

Audit Report

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2005



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

October 3, 2006

Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Delegate Charles E. Barkley, 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, 2005. 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, 2005. 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 80 local governments and to 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 21 local governments with uninsured/ uncollateralized bank deposits, which is an area of noncompliance with State law. The financial statements also disclosed that 1 local government's investments in commercial paper exceeded the level allowed by State law. In addition, our desk reviews identified 5 local governments with potential financial problems (such as deficit fund balances or 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 189 local government audit reports due for fiscal year 2005 (24 counties, 148 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 for 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 2005 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as of nine fiscal year 2004 reports (Town of Capitol Heights, Town of Centreville, City of College Park, City of Cumberland, Town of Edmonston, Town of Emmitsburg, Town of Forest Heights, City of Mount Rainier, and the Washington Suburban Transit Commission), and of two fiscal year 2003 reports (Town of Emmitsburg and the Washington Suburban Transit Commission) 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 analyses of financial data over the most recent five-year period (July 1, 2000 through June 30, 2005)

We also reviewed each of the fiscal year 2005 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

Four local governments had not filed audit reports for fiscal years 2004 and 2005, and two local governments had not filed an audit report for fiscal year 2005 only. Thirty-eight local governments submitted audit reports after the required filing date.

Four local governments had not filed audit reports for fiscal years 2004 and 2005, and two local governments had not filed an audit report for fiscal year 2005 only. Furthermore, thirty-eight local governments submitted audit reports after the required filing date. The failure of a local government to file an audit or a delay in filing results in the lack of timely accountability to its citizens. The submission of audit reports after the required filing date was also noted for 17 of these 38 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, 2004 and June 30, 2005 had not been received as of August 31, 2006 for the following four local governments:

1. Town of Burkittsville
2. Town of Charlestown
3. Town of Eagle Harbor
4. Town of Morningside

The failure of these towns to submit audit reports has been reported to the Executive Director of the Department of Legislative Services. If these reports are not filed, the State Comptroller, acting upon the advice of the Executive Director, is authorized by law to discontinue the payment of all funds, grants, or State aid to which the towns are entitled.

Audit reports for the fiscal year ended June 30, 2005 had not been received as of August 31, 2006 for the following two local governments:

1. Town of Williamsport
2. Washington Suburban Transit Commission

We will review these fiscal year 2004 and 2005 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 2006 local government audit reports.

The Towns of Brookview, Church Creek, Eldorado, Galestown, Henderson, Hillsboro, and Queen Anne requested and were granted waivers from filing audit reports in fiscal year 2005 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 an audit report for fiscal year 2008. The Village of Port Tobacco had previously requested and was granted a waiver from filing an audit report. This Village will next be required to file an audit report for fiscal year 2006.

The audit reports for one local government contained adverse opinions and one other local government's report did not contain an adverse opinion on one opinion unit when appropriate.

The audit reports for the City of Mount Rainier contained adverse opinions related to the governmental activities opinion unit for both fiscal years 2004 and 2005 because capital assets and related depreciation for assets purchased prior to July 1, 2003 were not reported. Furthermore, the audit reports should have contained adverse opinions on the financial statements taken as a whole as required by auditing standards when the governmental activities opinion unit is the only required presentation in an entity's government-wide financial statements. The purpose of recording capital assets is to provide for physical and dollar value control, and to establish accountability for capital expenditures made over the years.

An adverse opinion states that the financial statements for an opinion unit (or for the financial statements taken as a whole) do not present fairly the financial position, changes in financial position or, where applicable, cash flows in conformity with generally accepted accounting principles.

Although required by our audit guidelines, the auditor for the City of Mount Rainier did not submit a separate letter to the Office of Legislative Audits explaining the reasons for the adverse opinions and the City's plan to rectify the problem to enable the auditor to express an unqualified opinion in the future.

In addition, the audit report for the Town of Sykesville did not express an adverse opinion on the financial statements of the aggregate discretely presented component units opinion unit as is appropriate when the report on the basic financial statements of a primary government omits the financial data of component units and does not also issue audited financial statements for the entire reporting entity.

Auditors' reports for 37 local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors' reports for 37 local governmental units were not presented in accordance with generally accepted auditing standards. The auditors' reports for 14 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 did not express an opinion(s) on all opinion units or on all financial statements.	19
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	13
Auditor's report did not include all basic elements of audit report (for example, report did not include appropriate explanatory language related to the omission of required supplementary information).	5

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 position, 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 45 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 45 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 21 of these local governments included one or more deficiencies that were also cited during our preceding year's review.

