

Audit Report

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2004



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

August 31, 2005

Delegate Charles E. Barkley, 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, 2004. 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.

Most of the local governments and their independent auditors substantially complied with accounting and auditing standards for the fiscal year ended June 30, 2004. 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 108 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 18 local governments with uninsured/ uncollateralized bank deposits which is an area 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 specified conditions) audit reports. There were 194 local government audit reports due for fiscal year 2004 (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 special taxing 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 2004 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as two fiscal year 2003 reports (Town of Eagle Harbor and City of Mount Rainier) 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, 1999 through June 30, 2004).

We also reviewed each of the fiscal year 2004 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

Eleven local governments had not filed an audit report for fiscal year 2004 and two local governments had not filed an audit report for either fiscal year 2003 or 2004. Thirty-nine local governments submitted audit reports after the required filing date.

Eleven local governments had not filed an audit report for fiscal year 2004, and two local governments had not filed audit reports for fiscal years 2003 and 2004. Furthermore, 39 local governments submitted audit reports after the required filing date. The failure of a local government to file an audit report or a delay in filing results in the lack of accountability to its citizens. The submission of audit reports after the required filing date was also noted for 11 of these 39 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 years ended June 30, 2003 and June 30, 2004 had not been received as of August 5, 2005 for the following two local governments:

1. Town of Emmitsburg
2. Washington Suburban Transit Commission

Audit reports for the fiscal year ended June 30, 2004 had not been received as of August 5, 2005 for the following eleven local governments:

1. Town of Burkittsville
2. Town of Capitol Heights
3. Town of Centreville
4. Town of Charlestown
5. City of College Park
6. City of Cumberland
7. Town of Eagle Harbor
8. Town of Edmonston
9. Town of Forest Heights
10. Town of Morningside
11. City of Mount Rainier

We will review these fiscal year 2003 and 2004 audit 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 2005 local government audit reports.

The Village of Port Tobacco, the Town of Marydel, and the Town of Templeville requested and were granted waivers from filing an audit report in fiscal year 2004 because the entities 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 an audit report for fiscal years 2006, 2005, and 2005, respectively.

The audit reports for two local governments contained either a qualified opinion or a disclaimer of opinion.

The audit report for the Town of Westernport contained a qualified opinion, and the audit report for Prince George's County contained a disclaimer of opinion.

The Town of Westernport's audit report contained a qualified opinion because management had not maintained an inventory of general fixed assets. 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 the Town of Westernport did not submit a separate letter to the Office of Legislative Audits explaining the reasons for the qualification and the Town's plan to rectify the problem to enable the auditor to express an unqualified opinion in the future.

In addition, the audit report for Prince George's County contained a disclaimer of opinion on the financial statements of one of the County's opinion units. Specifically, the auditor disclaimed an opinion on the financial statements of the aggregate discretely presented component units since the financial statements of the Board of Education of Prince George's County had not been audited.

A disclaimer of opinion is issued when the auditor has not performed an audit sufficient in scope to enable him or her to form an opinion on the financial statements of the opinion unit. (Subsequent to the submission of Prince George's

County's audit report, the County Board of Education was audited and the auditor expressed an unqualified opinion, stating that the Board of Education's financial statements were fairly presented.)

Auditors' reports for 51 local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors' reports for 51 local governments were not presented in accordance with generally accepted auditing standards. The following is a summary of these deficiencies:

Area of Noncompliance	Number of Audit Reports
Auditor did not express an opinion(s) on all opinion units or financial statements.	37
Auditor's report did not include all basic elements of audit report (for example, auditor did not sign the audit report, auditor did not refer to the country of origin of the generally accepted accounting principles used to prepare the financial statements).	7
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	7

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 accounting principles generally accepted in the United States of America.

