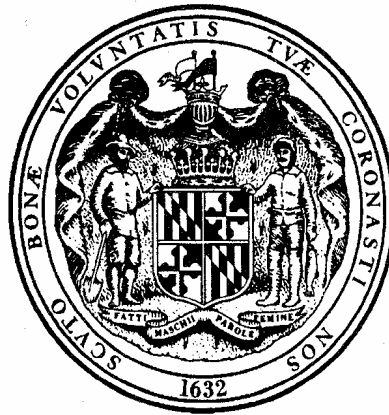

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2003



Office of Legislative Audits
Department of Legislative Services
Maryland General Assembly

-
- This report and any related follow-up correspondence are available to the public. Alternate formats may also be requested by contacting the **Office of Legislative Audits** as indicated at the bottom of the next page or through the Maryland Relay Service at 1-800-735-2258.
 - Please address specific inquiries regarding this report to the Assistant Director listed on the inside back cover by telephone at **(410) 946-5900**.
 - Electronic copies of our audit reports can be viewed or downloaded from the Internet via <http://www.ola.state.md.us>.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at (410) 946-5400 or (301) 970-5400.
-



Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

June 30, 2004

Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Delegate Van T. Mitchell, 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, 2003. The desk reviews consisted of assessments of compliance with accounting and auditing standards, evaluations 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, 2003. 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 69 local governments and their independent auditors to notify them of the deficiencies disclosed by our reviews so that corrective actions could be taken to help ensure future compliance.

The financial statements disclosed 27 local governments with uninsured/ uncollateralized bank deposits, and 2 local governments with disallowed investments, both of which are areas 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 these local governments (and to their State 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

Table of Contents

Introduction and Scope	4
Results of Desk Reviews	
Audit Reports	
Audit Reports Not Filed on Time	6
Auditors' Reports Not Presented in Accordance with Generally Accepted Auditing Standards	7
Financial Statements	
Financial Statements Did Not Meet Certain Requirements of Generally Accepted Accounting Principles	8
Financial Statements and Accompanying Notes Did Not Include Certain Required Disclosures	8
Noncompliance with State Law	
Uninsured/Uncollateralized Cash Deposits	9
Investments Held in Violation of State Law	9
Potential Financial Problems	
Unreserved General Fund Deficits	10
Unfavorable Trends and Ratios	10
Underfunded Pension Plans	11
Special Taxing Districts	11
Required Report Not Filed	11
Exhibit A – Schedule of Audit Reports Containing Disclosures That Cash Deposits Were Not Fully Collateralized or Otherwise Insured	12
Exhibit B – Schedule of General Fund Deficits	13
Exhibit C – Schedule of Unfavorable General Fund Trends and Ratios	14

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 specified conditions) audit reports. There were 191 local government audit reports due for fiscal year 2003 (24 counties, 150 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 2003 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as the three fiscal year 2002 reports (Cities of Glenarden and Mount Rainier and the Town of Willards) received subsequent to our previous review. The desk reviews were performed to accomplish the following tasks:

- Identify 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, 1998 through June 30, 2003).

We also reviewed each of the fiscal year 2003 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

Twenty-seven local governments submitted audit reports after the required filing date, and four local governments had not filed an audit report.

Twenty-seven local governments submitted audit reports after the required filing date, and four 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 5 of these 27 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, 2003 had not been received as of June 22, 2004 for the City of Mount Rainier, the Towns of Eagle Harbor and Emmitsburg, and the Washington Suburban Transit Commission. 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 2004 local government audit reports.

The Village of Port Tobacco requested and was granted a waiver from filing an audit report in fiscal year 2003 because it met the conditions for filing an audit report every fourth year as provided for under Article 19, Section 40(a). This entity will next be required to file an audit report for fiscal year 2006. The Towns of Marydel and Templeville had requested and were granted waivers in the previous fiscal year. 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 also previously granted waivers. These entities will next be required to file audit reports for fiscal year 2004.

<p>Auditors' reports for 24 local governmental units were not presented in accordance with certain generally accepted auditing standards.</p>
--

Auditors' reports for 24 local governmental units were not presented in accordance with generally accepted auditing standards. The auditors' reports for two of these local governments included two such deficiencies, and the auditors' reports for two 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 and the corresponding number of reports:

Area of Noncompliance	Number of Audit Reports
Auditor did not report on all required information (for example, supplemental information accompanying the basic financial statements).	10
Auditor did not express an opinion(s) on all opinion units or financial statements.	8
Auditor's report did not include all basic elements of audit report (for example, auditor did not refer to the budgetary comparison information for the general fund in the opinion paragraph as required when the information is presented as a basic financial statement).	6
Auditor's report did not properly reference the division of responsibility for the audit between the principal and other auditors.	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(s) as to whether the basic financial statements present fairly, in all material respects, the respective financial positions, the respective changes in financial position, and cash flows, where applicable, of the local government in conformity with generally accepted accounting principles.

Financial Statements

Financial statements submitted by 33 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 33 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of 11 of these local governments included two or more such deficiencies, and the financial statements of four of these local governments included at least one deficiency that was also cited during our preceding year's review. The following is a summary of these deficiencies and the corresponding number of instances:

Deficiency	Number of Instances
Misclassification or improper presentation (for example, improper presentation of net assets) on statement.	34
All required financial statements were not presented, or presentation of statement was inappropriate.	13

Financial statements and accompanying notes for 26 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 26 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 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	10
Long-term debt	9
Basis of accounting or revenue recognition policies	3
Pensions	2
Significant accounting policies	2
Short-term debt	1

Noncompliance with State Law

Financial statements of 27 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 27 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 two local governments.