The following is a summary of the deficiencies and the corresponding number of instances:

Deficiency	Number of Instances
Misclassification or improper presentation (for example, interfund transactions or internal balances on statement).	31
All required financial statements were not presented or presentation of statement was inappropriate.	29

Financial statements and accompanying notes for 12 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 12 audit reports. The financial statements for two 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 these areas of insufficient disclosure and the corresponding number of instances:

Area of Insufficient Disclosure	Number of Instances
Basis of accounting or revenue recognition policies	7
Long-term or short-term debt	4
Reconciliation of the budgetary basis of accounting to the modified accrual basis	1

Noncompliance with State Law

Financial statements of 21 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured, as required by State law.

Financial statements of 21 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured, as required by State law (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.

One local government held an excessive amount of commercial paper in violation of State law.

The financial statements of the Town of Mount Airy disclosed that the Town had invested an excessive amount (greater than 5 percent of total Town investments) in commercial paper in violation of State law. Article 95, Section 22 of the Annotated Code of Maryland authorizes local governmental units to invest surplus moneys in commercial paper that has received the highest letter and numerical rating by at least one nationally recognized rating organization, provided that the commercial paper may not exceed 5 percent of the total investments made by the government. The Town's financial statements also indicated that the diversification of the investments would be corrected as the securities matured, no later than December 2005.

Potential Financial Problems

For the fiscal year ended June 30, 2005, 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, 2005.

Unreserved general fund deficit balances were noted for three local governments as of June 30, 2005 (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 one local government as of June 30, 2005.

Significant unfavorable trends and ratios were noted for one local government as of June 30, 2005 (Exhibit C). The unfavorable trends and ratios occurred because, over the five-year period reviewed, the local government had general fund expenditures that exceeded general fund revenues, significant decreases in its general fund balances, and significant decreases in its ratio of general fund balances to general fund expenditures. Significant unfavorable trends and ratios were also noted for this government 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 2005, the City contributed approximately \$3.0 million to the plan. The present value of future benefits related to this plan was approximately \$13.4 million as of June 30, 2005.

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 for submitting copies of these reports to the Office of Legislative Audits.

We reviewed the reports submitted to us by the counties. All 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, 2005		
Counties		
Anne Arundel County	\$ 946,945	2000
Caroline County	22,000	
Dorchester County	42,000	2003
Harford County	294,097	
Montgomery County	793,082	2003
Somerset County	178,052	2003
Cities and Towns		
Town of Chesapeake City	25,346	2004
Village of Chevy Chase, Section 3	2,700	2004
Village of Chevy Chase, Section 5	3,756	2003
Town of Church Hill	3,939	
City of Frederick	50,052	
City of Havre de Grace	43,619	2004
Town of Hurlock	123,000	
City of Hyattsville	272,121	
City of Laurel	244,026	
Town of Pittsville	194,494	2003
Town of Poolesville	67,569	
City of Salisbury	384,000	
Town of Snow Hill	373,593	
Other Than at June 30, 2005		
Cities and Towns		
Town of Glen Echo	*	2001
Other Than at June 30, 2004		
Taxing Districts		
Washington Suburban Transit Commission	*	2003
<p>* 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 2003 and 2004 reports, both of which were included in this year's review. The status at June 30, 2005 could not be determined since the Commission had not filed its fiscal year 2005 report as of August 31, 2006.</p>		

Exhibit B
Schedule of General Fund Deficits
Fiscal Year Ended June 30, 2005

Entity	Unreserved Fund Balance (Deficit) at July 1, 2004	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2005
Cities and Towns				
City of Cumberland	\$ 1,142,663	\$13,890,940	\$15,115,306	\$ (81,703)
Town of Easton	304,489	10,539,491	11,373,370	(529,390)
Town of North Beach*	(113,540)	1,528,150	1,656,062	(241,452)

* 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 31, 2006, the Town had not filed its audit reports for the years ended June 30, 2004 or 2005.

Exhibit C
Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2005

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
Town of Fairmount Heights*	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2001, 2002, 2003, and 2004.</p> <p>Fund balance decreased from \$137,027 as of June 30, 2001 to \$16,324 as of June 30, 2005.</p> <p>Fund balance as a percentage of annual expenditures decreased from 24% as of June 30, 2001 to 3% as of June 30, 2005.</p>
* Significant unfavorable trends and ratios were also noted for this local government for the fiscal year ended June 30, 2004.	

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