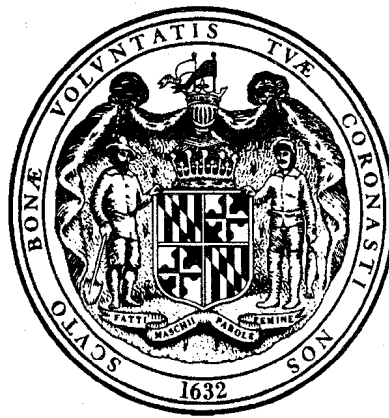

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2001



Office of Legislative Audits
Department of Legislative Services
Maryland General Assembly

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

June 21, 2002

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Delegate Samuel I. Rosenberg, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Mr. William Donald Schaefer
Comptroller of the Treasury

Mr. Karl S. Aro, Executive Director
Department of Legislative Services

Ladies and Gentlemen:

In accordance with Article 19, Section 40(a) of the Annotated Code of Maryland, we have performed desk reviews of the audit reports filed by each county, incorporated city or town, and taxing district in Maryland for the fiscal year ended June 30, 2001. The desk reviews consisted of assessments of compliance with accounting and auditing standards, evaluation of compliance with certain State laws, and analyses of selected financial data to identify potential financial problems.

Virtually all of the local governments and their independent auditors substantially complied with accounting and auditing standards for the fiscal year ended June 30, 2001. Nevertheless, we identified instances of noncompliance with certain requirements of our audit guidelines, generally accepted accounting principles, and/or generally accepted auditing standards. Letters were sent to 70 local governments and their independent auditors to notify them of the deficiencies disclosed by our reviews so that corrective action could be taken to help ensure future compliance.

The financial statements for 20 local governments disclosed uninsured/uncollateralized bank deposits, which is an area of noncompliance with State law. In addition, our desk reviews identified 8 local governments with potential financial problems (for example, deficit fund balances, unfavorable financial trends). Where appropriate, letters were sent to notify these local governments of their noncompliance or potential financial problems and to request that the local governments advise us of the corrective actions that will be taken.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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Introduction and Scope

Article 19, Section 40(a) of the Annotated Code of Maryland requires each county, incorporated city or town, and taxing district in Maryland to file annual (once every four years under certain specified conditions) audit reports. There were 194 local government audit reports due for fiscal year 2001 (24 counties, 153 cities and towns, and 17 taxing districts). The reports are to include financial statements with accompanying notes, and auditors' reports that express opinions as to whether the financial statements are fairly presented. The financial statements are required to be prepared in accordance with generally accepted accounting principles and audited in accordance with generally accepted auditing standards. We have prepared and distributed audit guidelines to provide additional information regarding the accounting, reporting, and auditing requirements.

Article 19, Section 40(a) of the Code requires the Office of Legislative Audits to perform a desk review of each local government's annual audit report for compliance with generally accepted accounting principles and auditing standards. Subsections (b) through (f) of Section 40 specify the reporting and review requirements applicable to special taxing districts created by the counties. The applicable county is responsible for reviewing each district's compliance with the applicable provisions of the law and submitting the districts' reports to the Office of Legislative Audits. The Office is required to review the results of the counties' reviews and the districts' reports for compliance with the law.

We conducted desk reviews of each of the fiscal year 2001 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as the four fiscal year 2000 reports (Towns of Burkittsville, Maryland, and Templeville, and the Washington Suburban Transit Commission) received subsequent to our previous review. The purposes of the desk reviews were to:

- determine areas of noncompliance with our audit guidelines and accounting and auditing standards, using a checklist for governmental audits published by the American Institute of Certified Public Accountants.
- identify any instances of noncompliance with certain provisions of State law (for example, collateral for bank deposits).
- identify local governments with potential financial problems relating to deficit fund balances, underfunded pension plans, or unfavorable trends and ratios, based on an analysis of financial data over the most recent five-year period (July 1, 1996 through June 30, 2001).

We also reviewed each of the fiscal year 2001 special taxing district reports received and the related results of the counties' reviews of these reports. The purpose of our review was to ensure that the counties had reviewed the reports submitted for compliance with the provisions of the law and to identify instances in which required reports were not submitted.

Results of Desk Reviews

Audit Reports

Fifteen local governments submitted audit reports after the required filing date and four local governments had not filed an audit report(s).

Fifteen local governments submitted audit reports after the required filing date and four local governments had not filed an audit report(s). A delay in filing by a local government results in the lack of timely accountability to its citizens. This area of noncompliance was also noted for 5 of these 15 local governments during our preceding years' reviews. Article 19, Section 40(a) of the Annotated Code of Maryland requires audit reports to be filed by November 1 after the close of the fiscal year, or by January 1 after the close of the fiscal year for those local governments with a population of more than 400,000.

