



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Department of
Military Affairs*

*For the Two Fiscal Years Ended
June 30, 2008*

OCTOBER 2008

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DIVISION

08-25

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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel



Deputy Legislative Auditors
James Gillett
Angie Grove

October 2008

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, 2008. Included in this report are recommendations related to internal controls and state and federal compliance.

The department's written response to the audit recommendations is included at the end of the audit report. We thank the Adjutant General and his staff for their assistance and cooperation.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

Department of Military Affairs

Major General Randal Mosley, Adjutant General (retired 9/1/2008)
 Brigadier General John Walsh, Adjutant General (as of 9/1/2008)
 Karen Revious, Administrator, Centralized Services Division
 Dan McGowan, Administrator, Disaster and Emergency Services
 Division
 Joseph Foster, Administrator, Veterans' Affairs Division
 Janice Thomson-Rouse, Director, Youth Challenge Program
 Mike Stone, Director, STARBASE

Board of Veterans' Affairs

Executive Committee

Don Kettner, Chairman

Bob Pavlovich, Vice Chairman

Joseph Foster, Administrator, Veterans' Affairs Division

		<u>Term Expires</u>
Major General Randall Mosley	Fort Harrison	8/01/2009
Jennifer Cole Perez	Helena	8/01/2009
Keith Heavyrunner	Browning	8/01/2009
Sylvia Beals	Forsyth	8/01/2010
Harry Lafriniere	Florence	8/01/2010
Kelly Williams	Helena	8/01/2010
Joe Tropila	Great Falls	8/01/2010
Teresa Bell	Fort Harrison	8/01/2010
Mary Creech	Butte	8/01/2010
Thomas Huddleston	Helena	8/01/2010
Lloyd Jackson	Ronan	8/01/2011
Bob Pavlovich	Butte	8/01/2011
Harvey Rattey	Glendive	8/01/2011

Charlie Crookshanks	Missoula	8/01/2011
James Heffernan	Helena	8/01/2011
Byron Erickson	Helena	8/01/2012
Don Kettner	Glendive	8/01/2012
Mathew McCombs, representing Senator Tester		8/01/2012
Don Slavens, representing Senator Baucus		8/01/2012
Mike Waite, representing Representative Rehberg		8/01/2012

For additional information concerning the Department of Military Affairs contact:

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REPORT SUMMARY

Department of Military Affairs

This is our financial-compliance audit of the Department of Military Affairs (department) for the two fiscal years ended June 30, 2008. Included in this audit report are eight recommendations related to internal controls and state and federal compliance. The previous audit report contained six recommendations; the department implemented five and did not implement one recommendation.

We issued an unqualified opinion on the financial schedules presented in this report. This means the reader can rely on the presented financial information and the supporting detailed information on the primary accounting records

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department follow established controls to ensure all Homeland Security costs are allowable.7
 Department response: Concur B-3

Recommendation #2

We recommend the department establish effective time approval controls for the Homeland Security grant to ensure all salaries charged to the Homeland Security grant are allowable.7
 Department response: Concur B-3

Recommendation #3

We recommend the department implement effective subrecipient monitoring controls to ensure its subrecipients comply with the federal requirements.8
 Department response: Concur B-3

Recommendation #4

We recommend the department obligate Homeland Security funds in accordance with federal requirements.9
 Department response: Concur B-3

Recommendation #5

We recommend the department implement effective controls to ensure it complies with Homeland Security cash management requirements. 10
 Department response: Concur B-3

Recommendation #6

We recommend the department implement adequate controls to ensure the department records assets on the state’s accounting system in accordance with state law and policy..... 11

Department response: Concur B-3

Recommendation #7

We recommend the department implement controls to ensure it complies with state law regarding search and rescue expenses. 12

Department response: Concur B-4

Recommendation #8

We recommend the department monitor and test implementation of its internal control procedures. 13

Department response: Concur B-4

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Military Affairs (department) for the two fiscal years ended June 30, 2008. The objectives of the audit were to:

1. Obtain an understanding of the department’s control systems to the extent necessary to support our audit of the department’s financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
2. Determine department compliance with selected laws and regulations.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the financial schedules present fairly the results of operations of the department for each of the fiscal years ended June 30, 2008, and June 30, 2007.

Auditing standards require us to communicate, in writing, control deficiencies we identified as a result of audit objective #1 above and considered to be significant or material. A control deficiency exists when the design or operation of a control does not allow management or employees to prevent or detect misstatements on a timely basis. A significant deficiency affects management’s ability to accurately process transactions. A material weakness is one or more significant deficiencies that adversely affect management’s ability to fairly present its financial schedules.

Table 1 below outlines the status of significant deficiencies and material weaknesses we identified during this audit.

Subject	Significant Deficiency	Material Weakness	Page
Homeland Security Internal Controls	Yes	No	5

This report contains eight recommendations to the department. In accordance with Section 5-13-307, MCA, we analyzed and disclosed, if significant, the costs of implementing the recommendations made in this report. Other areas of concern deemed not to have a significant effect on the successful operations of the department are not specifically included in the report, but have been discussed with management.

Background

The department was created under the Executive Reorganization Act of 1971. The department consists of the following programs and authorized full-time equivalent positions (FTE) for fiscal year 2007-08.

