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## **Review of Local Government Audit Reports**

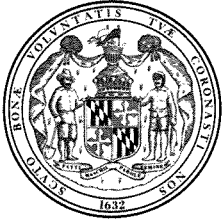
Fiscal Year Ending June 30, 2012

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**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

Thomas J. Barnickel III, CPA  
Legislative Auditor

September 17, 2013

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

The Honorable Peter V. R. Franchot  
Comptroller of Maryland

Mr. Karl S. Aro, Executive Director  
Department of Legislative Services

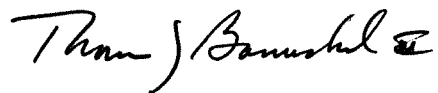
Ladies and Gentlemen:

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, 2012. 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, 2012. 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 64 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 12 local governments with cash deposits that were not adequately collateralized, or otherwise insured, which is an area of noncompliance with State law. In addition, our desk reviews identified four local governments with potential financial problems, as indicated by 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,

A handwritten signature in cursive script, reading "Thomas J. Barnickel III".

Thomas J. Barnickel III, 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 (or once every four years under specified conditions) audit reports. There were 193 local government audit reports due for fiscal year 2012 (25 counties, 154 cities and towns, and 14 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 2012 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as four fiscal year 2011 reports (Baltimore City, Town of Deer Park, Town of Fairmount Heights, and Town of Forest Heights). The desk reviews were performed to accomplish the following tasks:

- Identify areas of noncompliance with our audit guidelines and accounting and auditing standards.
- 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 or unfavorable trends and ratios, based on analyses of financial data over the most recent five-year period (July 1, 2007 through June 30, 2012).

We also reviewed each of the fiscal year 2012 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

**Certain audit reports were not filed or were not filed on time.**

One local government had not filed audit reports for fiscal years 2011 and 2012, and four other local governments had not filed audit reports for fiscal year 2012. Furthermore, 41 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 17 of these 41 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 years ended June 30, 2011 and June 30, 2012 had not been received, as of August 9, 2013, for the City of Hyattsville. The failure of this city 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 city is entitled.

Additionally, audit reports for the fiscal year ended June 30, 2012 had not been received, as of August 9, 2013, for the following four local governments:

1. Baltimore City
2. Town of Deer Park
3. City of Fruitland
4. Town of Sharptown

We will review these fiscal year 2012 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 2013 local government audit reports.

The town of Eagle Harbor and the Ellerslie and Mount Savage special taxing areas requested and were granted a waiver from filing an audit report in fiscal year 2012 because the local governments met the conditions for filing an audit report every fourth year as provided for under Article 19, Section 40(a) of the Code. These entities will next be required to file an audit report for fiscal year



2015. The towns of Barclay, Burkittsville, Marydel, Port Tobacco, and Templeville had previously requested and were granted waivers from filing audit reports. These entities will next be required to file audit reports for either fiscal year 2013 or fiscal year 2014.

**The auditor's report for one local government contained an adverse opinion on one opinion unit and a qualified opinion on another opinion unit.**

The auditor's report for the Town of Sykesville contained an adverse opinion (a statement that the financial statements are not presented fairly in conformity with generally accepted accounting principles) on the discretely presented component unit opinion unit because of the omission of financial data for the Town's component unit. Specifically, financial data related to a development corporation that is a component unit of the Town had not been audited and was not included in the Town's financial statement.

The Town's audit report also contained a qualified opinion (a statement that, except for the effects of the matter to which the qualification relates, the financial statements are presented fairly in conformity with generally accepted accounting principles) on the governmental activities opinion unit because the Town had not measured the effect of Governmental Accounting Standards Board Statement No. 49 entitled "*Accounting and Financial Reporting for Pollution Remediation Obligations*." According to the report, certain buildings of the development corporation contained asbestos and, although deemed improbable, the Town could become liable for the cost of abatement.

As a result, the Town's financial statements were not presented in accordance with generally accepted accounting principles as required by State law. The Town's audit reports for each fiscal year since 2009 also contained an adverse opinion and a qualified opinion due to these situations.