Audit reports for the fiscal year ended June 30, 2001 had not been received as of June 17, 2002 for the City of Glenarden, the Towns of Mardela Springs and Williamsport, and the Washington Suburban Transit Commission. An audit report for the fiscal year ended June 30, 2000 had also not been received as of June 17, 2002 for the Town of Williamsport. We were advised by the Town that it is working with their auditor in an effort to get their fiscal year 2000 and 2001 audit reports filed. We will review these reports and take any follow-up action necessary when they are received. The results of these reviews will be included in the report on our review of fiscal year 2002 local government audit reports.

The Towns of Brookview, Church Creek, and Eldorado requested and were granted waivers from filing an audit report for fiscal year 2001 because they met the conditions for filing an audit report every fourth year as provided for under Article 19, Section 40(a). These entities will next be required to file audit reports for fiscal year 2004.

The audit report for one local government contained a qualified opinion because of inadequate fixed asset records, and a letter explaining the problem and how it would be rectified was not submitted.

The audit report for the Town of La Plata contained a qualified opinion because detailed fixed asset records were not maintained. This area of noncompliance was also noted during our preceding review. The purpose of recording fixed assets is

to provide for physical and dollar value control, and to establish accountability for capital expenditures made over the years.

A qualified opinion is issued when the auditor states that, “except for” the effects of the matter to which the qualification relates, the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

Although required by our audit guidelines, the auditor for this local government did not submit a separate letter to the Office of Legislative Audits explaining the reasons for the qualification, as well as the entity’s plan to rectify the problem to enable the auditor to express an unqualified opinion in the future. This area of noncompliance was also noted for this local government during our preceding year’s review.

Auditors’ reports for forty-three local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors’ reports for forty-three local governmental units were not presented in accordance with generally accepted auditing standards. The following is a summary of these deficiencies:

<u>Area of Noncompliance</u>	<u>Number of Audit Reports</u>
Auditor’s report did not reference the country of origin of the generally accepted accounting principles used to prepare the financial statements and/or of the generally accepted auditing standards the auditor followed in conducting the audit.....	41
Auditor’s report did not include all basic elements of an audit report (for example, auditor’s opinion did not cover all financial statements)	2

Article 19, Section 40(a) of the Annotated Code of Maryland requires that audits be performed in accordance with generally accepted auditing standards. These standards require, in part, that the auditor express an opinion as to whether the financial statements present fairly, in all material respects, the financial position, the results of operations and, where applicable, the cash flows of the local government in conformity with generally accepted accounting principles.

It should be noted that the majority of these deficiencies related to recent changes in reporting standards. In this regard, Statement on Auditing Standards 93 requires the auditor's report to refer to the country of origin of the generally accepted accounting principles and auditing standards that were followed. We anticipate that a substantial improvement will be made in this area in next year's reports.

Financial Statements

Financial statements submitted by 12 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 12 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of one of these local governments included two such deficiencies and the financial statements of one of these local governments included a deficiency that was also cited during our preceding year's review. The following is a summary of these deficiencies:

<u>Deficiency</u>	<u>Number of Instances</u>
All required financial statements were not presented or presentation of statement was inappropriate	7
Misclassification or improper presentation (for example, improper presentation of interfund transactions)	6

Financial statements and accompanying notes for 19 local governments did not include certain disclosures required by generally accepted accounting principles.

All required information was not included in the financial statements, or in the accompanying notes, for 19 audit reports. The financial statements of one of these local governments included two areas of insufficient disclosure and the financial statements for three local governments included areas of insufficient disclosure that were also cited during our preceding year's review. Adequate disclosure is necessary to facilitate the understanding, and provide for fair presentation, of the financial information.

The following is a summary of the areas of insufficient disclosure and the corresponding number of instances:

<u>Area of Insufficient Disclosure</u>	<u>Number of Instances</u>
Cash deposits with financial institutions and investments.....	12
Basis of accounting	3
Deficit retained earnings	1
Excess of expenditures over appropriations	1
Long-term debt	1
Pensions	1
Reconciliation of the budgetary basis of accounting to the modified accrual basis	1

Noncompliance with State Law

Financial statements of 20 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured (see Exhibit A), as required by State law.

Financial statements of 20 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured as required by State law. Article 95, Section 22 of the Annotated Code of Maryland requires that deposits with financial institutions by local governmental units be fully collateralized. Full collateralization minimizes the risk of loss of deposits in the event the financial institution defaults.

Potential Financial Problems

For the fiscal year ended June 30, 2001, the following potential financial problems were noted based on the information presented in the local governments' audited financial statements and accompanying notes:

Unreserved general fund deficit balances were noted for four local governments as of June 30, 2001 (see Exhibit B).

Unreserved general fund deficit balances were noted for four local governments as of June 30, 2001. The general fund is used to account for most of the current operating expenditures of a local governmental unit. A general fund deficit balance represents the costs of current or past services that will need to be financed in future periods. Consequently, a general fund deficit may indicate a potential financial problem. General fund deficit balances were also noted for two of these local governments in our previous year's review.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2001 (see Exhibit C).

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2001. The unfavorable trends and ratios occurred because, over the five-year period reviewed, the local governments had general fund expenditures that exceeded general fund revenues, significant decreases in their general fund balances, and/or significant decreases in their ratio of general fund balances to general fund expenditures.

