

Audit Report

Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2008



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 2, 2009

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Verna L. Jones, 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, 2008. 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, 2008. 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 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 22 local governments with uninsured or uncollateralized bank deposits, which is an area of noncompliance with State law. In addition, our desk reviews identified 9 local governments with potential financial problems, including deficit fund balances and 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 2008 (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 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 2008 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as one fiscal year 2007 report (Mount Savage Special Taxing Area) and one fiscal year 2006 report (Mount Savage Special Taxing Area) 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, 2003 through June 30, 2008).

We also reviewed each of the fiscal year 2008 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

One local government had not filed audit reports for fiscal years 2007 and 2008, and six other local governments had not filed audit reports for fiscal year 2008. Forty-seven local governments submitted audit reports after the required filing date.

One local government had not filed audit reports for fiscal years 2007 and 2008, and six other local governments had not filed audit reports for fiscal year 2008. Furthermore, 47 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 timely accountability to its citizens. The submission of audit reports after the required filing date was also noted for 12 of these 47 local governments during our preceding year's review. Article 19, Section 40(a) of the Annotated Code of Maryland generally 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, 2007 and June 30, 2008 had not been received, as of August 12, 2009, for the Town of Forest Heights. The failure of this town 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 town is entitled.

Additionally, audit reports for the fiscal year ended June 30, 2008 had not been received, as of August 12, 2009, for the following six local governments:

1. Town of Capitol Heights
2. Town of Deer Park
3. City of Hyattsville
4. Town of Lonaconing
5. Town of Westernport
6. Washington Suburban Transit Commission

We will review these fiscal year 2007 and 2008 audit reports and take any follow-up action necessary when the reports are received. The results of these reviews will be included in the report on our review of fiscal year 2009 local government audit reports.

The Ellerslie Special Taxing Area requested and was granted a waiver from filing an audit report in fiscal year 2008 because the Area met the conditions for filing an audit report every fourth year as provided for under Article 19, Section 40(a) of the Code. This entity will next be required to file an audit report for fiscal year 2011. The Towns of Barclay, Marydel, and Templeville, and the Village of Port Tobacco had previously requested and were granted waivers from filing audit reports. These entities will next be required to file an audit report for either fiscal year 2009 or fiscal year 2010.

The audit report for one local government contained a qualified opinion but did not appropriately identify the opinion units affected.

The audit report for the Town of Queenstown contained a qualified opinion on the Town's financial statements because certain financial data were not presented in accordance with the requirements of the Governmental Accounting Standards Board. Furthermore, the auditor did not distinguish between opinion units affected by the qualified opinion and those not affected as explained in the *State and Local Governments Audit and Accounting Guide* published by the American Institute of Certified Public Accountants.

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 Queenstown did not submit a separate letter to the Office of Legislative Audits explaining both the reasons for the qualified opinion, and the Town's plan to rectify the problem to enable the auditor to express an unqualified opinion in the future.

Auditors' reports for 10 local governmental units were not presented in accordance with certain generally accepted auditing standards.

Auditors' reports for 10 local governmental units were not presented in accordance with generally accepted auditing standards. The auditors' reports for 4 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.	5
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	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 24 local governments did not meet certain requirements of generally accepted accounting principles.

Financial statements submitted by 24 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of 3 of these local governments included two or more such deficiencies, and the financial statements of 4 of these local governments included a deficiency that was 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).	24
All required financial statements were not presented or presentation of statement(s) was inappropriate.	4

Financial statements and accompanying notes for five local governments did not include certain disclosures required by generally accepted accounting principles.

Certain required information was not included in the financial statements, or in the accompanying notes, for five audit reports. The financial statements of one of these local governments included two areas of insufficient disclosure, and the financial statements for another 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
Cash deposits with financial institutions	3
Basis of accounting or revenue recognition policies	2
Capital assets	1

Noncompliance with State Law

Financial statements of 22 local governments contained disclosures that cash deposits were not fully collateralized, or otherwise insured, as required by State law.

Financial statements of 22 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.

Potential Financial Problems

For the fiscal year ended June 30, 2008, 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 six local governments as of June 30, 2008.

Unreserved general fund deficit balances were noted for six local governments as of June 30, 2008 (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, 2007.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2008.

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2008 (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.

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 2008, the City contributed approximately \$1.9 million to the plan. The present value of future benefits related to this plan was approximately \$7.9 million as of June 30, 2008.

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 the districts 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 seven special taxing districts.

As of August 12, 2009, we had not received the required reports for the fiscal year ended June 30, 2008 for seven special taxing districts, of which three are located in Anne Arundel County and four are located in Baltimore City. Anne Arundel County and Baltimore City 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 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>
<u>At June 30, 2008</u>		
Counties		
Anne Arundel County	\$ 578,938	2000
Caroline County	629,000	2005
Cecil County	10,994	
Dorchester County	135,246	2003
Somerset County	298,000	
Cities and Towns		
Town of Burkittsville	4,411	
Town of Cheverly	260,000	2006
Village of Chevy Chase, Section 3	3,852	
Town of Chevy Chase View	26,802	2007
Town of East New Market	41,827	2007
Town of Emmitsburg	7,611	2007
Town of Glen Echo*	11,665	2001
City of Havre de Grace	83,823	2004
Town of Hillsboro	14,702	
Town of Hurlock	68,000	2007
Town of Midland	4,187	
Town of Morningside	28,725	2007
City of Mount Rainier	265,766	
Town of New Market	94,175	
Town of Oxford	526,221	2007
Town of Pittsville	3,818	2003
Town of Queen Anne	97,020	
<p>* This Town's financial statements also disclosed that uninsured/uncollateralized cash existed throughout the fiscal year, although the financial statements did not disclose the dollar amount of the uninsured/uncollateralized cash deposits during the year.</p>		

Exhibit B
Schedule of General Fund Deficits
Fiscal Year Ended June 30, 2008

Entity	Unreserved Fund Balance (Deficit) at July 1, 2007	Revenues and Other Increases	Expenditures and Other Decreases	Unreserved Fund Balance (Deficit) at June 30, 2008
Cities and Towns				
City of Cambridge	\$ 207,633	\$ 14,323,958	\$ 15,492,743	\$ (961,152)
City of Cumberland	1,390,855	16,604,789	18,710,289	(714,645)
Town of Fairmount Heights	88,406	822,182	934,819	(24,231)
Town of Myersville	(420,676)	1,751,203	1,524,744	(194,217)
Town of Princess Anne	29,697	3,164,914	3,268,471	(73,860)
Town of Ridgely	(63,728)	1,059,276	1,237,271	(241,723)

Exhibit C
Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2008

<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, 2006, and 2008.</p> <p>Fund balance decreased from \$982,325 as of June 30, 2004 to \$224,022 as of June 30, 2008.</p> <p>Fund balance as a percentage of annual expenditures decreased from 40% as of June 30, 2004 to 6% as of June 30, 2008.</p>
Town of Riverdale Park	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2007 and 2008.</p> <p>Fund balance decreased from \$1,082,037 as of June 30, 2006 to \$252,310 as of June 30, 2008.</p> <p>Fund balance as a percentage of annual expenditures decreased from 32% as of June 30, 2006 to 6% as of June 30, 2008.</p>

AUDIT TEAM

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