Montana National Guard is authorized approximately 73 FTE that are paid through the state's payroll system. An additional 867 full-time personnel are paid through the federal payroll system. The Montana National Guard has two programs – the Air National Guard and the Army National Guard. The Air National Guard provides firefighting personnel, maintenance, and support for Air National Guard facilities at Great Falls. The Army National Guard provides administration, construction, maintenance, and support for military facilities and training areas throughout the state.

Centralized Services Division (9 FTE) is the primary administrative support organization for the department, including financial management, budgeting, personnel, and other administrative functions.

Disaster and Emergency Services Division (DES) (25 FTE) works with local, state, and federal officials to prepare, update, and coordinate emergency preparedness, response and recovery plans. DES provides technical support for civil defense shelters, exercises, and radiological defense and monitoring. The division also receives, records, and disburses federal funds to eligible government entities.

Montana National Guard Youth Challenge Program (48 FTE) is a program for youth ages 16 to 18 who stopped attending secondary school before graduating. Challenge is a 17-month, voluntary, military-modeled training program. It targets unemployed, drug-free, nonfelons who are not currently under judicial supervision. The program provides an opportunity for eligible high school age youths to enhance their life skills, increase their educational levels, and increase their employment potential.

Veterans' Affairs Division (23 FTE) is responsible for assisting Montana's veterans and dependents in obtaining veterans' benefits and managing the State Veterans' Cemetery program. The division provides information on benefits, guidance on completing veterans' administration forms, and referral to other agencies. The division is attached to the department for administrative purposes. The division administrator is hired by, and reports to, the Board of Veterans' Affairs, a 20-member board, of which 17 are appointed by the Governor and three represent the members of Montana's congressional delegation.

Montana STARBASE Program (2 FTE) is for elementary school aged children. Its goals include raising interest and improving the knowledge and skills 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 its experimental learning, simulations, experiments in aviation and space-related fields. This science and math based program also addresses drug use prevention, health, self-esteem, and life skills issues.

Montana Military Family Relief Fund (MMFRF), provides monetary grants to families of Montana National Guard and Reserve Component members who on or after April 28, 2007, are on active duty for federal service in a contingency operation. MMFRF 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 was established by the 56th Legislature to assist in recruiting and retention efforts for the Montana Air and Army 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

Our office performed the department's financial-compliance audit for the two fiscal years ended June 30, 2006. The report contained six recommendations, of which the department implemented five and did not implement one. The recommendation not implemented relates to the payment of unallowable costs discussed on page 5.

Chapter II – Findings and Recommendations

Federal Compliance and Controls

Homeland Security Internal Controls

Federal regulations require the department to maintain internal control over federal programs to provide reasonable assurance that the department is managing its federal awards in compliance with laws, regulations, and grant agreements that could have a material effect on each of its federal programs. The following report sections address areas where the department can improve both compliance and internal controls over activity related to these federal awards.

For an expenditure to be allowable to a federal program it needs to be necessary, reasonable, support the federal program, and comply with federal regulations. This includes having adequate documentation to demonstrate the cost meets the program objectives and federal regulations. Federal regulations require the department to follow state procurement policies and procedures when purchasing goods and services.

Subrecipients and Procurement

The department did not follow established internal controls, resulting in noncompliance with federal regulations regarding procurement and allowable costs.

In fiscal year 2004-05, the federal Department of Homeland Security (DHS) approved agreements between the department and its subrecipients allowing the department to retain Homeland Security funds required to be distributed to local governments. The department agreed to pay bills directly to vendors on behalf of its subrecipients. These agreements contained the control procedures listed below for the department and its subrecipients to follow to ensure the federal funds are spent as allowed by federal regulations.

- ◆ All contracts for goods or services would follow state of Montana procurement policies.
- ◆ The project director for a subrecipient shall certify all services have been performed for the department to disburse funds to a vendor. The project director, the chief executive officer of the subrecipient, is responsible for its day to day operations and provides coordination between the department, the subrecipient, and vendors.

The department designated the Homeland Security Grant Administrator (HSGA) to review expenditure documentation, verify its completeness and allowability, and

approve Homeland Security expenditures as an additional control because the HSGA is knowledgeable about the grant. This individual ensures all federal requirements are followed prior to processing the payments.

We identified the following instances where department controls were not followed:

- ◆ None of the project management invoices were approved by a project director of any of the subrecipients. Project management invoices totaled \$1,059,722 and \$1,671,208 in fiscal years 2006-07, and 2007-08, respectively. Department personnel stated the department does not require project directors to approve project management bills because project management updates the project directors on a monthly basis. This subsequent control is not adequate because the project directors with knowledge of the project are not reviewing the invoices. Therefore unallowable costs could be authorized. Additionally, the department had no documentation from the DHS releasing the project directors from their responsibility to approve the project management bills.
- ◆ The HSGA originally denied \$4,654 of project management costs which were not supported. The department later received updated information regarding these project management costs. Department management accepted the updated information and directed the HSGA to pay the project management costs even though the additional information did not meet their established documentation requirements.
- ◆ The department contracted with a vendor to provide accounting services for one of its subrecipients. Since the contract was for \$10,000, state policy requires the department to use limited solicitation procedure to contract with a vendor. Documentation of the informal bid process could not be provided to us although department personnel stated it was completed.
- ◆ The department does not have documentation to support it followed state purchasing policies for payments of \$18,202 to two vendors. In addition the invoices were not approved by an eligible project director. Department management indicated these payments were for allowable activities of the Homeland Security grant and directed the HSGA to pay the bills even though the HSGA denied the invoices because the department did not have documentation that state purchasing policies were followed. Regardless of expenditures being for allowable activities of the federal grant, the department is required to follow all state purchasing regulations for the expenditures to be allowable for payment by the federal program.

