
Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2006



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

September 12, 2007

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Nathaniel J. McFadden, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

The Honorable Peter V. R. Franchot
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, 2006. 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, 2006. 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 75 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 15 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 held investments in common stock, in violation of State law. In addition, our desk reviews identified 8 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 198 local government audit reports due for fiscal year 2006 (24 counties, 156 cities and towns, and 18 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 2006 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as of six fiscal year 2005 reports (Towns of Burkittsville, Charlestown, Eagle Harbor, Morningside, and Williamsport, and the Washington Suburban Transit Commission), and of four fiscal year 2004 reports (Towns of Burkittsville, Charlestown, Eagle Harbor, and Morningside) 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, 2001 through June 30, 2006)

We also reviewed each of the fiscal year 2006 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 an audit report for fiscal year 2006. Thirty-nine local governments submitted audit reports after the required filing date.

Four local governments had not filed an audit report for fiscal year 2006. Furthermore, 39 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 14 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 year ended June 30, 2006 had not been received, as of August 30, 2007, for the following four local governments:

1. Town of East New Market
2. Town of Forest Heights
3. City of Glenarden
4. Mount Savage Special Taxing Area

We will review these fiscal year 2006 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 2007 local government audit reports.

The Towns of Marydel and Templeville requested and were granted waivers from filing audit reports in fiscal year 2006 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 2009. The Towns of Brookview, Church Creek, Eldorado, Galestown, Henderson, Hillsboro, and Queen Anne had previously requested and were granted waivers from filing audit reports. These towns will next be required to file an audit report for fiscal year 2008.

The audit report for one local government contained an adverse opinion and one other local government's report contained a qualified opinion but did not appropriately identify the opinion units affected.

The audit report for the Town of Sykesville contained an adverse opinion related to the discretely presented component unit for fiscal year 2006 due to the omission of financial data for the Town's legally separate component unit. Specifically, the Warfield Development Corporation was determined to be a component unit of the Town based on criteria established by generally accepted accounting principles. Accordingly, financial data for the Corporation should be reported as part of the Town's financial reporting entity. However, the Corporation's financial statements were not included in the Town's financial statements because audited financial statements were not available for the Corporation for the year ended June 30, 2006.

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.

In addition, the audit report for the Town of Williamsport contained a qualified opinion because of a scope limitation related to inadequacies in the Town's accounting records for meter deposits reported in the Electric Fund. However, the auditor did not distinguish between the opinion units affected by the scope limitation and those not affected. In this regard, the aforementioned scope limitation would affect the "each major fund" and "business-type activities" opinion units, and the opinion should have been qualified for those opinion units. Conversely, the "governmental activities" and "aggregate remaining fund information" opinion units would not be affected by the aforementioned scope limitation and a separate unqualified opinion should have been expressed for those opinion units as specified by auditing standards.

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 auditors for the Towns of Sykesville and Williamsport did not submit separate letters to the Office of Legislative Audits explaining the reasons for the adverse opinion and the qualified opinion, respectively, and the Towns' plans to rectify the problems to enable the auditors to express unqualified opinions in the future.

Auditors' reports for 30 local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors' reports for 30 local governmental units were not presented in accordance with generally accepted auditing standards. The auditors' reports for 11 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 include all basic elements of an audit report (for example, report was not presented in accordance with the State and Local Governments Audit Guide published by the American Institute of Certified Public Accountants).	13
Auditor did not express an opinion(s) on all opinion units or on all financial statements.	9
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	8

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 39 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 39 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of 9 of these local governments included two or more such deficiencies, and the financial statements of 15 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, presentation of Statement of Cash Flows was improper).	38
All required financial statements were not presented or presentation of statement was inappropriate.	15

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 2 of these local governments included three areas of insufficient disclosure, and the financial statements for 4 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 of, 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
Long-term or short-term debt	8
Basis of accounting or revenue recognition policies	7
Reconciliation of the budgetary basis of accounting to the modified accrual basis	4
Capital assets	2
Other (significant accounting policies, cash)	2

Noncompliance with 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.

Financial statements of 15 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 invested in common stock which is a violation of State law.

The financial statements of the Town of Lonaconing disclosed that the Town had investments in common stock, totaling \$49,974 as of June 30, 2006, which is a violation of State law. Article 95, Section 22 of the Annotated Code of Maryland restricts the types of investments authorized for local governments to those specified in the State Finance and Procurement Article, Section 6-222 of the Code. Investments not authorized by State law increase the Town's risk of loss associated with investments.

Potential Financial Problems

For the fiscal year ended June 30, 2006, 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 five local governments as of June 30, 2006.

Unreserved general fund deficit balances were noted for five local governments as of June 30, 2006 (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. Two of these local governments also had a general fund deficit as of June 30, 2005.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2006.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2006 (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 general fund balances, and significant decreases in the ratio of general fund

balances to general fund expenditures. Significant unfavorable trends and ratios have been noted for one of these local governments for each fiscal year since 2004.

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 2006, the City contributed approximately \$2.3 million to the plan. The present value of future benefits related to this plan was approximately \$10.8 million as of June 30, 2006.

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.

The required reports have not been filed for four special taxing districts.

As of August 30, 2007, we had not received the required reports for four special taxing districts located in Anne Arundel County for the fiscal year ended June 30, 2006. The County advised us that they were in the process of pursuing compliance with applicable filing requirements for these districts 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, 2006		
Counties		
Anne Arundel County	\$ 744,149	2000
Caroline County	11,000	2005
Cecil County	4,478,332	
Dorchester County	1,297,000	2003
Cities and Towns		
Town of Cheverly	171,760	
Village of Chevy Chase, Section 5	6,634	2003
Town of Eagle Harbor	281,079	2004
City of Havre de Grace	168,332	2004
Town of Lonaconing	95,172	
Town of North Beach	183,494	
Town of Pittsville	26,894	2003
Town of Ridgely	35,704	
City of Salisbury	334,000	2005
Other Than at June 30, 2006		
Cities and Towns		
Village of Chevy Chase, Section 3	*	2004
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, 2006

Entity	Unreserved Fund Balance (Deficit) at July 1, 2005	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2006
Cities and Towns				
Town of Easton	\$ (529,390)	11,413,395	11,176,676	(292,671)
Town of Morningside	(260,558)	920,978	1,007,978	(347,558)
Town of Myersville	861,519	1,932,211	3,091,054	(297,324)
Town of Princess Anne	241,763	2,486,777	2,743,724	(15,184)
Town of Ridgely	88,163	1,290,725	1,412,201	(33,313)

Exhibit C
Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2006

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
City of District Heights	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2005 and 2006.</p> <p>Fund balance decreased from \$982,325 as of June 30, 2004 to \$202,412 as of June 30, 2006.</p> <p>Fund balance as a percentage of annual expenditures decreased from 40% as of June 30, 2004 to 6% as of June 30, 2006.</p>
Town of Fairmount Heights*	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2002, 2003, 2004 and 2006.</p> <p>Fund balance decreased from \$110,325 as of June 30, 2002 to \$18,270 as of June 30, 2006.</p> <p>Fund balance as a percentage of annual expenditures decreased from 18% as of June 30, 2002 to 2% as of June 30, 2006.</p>

* Significant unfavorable trends and ratios were also noted for this local government for the fiscal years ended June 30, 2004 and 2005.

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