The financial statements of the Towns of Bel Air and Morningside disclosed that the Towns held certificates of deposit at financial institutions that were not located within the State of Maryland, as required by State law. This area of noncompliance with State law was also noted for the Town of Morningside in the preceding year's review. 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 years ended June 30, 2003 and June 30, 2002 (for one local government whose report was received subsequent to our preceding review and whose fiscal year 2003 report had not been received as of June 22, 2004), 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, 2003 and for one local government as of June 30, 2002 (see Exhibit B).

Unreserved general fund deficit balances were noted for three local governments as of June 30, 2003 and for one local government 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, and also had a capital projects fund deficit as of June 30, 2003. In addition, two other local governments have had a general fund deficit balance for each fiscal year since 2000.

Significant unfavorable trends and ratios were noted for three local governments as of June 30, 2003 (see Exhibit C).

Significant unfavorable trends and ratios were noted for three local governments as of June 30, 2003. 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. Significant unfavorable trends and ratios were also noted for two of these local governments in the preceding year's review.

The pension plan for one local government was significantly underfunded.

One local government had a pension plan that was significantly underfunded. Specifically, 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. During fiscal year 2003, the City contributed approximately \$4.4 million to the plan. The present value of future benefits related to this plan was approximately \$21.7 million as of June 30, 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.

The required report had not been filed for one special taxing district.

As of June 22, 2004, we had not received the required report for one special taxing district located in Anne Arundel County for the fiscal year ended June 30, 2003. The County advised us that they were in the process of pursuing compliance with the applicable filing requirements for this district and that appropriate follow-up action would be taken (for example, withholding County funds).

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, 2003:		
Counties:		
Allegany County	\$ 61,766	
Anne Arundel County	347,122	2000
Caroline County	585,000	
Cecil County	11,774	
Charles County	2,347,119	2002
Dorchester County	90,000	
Frederick County	4,239,917	
Howard County	79,046	2002
Montgomery County	32,505	
Prince George's County	5,440,057	1998
Somerset County	513,122	
Worcester County	140,000	
Cities and Towns:		
Town of Cecilton	\$ 30,877	
Village of Chevy Chase, Section 5	3,004	
Town of Easton	1,336,305	
City of Gaithersburg	2,202,054	
Town of Grantsville	61,184	
Town of Hurlock	2,121	2002
Town of Middletown	111,978	2002
Town of Pittsville	50,749	
Town of Queen Anne	37,003	
City of Salisbury	146,804	
City of Takoma Park	344,551	
Town of Williamsport	958,042	
Taxing Districts:		
Village of Friendship Heights	\$ 14,601	
Other Than at June 30, 2003:		
Cities and Towns:		
Town of Barnesville	*	1999
Town of Glen Echo	*	2001

* 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 Years Ended June 30, 2003 and 2002

Entity	Unreserved Fund Balance (Deficit) at July 1, 2002	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2003
---------------	--	---	---	---

Cities and Towns

Town of Morningside	\$ 144,521	\$ 793,183	\$1,038,012	\$ (100,308)
Town of North Beach*	(109,884)	1,578,886	1,555,081	(86,079)
Town of Westernport**	(111,036)	905,970	936,711	(141,777)

* This local government has not had a positive general fund balance since fiscal year 1992. (The Town has had a deficit each fiscal year except 2001 when its general fund balance was \$0). In addition, this local government had a capital projects fund deficit balance of (\$49,504) as of June 30, 2003, due to a bank overdraft.

** This local government has had a general fund deficit balance since June 30, 2000. The Town adjusted and reduced its beginning deficit fund balance by allocating certain administrative expenses originally paid by the general fund to its proprietary funds. In this regard the unreserved deficit at July 1, 2002 is lower than the deficit we reported (\$277,983) in our preceding year's review as of 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
---------------	--	---	---	---

Cities and Towns

City of Mount Rainier	\$ (107,448)	\$2,151,568	\$2,198,173	\$ (154,053)
-----------------------	--------------	-------------	-------------	--------------

This local government has had a general fund deficit balance since June 30, 2000. This local government's audited financial statements for the fiscal year ended June 30, 2002 were submitted subsequent to our preceding review, and statements for the fiscal year ended June 30, 2003 had not been submitted as of June 22, 2004.

Exhibit C – Schedule of Unfavorable General Fund Trends and Ratios

Fiscal Year Ended June 30, 2003

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
Town of Denton	<p>Expenditures exceeded revenues and other fund sources for the fiscal years ending June 30, 2002 and 2003.</p> <p>Fund balance decreased from \$145,544 as of June 30, 2001 to \$69,987 as of June 30, 2003.</p> <p>Fund balance as a percentage of annual expenditures decreased from 13% as of June 30, 2001 to 4% as of June 30, 2003.</p>
Town of Princess Anne*	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2001, 2002, and 2003.</p> <p>Fund balance decreased from \$382,536 as of June 30, 2000 to \$16,516 as of June 30, 2003.</p> <p>Fund balance as a percentage of annual expenditures and other fund uses decreased from 36% as of June 30, 2000 to 1% as of June 30, 2003.</p>
Town of Riverdale Park*	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2001, 2002, and 2003.</p> <p>Fund balance decreased from \$1,014,553 as of June 30, 2000 to \$33,590 as of June 30, 2003.</p> <p>Fund balance as a percentage of annual expenditures decreased from 37% as of June 30, 2000 to 1% as of June 30, 2003.</p>

* Significant unfavorable trends and ratios were also noted for this local government for the fiscal year ended June 30, 2002.

AUDIT TEAM

Robert A. Garman, CPA
Assistant Director

Angela M. Phillips, CPA
Senior Auditor

Tonika N. Coley, CPA
Nadine L. Forgenie
Staff Auditors