As a result of the items discussed above, we question \$28,202 of Homeland Security expenditures in fiscal year 2007-08. Because of the control issues identified above, we believe additional questioned costs may exist.

The department should follow established controls to ensure Homeland Security funds are used only for allowable federal costs.

RECOMMENDATION #1

We recommend the department follow established controls to ensure all Homeland Security costs are allowable.

Personal Services

The department does not have effective time approval controls in place to ensure employees' time charged to the Homeland Security grant is allowable.

The Homeland Security grant supports three employees, whose salaries total approximately \$100,000 per year. The individual approving two of these employees' time cards, signifying the time worked should be charged to the Homeland Security grant, does not direct their work and does not work with the Homeland Security grant. The approver relies on the employees to be accurate and honest with their time reporting and does not know if the employees actually worked the hours they charged to the Homeland Security grant. The department does not have any other procedures verifying the time charged to the Homeland Security grant was actually spent performing work on the grant.

These procedures do not provide adequate control to ensure time charged to the federal program is reasonable or necessary. Inadequate controls increase the possibility for unallowable costs to be charged to the federal program. The department should establish effective approval for time charged to the Homeland Security grant.

RECOMMENDATION #2

We recommend the department establish effective time approval controls for the Homeland Security grant to ensure all salaries charged to the Homeland Security grant are allowable.

Subrecipient Monitoring

The department does not have effective monitoring controls to ensure its subrecipients comply with federal requirements.

Federal regulations require the department to monitor its subrecipients to ensure they comply with federal regulations. Monitoring includes:

- ◆ issuing management decisions on audit findings within six months of receipt
- ◆ ensuring the subrecipient takes appropriate corrective action
- ◆ reviewing subrecipient activities to ensure the subrecipients are in compliance with laws, regulations, and provisions of grant agreements

The department grants 95 percent of the Homeland Security funds it receives to subrecipients. We identified the following instances where the department's monitoring of its subrecipients is inadequate to comply with federal subrecipient monitoring requirements.

- ◆ The department received notification of seven audit findings in audit reports. Department personnel did not issue management decisions or require corrective action on five of the audit findings in the required timeframe. In April 2008, the department granted \$400,000 to one subrecipient which had an audit finding. By not following up with subrecipient audit findings, the department may allow noncompliance with federal grant regulations by its subrecipients.
- ◆ The department's subrecipient monitoring tracking spreadsheet only lists 78 of the departments 84 subrecipients. Without a complete list, department personnel cannot make informed decisions when selecting the subrecipients to monitor, and may not detect noncompliance with grant requirements.

Department personnel stated the monitoring specialist position was filled for only part of the audit period. Additionally, they did not know why all subrecipients were not included on the monitoring checklist.

RECOMMENDATION #3

We recommend the department implement effective subrecipient monitoring controls to ensure its subrecipients comply with the federal requirements.

Obligation of Homeland Security Funds

The department did not obligate its 2007 Homeland Security grant within 60 days, as required by federal requirements.

Federal guidelines require the department to obligate funds for subgrants within 60 days of the date of the grant award. Obligating funds requires the department to establish a firm, unconditional commitment on the part of the state; maintain documentation of the commitment; and communicate the award terms to the subrecipient.

The department received its 2007 Homeland Security grant in August of 2007. The department established a commitment and maintained documentation of the commitment, but it did not communicate the award terms to the Homeland Security subrecipients within the 60-day requirement. The department's first grant communication regarding its obligation was 105 days after the department received its grant award. As of June 2008, the department had only communicated 18 percent of the 2007 grant obligations. The majority of the funds, \$5,480,997, had not been obligated by June 2008, because the department is subgranting the funds to a new entity made up of all the local subrecipients. This combined entity did not exist until May of 2008.

RECOMMENDATION #4

We recommend the department obligate Homeland Security funds in accordance with federal requirements.

Cash Management

The department's cash management controls for Homeland Security cash requests amounting to \$8,948,059 are not adequate.

Federal requirements allow the department to draw Homeland Security funds from the federal government up to 120 days prior to spending it, as long as the department invests the cash in an interest bearing account and pays the interest to the federal government. Through review of a five-month period we found the department had an average daily cash balance of \$97,000, meaning the department drew cash prior to paying expenditures. The department did not invest any of the funds drawn in advance of the expenditures as required by federal requirements.

Homeland Security program personnel said that cash was ordered when the expenditures were sent up to Centralized Services Division (CSD) for processing believing cash would arrive as expenditures were paid. CSD processes all cash requests on a daily basis and pays bills on a first come, first serve basis. Some bills will sit in CSD a few days before payments are processed, while the cash has already been deposited, resulting in a cash balance. The department did not invest the cash because the expenditures associated with the cash were going to process within a few days. Department personnel should adjust their draw pattern or invest the funds to comply with the federal requirements.

