

U10B00
Maryland Environmental Service

Program Description

The Maryland Environmental Service (MES) is an instrumentality of the State. MES provides technical services including engineering, design, financing, construction, and operation of water supply and wastewater treatment facilities. MES also provides similar services in the area of hazardous and solid waste facility management, including sanitary landfills, incinerators, and resource recovery facilities. Additional services offered include sludge and dredged materials management, recycling and marketing of end products, regulatory monitoring, and renewable energy needs servicing. MES operates on a fee-for-service (FFS) basis. Four goals guide MES’s activities: improving the environment; improving infrastructure to convey and treat water and wastewater in the State; working more safely; and providing excellent customer service and satisfaction.

Operating Budget Summary

Maryland Environmental Service
Fiscal 2017-2020
(\$ in Thousands)

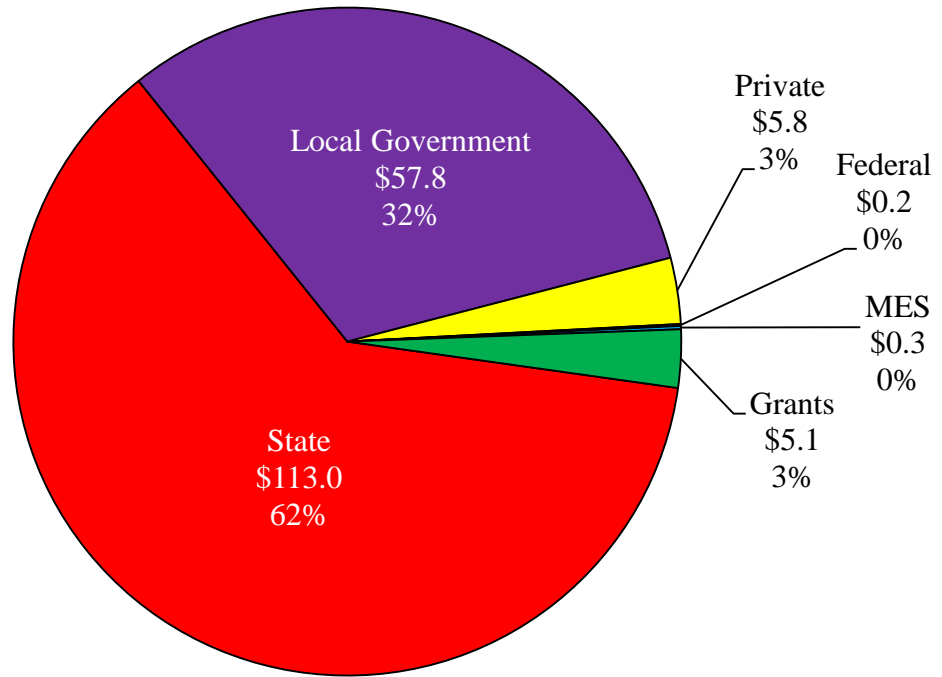
	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>Change 2019-2020</u>
Total Assets	\$88,907	\$85,412	\$91,767	\$101,114	\$9,347
Total Liabilities	62,671	57,338	62,010	70,630	8,620
Total Net Assets	\$26,236	\$28,074	\$29,757	\$30,484	\$727
Total Revenue	\$165,784	\$155,299	\$161,121	\$182,221	\$21,100
Total Expenditures	163,207	152,868	159,699	181,600	21,901
Operating Income	\$2,577	\$2,431	\$1,422	\$621	-\$801

- Between fiscal 2019 and 2020, MES’s net operating income decreased by \$0.8 million for all operations excluding the Midshore Regional Landfill Private Purpose Trust Fund. According to MES’s audited financial statements, the reasons for the decrease include increased personnel costs, including benefit costs; upgrades to information technology (IT) hardware and software programs for agencywide efficiency enhancement; and COVID-19 related expenses.

MES’s Fiscal 2020 Financial Position

MES breaks down its revenue by fund sources and type of business activity. **Exhibit 1** provides an overview of fiscal 2020 revenue by fund source and shows that approximately 94% of MES’ revenue comes from State and local government. In terms of its relationship with the State, MES has two arrangements: (1) reimbursable projects are related to Executive Order 01.01.1971.11 and the Board of Public Works directive that MES operate wastewater and drinking water plants for State agencies; and (2) contractual projects for which MES has a contract with a State agency to do the work. Between fiscal 2019 and 2020, MES’s State government revenues increased by \$8.8 million, and local government revenues increased by \$9.7 million. The State revenues increased due to the Cox Creek expansion projects and the Masonville dredging and construction projects. The local government revenues increased mainly due to a \$6.0 million increase in the Lake Linganore dredging project and a \$1.6 million increase for Prince George’s County contract management.