Financial Statements

Financial statements submitted by 62 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 62 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of 27 of these local governments included two or more such deficiencies, and the financial statements of four of these local governments included 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 interfund transactions or internal balances) on statement.	63
All required financial statements were not presented or presentation of statement was inappropriate.	41

Financial statements and accompanying notes for 21 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 21 audit reports. The financial statements of three of these local governments included two areas of insufficient disclosure, and the financial statements of 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 to 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
Basis of accounting or revenue recognition policies	6
Significant accounting policies	5
Cash deposits with financial institutions and investments	4
Long-term debt	4
Short-term debt	3
Fixed Assets	2

Noncompliance with State Law

Financial statements of 18 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured, as required by State law.

Financial statements of 18 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured as required by State law (see Exhibit A). 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, 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, 2004.

Unreserved general fund deficit balances were noted for three local governments as of June 30, 2004 (see Exhibit B). 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.

Significant unfavorable trends and ratios were noted for three local governments as of June 30, 2004.

Significant unfavorable trends and ratios were noted for three local governments as of June 30, 2004 (see Exhibit C). 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 at least 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 2004, the City contributed approximately \$3.5 million to the plan. The present value of future benefits related to this plan was approximately \$16.9 million as of June 30, 2004.

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, 2004		
Counties:		
Anne Arundel County	\$ 231,671	2000
Cecil County	155,937	2003
Dorchester County	39,000	2003
Garrett County	67,061	
Howard County	229,218	2002
Montgomery County	2,845,524	2003
Somerset County	607,946	2003
Talbot County	1,049,406	
Cities and Towns:		
Town of Cecilton	\$ 43,329	2003
Town of Chesapeake City	16,038	
Village of Chevy Chase, Section 3	75,000	
Village of Chevy Chase, Section 5	3,004	2003
Town of Federalsburg	3,000	
City of Havre de Grace	13,843	
Town of Middletown	13,882	2002
Town of Pittsville	117,791	2003
Town of Ridgely	27,937	
Other Than at June 30, 2004		
Cities and Towns:		
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 Year Ended June 30, 2004

Entity	Unreserved Fund Balance (Deficit) at July 1, 2003	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2004
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Cities and Towns

Town of Easton	\$ 893,734	\$ 9,696,543	\$ 10,678,678	\$ (88,401)
City of Havre de Grace	0	7,656,647	7,667,361	(10,714)
Town of North Beach*	(86,079)	2,337,823	2,314,568	(62,824)

* 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.)

Note: The Town of Morningside had an unreserved General Fund deficit of (\$100,308) as of June 30, 2003. We were unable to determine a more current status of this deficit since, as of August 5, 2005, the Town had not filed its audit report for the year ended June 30, 2004.

Exhibit C – Schedule of Unfavorable General Fund Trends and Ratios

Fiscal Year Ended June 30, 2004

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
Town of Denton*	<p>Fund balance decreased from \$145,544 as of June 30, 2001 to \$82,218 as of June 30, 2004.</p> <p>Although the fund balance increased from \$69,987 as of June 30, 2003 to \$82,218 as of June 30, 2004, the increase was the result of loan proceeds of \$729,757 and operating transfers of \$27,000 rather than as a result of ongoing operations.</p> <p>Fund balance as a percentage of annual expenditures decreased from 13% as of June 30, 2001 to 4% as of June 30, 2004.</p>
Town of Fairmount Heights	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2000, 2001, 2002, 2003, and 2004.</p> <p>Fund balance decreased from \$159,447 as of June 30, 2000 to \$16,442 as of June 30, 2004.</p> <p>Fund balance as a percentage of annual expenditures decreased from 32% as of June 30, 2000 to 2% as of June 30, 2004.</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 \$43,293 as of June 30, 2004.</p> <p>Fund balance as a percentage of annual expenditures decreased from 37% as of June 30, 2000 to 2% as of June 30, 2004.</p>

* Significant unfavorable trends and ratios were also noted for this local government for the fiscal year ended June 30, 2003.

** Significant unfavorable trends and ratios were also noted for this local government for the fiscal years ended June 30, 2002 and June 30, 2003.

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