RECOMMENDATION #5

We recommend the department implement effective controls to ensure it complies with Homeland Security cash management requirements.

State Compliance and Controls

State accounting policy requires department management to establish and maintain internal control to ensure their agencies, programs, and functions operate efficiently and effectively in conformance with applicable laws and regulations, and that the related transactions are accurate, properly recorded, and executed in accordance with management's directives. Additionally, section 17-1-102(4), MCA, requires the department to record all transactions on the state's accounting records to show the receipt, use, and disposition of all money and property in accordance with generally accepted accounting principles.

Equipment

The department did not capitalize \$1,147,603 of equipment in accordance with state accounting policy and state law.

State accounting policy and state law require the department to record equipment costing more than \$5,000 as an asset of the department's accounting and property records. The accounting records are comprised of various ledgers including the actuals, a accrual, and the entitywide ledgers.

CSD personnel rely on the divisions purchasing the equipment to inform them of the individual items to be recorded. In a unique situation at the end of fiscal year 2006-07, the department purchased equipment totaling \$1,147,603. This equipment should have been recorded as assets on both the accounting and property records. CSD personnel

were aware of the equipment purchase, however, they did not receive notification from the divisions indicating which pieces of equipment they should record on the accounting and property records. Therefore CSD did not record any equipment on either the department's property or accounting records.

The divisions should communicate with CSD in a timely manner to ensure the activity is properly recorded on the state's accounting and property records by the close of the fiscal year. As a result of not making any entries on the entitywide ledger, the department's assets are understated and expenses are overstated by \$1,147,605 as of June 30, 2007. The financial presentation on pages A-5 to A-10 appropriately exclude the entitywide ledger, therefore the presented financial schedules have no misstatements.

RECOMMENDATION #6

We recommend the department implement adequate controls to ensure the department records assets on the state's accounting system in accordance with state law and policy.

Search and Rescue

Department controls do not ensure it spends search and rescue funds in accordance with state law.

Effective January 1, 2004, section 10-3-801, MCA, required the department to spend at least 50 percent of its search and rescue funds defraying the cost of local search and rescue missions. The law allows the department to use remaining funds to pay for local search and rescue training and equipment purchases.

Since the inception of the search and rescue statute the department has collected \$1,082,500 of search and rescue revenue. The department is in compliance with this statute because it has only spent \$169,993 on training and equipment purchases and \$88,769 on missions. Even though the department is in compliance, it does not have adequate control procedures in place to ensure it spends at least fifty percent of the search and rescue funds defraying the cost of local search and rescue missions.

Currently the department receives more reimbursement requests for training and equipment purchases than it does for funding local search and rescue missions. The department's procedures regarding training and equipment reimbursement requests consist of reviewing the cash balance the day of the request. If the training and equipment request is less than

one-half the cash balance on the day of the request, the department pays the training and equipment reimbursement request.

These procedures are not adequate to ensure the department spends at least one-half of its funds on reimbursing local search and rescue missions. The department should track the funds it receives for and spends on search and rescue missions, training, and equipment to ensure it complies with the requirements of state law.

RECOMMENDATION #7

We recommend the department implement controls to ensure it complies with state law regarding search and rescue expenses.

Internal Control Monitoring and Testing

The department did not monitor and test its internal controls procedures.

State accounting policy outlines management's responsibility for establishing and maintaining agency internal controls to safeguard and account for the resources entrusted to them to carry out government programs. To assist agencies with the implementation process, the Department of Administration issued an Internal Control Guidebook. The guide includes an internal control evaluation and monitoring plan, which recommends agencies monitor and test its internal controls and evaluate and report the results of its testing.

Based on the Internal Control Guidebook the department documented its internal control procedures. Additionally, CSD personnel identified three integral internal control procedures, including monitoring controls, which the department uses to ensure its activity recorded on its accounting records is accurate. We observed documentation where the department tested two of its three integral internal control procedures and took action when one of the internal controls were not being followed. The department did not maintain documentation of testing one of its integral internal control procedures and it does not have a system to test the remaining controls identified in the various divisions in the department.

Department personnel were aware of the requirement to monitor and test its internal control procedures. However, they did not have time to develop a system to monitor and test its internal control procedures. The department should develop a system to monitor and test its identified internal controls and maintain documentation of that testing.

RECOMMENDATION #8

We recommend the department monitor and test implementation of its internal control procedures.

