

ANNE ARUNDEL COUNTY, MARYLAND
Annapolis, Maryland

MANAGEMENT LETTER
June 30, 2012



CliftonLarsonAllen

The Honorable County Executive
The Honorable Members of the County Council
Teresa Sutherland, CPA, County Auditor
Anne Arundel County, Maryland

In planning and performing our audit of the basic financial statements of Anne Arundel County, Maryland (the County) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered the County's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

The County's basic financial statements include the operations of the Anne Arundel County Retirement and Pension System, the Anne Arundel County Board of Education, the Anne Arundel Community College, the Public Library of Annapolis and Anne Arundel County, the Anne Arundel Economic Development Corporation, Inc., the Tipton Airport Authority, and the Anne Arundel Workforce Development Corporation. Our audit did not include the operations of the Anne Arundel Community College, the Anne Arundel Economic Development Corporation, the Tipton Airport Authority and the Anne Arundel Workforce Development Corporation because these component units engaged other auditors. The other auditors have issued separate management letters if conditions were noted. The Anne Arundel County Board of Education and the Anne Arundel County Retirement and Pension System engaged CliftonLarsonAllen LLP as its auditor. CliftonLarsonAllen LLP did provide management letters for both the Board of Education and Pension System. This report does not include any comments regarding the discretely presented component units of the County or the Pension System.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the County's internal control to be significant deficiencies:

2012-1 PREPARATION OF BASIC FINANCIAL STATEMENTS

Inadequate Review Procedures

We noted that the County does not have appropriate review procedures in certain areas to ensure that the financial statements are fairly stated. Heavy reliance is placed on complex spreadsheets that are used to determine amounts to be reported in the financial statements and related disclosures. We noted certain instances where there were errors or discrepancies in both the underlying information contained in the spreadsheets, and consequently, the related financial statements and disclosures. Such items included the following:

- Within the Self-Insurance fund, there was a variance of approximately \$113,000 between the amount of workers' compensation claims expense recorded in the County's Comprehensive Annual Financial Report (CAFR), and the amount reported to the County's actuary for use in determining the estimated actuarial liability related to Self-Insurance. The accuracy of such information is important in ensuring the integrity of these estimates.
- Due to the manner in which water and wastewater billings are generated, it is necessary to estimate a portion of the water and wastewater billings receivable at year end. These estimates are based on historical billing data and adjusted where necessary for any expected future events that are likely to occur. The spreadsheet used to calculate the estimate is maintained by the Department of Finance. For the year under audit, the Department of Finance did not consider Excess Use Credits of approximately \$806,000 to be received by customers on the same billings that the Department of Finance estimated. As these amounts were available prior to the issuance of the County's CAFR, the Department of Finance should have evaluated the impact of these credits and whether it was material to the financial statements.
- The Office of Finance discovered computational and formula errors totaling approximately \$765,000 in the spreadsheet used to calculate depreciation and disposals of the book collection held by the Anne Arundel County Public Library, a component unit of the County, in the prior year.

To enhance the accuracy of the County's financial reporting, we recommend that the Office of Finance review their methodology both for compiling financial data, and for reviewing the CAFR to ensure that the basic financial statements and related disclosures are complete and accurate. Management should also review supporting documentation used to prepare the basic financial statements and related disclosures.

Management Response:

The Office of Finance agrees to review its methodology for compiling financial data and reviewing the CAFR to ensure accuracy and enhance review of supporting documentation. Specific to the findings noted:

- *Within the Self-Insurance Fund, Finance will reconcile claims expense in the CAFR to the amounts reported to the actuary to ensure agreement.*
- *For water and wastewater billings, Finance will have appropriate revenue managers review and approve our estimate of year end receivables.*
- *The Office of Finance review effort that detected and corrected the calculation errors noted for the Library's depreciation and disposals will continue to occur.*

2012-2 INADEQUATE MONITORING OF FINANCIAL DATA PROCESSED OUTSIDE THE OFFICE OF FINANCE

Significant financial data is prepared or compiled by departments other than the Office of Finance. Our assessment of the internal controls of the Department of Public Works (DPW) revealed a need for enhanced review and reconciliation procedures.