Exhibit 1
MES Revenue by Fund Source
Fiscal 2020
(\$ in Millions)

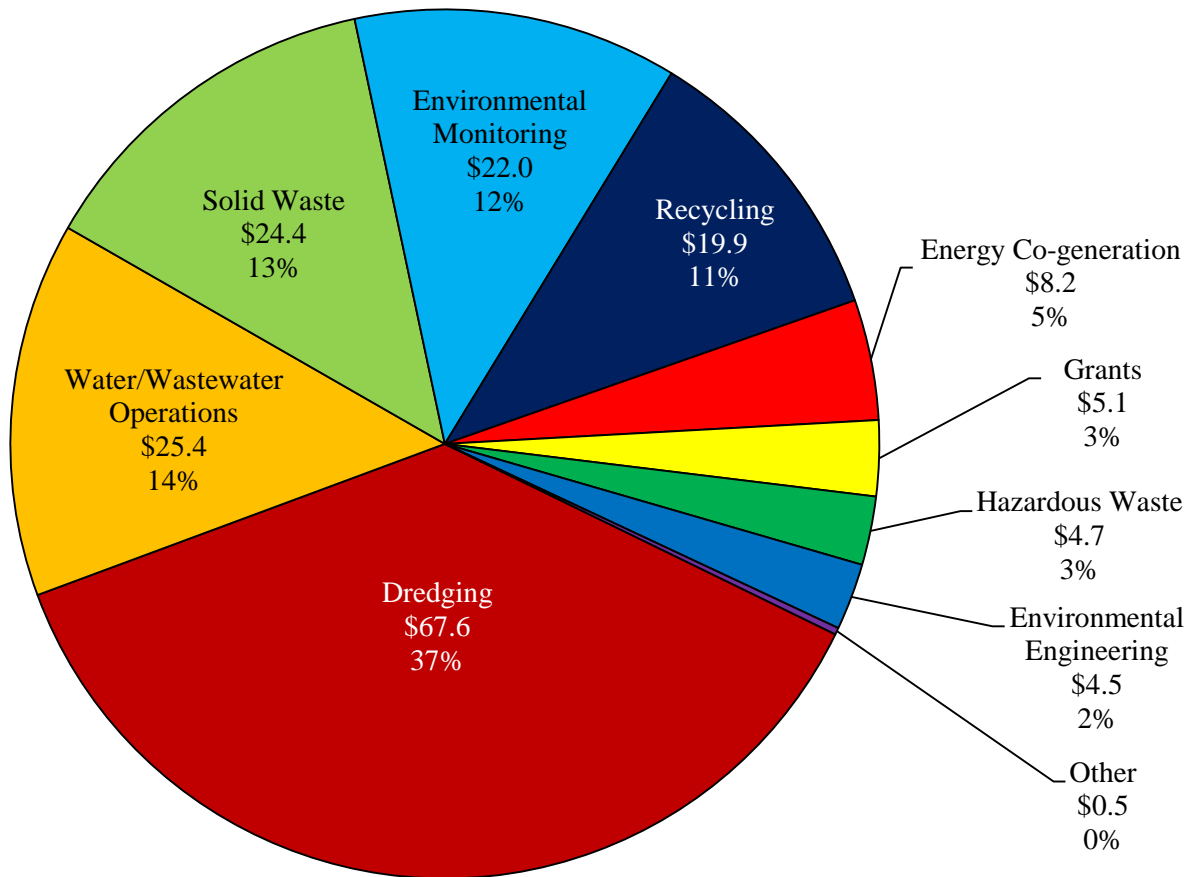


MES: Maryland Environmental Service

Source: Maryland Environmental Service

Exhibit 2 provides an overview of fiscal 2020 revenue by business activity type and shows that the largest three categories are dredging, water/wastewater operations, and solid waste. These three business activity types account for 64% of MES’s revenue. In recent years, MES has entered the market for energy efficiency and renewable energy.

Exhibit 2
MES Revenue by Business Activity Type
Fiscal 2020
(\$ in Millions)



MES: Maryland Environmental Service

Source: Maryland Environmental Service

Financial Changes

MES's operating income decreased by \$0.8 million between fiscal 2019 and 2020 because of increased personnel costs, including benefit costs; upgrades to IT hardware and software programs for agencywide efficiency enhancement; and COVID-19 related expenses. MES's revenues increased by \$21.1 million between fiscal 2019 and 2020, as shown by the revenue by business type activity in **Exhibit 3**. This reflects the following.

Exhibit 3
Revenues by Business Type Activity
Fiscal 2016-2020
(\$ in Thousands)

<u>Business Type Activity</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>Change 2018-2019</u>	<u>Change 2019-2020</u>
Environmental Dredging and Restoration	\$41,666	\$50,742	\$44,243	\$52,584	\$67,646	\$8,341	\$15,062
Grants	2,061	2,092	1,699	2,867	5,123	1,168	2,256
Environmental Engineering	2,735	2,263	2,398	2,594	4,518	196	1,924
Recycling	16,001	16,834	15,714	17,989	19,868	2,275	1,879
Environmental Monitoring	16,499	17,580	19,384	20,584	21,992	1,200	1,408
Energy Co-generation	6,769	6,887	7,162	7,155	8,173	-7	1,018
Other	408	395	506	361	461	-145	100
Solid Waste Management	34,738	34,009	29,430	24,316	24,385	-5,114	69
Hazardous Waste Treatment	4,819	4,766	4,837	4,994	4,653	157	-341
Water/Wastewater Operations	33,809	30,216	29,926	27,677	25,402	-2,249	-2,275
Total Revenue	\$159,505	\$165,784	\$155,299	\$161,121	\$182,221	\$5,822	\$21,100

Source: Maryland Environmental Service

- Environmental Dredging and Restoration:*** An increase of \$15.1 million due to the Cox Creek expansion project that was comprised of design for more than 60 dike construction and continuation of large construction projects, including operations complex relocation, base dike widening, and upland demolition and remediation; the Lake Linganore dredging project work increase in Frederick County, which began at the end of fiscal 2019 and is continuing through fiscal 2021; the Masonville dredging and construction project, including more than 18 dike construction and mitigation projects; Gwynns Falls Trash Interceptor; and Bloede Dam removal.

