
Review of Local Government Audit Reports

Fiscal Year Ending June 30, 2016



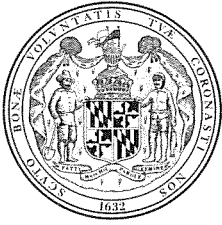
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

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Legislative Auditor

September 19, 2017

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

The Honorable Peter V. R. Franchot
Comptroller of Maryland

Mr. Warren G. Deschenaux, Executive Director
Department of Legislative Services

Ladies and Gentlemen:

In accordance with the Local Government Article, Section 16-307 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, 2016. The desk reviews consisted of assessments of compliance with certain 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 financial statements filed by the local governments for the fiscal year ended June 30, 2016, along with the related independent auditors' reports, complied with the accounting and auditing standards that we assessed. 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 76 local governments and, as applicable, 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.

A number of audit reports were not filed timely in accordance with the requirements of State law. As of July 29, 2017, seven local governments had not

submitted audit reports for the fiscal year ended June 30, 2016; five of these also had not filed audit reports for certain prior years.

If a local government does not comply with the audit report filing requirements, State law provides that the Comptroller, on notice from the Executive Director of the Department of Legislative Services, may order the discontinuance of all moneys, grants, or State aid to which the local governments are entitled. Accordingly, provisions were included in Chapter 143, 2016 Laws of Maryland (the State's Budget Bill) to withhold certain transportation aid for two of the aforementioned local governments until the governments have submitted audit reports for fiscal years 2013 – 2015. We notified the Executive Director of the Department of Legislative Services of those local governments with more than one audit report outstanding.

The financial statements disclosed 16 local governments with cash deposits that were not adequately collateralized, or otherwise insured, which is also an area of noncompliance with State law. In addition, our desk reviews identified two local governments with potential financial problems, as indicated by a deficit fund balance or unfavorable financial trends.

As 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 black ink, appearing to read "TJ Barnickel III". The signature is written in a cursive style with a horizontal line at the end.

Thomas J. Barnickel III, CPA
Legislative Auditor

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Introduction and Scope, Objectives, and Methodology

The Local Government Article, Section 16-306 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 203 local government audit reports due for our fiscal year 2016 review (25 counties, 161 cities and towns, and 17 taxing areas which are created under State law). 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.

The Local Government Article, Section 16-307 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. As part of the desk review process, we also addressed other attributes as described below. Section 16-308 of the Article specifies 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 2016 reports that had been received from the counties, incorporated cities and towns, and taxing districts, as well as four fiscal year 2015 reports (Baltimore City, City of Glenarden, Town of Morningside, and City of Mount Rainier) and one fiscal year 2013 report (Town of Deer Park) that were received over the last year. The desk reviews consisted of reading each audit report in order to accomplish the following tasks:

- Identify areas of noncompliance with our audit guidelines and certain accounting and auditing standards pertaining to the presentation of the financial statements and auditors' reports.
- Identify any instances of noncompliance with certain provisions of State law (for example, collateral for bank deposits, timely filing of audit reports).

- 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, 2011 through June 30, 2016).

We also reviewed each of the fiscal year 2016 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.

At the conclusion of our review, letters are sent to applicable local governments and their independent auditors to notify them of the deficiencies disclosed during the review so that corrective actions can be taken to help ensure future compliance. Additionally, as appropriate, letters are also sent to local governments, and to their legislative representatives, to communicate noncompliance with State law or potential financial problems. For these issues, the local governments are asked to advise us of corrective actions that will be taken.

Results of Desk Reviews

Audit Reports

Finding 1

A number of local governments had not filed the required audit reports or had filed after the required filing date.

As of July 29, 2017, seven local governments were delinquent in filing audit reports as required by the Local Government Article of the Annotated Code of Maryland.

Local Government	Fiscal Years Outstanding
Town of Deer Park	2014, 2015, 2016
City of Glenarden	2016
City of Hyattsville	2015, 2016
Town of Marydel	2013, 2014, 2015, 2016
City of Mount Rainier	2016
Bel Air Special Taxing Area	2015, 2016
Mount Savage Special Taxing Area	2015, 2016

Furthermore, 29 local governments submitted audit reports after the required filing date. The submission of audit reports after the required filing date was also noted for 12 of these 29 local governments during at least our preceding year's review. 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 Local Government Article, Section 16-306 of the Annotated Code of Maryland generally requires audit reports to be filed on or before October 31 after the close of the fiscal year or on or before December 31 after the close of the fiscal year for those local governments with a population of more than 400,000.