Independent Auditor's Report and Department Financial Schedules

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel



Deputy Legislative Auditors
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances, 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, 2008, and 2007. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets and liabilities.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the department of Military Affairs for each of the fiscal years ended June 30, 2008, and 2007, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

August 19, 2008

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Capital Projects Fund
FUND BALANCE: July 1, 2007	\$ (119,808)	\$ 1,391,348	\$ (502,750)	\$ (1)
ADDITIONS				
Budgeted Revenues & Transfers-In	4,470	1,920,270	38,993,825	3,684,714
Nonbudgeted Revenues & Transfers-In	3,501,303	148,507	20	
Prior Year Revenues & Transfers-In Adjustments	69	13,874	3,509,430	
Direct Entries to Fund Balance	7,727,702	23,889	(6,118,815)	29,553
Total Additions	<u>11,233,544</u>	<u>2,106,540</u>	<u>36,384,460</u>	<u>3,714,267</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	11,295,224	1,138,437	37,021,282	3,714,266
Nonbudgeted Expenditures & Transfers-Out		93,648	148,334	
Prior Year Expenditures & Transfers-Out Adjustments	177,578	(17,718)	(214,750)	
Total Reductions	<u>11,472,802</u>	<u>1,214,367</u>	<u>36,954,866</u>	<u>3,714,266</u>
FUND BALANCE: June 30, 2008	<u>\$ (359,066)</u>	<u>\$ 2,283,521</u>	<u>\$ (1,073,156)</u>	<u>\$ 0</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-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Capital Projects Fund
FUND BALANCE: July 1, 2006	\$ (588,338)	\$ 1,299,653	\$ (883,250)	\$ (1)
ADDITIONS				
Budgeted Revenues & Transfers-In	47,119	874,501	38,584,528	7,905
Nonbudgeted Revenues & Transfers-In	1,333			
Prior Year Revenues & Transfers-In Adjustments	62	14,141	(373,862)	
Direct Entries to Fund Balance	6,383,293	4,336	(1,711,135)	
Total Additions	<u>6,431,807</u>	<u>892,978</u>	<u>36,499,531</u>	<u>7,905</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	5,981,340	856,853	36,217,975	7,905
Nonbudgeted Expenditures & Transfers-Out	(712)	(8)		
Prior Year Expenditures & Transfers-Out Adjustments	(17,351)	(55,562)	(98,944)	
Total Reductions	<u>5,963,277</u>	<u>801,283</u>	<u>36,119,031</u>	<u>7,905</u>
FUND BALANCE: June 30, 2007	<u>\$ (119,808)</u>	<u>\$ 1,391,348</u>	<u>\$ (502,750)</u>	<u>\$ (1)</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-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	<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					
Licenses and Permits	\$	29,370			\$ 29,370
Taxes	1,288				1,288
Charges for Services	4,539	68,926	2,956		76,421
Investment Earnings		27,728			27,728
Grants, Contracts, Donations and Abandonments		6,681			6,681
Other Financing Sources	3,500,015	1,949,946	20	3,684,714	9,134,695
Federal			42,441,780		42,441,780
Federal Indirect Cost Recoveries			58,519		58,519
Total Revenues & Transfers-In	<u>3,505,842</u>	<u>2,082,651</u>	<u>42,503,275</u>	<u>3,684,714</u>	<u>51,776,482</u>
Less: Nonbudgeted Revenues & Transfers-In	3,501,303	148,507	20		3,649,830
Prior Year Revenues & Transfers-In Adjustments	69	13,874	3,509,430		3,523,373
Actual Budgeted Revenues & Transfers-In	4,470	1,920,270	38,993,825	3,684,714	44,603,279
Estimated Revenues & Transfers-In	4,471	1,919,940	38,958,111	3,648,990	44,531,512
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>(1)</u>	<u>330</u>	<u>35,714</u>	<u>35,724</u>	<u>71,767</u>
	\$	\$	\$	\$	\$
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS					
Licenses and Permits	\$	60			\$ 60
Charges for Services	(1)	(46)	(0)		(47)
Investment Earnings		(195)			(195)
Grants, Contracts, Donations and Abandonments		(10)			(10)
Other Financing Sources		521		35,724	36,245
Federal			33,904		33,904
Federal Indirect Cost Recoveries			1,810		1,810
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>(1)</u>	<u>330</u>	<u>35,714</u>	<u>35,724</u>	<u>71,767</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-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<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					
Licenses and Permits					
Taxes	\$ 1,333	19,030		\$	19,030
Charges for Services	47,181	64,698	2,018		3,351
Rentals, Leases and Royalties		1,725	6,687		118,566
Grants, Contracts, Donations and Abandonments		5,345			1,725
Other Financing Sources		797,844		7,905	5,345
Federal			38,190,088		805,749
Federal Indirect Cost Recoveries			11,873		38,190,088
Total Revenues & Transfers-In	<u>48,514</u>	<u>888,642</u>	<u>38,210,666</u>	<u>7,905</u>	<u>39,155,727</u>
Less: Nonbudgeted Revenues & Transfers-In	1,333				1,333
Prior Year Revenues & Transfers-In Adjustments	62	14,141	(373,862)		(359,659)
Actual Budgeted Revenues & Transfers-In	<u>47,119</u>	<u>874,501</u>	<u>38,584,528</u>	<u>7,905</u>	<u>39,514,053</u>
Estimated Revenues & Transfers-In	<u>47,800</u>	<u>429,886</u>	<u>38,574,078</u>	<u>7,905</u>	<u>39,059,669</u>
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>(681)</u>	<u>444,615</u>	<u>10,450</u>	<u>(0)</u>	<u>454,384</u>
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS					
Licenses and Permits					
Taxes	\$ (9)	4,000		\$	4,000
Charges for Services	(665)		(1)		(9)
Rentals, Leases and Royalties		(3)	(1)		(669)
Grants, Contracts, Donations and Abandonments		(5)			(5)
Other Financing Sources	(7)	440,629		(0)	(6)
Federal			10,451		440,622
Federal Indirect Cost Recoveries			(0)		10,451
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>(681)</u>	<u>444,615</u>	<u>10,450</u>	<u>(0)</u>	<u>454,384</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-11.

