

**PRESENTATION TO**  
**THE JOINT COMMITTEE ON THE MANAGEMENT OF PUBLIC FUNDS**  
**Monitoring of Local Government Audits**

Office of Legislative Audits  
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## **INTRODUCTION**

Ladies and Gentlemen:

As requested by this Committee, I am here today to make a presentation regarding the Office of Legislative Audits' responsibilities applicable to audits of local governments within the State of Maryland. My Office performs desk reviews of the audit reports submitted by each local government. Our review of the reports for the fiscal year ending June 30, 2011 disclosed that the local governments have generally complied with generally accepted accounting principles and auditing standards. Additionally, our review disclosed that local governments generally appeared to be in good financial condition at that time. When areas of noncompliance or potential financial problems were noted, we sent letters describing the conditions to the governments and, when appropriate, to their auditors in an effort to ensure the conditions do not recur. My presentation will address the following areas:

1. Overview of the local government auditing process
2. Problems disclosed by our review of local government audits
3. Follow-up action taken on problems
4. Concluding comments

## **OVERVIEW**

Generally, each county, incorporated city or town, and taxing district located in Maryland is required by law to have an annual audit. Based on the provisions of Article 19, Section 40 of the Annotated Code of Maryland, each local government is required to have its financial statements audited by an independent certified public accountant in accordance with generally accepted auditing standards. This law also requires that the financial statements be presented in accordance with generally accepted accounting principles and that the results of the audits be submitted to the Office of Legislative Audits.

Most local governments must file their reports by November 1, for the proceeding fiscal year ended June 30; however, local governments whose populations exceed 400,000, and certain other counties, must file by January 1 of each year. In addition, extensions may be granted to local governments for valid reasons. By law, certain small governments may request a waiver of the annual filing requirement and instead only have an audit once every four years. Fourteen local governments requested, and were granted, waivers of the annual filing requirement under this law.

As provided for under the law, we have issued audit guidelines that address the basic requirements that must be met by the local governments and their independent auditors. While the independent auditors determine the specific procedures necessary in each audit, the guidelines are intended to help ensure that a minimum acceptable level of quality is maintained for audits and financial reports of local governments.

The Office of Legislative Audits performs a desk review of each audit report to determine areas of noncompliance by using a checklist for government audits published by the American Institute of Certified Public Accountants. For example, we determine whether the auditor's report was presented in accordance with generally accepted auditing standards, whether the local government's financial statements were presented in accordance with generally accepted accounting principles, and whether financial statement disclosures were adequate.

Our desk review also includes a review to identify noncompliance with certain State laws, primarily Article 95 Section 22 of the Annotated Code of Maryland which requires all deposits held in banks by local governments be insured or otherwise collateralized. Additionally, our desk review includes a basic financial analysis of each local government. This analysis includes a review of various financial trends and ratios (for example, ratio of general

fund balance to annual expenditures) to provide some insight regarding potential financial problems at the local government level.

Upon completion of each year's review, we prepare a report summarizing the areas of noncompliance with the audit guidelines (for example, departures from generally accepted accounting principles) or with State law (for example, uncollateralized cash deposits). In addition, our report discloses potential financial problems at the local government level such as deficit fund balances and unfavorable financial trends and ratios. This summary report is submitted to the State Comptroller and the Executive Director of the Department of Legislative Services, as required by law, as well as other interested parties.

Finally, the law requires applicable counties to file reports with our Office on their reviews of financial reports and audits of special taxing districts created by the counties. Our annual summary reports also include the results of our reviews of such financial information on county-created special taxing districts.

**PROBLEMS DISCLOSED:**

As reflected on Exhibit A, page 1, most local governments have substantially complied with standards over the past several years. However, for the fiscal year ended June 30, 2011, 73 out of the 187 local government reports due contained areas of noncompliance with the audit guidelines. During our fiscal year 2011 review, the number of local governments with areas of noncompliance with the audit guidelines increased somewhat in comparison to the preceding year. The increase was primarily due to areas of noncompliance related to the implementation of a new accounting principle in fiscal year 2011.

In addition, our review disclosed areas of noncompliance with State law for 16 local governments (local governments with unsecured cash deposits) and potential financial problems for 3 local governments. See Exhibit A, page 2 for a summary of these areas and problems over

the past several years. Some local governments had more than one area of noncompliance with the guidelines.