U10B00 – Maryland Environmental Service

- **Grants:** An increase of \$2.3 million was mainly due to U.S. Environmental Protection Agency’s Diesel Emissions Reduction Act funding for the Dray Truck Replacement Program and Cargo Handling Equipment Rebate Program. However, grant funding is a revenue category and not a business type activity; grant funding may apply to one or more of MES’s actual business type activities. For instance, the \$5.1 million in grant funding reflected for fiscal 2020 includes \$1.6 million that is actually used for water/wastewater operations.
- **Water/Wastewater Operations:** There is a decrease of \$2.3 million for water/wastewater operations, but this partially reflects the inclusion of grant revenue under the grants category noted above. Large changes in the wastewater operations revenues include a reduction due to the completion of construction activities at the Freedom Enhanced Nutrient Removal construction upgrade project and an increase of \$813,828 as a result of entering into a partnership with Garrett County for operation of the county’s 27 water and wastewater operations.

As shown in **Exhibit 4**, MES’s overall operating expenses increased by \$5.4 million between fiscal 2020 and 2021 and increased by \$5.5 million between fiscal 2021 and 2022. The major changes are for salaries, wages, and fringe benefits; land and structures; and contractual services. The major changes between fiscal 2021 and 2022 are increases of \$2.0 million in salaries, wages, and fringe benefits for a 3% cost-of-living adjustment estimate; \$1.2 million in land and structures based on a 3% increase for new fleet vehicles, custodial equipment, tools, and machinery; and \$1.1 million for contractual services for equipment repair and maintenance, information and technology expenses, and Workday software expenses.

Exhibit 4
Operating Expenses
Fiscal 2020-2022

<u>Operating Expense</u>	<u>Expenditures</u> <u>2020</u>	<u>Legislative</u> <u>Appropriation</u> <u>2021</u>	<u>Allowance</u> <u>2022</u>	<u>Change</u> <u>2020-2021</u>	<u>Change</u> <u>2021-2022</u>
Salaries, Wages, and Fringe Benefits	\$65,261,816	\$67,219,670	\$69,236,261	\$1,957,854	\$2,016,591
Technical and Special Fees	12,680,005	13,060,405	13,452,217	380,400	391,812
Communication	541,010	557,240	573,958	16,230	16,718
Travel	333,430	343,433	353,736	10,003	10,303
Fuel and Utilities	7,094,336	7,307,166	7,526,381	212,830	219,215
Motor Vehicle Operation and Maintenance	4,821,834	4,966,489	5,115,484	144,655	148,995
Contractual Services	35,845,702	36,921,073	38,028,705	1,075,371	1,107,632
Supplies and Materials	8,763,543	9,026,449	9,297,243	262,906	270,794
Fixed Charges	3,717,426	3,828,949	3,943,817	111,523	114,868
Land and Structures	39,707,573	40,898,800	42,125,764	1,191,227	1,226,964
Total Operating Expenses	\$178,766,675	\$184,129,674	\$189,653,566	\$5,362,999	\$5,523,892

Source: Department of Budget and Management

Types of MES Operations

MES's business type activities can generally be viewed as FFS and revenue-generating activities. Revenue-generating activities can be further divided into products and services. Before the sale of the scrap tire recycling facility in January 2008, MES sold recycled crumb rubber products. Currently, on behalf of its clients, MES produces two products – Leafgro and Leafgro Gold. Leafgro – composted yard waste such as grass clippings and leaves – and Leafgro Gold – composted food residual and yard waste – are produced under the contract that MES has to operate composting facilities for Montgomery and Prince George's counties; thus, the two counties receive the revenues from sales. However, MES continues to perform three revenue generating services: yard waste grinding; waste oil collection; and geospatial and engineering services.

Exhibit 5 reflects some of MES's revenue-generating services. As can be seen, revenues exceeded expenses for all but yard waste grinding in fiscal 2020. MES notes that the reversal in the operating loss for used oil collection in fiscal 2020 reflects the shift to a contract with a new vendor that is paying MES for the collected used oil as opposed to MES paying for the collection of used oil

U10B00 – Maryland Environmental Service

under the contract with the prior vendor. The increase in the operating gain for geospatial and engineering services reflects increases in funding from three sources: grants due to MES being a secondary recipient of funding; stormwater services work with higher education systems throughout the State; and contractual services support for the State Highway Administration. Yard waste grinding experienced an operating loss for the second year in a row. The fiscal 2020 operating loss is due to unexpected repairs and a major overhaul of the mill, which reduced production time and thus reduced the amount of revenue received from customers.