Budget language adopted during the 2016 Session of the Maryland General Assembly (Chapter 143, 2016 Laws of Maryland) has resulted in the withholding of certain transportation aid from two local governments (Towns of Deer Park and Marydel) pending receipt of their audit reports for fiscal years 2013, 2014, and 2015. Furthermore, failure to file a required report with the Department of Legislative Services for three successive years provides the Executive Director with reasonable cause to suppose that the municipality is no longer actively operating under its charter, which could cause these towns to have their charter repealed. The failure of these two local governments to submit audit reports has been reported to the Executive Director.

Subsequent to July 29, 2017, the Bel Air Special Taxing Area submitted its audit report for the fiscal year ended June 30, 2015, although its fiscal year 2016 report is still outstanding. The failure of the City of Hyattsville and the Mount Savage Special Taxing Area to file the required reports has been reported to the Executive Director.

We will review all fiscal year 2013, 2014, 2015, and 2016 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 2017 local government audit reports.

The towns of Barclay, Eagle Harbor, Highland Beach, Port Tobacco, Templeville, and the Ellerslie Special Taxing Area had previously requested and were granted waivers from filing audit reports. These local governments met the conditions for filing an audit report every fourth year as provided for under the Local Government Article, Section 16-305 of the Code and, depending on the waiver period, will be required to file its next audit report for either fiscal year 2017, 2018, or 2019.

Finding 2

Auditor reports for two local governments each contained an adverse opinion on one opinion unit and a qualified opinion on another opinion unit.

Audit reports for two local governments each contained an adverse opinion on one opinion unit and a qualified opinion on another opinion unit. The following is a summary of these opinions.

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.

The audit report for Baltimore City for fiscal year 2015 contained an adverse opinion on the aggregate discretely presented component units because of the omission of financial data for a component unit from the City’s financial statements. Specifically, financial data related to the Baltimore City Public School System that is a component unit of the City was not included in the City’s financial statements.

The audit report for Baltimore City for fiscal year 2015 also contained a qualified opinion on the City’s Grant Revenue Fund opinion unit because, the auditor was unable to obtain sufficient evidential matter that supported approximately \$14 million of the unearned revenue reported in the fund. The City’s audit report for fiscal year since 2014 also contained a qualified opinion due to the same situation.

Although required by our audit guidelines, the auditors for Baltimore City did not submit a separate letter to the Office of Legislative Audits explaining the reason for the qualified opinion, and the City’s plans to rectify the problem to enable the auditors to express an unqualified opinion in the future. Subsequently, we received the fiscal year 2016 audit report in which Baltimore City received an unqualified opinion on all opinion units. The auditor for the Town of Sykesville submitted a letter providing explanations regarding the opinions that were not unqualified as required, but the resolution of the applicable conditions is uncertain.

Finding 3

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

Auditors’ reports for eight local governmental units were not presented in accordance with certain generally accepted auditing standards. The following is a summary of these deficiencies:

Area of Noncompliance	Number of Audit Reports
Auditor's report did not include all basic elements (for example, auditor did not include an emphasis-of-matter paragraph related to adjustments to correct a material misstatement).	3
Auditor's report did not report on all required information (for example, supplemental information accompanying the basic financial statements).	3
Auditor did not express an opinion on all opinion units or financial statement.	2

The Local Government Article, Section 16-306 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

Finding 4
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 two of these local governments included two such deficiencies, and the financial statements of one of these local governments included three such deficiencies. Furthermore, the financial statements of 2 of these 39 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 net position was improper).	19
All required financial statements were not presented or presentation of statement(s) was inappropriate.	14
Governmental fund balances were not properly classified.	5
Items reported as assets, deferred outflows of resources, liabilities, or deferred inflows of resources were not properly displayed.	5

Finding 5
Financial statements, accompanying notes, and required supplementary information did not include certain disclosures required by generally accepted accounting principles for 17 local governments.