DEPARTMENT OF MILITARY AFFAIRS
 SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
 FOR THE FISCAL YEAR ENDED JUNE 30, 2008

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	AIR NATIONAL GUARD PROGRAM	ARMY NATIONAL GUARD PROGRAM	CENTRALIZED SERVICES DIVISION	CHALLENGE PROGRAM	DISASTER & EMERGENCY SERVICES	DISASTER FUND	MILITARY CAPITAL CONSTRUCTION	MONTANA MILITARY FAMILY RELIEF FUND	SCHOLARSHIP PROGRAM	STARBASE	VETERANS AFFAIRS PROGRAM	Total
Personal Services												
Salaries	\$ 1,469,185	\$ 1,602,845	\$ 526,691	\$ 1,496,194	\$ 1,005,733	\$ 1,347,557	\$ 1,519			\$ 96,391	\$ 916,245	\$ 8,462,360
Hourly Wages					2,331							2,331
Employee Benefits	525,218	495,188	144,135	564,328	311,336	149,856	476			28,759	319,212	2,538,508
Total	1,994,403	2,098,033	670,826	2,060,522	1,319,400	1,497,413	1,995			125,150	1,235,457	11,003,199
Operating Expenses												
Other Services	792,480	5,886,117	36,536	428,224	136,095	1,723,418				12,448	9,286	9,024,604
Supplies & Materials	195,419	462,925	19,486	144,931	43,218	241,217				61,336	55,052	1,223,584
Communications	1,154	690,272	17,830	68,917	24,698	476				746	57,256	861,349
Travel	15,832	88,248	11,587	111,263	118,114	107,194				17,915	40,373	510,526
Rent		411,314		278,363	4,656						65,346	759,679
Utilities	628,519	1,980,551			53						9,716	2,618,839
Repair & Maintenance	112,016	2,529,207	216	34,814	13,004	1,653	6,243			64,692	25,537	2,787,382
Other Expenses	7,513	82,176	12,939	44,081	32,093	39,931			\$ 250,000	107,884	85,966	662,583
Goods Purchased For Resale	78	10										88
Total	1,753,011	12,130,820	98,594	1,110,593	371,931	2,113,889	6,243		250,000	265,021	348,532	18,448,634
Equipment & Intangible Assets												
Equipment		281,375	26,291		5,267						17,730	330,663
Total		281,375	26,291		5,267						17,730	330,663
Capital Outlay												
Land & Interest In Land		1,982,948					141,727					2,124,675
Buildings							5,636,632				22,252	5,658,884
Other Improvements							178,937					178,937
Total		1,982,948					5,957,296				22,252	7,962,496
Grants												
From State Sources					305,864	189,755		\$ 81,750				577,369
From Federal Sources					10,956,680	125,377						11,082,057
Total					11,262,544	315,132		81,750				11,659,426
Benefits & Claims												
To Individuals			2,280									2,280
Total			2,280									2,280
Transfers												
Accounting Entity Transfers			93,648			22,908	3,833,027				20	3,949,603
Total			93,648			22,908	3,833,027				20	3,949,603
Total Expenditures & Transfers-Out	\$ 3,747,414	\$ 16,493,176	\$ 891,639	\$ 3,171,115	\$ 12,959,142	\$ 3,949,342	\$ 9,798,561	\$ 81,750	\$ 250,000	\$ 390,171	\$ 1,623,991	\$ 53,356,301
EXPENDITURES & TRANSFERS-OUT BY FUND												
General Fund	\$ 350,537	\$ 3,485,274	\$ 574,098	\$ 1,251,320	\$ 1,057,977	\$ 3,797,881			\$ 250,000		\$ 705,715	\$ 11,472,802
State Special Revenue Fund			100,000	90,471	23,890			\$ 81,750			918,256	1,214,367
Federal Special Revenue Fund	3,396,877	13,007,902	217,541	1,919,795	11,810,694	127,571	6,084,295			\$ 390,171	20	36,954,866
Capital Projects Fund							3,714,266					3,714,266
Total Expenditures & Transfers-Out	3,747,414	16,493,176	891,639	3,171,115	12,959,142	3,949,342	9,798,561	81,750	250,000	390,171	1,623,991	53,356,301
Less: Nonbudgeted Expenditures & Transfers-Out			93,648				148,314				20	241,982
Prior Year Expenditures & Transfers-Out Adjustments	(4,797)	(205,832)	415	(62)	(11,744)	178,034	12,293				(23,197)	(54,890)
Actual Budgeted Expenditures & Transfers-Out	3,752,211	16,699,008	797,576	3,171,177	12,970,886	3,771,308	9,637,954	81,750	250,000	390,171	1,647,168	53,169,209
Budget Authority	5,352,228	22,135,227	929,049	3,185,102	37,930,077	3,779,577	107,104,290	100,000	250,000	404,781	2,010,933	183,181,264
Unspent Budget Authority	\$ 1,600,017	\$ 5,436,219	\$ 131,473	\$ 13,925	\$ 24,959,191	\$ 8,269	\$ 97,466,336	\$ 18,250	\$ 0	\$ 14,610	\$ 363,765	\$ 130,012,055
UNSPENT BUDGET AUTHORITY BY FUND												
General Fund	\$ 1,317	\$ 1,215,245	\$ 3,130	\$ 559	\$ 3,695	\$ 2,606					\$ 684	\$ 1,227,236
State Special Revenue Fund		12,000	93,648		243,937			\$ 18,250			363,081	730,916
Federal Special Revenue Fund	1,598,700	4,208,974	34,695	13,366	24,711,559	5,663	53,971,391			\$ 14,610		84,558,958
Capital Projects Fund							43,494,945					43,494,945
Unspent Budget Authority	\$ 1,600,017	\$ 5,436,219	\$ 131,473	\$ 13,925	\$ 24,959,191	\$ 8,269	\$ 97,466,336	\$ 18,250	\$ 0	\$ 14,610	\$ 363,765	\$ 130,012,055