Exhibit 5
Revenue Generating Services
Fiscal 2013-2020
(\$ in Thousands)

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>Difference</u> <u>2019-2020</u>
Used Oil Collection									
Revenue	\$721	\$753	\$585	\$218	\$147	\$120	\$86	\$146	\$60
Expense	-368	-338	-301	-242	-80	-126	-87	-130	-43
Total	\$353	\$415	\$284	-\$24	\$67	-\$6	-\$1	\$16	\$17
Geospatial and Engineering Services									
Revenue	\$2,878	\$3,447	\$4,549	\$4,546	\$4,611	\$5,291	\$6,056	\$9,453	\$3,397
Expense	-3,137	-3,404	-4,600	-4,753	-4,460	-5,024	-5,869	-9,216	-3,347
Total	-\$259	\$43	-\$51	-\$207	\$151	\$267	\$187	\$237	\$50
Yard Waste Grinding (Tub Grinding)									
Revenue	\$510	\$347	\$516	\$570	\$612	\$751	\$656	\$519	-\$137
Expense	-378	-282	-345	-498	-570	-672	-700	-569	131
Total	\$132	\$65	\$171	\$72	\$42	\$79	-\$44	-\$50	-\$6

Source: Maryland Environmental Service

Fiscal 2021 Refund to the State

The State's fiscal 2022 budget plan includes a refund of \$2,250,000 from MES in fiscal 2021. This funding reflects unexpended monies in fiscal 2020, primarily from reduced costs for utilities and fuel at the Maryland Correctional Institution – Hagerstown Power Generation project (\$917,139) and the Eastern Correctional Institution (ECI) – Co-Generation Facility (\$743,557), and salary savings at the Maryland Park Service due to operators in the water/wastewater operations activity resigning or retiring and being replaced with lower salaried operators in training (\$379,368). The total amount of the unexpended monies is \$3,028,238, which includes \$2,610 for the Albert Powell Hatchery that was billed for fiscal 2019 but not received until fiscal 2020. Of this amount, \$350,548 is being requested to be held in the State Reimbursable Project Contingency Fund, \$299,677 has already been reimbursed to the State through the elimination of MES's June billing for the Department of Natural Resources (DNR), and \$79,701 in special funds is to be returned to DNR. Therefore, it appears that MES may actually be remitting \$2,298,312 to the State in fiscal 2022.

Fiscal 2022 Overview of Agency Spending

The discussion of the proposed budget focuses on the State reimbursable projects portion of MES's budget. As shown in **Exhibit 6**, the overall change in reimbursable project charges to State agencies between fiscal 2021 and 2022 is \$1,251,036. The major changes are an increase of \$1,527,630 for fuel and utilities and a decrease of \$426,459 for contractual services. Fuel and utilities increase because of increased fuel costs at the various steam plants MES operates and costs for converting the ECI – Co-Generation Facility from wood-burning to natural gas. Contractual services decrease for equipment repairs and contract labor. Overall, MES notes that the fiscal 2021 and 2022 budgets were prepared before the fiscal 2020 actuals were known, which means that the fiscal 2021 and 2022 budgets are based on the fiscal 2020 approved budget.

Exhibit 7 shows specific project changes between fiscal 2021 and 2022. The main change is the \$719,726 increase for the ECI – Co-Generation Facility as a result of the conversion from wood-burning to natural gas. There is also an increase of \$302,681 for the Maryland Park Service due to increased labor and supplies for algae testing in lakes; well repairs and replacements; chemicals, equipment, and repair parts; contingency funding for emergency repairs of collection systems; funding for a carbon exchange; service repairs for membranes; and service needed for backflow preventers. There is also an increase of \$185,583 at ECI for the startup of a new membrane system for the wastewater treatment plant, which includes costs for training and unanticipated issues; electricity costs are also expected to be higher.

Exhibit 6
Reimbursable Projects Operating Expenses
Fiscal 2020-2022

<u>Operating Expense</u>	<u>Expenditures</u> <u>2020</u>	<u>Appropriation</u> <u>2021</u>	<u>Allowance</u> <u>2022</u>	<u>Change</u> <u>2020-2021</u>	<u>Change</u> <u>2021-2022</u>
Salaries, Wages, and Fringe Benefits	\$15,771,796	\$17,487,897	\$17,550,637	\$1,716,101	\$62,740
Technical and Special Fees	516,981	517,482	501,905	501	-15,577
Communication	104,173	123,884	131,110	19,711	7,226
Travel	756	17,690	14,969	16,934	-2,721
Fuel and Utilities	5,855,904	7,002,668	8,530,298	1,146,764	1,527,630
Equipment Operations and Maintenance	465,709	562,275	537,054	96,566	-25,221
Contractual Services	1,320,476	2,034,438	1,607,979	713,962	-426,459
Materials and Supplies	2,299,499	2,191,458	2,314,876	-108,041	123,418
Total Operating Expenses	\$26,335,294	\$29,937,792	\$31,188,828	\$3,602,498	\$1,251,036