Pension plans for two local governments were significantly underfunded.

Two local governments had pension plans that were significantly underfunded as follows:

- Members of the Fire and Police Departments of Baltimore City who were hired prior to January 1, 1947 were eligible for coverage under a defined benefit retirement plan. All employees eligible under the plan have retired.

The City funds pension benefits under this plan on a “pay-as-you-go” basis. Specifically, the City contributed approximately \$6.8 million to the plan during fiscal year 2001. The present value of future benefits related to this plan was approximately \$23.7 million as of June 30, 2001.

- All elected officials and certain employees of the Town of Capitol Heights were eligible to participate in a defined benefit pension plan to which all participants were required to contribute 2.5% of their pay. The balance of the funding of the plan has been provided by the Town. Effective December 31, 1992, the Town “froze” the plan. The benefits that had been earned by each participant as of that date were to be calculated and “locked in” until each participant has the right to withdraw or otherwise receive benefits. The most recent actuarially determined minimum recommended contribution was \$51,133 for calendar year 1997. The Town contributed \$19,800 to the plan for calendar year 2000. The unfunded actuarial liability related to this plan was \$242,228 as of January 1, 1997.

Special Taxing Districts

Background

The preceding contents of this report are applicable to local governments filing audit reports in accordance with the provisions of Article 19, Section 40(a) of the Code. Subsections (b) through (f) of this Section require that certain types of special taxing districts file annual audit or financial reports with the county in which they are located within 90 days of the close of the fiscal year in accordance with the rules and regulations established by the applicable county. The applicable county is responsible for reviewing each district’s compliance with the applicable provisions of the law and submitting copies of these reports to the Office of Legislative Audits.

Required reports had not been filed for four special taxing districts.

As of June 17, 2001, we had not received three of the reports required to be submitted by Anne Arundel County and one report by Calvert County for the fiscal year ended June 30, 2001. Furthermore, Anne Arundel County had not submitted a report for one of the districts for the fiscal year ended June 30, 2000. The Counties advised us that they were in the process of pursuing compliance with the applicable filing requirements for these four districts (for example, withholding County funds).

Exhibit A: Schedule of Audit Reports Containing Disclosures That Cash Deposits Were Not Fully Collateralized or Otherwise Insured

<u>Entities</u>	<u>Uninsured/ Uncollateralized Amount</u>	<u>Similar Disclosures Included in Audit Reports for Each Year Since Fiscal Year</u>
At June 30, 2001:		
Counties:		
Anne Arundel County	\$ 797,100	2000
Baltimore County	4,541,912	
Dorchester County	27,000	
Garrett County	76,569	1998
Montgomery County	70,241	2000
Prince George's County	94,325	1998
Cities and Towns:		
City of Brunswick	\$ 41,590	
City of Cambridge	135,329	
Town of Chevy Chase Village	313,115	
Town of Kensington	11,437	2000
Village of Martin's Additions	5,749	
Town of Mount Airy	*	
Town of Union Bridge	20,699	
Taxing Districts:		
Cresaptown Civic Improvement Association	\$ 8,025	
Other Than at June 30, 2001:		
Cities and Towns:		
Town of Barnesville	*	1999
Village of Chevy Chase, Section 3	*	1995
Village of Chevy Chase, Section 5	*	
Town of Glen Echo	*	
Town of Leonardtown	*	2000
Taxing Districts:		
Washington Suburban Transit Commission (Fiscal year 2000)	*	

* This entity did not disclose the dollar amount of the uninsured/uncollateralized cash deposits in the audit report.

Exhibit B: Schedule of General Fund Deficits
Fiscal Year Ended June 30, 2001

Entity	Unreserved Fund Balance (Deficit) at July 1, 2000	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2001
<u>Cities and Towns</u>				
Town of Elkton	\$ 990,246	\$ 6,698,932	\$ 7,979,672	\$ (290,494)
Town of Hurlock	28,999	1,556,933	1,710,481	(124,549)
City of Mount Rainier	(100,310)	2,192,903	2,200,041	(107,448)
Town of Westernport	(65,413)	816,306	971,968	(221,075)

Exhibit C: Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2001

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
Town of North Beach	<p>Fund balance was \$0 as of June 30, 2001.</p> <p>Although the fund balance increased from a deficit \$114,311 as of June 30, 2000 to \$0 as of June 30, 2001, the increase was the result of loan proceeds of \$172,018 and operating transfers totaling \$222,140, rather than as a result of on-going operations.</p> <p>Expenditures (\$1,506,255) exceeded revenues (\$1,226,408) by \$279,847 for the year ended June 30, 2001.</p>
Town of Vienna	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 1998, 1999, 2000, and 2001.</p> <p>Fund balance decreased from \$128,761 as of June 30, 1997 to \$6,651 as of June 30, 2001.</p> <p>Fund balance as a percentage of annual expenditures and other fund uses decreased from 233% as of June 30, 1997 to 4% as of June 30, 2001.</p>

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