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-11.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	AIR NATIONAL GUARD PROGRAM	ARMY NATIONAL GUARD PROGRAM	CENTRALIZED SERVICES DIVISION	CHALLENGE PROGRAM	DISASTER & EMERGENCY SERVICES	DISASTER FUND	MILITARY CAPITAL CONSTRUCTION	SCHOLARSHIP PROGRAM	VETERANS AFFAIRS PROGRAM	TOTAL
Personal Services										
Salaries	\$ 1,378,571	\$ 1,545,923	\$ 490,635	\$ 1,365,592	\$ 1,045,364	\$ 358,125			\$ 814,209	\$ 6,998,419
Employee Benefits	515,425	483,976	119,157	508,506	317,261	33,669			282,643	2,260,637
Total	<u>1,893,996</u>	<u>2,029,899</u>	<u>609,792</u>	<u>1,874,098</u>	<u>1,362,625</u>	<u>391,794</u>			<u>1,096,852</u>	<u>9,259,056</u>
Operating Expenses										
Other Services	478,584	4,084,411	25,826	513,366	175,632	702,881			67,100	6,047,800
Supplies & Materials	121,550	797,472	90,072	117,046	21,780	89,278			59,036	1,296,234
Communications	1,873	804,759	5,139	50,014	39,196	109	205		64,624	965,919
Travel	7,724	71,205	17,962	113,530	104,613	39,951			36,143	391,128
Rent	68	241,517		278,476	6,807				37,001	563,869
Utilities	612,293	1,743,917							8,196	2,364,406
Repair & Maintenance	108,479	1,555,483	73,024	28,972	(3,648)	543	80		29,067	1,792,000
Other Expenses	1,754	88,561	10,358	53,128	22,382	34,472		250,000	74,915	535,570
Goods Purchased For Resale		8								8
Total	<u>1,332,325</u>	<u>9,387,333</u>	<u>222,381</u>	<u>1,154,532</u>	<u>366,762</u>	<u>867,234</u>	<u>285</u>	<u>250,000</u>	<u>376,082</u>	<u>13,956,934</u>
Equipment & Intangible Assets										
Equipment		1,397,955							(75,000)	1,322,955
Total		<u>1,397,955</u>							<u>(75,000)</u>	<u>1,322,955</u>
Capital Outlay										
Buildings							5,020,166			5,020,166
Other Improvements							251,241			251,241
Total							<u>5,271,407</u>			<u>5,271,407</u>
Grants										
From State Sources					95,507	34,163				129,670
From Federal Sources					12,732,307	202,969				12,935,276
Total					<u>12,827,814</u>	<u>237,132</u>				<u>13,064,946</u>
Benefits & Claims										
To Individuals			2,280							2,280
Total			<u>2,280</u>							<u>2,280</u>
Transfers										
Accounting Entity Transfers			6,013				7,905			13,918
Total			<u>6,013</u>				<u>7,905</u>			<u>13,918</u>
Total Expenditures & Transfers-Out	<u>\$ 3,226,321</u>	<u>\$ 12,815,187</u>	<u>\$ 840,466</u>	<u>\$ 3,028,630</u>	<u>\$ 14,557,201</u>	<u>\$ 1,496,160</u>	<u>\$ 5,279,597</u>	<u>\$ 250,000</u>	<u>\$ 1,397,934</u>	<u>\$ 42,891,496</u>
EXPENDITURES & TRANSFERS-OUT BY FUND										
General Fund	\$ 315,644	\$ 1,096,661	\$ 452,992	\$ 1,168,763	\$ 668,129	\$ 1,288,742		\$ 250,000	\$ 722,346	\$ 5,963,277
State Special Revenue Fund			11,161		114,533				675,589	801,283
Federal Special Revenue Fund	2,910,677	11,718,526	376,313	1,859,867	13,774,539	207,418	5,271,692		(1)	36,119,031
Capital Projects Fund							7,905			7,905
Total Expenditures & Transfers-Out	<u>3,226,321</u>	<u>12,815,187</u>	<u>840,466</u>	<u>3,028,630</u>	<u>14,557,201</u>	<u>1,496,160</u>	<u>5,279,597</u>	<u>250,000</u>	<u>1,397,934</u>	<u>42,891,496</u>
Less: Nonbudgeted Expenditures & Transfers-Out	(131)	(150)	(37)	(189)	(127)				(87)	(721)
Prior Year Expenditures & Transfers-Out Adjustments	(1,527)	(58,861)	7,150	1,150	(49,846)				(69,923)	(171,857)
Actual Budgeted Expenditures & Transfers-Out	<u>3,227,979</u>	<u>12,874,198</u>	<u>833,353</u>	<u>3,027,669</u>	<u>14,607,174</u>	<u>1,496,160</u>	<u>5,279,597</u>	<u>250,000</u>	<u>1,467,944</u>	<u>43,064,074</u>
Budget Authority	3,672,119	14,984,985	1,328,800	3,035,651	35,597,913	6,169,093	22,649,429	250,000	1,601,391	89,289,381
Unspent Budget Authority	<u>\$ 444,140</u>	<u>\$ 2,110,787</u>	<u>\$ 495,447</u>	<u>\$ 7,982</u>	<u>\$ 20,990,739</u>	<u>\$ 4,672,933</u>	<u>\$ 17,369,832</u>	<u>\$ 0</u>	<u>\$ 133,447</u>	<u>\$ 46,225,307</u>
UNSPENT BUDGET AUTHORITY BY FUND										
General Fund	\$ 1,067	\$ 121,541	\$ 5,507	\$ 518	\$ 2,465	\$ 42,406			\$ 42	\$ 173,546
State Special Revenue Fund		101,300	354,378		120,540				133,405	709,623
Federal Special Revenue Fund	443,073	1,887,946	135,562	7,464	20,867,734	4,630,527	17,039,535			45,011,841
Capital Projects Fund							330,297			330,297
Unspent Budget Authority	<u>\$ 444,140</u>	<u>\$ 2,110,787</u>	<u>\$ 495,447</u>	<u>\$ 7,982</u>	<u>\$ 20,990,739</u>	<u>\$ 4,672,933</u>	<u>\$ 17,369,832</u>	<u>\$ 0</u>	<u>\$ 133,447</u>	<u>\$ 46,225,307</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-11.