Source: Maryland Environmental Service

Exhibit 7
Reimbursable Projects
Fiscal 2022 Allowance Data

<u>Facilities</u>	<u>Expenditures</u> <u>2020</u>	<u>Allocation</u> <u>2021</u>	<u>Allowance</u> <u>2022</u>	<u>Change</u> <u>2020-2021</u>	<u>Change</u> <u>2021-2022</u>
Military Department	\$194,733	\$256,104	\$228,888	\$61,371	-\$27,216
Maryland Department of Veterans Affairs	496,917	635,194	613,967	138,277	-21,227
Maryland Aviation Administration	30,778	28,151	36,070	-2,627	7,919
DNR – Maryland Park Service	3,195,658	3,298,518	3,601,199	102,860	302,681
DNR – Fishing and Boating Services	56,266	77,716	79,839	21,450	2,123
MDH – Springfield Hospital Center	516,802	479,026	498,957	-37,776	19,931

U10B00 – Maryland Environmental Service

Facilities	Expenditures <u>2020</u>	Allocation <u>2021</u>	Allowance <u>2022</u>	Change <u>2020-2021</u>	Change <u>2021-2022</u>
MDH – Clifton T. Perkins Hospital Center	194,804	115,039	135,684	-79,765	20,645
MDH – Crownsville Hospital Center	624,071	661,377	691,582	37,306	30,205
DPSCS – Patuxent Institution	497,831	380,547	501,489	-117,284	120,942
DPSCS – MCI-H	1,830,267	1,921,130	1,936,042	90,863	14,912
DPSCS – MCI-H: Power Generation	3,754,017	4,859,783	4,849,320	1,105,766	-10,463
DPSCS – Western Correctional Institution	161,166	203,040	210,372	41,874	7,332
DPSCS –Dorsey Run Correctional Facility	1,754,088	1,749,903	1,655,084	-4,185	-94,819
DPSCS – ECI	2,314,817	2,588,783	2,774,366	273,966	185,583
DPSCS – ECI Co-Generation Facility	7,428,512	8,399,543	9,119,269	971,031	719,726
DPSCS – MCI-J	584,410	346,036	373,945	-238,374	27,909
DPSCS – MCI-W	238,093	320,267	293,621	82,174	-26,646
DPSCS – Jessup Steam Plant	1,092,661	1,967,543	1,902,416	874,882	-65,127
St. Mary’s College of Maryland	92,268	80,562	90,090	-11,706	9,528
UMCES – Horn Point	71,932	88,566	91,783	16,634	3,217
DJS – Statewide Youth Centers	410,124	483,287	471,157	73,163	-12,130
DJS – Victor Cullen Center	347,870	354,089	368,267	6,219	14,178
DJS – Cheltenham Youth Detention Center	447,210	643,588	665,421	196,378	21,833
Total	\$26,335,295	\$29,937,792	\$31,188,828	\$3,602,497	\$1,251,036

DJS: Department of Juvenile Services
DNR: Department of Natural Resources
DPSCS: Department of Public Safety and Correctional Services
ECI: Eastern Correctional Institution
MCI-H: Maryland Correctional Institution – Hagerstown
MCI-J: Maryland Correctional Institution – Jessup
MCI-W: Maryland Correctional Institution for Women
MDH: Maryland Department of Health
UMCES: University of Maryland Center for Environmental Science

Source: Governor’s Fiscal 2022 Budget Books; Maryland Environmental Service

Personnel Data

	<u>FY 20</u>	<u>FY 21</u>	<u>FY 22</u>	<u>FY 21-22</u>
	<u>Actual</u>	<u>Working</u>	<u>Allowance</u>	<u>Change</u>
Regular Positions	830.31	830.31	830.31	0.00
Contractual FTEs	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Total Personnel	830.31	830.31	830.31	0.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	0.00	0.00%
Positions and Percentage Vacant as of 12/31/20	n/a	n/a
Vacancies Above (Below) Turnover	n/a	

- Regular positions remain unchanged in the fiscal 2022 allowance. This reflects no change in anticipated needs.

Key Observations

1. COVID-19 Impact on MES

Almost two-thirds of MES’s personnel are considered essential, so MES has been at the forefront of maintaining Maryland’s utility infrastructure – water and wastewater operations, solid waste management, and recycling services – during the COVID-19 pandemic. MES has taken actions to address the pandemic, including teleworking, remote interviews for hiring, and the advancement of the annual Building Excellence and Success Together (BEST) performance incentive program payments to employees. The incentive is usually provided in the fall after the fiscal year closeout but, according to a March 2020 press release and April 2020 Board of Directors resolution, the approximately \$2.1 million incentive payment was advanced to April 2020 in order to provide MES’s employees with a financial boost right as the COVID-19 pandemic began impacting the economy. The plan for the fiscal 2020 incentive payment included \$3,000 per employee provided in April 2020 with an additional \$250 per employee to be paid in fall 2020 and was made possible because of a strong economic performance. However, a November 2020 Board of Directors resolution deferred the fiscal 2020 BEST program and suspended implementation until after the conclusion of the 2021 legislative session. As a result, the \$2.1 million incentive payment comprised of \$3,000 per eligible employee was made in April 2020, and the \$250 to \$300 remaining estimated amount will probably be paid by June 2021 upon board approval.