Currently, the DPW tracks revenues, deferred revenues, and related receivables using detailed and complex spreadsheets with voluminous amounts of information (project file listing). The accuracy of the information in the project file listing is imperative to determine when revenues, deferred revenues, and related receivables should be recognized and reported to the Office of Finance. We noted several errors that occurred in the maintenance of these spreadsheets; including entering project information incorrectly and neglecting to adjust project records at the time that the projects are billed and paid. These records are adjusted on an "ad-hoc" basis rather than being updated automatically or at regular intervals. These errors and lack of real time data increase the possibility that the financial data is not accurately accumulated and reported to the Office of Finance.

Furthermore, because heavy reliance is placed on spreadsheets that are used to track the receivables and deferred revenues processed by the DPW, there appears to be a lack of overall understanding of how adjustments to these spreadsheets, and other factors, including overall permitting activity, impact capital connection revenues recorded by the Office of Finance.

We understand that DPW and the Office of Finance work together to perform an annual review of this information. However, given the volume, complexity, and inherent lack of automated controls, an annual review is not sufficient to detect errors and misstatements on a timely basis. We recommend that management implement more frequent review procedures, including verifying the accuracy of the data, as well as reconciling revenue recorded to the underlying permitting data maintained by the DPW, in order to make this review more manageable and effective.

Management Response:

While the finding does not cite any adverse impacts as it relates to DPW's current financial data management practices, DPW agrees that improvements can always be made. The auditors correctly note that the data management needs in the Bureau of Utilities section are voluminous, complex, and lack automation in some cases. The DPW will work with the Office of Finance to develop a structured program of regular reviews of data files to ensure complete and accurate information is retained to limit the potential for significant and costly errors. The Office of Finance agrees to cooperate with this effort and jointly pursue technology enhancements to streamline the process as funding is available.

In addition to the significant deficiencies identified above, we noted the following matters which we would like to bring to your attention.

Application of Government Accounting Principles

We found that the Office of Finance made certain errors applying governmental accounting principles in the preparation of the County's basic financial statements, specifically in the preparation of disclosures of defeased debt. In the current year, the County defeased the callable portion of certain series of General Obligation and Water and Waste Water bonds by placing the proceeds of the refunding bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. While the

related ending debt balances and the deferred loss on refunding were recorded properly, errors were made in reporting the proceeds of the refunding bonds, the removal of the refunded bonds, the deposit of refunding proceeds in the irrevocable trust, and the associated premiums in the Reconciliations of Governmental Fund Balance to Governmental Net Assets and of Changes in Fund Balances to Changes in Net Assets, and the Notes to the Financial Statements.

Management Response:

The Office of Finance requested and received the expertise of the external auditors during the preparation of disclosures of defeased debt to ensure that the disclosures were recorded correctly. The auditors requested that the County include the defeased debt on the County's cash flow statements. These funds were handled by an escrow agent and never flowed through the County. The County made the requested updates to the cash flow presentation and management agrees to apply this knowledge to future disclosures to assure their proper presentation.

Expenditures in Excess of Appropriations:

Section § 715 of the County Charter prohibits departments from making expenditures in excess of the amounts appropriated. Spending funds in excess of the amounts appropriated can lead to deficit fund balances. In prior years' management letters we noted that some departments, funds, and capital projects incurred expenditures in excess of budget appropriations. We also noted expenditures in excess of appropriations during this year's audit within the following departments: Ethics Commission (\$4,110 in excess of appropriations), Office of Administrative Hearings (\$1,793 in excess of appropriations), and Orphans Court (\$1,322 in excess of appropriations).

We recommend that the Office of the Budget, the Office of Finance, and the individual departments review their monitoring procedures to determine if improvements can be made to ensure that no department's expenditures exceed its appropriations. Management should also review expenditures prior to year-end to determine if any departments need additional appropriations to avoid over-expenditures.

Management Response:

Following a similar report item in 2011, management enhanced communication with departments and enhanced year-end monitoring to deter over-expenditures. Nevertheless, the auditor has correctly noted that three departments over-spent their 2012 appropriation limits by a combined \$7,225. Management agrees to consult with these departments to improve monitoring of their expenditures versus budget limits and to improve the review of expenditures prior to year-end to more accurately calculate and provide departments with additional appropriations before closing the year.

