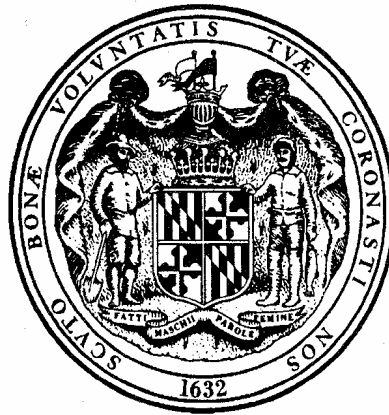

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2002



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 30, 2003

Delegate Van T. Mitchell, Co-Chair, Joint Audit Committee
Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

The Honorable 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, 2002. 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, 2002. 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 59 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 disclosed 15 local governments with uninsured/ uncollateralized bank deposits and 1 local government with disallowed investments, both of which are areas of noncompliance with State law. In addition, our desk reviews identified 7 local governments with potential financial problems (for example, deficit fund balances, unfavorable financial trends). Where appropriate, letters were sent to these local governments (and to their legislative representatives) to communicate 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 192 local government audit reports due for fiscal year 2002 (24 counties, 151 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 a desk review of each of the fiscal year 2002 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as the four fiscal year 2001 reports (City of Glenarden, Towns of Mardela Springs and Williamsport, and the Washington Suburban Transit Commission) and the one fiscal year 2000 report (Town of Williamsport) received subsequent to our previous review. The desk reviews were performed to accomplish the following tasks:

- 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, 1997 through June 30, 2002).

We also reviewed each of the fiscal year 2002 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

Seventeen local governments submitted audit reports after the required filing date and three local governments had not filed an audit report.

Seventeen local governments submitted audit reports after the required filing date and three local governments had not filed an audit report. 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 6 of these 17 local governments during our preceding year's review. 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, 2002 had not been received as of June 20, 2003 for the Cities of Glenarden and Mount Rainier, and the Town of Willards. 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 2003 local government audit reports.

The Towns of Marydel and Templeville requested and were granted waivers from filing an audit report for fiscal year 2002 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 2005. The Towns of Brookview, Church Creek, and Eldorado had requested and were granted waivers in the previous fiscal year. 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 has been noted for each fiscal year since 2000. 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 has also been noted for this local government for each fiscal year since 2000.

Auditors’ reports for 11 local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors’ reports for 11 local governmental units were not presented in accordance with generally accepted auditing standards. The financial statements of six of these local governmental units included a deficiency that was also cited during our previous year’s review. The following is a summary of these deficiencies:

Area of Noncompliance	Number of Audit Reports
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	7
Auditor’s opinion did not cover all financial statements	2
Auditor’s report did not contain the manual or printed signature of the auditor’s firm	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.

Financial Statements

Financial statements submitted by 34 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 34 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of six of these local governments included two such deficiencies, and the financial statements of two 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:

Deficiency	Number of Instances
Misclassification or improper presentation (for example, improper presentation of retained earnings and contributed capital)	30
All required financial statements were not presented or presentation of statement was inappropriate	10

Financial statements and accompanying notes for 13 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 13 audit reports. The financial statements of one of these local governments included two areas of insufficient disclosure, and the financial statements for one local government included an area of insufficient disclosure that was 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:

Area of Insufficient Disclosure	Number of Instances
Cash deposits with financial institutions and investments	6
Basis of accounting	4
Deficit fund balance	1
Excess of expenditures over appropriations	1
Significant accounting policies	1
Long-term debt	1

Noncompliance with State Law

Financial statements of 15 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 15 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.

Investments held in violation of State law were noted for one local government.

The financial statements of the Town of Morningside disclosed that the Town held certificates of deposit at financial institutions that were not located within the State of Maryland as required by State law. Article 95, Section 22 of the Annotated Code of Maryland authorizes local governmental units to deposit unexpended or surplus money in any federally insured bank or savings and loan association in the State of Maryland.

Potential Financial Problems

For the fiscal year ended June 30, 2002, 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 three local governments as of June 30, 2002 (see Exhibit B).

Unreserved general fund deficit balances were noted for three local governments as of June 30, 2002. 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. One local government has not had a positive general fund balance since fiscal year 1992, while another local government has had a general fund deficit balance for each fiscal year since 2000.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2002 (see Exhibit C).

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2002. 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 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:

- 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 \$6.3 million to the plan during fiscal year 2002. The present value of future benefits related to this plan was approximately \$21.6 million as of June 30, 2002.

- 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. Since 1997, the Town has made contributions to cover only the annual retirement benefits. The Town contributed \$24,200 to the plan for fiscal year 2002. The unfunded actuarial liability related to this plan was \$242,228 as of January 1, 1997. According to the Town’s financial statements, the Town intended to have an actuarial valuation performed, and intended to satisfy the necessary annual obligation in fiscal year 2003.

Special Taxing Districts

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.

We reviewed the reports submitted to us by the counties. All required reports were filed for the most recent fiscal year.

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

<u>Entity</u>	<u>Uninsured/ Uncollateralized Amount</u>	<u>Similar Disclosures Included in Audit Reports for Each Year Since Fiscal Year</u>
At June 30, 2002:		
Counties:		
Anne Arundel County	\$ 932,463	2000
Charles County	162,220	
Howard County	1,193,759	
Prince George's County	221,534	1998
Cities and Towns:		
Town of Barnesville	\$ 6,723	1999
City of Brunswick	62,751	2001
City of Crisfield	222,774	
Town of Galena	56,728	
Town of Glen Echo	36,376	2001
Town of Hurlock	51,959	
Town of Kensington	16,425	2000
Village of Martin's Additions	17,304	2001
Town of Middletown	12,830	
Other Than at June 30, 2002:		
Cities and Towns:		
Town of Leonardtown	*	2000
Taxing Districts:		
Washington Suburban Transit Commission	*	2000

* This entity did not disclose the dollar amount of the uninsured/uncollateralized cash deposits in the audit report. For the Washington Suburban Transit Commission, this condition was noted for fiscal year 2001 and 2002 reports, both of which were included in this year's review.

Exhibit B – Schedule of General Fund Deficits
Fiscal Year Ended June 30, 2002

Entity	Unreserved Fund Balance (Deficit) at July 1, 2001	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2002
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Cities and Towns

Town of North Beach*	\$ 0	\$ 1,440,202	\$ 1,550,086	\$ (109,884)
Town of Ridgely	16,709	769,667	933,903	(147,527)
Town of Westernport**	(221,075)	1,588,384	1,645,292	(277,983)

* This local government has not had a positive general fund balance since fiscal year 1992 (Town has had a deficit each fiscal year except 2001 when its general fund balance was \$0).

** This local government has had a general fund deficit balance since June 30, 2000.

Exhibit C – Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2002

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
Town of Princess Anne	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2001 and 2002.</p> <p>Fund balance decreased from \$382,536 as of June 30, 2000 to \$61,958 as of June 30, 2002.</p> <p>Fund balance as a percentage of annual expenditures and other fund uses decreased from 36% as of June 30, 2000 to 4% as of June 30, 2002.</p>
Town of Riverdale Park	<p>Expenditures exceeded revenues for the fiscal years ending June 30, 2001 and 2002.</p> <p>Fund balance decreased from \$1,014,553 as of June 30, 2000 to \$167,158 as of June 30, 2002.</p> <p>Fund balance as a percentage of annual expenditures decreased from 37% as of June 30, 2000 to 6% as of June 30, 2002.</p>

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