2. Former Director Severance Payment and Reimbursement Concerns

The Joint Committee on Fair Practices and State Personnel Oversight held several hearings during the 2020 interim concerning a severance payment and the timing and amount of reimbursements received by MES's former director. As a result, Governor Lawrence J. Hogan, Jr. has initiated administrative changes, reform legislation has been introduced in the 2021 legislative session, and MES has made several administrative and policy changes to address the concerns raised.

Background

During the 2020 interim, concerns were raised about the \$233,647 severance payment and final expense reimbursement of \$55,888 provided to the former director of MES. While previous directors and other members of management at MES had received severance payments in the past, the former director's payment was larger, despite a relatively short tenure, and the former director's situation was unique because all previous members of management receiving a payment were retiring from State service. In contrast, the former director was leaving for another State position – to be the Governor's chief of staff – which gave the appearance of a conflict of interest in that, as the chief of staff, the former director potentially had the ability to influence MES's Board of Directors on the decision to provide the severance payment and the amount. The reimbursements received by the former director were not submitted in a timely manner, and both the amount and reason for the reimbursements gave the appearance of being only tangentially related to MES's core mission.

The Joint Committee on Fair Practices and State Personnel Oversight held meetings to review MES's personnel and board practices on August 25, 2020, and September 2, 2020. The joint committee then briefed the Legislative Policy Committee (LPC) on September 23, 2020. LPC authorized subpoenas for the former MES director of operations and the former MES director. The joint committee then met again on December 10, 2020, and December 16, 2020, to question the former director of operations and former MES director, respectively. On January 18, 2021, LPC authorized additional subpoenas for the former MES managing director of finance and the current MES director of communications.

Governor Hogan's Administrative Changes

Governor Hogan has taken actions to address the severance payment and reimbursement concerns as follows.

- **Audit:** On August 25, 2020, Governor Hogan announced that he directed the Department of Budget and Management (DBM) to conduct an audit of MES.
- **Board Changes and Possible Legislation:** On September 23, 2020, the Governor noted in a letter to the presiding officers of the General Assembly that the chair of the Board of Directors and members of the executive staff of MES had been removed and that the retired Chief Judge of the U.S. District Court for the District of Maryland had been appointed as the new secretary of the board. In addition, the Governor noted that his legislative affairs office was reviewing

potential reforms, including substantial changes to MES's governing structure and oversight capability; restoring MES as a State agency; and moving to sell MES to the private sector.

- ***State Transparency and Accountability Reform Commission:*** The Governor issued an executive order on December 16, 2020, creating a State Transparency and Accountability Reform Commission. The commission, largely appointed by the Governor, is charged with reviewing and investigating the operations and structures of 14 quasi-governmental agencies, including MES, and reporting to the Governor and General Assembly on the commission's findings and recommendations by December 1, 2021.
- ***Governor's Legislation:*** HB 741 and SB 575 of 2021 are emergency Administration bills that alter the composition, selection, and duties of the Board of Directors of MES; require board members to observe a standard of care; and require the board to annually evaluate the director of MES in accordance with certain criteria and procedures. In addition, under the bills, board members must disclose financial interests; the board must adopt a conflict of interest policy by October 31, 2021; and the board must obtain and review independent assessments and audits and make changes and recommendations as appropriate. Finally, by December 31, 2021, the board must review policies, practices, and procedures and report its findings and recommendations to the Governor and the General Assembly.

Legislation

SB 2 and HB 2 have been introduced in the 2021 legislative session as well. The bills make overarching changes to the governance and administration of MES, including (1) altering the composition, selection, and standards of conduct for MES Board of Directors; (2) adding new spending and contracting restrictions; (3) prohibiting the award of specified severance packages to former MES executives; (4) requiring the director to appoint a diversity officer; (5) instituting new training and required policies; (6) establishing new requirements and standards for holding board meetings; and (7) clarifying the application of collective bargaining provisions for MES employees.

MES Administrative and Policy Changes

MES has instituted several administrative and policy changes as a result of the concerns noted above. The changes are as follows.

- ***Executive Leave Accrual:*** The Board of Directors approved Resolution 2020-10-1R at its October 22, 2020 meeting. The resolution specified that executives will be paid only for annual leave accrued for the pay periods worked at the time of termination and not for the entire year. MES notes that previously, executives were accruing 200 hours of annual leave on January 1 of each calendar year.
- ***Board Notification for Expenditures of Director:*** The Board of Directors approved Resolution 2020-10-2R at its October 22, 2020 meeting. The resolution specifies that the

director of finance reviews reimbursement of expenses and credit card use by the director and that the director of finance reports this information to the Board of Directors.

- ***Expense Reimbursement Timeline:*** MES has included a policy on its company intranet specifying that expense reports must be submitted within 30 calendar days of the completion of travel and that employees on extended travel status are required to submit expense reports on a monthly basis.