Department of Military Affairs

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2008

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, and 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 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 is in accordance with the policy of 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. The majority of the department State Special Revenue Funds relate to Veterans Affairs Cemeteries.
- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. The majority of the department Federal Special Revenue Funds include Homeland Security and the National Guard and Military Capital Construction.

- ♦ **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 construction of state/federal facilities appropriated by the Legislature.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department 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 balances for the two fiscal years ended June 30, 2008.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General and the Federal Special Revenue funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

4. Other Financing Sources

Fiscal year 2008 other financing sources increased from fiscal year 2007 due to the sale of the Missoula Armory, a transfer from the General Fund to fund the Montana Military Family Relief Fund, and a transfer from the Federal Special Revenue Fund to construct the Miles City Armed Forces Reserve Center, the Missoula Armed Forces Reserve Center and the Missoula Veterans Cemetery.

DEPARTMENT OF
MILITARY AFFAIRS

DEPARTMENT RESPONSE

DEPARTMENT OF MILITARY AFFAIRS B-3



BRIAN SCHWEITZER
GOVERNOR

ARMED FORCES RESERVE CENTER
1956 MAJO STREET

STATE OF MONTANA

OFFICE OF THE ADJUTANT GENERAL
BRIGADIER GENERAL JOHN E. WALSH
(406) 324-3000 - FAX (406) 324-3011

P.O. BOX 4789
FORT HARRISON, MONTANA 59636-4789

September 26, 2008

Laura L. Norris
Senior Auditor
PO Box 201705
Helena, MT 59620-1705

RECEIVED

OCT 1 2008

LEGISLATIVE AUDIT DIV.

Dear Ms Norris

In reply to the Financial Compliance Audit Report received by this office September 19, 2008, we are submitting the following comments:

Recommendation #1:

We concur with your recommendation. The department will follow established controls to ensure all Homeland Security costs are allowable.

Recommendation #2:

We concur with your recommendation. The department is developing written time approval controls to ensure all salaries charged to grants are allowable. These controls will be in place by November 1, 2008.

Recommendation #3:

We concur with your recommendation. The department anticipates filling the quality assurance position by March 31, 2009, which will enable the implementation of effective subrecipient monitoring controls.

Recommendation #4:

We concur with your recommendation. The department will ensure that we obligate Homeland Security funds in accordance with federal requirements.

Recommendation #5:

We concur with your recommendation. The department has implemented controls to ensure we comply with Homeland Security cash management requirements.

Recommendation #6:

We concur with your recommendation. The department is developing controls to ensure we record assets on the state's accounting system in accordance with state law and policy and will have them in place no later than December 31, 2008.

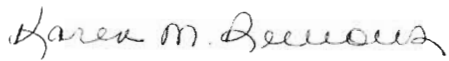
Recommendation #7:

We concur with your recommendation: The department has implemented controls to ensure we remain in compliance with state law regarding search and rescue expenses.

Recommendation #8:

We concur with your recommendation: The department will continue development of systems to monitor and test our internal control procedures and have them in place no later than June 30, 2009.

Sincerely,

A handwritten signature in cursive script that reads "Karen M. Revious".

Karen M. Revious
Administrator
Centralized Services Division