**Auditors' reports for 13 local governmental units were not presented in accordance with certain generally accepted auditing standards.**

Auditors' reports for 13 local governmental units were not presented in accordance with generally accepted auditing standards. The auditor's report for two of these local governmental units included a deficiency that was also cited during our preceding 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.	6
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	5
Auditor's report did not report on all prior-period financial information presented.	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 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 19 local governments did not meet certain requirements of generally accepted accounting principles.**

Financial statements submitted by 19 local governments did not meet certain requirements of generally accepted accounting principles. The financial statements of two of these local governments included two such deficiencies, and the financial statements of one 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
Governmental fund balances were not properly classified.	10
Misclassification or improper presentation (for example, presentation of net assets was improper).	8
All required financial statements were not presented or presentation of statement(s) was inappropriate.	3

**Financial statements and accompanying notes for 13 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 13 audit reports. The audit report for one of these local governments included two such deficiencies. 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	10
Significant accounting policies	3
Cash and cash equivalents	1

## **Noncompliance with State Law**

**Financial statements of 12 local governments contained disclosures that cash deposits were not adequately collateralized, or otherwise insured, as required by State law.**

Financial statements of 12 local governments contained disclosures that cash deposits were not adequately 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. In addition, this law requires that collateral be of the types specified in the State Finance and Procurement Article, Section 6-202 of the Code.

## **Potential Financial Problems**

For the fiscal year ended June 30, 2012, the following potential financial problems were noted based on the information presented in the local governments' audited financial statements and accompanying notes.

**Unrestricted general fund deficit balances were noted for two local governments as of June 30, 2012.**

Unrestricted general fund deficit balances were noted for two local governments as of June 30, 2012 (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 of these local governments has had a general fund deficit since June 30, 2006, and the other has had such a deficit since June 30, 2008. In both cases, the local governments' general fund deficits were reduced during fiscal year 2012.

**Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2012.**

Significant unfavorable trends and ratios were noted for two local governments as of June 30, 2012 (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.

## **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 five special taxing districts as of September 9, 2013.**

As of September 9, 2013, we had not received the required reports for the fiscal year ended June 30, 2012 for five special taxing districts which are located in Anne Arundel County. Anne Arundel 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 funds).

# Exhibit A

## Schedule of Audit Reports Containing Disclosures That Cash Deposits Were Not Fully Collateralized or Otherwise Insured

Entity	Uninsured/ Uncollateralized Amount	Similar Disclosures Included in Audit Reports for Each Year Since Fiscal Year
<b><u>At June 30, 2012</u></b>		
<b>Counties</b>		
Anne Arundel County	\$1,059,843	2000
Dorchester County	1,409,099	
Somerset County	1,292,993	
Wicomico County	154,623	2011
<b>Cities and Towns</b>		
Town of Clear Spring	2,605	
City of Frostburg	310,339	
City of Hagerstown	198,127	2011
Town of Indian Head	162,174	
City of Salisbury	302,528	
Town of Snow Hill	624,200	
Town of Thurmont	6,904	2009
<b>Cash Deposits That Were Secured <u>by Unacceptable Types of Collateral</u></b>		
Town of Hancock	*	2011

\* Secured by collateral which was not one of the types authorized by the State Finance and Procurement Article, Section 6-202 of the Annotated Code of Maryland at June 30, 2012

**Exhibit B**  
**Schedule of General Fund Deficits**  
**Fiscal Year Ended June 30, 2012**

<b>Entity</b>	<b>Unrestricted Fund Balance (Deficit) at July 1, 2011</b>	<b>Revenues and Other Increases</b>	<b>Expenditures and Other Decreases</b>	<b>Unrestricted Fund Balance (Deficit) at June 30, 2012</b>
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**Cities and Towns**

City of Cumberland*	\$ (1,606,117)	\$ 21,101,843	\$ 20,358,204	\$ (862,478)
Town of Ridgely**	(95,914)	1,205,600	1,172,296	(62,610)

\* This local government has had an unrestricted General Fund deficit balance since June 30, 2008.

\*\* This local government has had an unrestricted General Fund deficit balance since June 30, 2006.

**Exhibit C**  
**Schedule of Unfavorable General Fund Trends and Ratios**  
**Fiscal Year Ended June 30, 2012**

<b><u>Entity</u></b>	<b><u>Unfavorable Trend or Ratio</u></b>
Town of Cecilton	<p>Expenditures exceeded revenues for the fiscal years ending June 30, 2009, 2010, 2011, and 2012.</p> <p>Fund balance decreased from \$274,096 as of June 30, 2008 to \$13,123 as of June 30, 2012.</p> <p>Fund balance as a percentage of annual expenditures decreased from 76% as of June 30, 2009 to 4% as of June 30, 2012.</p>
Pocomoke City	<p>Expenditures and other fund uses exceeded revenues and other fund sources for the fiscal years ending June 30, 2008, 2010, and 2012.</p> <p>Fund balance decreased from \$668,275 as of June 30, 2011 to \$162,329 as of June 30, 2012.</p> <p>Fund balance as a percentage of annual expenditures and other financing uses decreased from 14% as of June 30, 2011 to 3% as of June 30, 2012.</p>



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