The actions taken by the Governor and MES and the actions proposed to be taken via legislation address a number of the concerns raised by the Joint Committee on Fair Practices and State Personnel Oversight. However, it does not appear that a determination has been made about whether the former director's severance payment should be repaid, and if so, then whether the former director or MES should be responsible for the repayment. **The Department of Legislative Services (DLS) recommends that MES comment on whether it has discussed the repayment of the severance payment with DBM and, if so, then how the repayment would occur.**

3. MES Funding Statement Reflects Agency Priorities

The 2020 *Joint Chairmen's Report* included committee narrative requesting an MES funding statement including information on MES's undesignated unrestricted net assets, overhead rate, project reserve fund status, and justification for reimbursable project funding changes. The submitted report and prior year information reflect the following.

- ***Undesignated Unrestricted Net Assets:*** MES considers its undesignated unrestricted net assets to be its fund balance. MES' unrestricted undesignated net position increased to \$3.4 million in fiscal 2017 and \$4.8 million in fiscal 2018 before decreasing to \$4.0 million in fiscal 2019. The fiscal 2020 amount was \$4.3 million, which is also reflected in the estimates for fiscal 2021 and 2022. MES used a portion of its undesignated unrestricted net assets in fiscal 2019 to pay for the implementation of the Workday human resources software and for building expansion costs at its Millersville headquarters in order to accommodate staff growth and to aggregate staff that are spread among several buildings including leased space. The building expansion originally was anticipated to be completed in calendar 2023, but has since been canceled in favor of modifying the existing building to accommodate staff working in leased space. In addition, MES has used its undesignated unrestricted net assets to expand its program providing health care benefits to retirees beginning in January 2019 since MES retirees do not participate in the Maryland State Retirement and Pension System. MES notes that the amount retained on an annual basis as undesignated unrestricted net assets are needed to upgrade technology, address unexpected expenditures, and address emergencies.
- ***Overhead Rate:*** An informal goal reflected by MES in the past is to reduce the overhead rate – general administrative rate – charged to State agencies and other clients as a result of increasing MES's client base, thus spreading overhead over more clients. In fact, overhead rates have mostly trended down in recent years, as follows: fiscal 2015 – 45.29%; fiscal 2016 – 44.75%; fiscal 2017 – 44.54%; fiscal 2018 – 43.60%; fiscal 2019 – 44.98%; fiscal 2020 –

U10B00 – Maryland Environmental Service

43.06%; fiscal 2021 – 46.56%; and fiscal 2022 – 44.80%. MES has noted that salary and other personnel increases required to fill vacant positions resulted in the increased overhead rate in fiscal 2021. Between fiscal 2020 and 2022, the group rates have either stayed the same or decreased for environmental dredging and restoration, environmental operations, and working capital. However, the water and wastewater rate is the rate that most impacts the State because it comprises the majority of State reimbursable projects, but the water and wastewater overhead rate trend is not clear. This is because MES has changed how the water and wastewater rate is charged over the last couple of years. This is important because the water and wastewater rate was 14.62% in fiscal 2015 – due to the heavy management component of water and wastewater treatment plant operations – and thus reflects a substantial determinant of the cost of MES’s services to the State. MES notes that the water and wastewater rate was 7.28% in fiscal 2020, when it was calculated in combination with the environmental services rate. Then in fiscal 2021, the water and wastewater rate was calculated on its own as 5.59%. Finally, in fiscal 2022, the water and wastewater rate was calculated in combination with the rates for environmental monitoring and geographic engineering services as 6.33%.

- ***Project Reserve Fund Status:*** MES has three project reserve funds: the State Reimbursable Project Contingency Fund; the ECI Steam Turbine Contingency Fund; and the DNR Project Contingency Fund. The status of these reserve funds is shown in **Exhibit 8**. MES notes that the \$355,157 shown as being used from the State Reimbursable Project Contingency Fund in fiscal 2020 reflects the amount used to operate the Jessup Steam Plant after a fiscal 2019 funding reduction. The \$350,548 retained in the State Reimbursable Project Contingency in fiscal 2020, but shown in the exhibit in fiscal 2021, reflects funding that is being retained for future revenue shortfalls and emergencies. MES notes that it anticipates using funds from the ECI Steam Turbine Contingency Fund in spring 2021 or fall 2022 since the original plan for how the money was going to be used was delayed due to postponements in upgrading the control system, a necessary step before the turbine overhaul.

Exhibit 8
Project Reserve Fund Balances
Fiscal 2020-2021

<u>Project Reserve Fund Activity</u>	<u>2020</u> <u>Amount</u>	<u>2021</u> <u>Amount</u>	<u>Cap</u>	<u>Difference</u>
State Reimbursable Project Contingency Fund				
Beginning Balance	\$489,768	\$149,452		
Approved Retainage (Fiscal 2020)	0	350,548		
Funds Used	-355,157	0		
Interest Earned	14,841	0		
Current Balance	\$149,452	\$500,000	\$1,000,000	-\$500,000
ECI Steam Turbine Contingency Fund				
Beginning Balance	\$1,202,666	\$1,232,941		
Approved Retainage	0	0		
Funds Used	0	0		
Interest Earned	30,275	0		
Current Balance	\$1,232,941	\$1,232,941	\$1,500,000	-\$267,059
DNR Project Contingency Fund				
Beginning Balance	\$3,408	\$3,495		
Approved Retainage	0	0		
Funds Used	0	0		
Interest Earned	87	0		
Current Balance	\$3,495	\$3,495	\$500,000	-\$496,505