The more significant and frequent problems disclosed by our review were as follows:

1. Local governments failed to file an audit report as required. Five local governments (Baltimore City, Deer Park, Fairmount Heights, Forest Heights, Hyattsville) had not filed an audit report for fiscal year 2011.
2. Auditor's reports were not presented in accordance with generally accepted auditing standards.
3. Financial statements that did not present all required statements or presentation was inappropriate.
4. Financial statements that lacked adequate disclosures in the statements and/or accompanying notes.
5. Local governments with uninsured/uncollateralized cash deposits. Sixteen local governments had unsecured cash deposits. In most cases, the amount of cash not secured was small in relation to the local governments' total assets and, in some cases, it was indicated in the financial statement disclosures that the local government had taken corrective action.
6. Local governments with unreserved general fund deficit balances. Two local governments (Cumberland and Ridgely) had deficit fund balances at June 30, 2011. The Town of Ridgely did not respond to our request for an explanation of actions being taken to address the deficit.
7. One local government (Fairmount Heights), whose fiscal year 2010 report had not been previously received, had an unreserved general fund deficit as of June 30, 2010. Furthermore, the auditor's report included an explanatory paragraph which

stated the Town's delinquency in making certain payments raised substantial doubt about its ability to continue as a going concern. As mentioned above, the Town had not yet filed their audit report for fiscal year 2011.

8. One report (Sykesville) contained an adverse opinion on one opinion unit and a qualified opinion on another opinion unit. An adverse opinion states that the financial statements do not present fairly the financial position, changes in financial position or, where applicable, cash flows in conformity with generally accepted accounting principles. This Town's audit report contained an adverse opinion on the Town's discretely presented component unit opinion unit because of the omission of financial data for the Town's legally separate component unit. 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. The Town's audit report also contained a qualified opinion 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.*" The Town's audit reports for each fiscal year since 2009 also contained an adverse opinion and a qualified opinion due to these situations.
9. One report (North East) contained a qualified opinion on the fiduciary fund financial statements because the auditor was unable to obtain sufficient evidence supporting the carrying value of assets held or the change in net assets of the fiduciary fund. The Town's audit report for fiscal year 2010 also contained a qualified opinion due to this situation.

10. One report (Westernport) contained a qualified opinion on the governmental activities, business-type activities, and the proprietary funds opinion units because the Town had not accounted for its unfunded pension liability and pension expense, along with related disclosures, in accordance with Governmental Accounting Standards Board Statements No. 25, 27, and 50. The Town's audit reports for each fiscal year since 2009 also contained a qualified opinion due to this situation.

**FOLLOW-UP ACTIONS:**

A letter describing the areas of noncompliance with the audit guidelines noted during our review was sent to each local government and its independent auditor. The letters requested that the matters be examined to avoid a recurrence in subsequent audits.

For areas of noncompliance with State laws and potential financial problems (for example, deficit fund balances), our Office requests the applicable local governments to provide written descriptions of the actions to be taken to eliminate the conditions, when appropriate. We then review and evaluate the responses to these requests. Additionally, as requested by the Committee, when letters were sent to local governments regarding noncompliance with State laws and potential financial problems, copies of the letters were also sent to the appropriate members of the Maryland General Assembly.

**CONCLUSION:**

In summary, the Office of Legislative Audits functions in an oversight capacity by issuing audit guidelines, reviewing local government audit reports for compliance with standards and regulations, and notifying the local governments and their auditors of any deficiencies noted. We believe that these efforts have helped improve the quality of audits and have promoted fiscal accountability among local governments in Maryland.

To further improve the quality of local government audits, we participate in various efforts to make technical information available to local governments. For example, we routinely respond to technical inquiries from local governments and their auditors and participate in the Maryland Association of Certified Public Accountants' Members in Government committee.

I will be happy to answer any questions you may have on this presentation.