OFFICE OF INFORMATION TECHNOLOGY

**Review of Automated Data Processing (ADP) Statements on Standards
for Attestation Engagements (SSAE 16) Report**

The County outsources a portion of its payroll processing to ADP, a service organization. This effectively makes ADP a part of the County's internal control structure. We noted that the County's Human Resources department obtains and reviews these reports. As a best practice, we recommend that an

employee from the Office of Information Technology review the report to ensure that any information technology deficiencies are addressed.

Management Response:

Management agrees to include an information technology specialist from the Office of Information Technology in the review of this annual report.

Password Parameters

The following was noted with respect to the County’s password policies for its various systems: the maximum password age for eTime is set to 90 days. This setting is not in compliance with the County’s Information Technology (IT) security policy. Additionally, eTime password complexity is not enabled. We recommend that management review the password setting for all County systems to ensure that they are appropriate and in accordance with County policies.

Management Response:

Management agrees to review security settings over eTime to ensure compliance with IT policy and to strengthen password complexity.

The following table reflects management’s progress in addressing those recommendations from prior years’ internal control communications that have not been described above or previously implemented. We recommend that management implement those recommendations where no progress has been made to date.

Recommendation	Year of Origination	Implemented	In Progress	Not Implemented
1. Management should obtain meter readings for all portable water meter customers, and management should require the customers to bring their meters to the County once a year for an accurate reading.	2007		X	
2. Management should establish a trust fund for OPEB.	2008		X	
3. Management should review the subsidiary records for escrow deposits in the Reforestation Fund and return the deposits or take the deposits into County revenue as appropriate.	2009		X	

<p>4. Management should research grading deposits held and determine the amounts to return to those who have met their grading requirements and the amounts to take into revenue to restore sites for those who did not meet their grading requirements.</p>	<p>2009</p>		<p>X</p>	
<p>5. Management should charge developers the actual costs of streetlight installation in accordance with the existing provisions of the County Code.</p>	<p>2009</p>		<p>X</p>	
<p>6. Management should determine the amounts received for the installation of streetlights in the Streetlight Fund that have not yet been encumbered and the amounts reserved for encumbrances, and transfer any fund balance in excess of these amounts to the General Fund.</p>	<p>2009</p>		<p>X</p>	

Recommendation	Year of Origination	Implemented	In Progress	Not Implemented
<p>7. Management should implement procedures to ensure the safe custody and timely deposit of all cash receipts.</p>	2010	X		
<p>8. The Office of Finance and DPW should work together to establish written procedures for calculating Front Foot Assessments and Capital Facility Connection Charges, to ensure transactions are accurate and reported on the financial statements in accordance with GAAP.</p>	2010		X	
<p>9. The Central Services Officer should review the County's inventory procedures and ensure the departments responsible for counting inventory and reconciling inventory records understand and comply with procedures.</p>	2010	X		
<p>10. The Office of Planning and Zoning should implement review procedures to ensure impact fees are being calculated correctly by the City of Annapolis.</p>	2010	X		
<p>11. The Office of Planning and Zoning should implement review procedures, as well as consistently applied policies, in order to ensure that both periodic changes to fee structures, and any changes or improvements to property, are properly handled at the time that impact fees are calculated.</p>	2010	X		

Recommendation	Year of Origination	Implemented	In Progress	Not Implemented
<p>12. The Office of Planning and Zoning should implement review procedures to ensure that the underlying information used in calculating impact fee amounts is correct.</p>	2010	X		
<p>13. The Office of Personnel should implement procedures to ensure the accuracy of health insurance enrollment figures for County employees and retirees.</p>	2011	X		
<p>14. The Office of Information Technology should formalize a process to ensure that documentation is maintained when major systems conversions or changes take place.</p>	2011	X		
<p>15. The Office of Finance should implement procedures to ensure that internal service fund deficits are corrected on a timely basis.</p>	2011	X		

Management Response:

Management agrees to continue working to address the prior year findings presented, with the goal of addressing all prior year findings in fiscal year 2013 if at all possible.

Management's written responses to the significant deficiencies and other matters have not been subjected to the auditing procedures applied in the audit of the County's basic financial statements and, accordingly, we express no opinion on management's responses.

This report is intended solely for the information and use of , the County Executive, the County Council, the County Auditor, and management. However, this report is a matter of public record, and its distribution is not limited.

We thank the personnel of Anne Arundel County for their courteous cooperation. We would be pleased to meet with you at your convenience to discuss these recommendations.

CliftonLarsonAllen LLP

Baltimore, Maryland
December 21, 2012