Certain required information was not included in the financial statements, or disclosed in the accompanying notes or the required supplementary information, for 17 audit reports. The financial statements of 1 of these 17 local governments included a deficiency 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 the areas of insufficient disclosure and the corresponding number of instances:

Area of Insufficient Disclosure	Number of Instances
Schedule of pension funding progress	11
Long-term debt	5
Cash and cash equivalents	1

Noncompliance with State Law

Finding 6

Financial statements of 16 local governments contained disclosures that cash deposits were not adequately collateralized, or otherwise insured, as required by State law.

Financial statements of 16 local governments contained disclosures that cash deposits were not adequately collateralized, or otherwise insured, as required by State law (Exhibit A). The Local Government Article, Section 17-101 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, 2016, the following potential financial problems were noted based on the information presented in the local governments' audited financial statements and accompanying notes.

Finding 7

An unrestricted general fund deficit balance was noted for one local government as of June 30, 2016.

An unrestricted general fund deficit balance was noted for one local government as of June 30, 2016 (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. This local government has had a general fund deficit each fiscal year since fiscal year ended June 30, 2014.

Finding 8**Significant unfavorable trends and ratios were noted for one local government as of June 30, 2016.**

Significant unfavorable trends and ratios were noted for one local government as of June 30, 2016 (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 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 the Local Government Article, Section 16-306 of the Code. Section 16-308 of this Article requires that certain types of special taxing districts file annual audit or financial reports with the county in which the districts are located not later than 90 days after 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.

Finding 9**The required reports had not been filed for two special taxing districts as of July 29, 2017.**

As of July 29, 2017, we had not received the required reports for the fiscal year ended June 30, 2016 for two 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
<u>At June 30, 2016</u>		
Counties		
Allegany County	\$1,623,360	
Anne Arundel County	615,491	2000
Dorchester County	303,819	
Howard County	739,583	
Wicomico County	621,371	2014
Cities and Towns		
Town of Berwyn Heights	2,207,396	
Town of Brentwood	503,363	
Town of Brookeville	101,740	2014
City of Cumberland	413,796	
Town of Glen Echo	44,181	2014
Town of Port Deposit	212,249	
Town of Rising Sun	150,527	
Special Taxing Areas		
Oakmont Special Taxing Area	82,477	
Maryland-National Capital Park And Planning Commission	303,354	
Cash Deposits That Were Secured <u>By Unacceptable Types of Collateral</u>		
Cities and Towns		
Town of Hancock (1)	1,174,682	2015
<u>At June 30, 2015 (2)</u>		
Cities and Towns		
City of Glenarden	73,828	2013

See explanations for (1) – (2) on the next page.

- (1) 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, 2016.
- (2) This City's financial statement for the year ended June 30, 2015 was not received in time to be included in our fiscal year 2015 review and, thus, was reviewed during the fiscal year 2016 review. As previously mentioned in this report, this City's fiscal year 2016 audit report had not been submitted by July 29, 2017.

Exhibit B
Schedule of General Fund Deficits
Fiscal Year Ended June 30, 2016

Entity	Unrestricted Fund Balance (Deficit) at July 1, 2015	Revenues and Other Increases	Expenditures and Other Decreases	Unrestricted Fund Balance (Deficit) at June 30, 2016
Cities and Towns				
City of Crisfield (1)	\$ (219,804)	\$ 2,867,170	\$ 2,861,090	\$ (213,724)

- (1) The June 30, 2015 unrestricted fund balance deficit noted above was restated. The deficit was (\$206,549) as presented in the fiscal year 2015 financial statements. An unrestricted general fund deficit balance has been noted for this local government each fiscal year since the fiscal year ended June 30, 2014.

Exhibit C
Schedule of Unfavorable General Fund Trends and Ratios
Fiscal Year Ended June 30, 2016

<u>Entity</u>	<u>Unfavorable Trend or Ratio</u>
City of Pocomoke City	<p>Expenditures and other financing uses exceeded revenues and other financing sources for the fiscal years ending June 30, 2014 and 2016.</p> <p>Fund balance decreased from \$556,278 as of June 30, 2013 to \$157,945 as of June 30, 2016.</p> <p>Fund balance as a percentage of annual expenditures and other financing uses decreased from 9.5% as of June 30, 2013 to 3.0% as of June 30, 2016</p>

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