DNR: Department of Natural Resources

ECI: Eastern Correctional Institution

Source: Maryland Environmental Service; Department of Legislative Services

- Reimbursable Project Funding Changes:** MES notes that it prepares the State reimbursable project budget two years in advance of the actual fiscal year and that it uses all available information to budget conservatively. In addition, MES notes that it either returns unused State funds to DBM or holds the funds in one or more of the three contingency funds, subject to DBM approval. In terms of the fiscal 2022 State reimbursable project funding increase, MES notes that the funding is primarily budgeted for the conversion of the ECI wood-burning facility to natural gas, increased labor projections under the assumption of full staffing, replacement of obsolete equipment, and diesel fuel costs.

DLS recommends that committee narrative be adopted requesting that MES continue to provide a MES funding statement, including information on MES’s undesignated unrestricted net assets, overhead rate, project reserve fund status, and justification for reimbursable project funding changes. As part of this continued response, DLS recommends that MES provide the water and wastewater operations overhead rate calculation separate from all of the other overhead rates for each fiscal year between fiscal 2015 and 2023 and comment on any trends in the data.

Operating Budget Recommended Actions

1. Adopt the following narrative:

Maryland Environmental Service Funding Statement: The committees request that the Maryland Environmental Service (MES) continue to provide a report on the following:

- undesignated unrestricted net assets for fiscal 2021, 2022, and 2023 estimated and an explanation for any changes between each of these years, including revenues credited to and expenditures debited from the net assets;
- overhead rate for fiscal 2021, 2022, and 2023 estimated, including a separate calculation for the water and wastewater overhead rate for each fiscal year from fiscal 2015 through 2023;
- project reserve fund status by beginning balance, approved retainage, funds used, and interest earned for fiscal 2021 and 2022 for the State Reimbursable Project Contingency Fund, the Eastern Correctional Institution Steam Turbine Contingency Fund, and the Department of Natural Resources Project Contingency Fund; and
- justification for the changes in reimbursable project funding for fiscal 2021, 2022, and 2023 estimated based on a discussion about how MES’s undesignated unrestricted net assets allow for reducing MES’s overhead rate for State reimbursable projects and how project reserve funds are available for any under budgeting.

The report should be submitted in coordination with the Department of Budget and Management (DBM) with the fiscal 2023 budget submission.

Information Request	Authors	Due Date
MES funding statement	MES DBM	Fiscal 2023 budget submission

Appendix 1
2020 Joint Chairmen’s Report Responses from Agency

The 2020 *Joint Chairmen’s Report* (JCR) requested that Maryland Environmental Service (MES) prepare one report. Electronic copies of the full JCR responses can be found on the Department of Legislative Services Library website.

- ***MES Funding Statement Reflects Agency Priorities:*** The 2020 JCR included committee narrative requesting an MES funding statement. The funding statement was requested to include information on MES’ undesignated unrestricted net assets, overhead rate, project reserve fund status, and reimbursable project funding change justifications. Further discussion of this data can be found in Key Observation 3 of this analysis.

**Appendix 2
Object/Fund Difference Report
Maryland Environmental Service**

<u>Object/Fund</u>	<u>FY 20 Actual</u>	<u>FY 21 Working Appropriation</u>	<u>FY 22 Allowance</u>	<u>FY 21 - FY 22 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	830.31	830.31	830.31	0.00	0%
Total Positions	830.31	830.31	830.31	0.00	0%
Objects					
01 Salaries and Wages	\$ 65,261,816	\$ 67,219,670	\$ 69,236,261	\$ 2,016,591	3.0%
02 Technical and Special Fees	12,680,005	13,060,405	13,452,217	391,812	3.0%
03 Communication	541,010	557,240	573,958	16,718	3.0%
04 Travel	333,430	343,433	353,736	10,303	3.0%
06 Fuel and Utilities	7,094,336	7,307,166	7,526,381	219,215	3.0%
07 Motor Vehicles	4,821,834	4,966,489	5,115,484	148,995	3.0%
08 Contractual Services	35,845,702	36,921,073	38,028,705	1,107,632	3.0%
09 Supplies and Materials	8,763,543	9,026,449	9,297,243	270,794	3.0%
13 Fixed Charges	3,717,426	3,828,949	3,943,817	114,868	3.0%
14 Land and Structures	39,707,573	40,898,800	42,125,764	1,226,964	3.0%
Total Objects	\$ 178,766,675	\$ 184,129,674	\$ 189,653,566	\$ 5,523,892	3.0%
Funds					
07 Nonbudgeted Fund	\$ 178,766,675	\$ 184,129,674	\$ 189,653,566	\$ 5,523,892	3.0%
Total Funds	\$ 178,766,675	\$ 184,129,674	\$ 189,653,566	\$ 5,523,892	3.0%

Note: The fiscal 2021 appropriation does not include deficiencies, targeted revenues, or across-the-board reductions. The fiscal 2022 allowance does not include contingent reductions or cost-of-living adjustments.