JOINT COMMITTEE ON THE MANAGEMENT OF PUBLIC FUNDS  
SUMMARY REVIEW  
LOCAL GOVERNMENT AUDIT REPORTS

REPORTS DUE	FY 2006				FY 2007				FY 2008				FY 2009				FY 2010				FY 2011			
	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT
	24	156	18	198	24	148	18	190	24	153	17	194	24	152	16	192	24	153	16	193	24	146	17	187
<u>Areas of Noncompliance with Audit Guidelines</u>																								
1. Audit reports not filed @	-	3	1	4	-	1	2	3	-	7	1	8	-	8	1	9	-	4	1	5	1	4	-	5
2. Audit reports not filed on time @	1	33	5	39	4	26	3	33	4	42	1	47	1	25	2	28	-	39	2	41	5	33	6	44
3. Auditor issued a qualified opinion / disclaimer / adverse opinion or improperly issued an unqualified opinion	-	2	-	2	-	1	-	1	-	1	-	1	-	2	-	2	-	4	-	4	-	3	-	3
4. Auditor's report not presented in accordance with generally accepted auditing standards @																								
a. Auditor's report did not contain one or more of the basic elements required by auditing standards	1	11	1	13	2	3	-	5	-	-	-	-	1	1	-	2	1	-	-	1	1	1	2	4
b. Auditor's opinion did not cover all opinion units or financial statements	1	7	1	9	1	9	-	10	-	1	4	5	1	2	-	3	1	6	-	7	1	6	1	8
c. Auditor did not report on all required information.	-	6	2	8	-	1	-	1	-	2	3	5	1	3	-	4	2	4	-	6	-	2	-	2
5. Financial statements not presented in accordance with generally accepted accounting principles @																								
a. Required statements not presented or presentation inappropriate	2	48	3	53	4	18	5	27	1	23	4	28	3	15	1	19	-	11	4	15	1	20	1	22
b. Inadequate disclosure in the financial statements (e.g., basis of accounting, cash deposits with financial institutions and investments)	1	22	-	23	1	14	-	15	-	6	-	6	1	5	-	6	1	6	-	7	1	7	-	8
c. Governmental fund balances were no properly classified	-	-	-	0	-	-	-	0	-	-	-	0	-	-	-	0	-	-	-	0	1	16	6	23
6. Auditor did not submit letter stating reasons for expressing other than an unqualified opinion	-	2	-	2	-	-	-	-	-	1	-	1	-	-	-	0	-	3	-	3	-	-	-	0
<b>TOTAL</b>	<b>6</b>	<b>134</b>	<b>13</b>	<b>153</b>	<b>12</b>	<b>73</b>	<b>10</b>	<b>95</b>	<b>5</b>	<b>83</b>	<b>13</b>	<b>101</b>	<b>8</b>	<b>61</b>	<b>4</b>	<b>73</b>	<b>5</b>	<b>77</b>	<b>7</b>	<b>89</b>	<b>11</b>	<b>92</b>	<b>16</b>	<b>119</b>

CO - Counties

CT - Cities and Towns

TD - Taxing Districts

TOT - Total Units

@ - Local governments may appear more than once as certain local governments had more than one deficiency in these areas.

JOINT COMMITTEE ON THE MANAGEMENT OF PUBLIC FUNDS  
SUMMARY REVIEW  
LOCAL GOVERNMENT AUDIT REPORTS

REPORTS DUE	FY 2006				FY 2007				FY 2008				FY 2009				FY 2010				FY 2011			
	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT	CO	CT	TD	TOT
	24	156	18	<b>198</b>	24	148	18	<b>190</b>	24	153	17	<b>194</b>	24	152	16	<b>192</b>	24	153	16	<b>193</b>	24	146	17	<b>187</b>
<u>Areas of Noncompliance with State Law*</u>																								
1. Uninsured/uncollateralized cash deposits	4	11	-	<b>15</b>	7	18	1	<b>26</b>	5	17	-	<b>22</b>	3	8	-	<b>11</b>	2	7	-	<b>9</b>	2	14	-	<b>16</b>
2. Miscellaneous	-	1	-	<b>1</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>
<b>TOTAL AREAS OF NONCOMPLIANCE</b>	<b>4</b>	<b>12</b>	<b>0</b>	<b>16</b>	<b>7</b>	<b>18</b>	<b>1</b>	<b>26</b>	<b>5</b>	<b>17</b>	<b>0</b>	<b>22</b>	<b>3</b>	<b>8</b>	<b>0</b>	<b>11</b>	<b>2</b>	<b>7</b>	<b>0</b>	<b>9</b>	<b>2</b>	<b>14</b>	<b>0</b>	<b>16</b>
<u>Potential Financial Problems *</u>																								
1. General fund deficits	-	5	-	<b>5</b>	-	3	-	<b>3</b>	-	6	-	<b>6</b>	-	6	-	<b>6</b>	-	6	-	<b>6</b>	-	3	-	<b>3</b>
2. Unfavorable general fund trends and ratios	-	2	-	<b>2</b>	-	2	-	<b>2</b>	-	2	-	<b>2</b>	-	3	-	<b>3</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>
3. Pension costs	1	-	-	<b>1</b>	1	-	-	<b>1</b>	1	-	-	<b>1</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>	-	-	-	<b>0</b>
<b>TOTAL POTENTIAL FINANCIAL PROBLEMS</b>	<b>1</b>	<b>7</b>	<b>0</b>	<b>8</b>	<b>1</b>	<b>5</b>	<b>0</b>	<b>6</b>	<b>1</b>	<b>8</b>	<b>0</b>	<b>9</b>	<b>0</b>	<b>9</b>	<b>0</b>	<b>9</b>	<b>0</b>	<b>6</b>	<b>0</b>	<b>6</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>3</b>

CO - Counties  
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\* Some local governments had more than one area of noncompliance with State law or potential financial problem (that is, certain local governments may be included in both categories).

Note - As of October 29, 2012, acceptable responses to all of our requests for corrective action plans had been submitted, except for one local government. Specifically, the Town of Ridgely (unreserved general fund deficit) did not submit a response.