

Disaster & Emergency Services (DES)

The DES program changed funding in the amount of \$3,910,024.00 of fire suppression expenditures to the Department of Natural Resources and Conservation for federal reimbursement. These were primarily related to helicopter usage during fire suppression efforts during the summer of 2017. These expenses were paid from statewide resources which include funds from the Governor's Disaster fund and funds from the Department of Natural Resources and Conservation's fire suppression fund.

The DES program received in the agency fund \$1,460,157.17 for Emergency Management Assistance Compact (EMAC) services from local first responders that were reimbursed to the services providers; \$1,451,261.11 from the State of California and \$8,896.06 from the State of Florida. EMAC services that were disbursed to local entities only took place in FY 18.

Military Capital Construction

The Army Aviation facility project was brought to completion in FY18, therefore the construction expenditures will be significantly lower in the following biennium. The Military Capital Construction program has a high amount of unspent budget authority (\$27.8 million for FY17 and \$33.3 million for FY18) as the construction spending authority must be established first before federal funding becomes available.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



B-1
Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity & Property Held In Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Military Affairs for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules, and have issued our report thereon dated August 23, 2019. Our report included adverse opinions on the Schedules of Changes in Fund Equity & Property Held In Trust and qualified opinions on the Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out for each of the fiscal years ended June 30, 2018, and 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the department's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination

of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial schedules will not be prevented, or detected and corrected on a timely basis. We consider the items outlined in the table below to be material weaknesses and provide a reference to their discussion in our 18-25 blue cover audit report.

Summary of Material Weaknesses in Internal Control	
Subject	Reference in 18-25 Report
Internal controls over nondisaster grant reimbursements.	Recommendation #1, page 5.
Internal controls over spending nongeneral fund appropriations first.	Recommendation #2, page 9.
Internal controls over drafting the note disclosures.	Recommendation #7, page 19.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency outlined in the table below to be a significant deficiency and provide a reference to the discussion in our 18-25 blue cover audit report.

Summary of Significant Deficiencies in Internal Control	
Subject	Reference in 18-25 Report
Internal controls over expenditure accruals.	Recommendation #6, page 17.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the department’s financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. The identified instance of material noncompliance is outlined in the table below, including a reference to the discussion in our 18-25 blue cover audit report.

Summary of Material Noncompliance	
Subject	Reference in 18-25 Report
Noncompliance with §17-2-108, MCA, and spending against general fund appropriations prior to exhausting nongeneral fund appropriations for National Guard fire suppression expenditures.	Recommendation #2, page 9.

Department of Military Affairs Response to Findings

The Department of Military Affairs' response to the findings identified in our audit are described on page C-1 of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

August 23, 2019

DEPARTMENT OF
MILITARY AFFAIRS

DEPARTMENT RESPONSE

DEPARTMENT OF MILITARY AFFAIRS STATE OF MONTANA



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THE HONORABLE STEVE BULLOCK
GOVERNOR

MAJOR GENERAL MATTHEW T. QUINN
ADJUTANT GENERAL

September 13, 2019

To: Angus Maciver
Legislative Auditor

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SEP 16 2019

RE: Department of Military Affairs Response to Financial -Compliance Audit 18-25 LEGISLATIVE AUDIT DIV.

Recommendation #1

We recommend the Department of Military Affairs implement internal controls in the Disaster & Emergency Services Division to ensure subrecipient reimbursements are supported and allowable under the grant awards at the time the reimbursement is made.

Conditionally Concur

MT DES and the Department of Military Affairs strongly support internal controls and grant management oversight. The department is willing to improve internal controls for preparedness grants but is unable to develop additional measures without knowing what specific concern to address and what adequate control measures will pass future state audits. The audit does not provide specific examples of instances where unallowable expenditures were reimbursed.

Recommendation #2

We recommend the Department of Military Affairs:

- A. Comply with state law by using nongeneral fund money first whenever possible for fire suppression National Guard costs.
- B. Work with the Department of Natural Resources and Conservation and the Governor's Office of Budget and Program Planning to develop internal controls to ensure nongeneral fund money is used first for future emergency National Guard costs.

Conditionally concur.

DMA concurs that nongeneral fund money should be used first whenever possible, but cannot implement the recommendation. The agency does not control the fund. DMA does not have additional fire fund appropriations to move expenditures and DMA cannot create one without OBPP approval.

Recommendation #3

We recommend the Department of Military Affairs:

- A. Comply with federal requirements to match percentages as required by the Funding Limitation section of each Master Cooperative Agreement Appendix and the Facilities Inventory and Support Plan.**
- B. Establish internal controls to ensure the basis of the splits is supported, and**
- C. Comply with state law by using nongeneral fund money first, when ever possible , for National Guard Military Operations and Maintenance program costs.**

Concur

DMA will have implemented the recommendation by 1 MAR 2020. CFMO will establish a working group to evaluate each facility with a federal/state split to ensure the calculations are correct and properly annotated. CFMO will update the real state standard operating procedures to include re-validation of splits every five years, or as necessary when change of use occurs.

Recommendation #4

We recommend the Department of Military Affairs comply with federal regulations by making timely payments to subrecipients once the department has closed out a disaster project.

Concur

The department has implemented this recommendation. The department adjusted internal procedures to provide final reimbursement to subrecipients prior to FEMA review of eligible costs. The department is aware that in a small number of cases there is an increased risk for subrecipients to repay expenses deemed ineligible by FEMA even after state staff review the claim and issue payment. Additionally, the department coordinated with OBPP to update the MOM policy (317 Disaster and Emergency Expenses) to account for instances where subrecipient cost overrun payments may be delayed until funding is approved by FEMA.

Recommendation #5

We recommend the department of Military Affairs record all valid obligations in accordance with state accounting policy.

Concur

DMA will have implemented the recommendation by 1 JUL 2019.

Recommendation #6

We recommend the department of Military Affairs:

- A. Improve internal controls over the fiscal year-end expenditure accrual process to ensure expenditures are accrued in accordance with state accounting policy, and**
- B. Record expenditure accruals in accordance with state accounting policy.**

Concur

DMA will have implemented the recommendation by 1 JUL 2019.

Recommendation #7

We recommend the department of Military Affairs strengthen internal controls over the drafting of the financial schedule note disclosures to ensure the information accurately reflects the department's operations and is not misleading to readers

Concur

DMA will have implemented the recommendation by 1 JUL 2019.



MATTHEW T. QUINN
Major General
Director, Department of Military Affairs
The Adjutant General