Clifton Gunderson LLP
Certified Public Accountants & Consultants

The Honorable Members of the County Council
The Honorable County Executive John Leopold
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, 2011, 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 Clifton Gunderson LLP as its auditor. Clifton Gunderson 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:

2011-1 PREPARATION OF BASIC FINANCIAL STATEMENTS

We noted certain errors that required adjustment to properly reflect the financial activities of the County. These errors resulted from improper interpretation of government accounting principles and the County Code. A detailed summary of these deficiencies follows:

Application of Government Accounting Principles

We found that the Office of Finance did not properly apply governmental accounting principles and certain provisions of the County Code to prepare the basic financial statements. Errors were noted in calculation and classification of certain items as noted below:

- Within the Reforestation Fund, the County improperly recorded deferred revenue of approximately $2.4 million relating to amounts received for fees in lieu of replanting. Effective September 6, 2010, County law was changed through the passing of Bill 50-10 to match the language of the Annotated Code of Maryland. This bill removed the requirement to spend such funds within two years or three growing seasons, or refund the applicant. As such, all fees in lieu of replanting that are received should be immediately recognized as revenue.
- The County improperly recorded a bond premium in the amount of $6.3 million within the Capital Projects fund instead of recognizing the amount as revenue within the Bond Premium Special Revenue Fund in accordance with County Code.

Inadequate Review Procedures

We noted that the Office of Finance does not have appropriate review procedures in certain areas to ensure that the financial statements are fairly stated. The staff places heavy reliance on complex spreadsheets to determine financial statement amounts and related entries. In some instances, we noted errors in the underlying information used to create the spreadsheets, as well as in the reporting of the information in the spreadsheets. We noted the following errors:

- The County's calculation of the liability related to other post-employment benefits (OPEB) and related expense improperly used the annual required contribution (ARC) rather than the annual OPEB cost (AOC), resulting in an understatement, in total, of the annual expense and liability of approximately $683,000.
- The County did not properly begin to record depreciation expense on certain capital projects that were 95 percent complete, as per the County policy. Some of these projects were completed in 2010 or prior. This resulted in an understatement of depreciation expense of approximately $800,000, an overstatement of beginning fund balance of approximately $3.8 million, and an overstatement of fixed assets of approximately $4.6 million.

To enhance the accuracy of the County's financial reporting, we recommend that the Office of Finance develop less complex methods of compiling financial data and that the Office of Finance enhance its review procedures to include upper-level management reviews of documentation supporting balances in the financial statements as well as the financial statements.

Management's Response:

For all issues noted, the Office of Finance agrees to continue to review the methods used to compile financial data to simplify this process and to evaluate its review procedures of the information included in the financial statements. For two of the bullets noted, Finance would also like to add additional explanation.

Regarding deferred revenue in the Reforestation Fund, after the passing of legislation Finance did not change accounting practice because Code of Maryland Regulations governing this fund had not changed as well. Finance accounted for the deferred revenue in accordance with COMAR. Legal counsel advised that the County Code overrides COMAR, but the correction to the accounting records was not made until after audit review. Finance agrees that revenues will be recognized as per the County Code.

Regarding the bond premium issue, this was a new process in fiscal year 2011. The funds were recorded in the Capital Projects Fund since that is the required use per the tax certificate, but this accounting did not account for the funds through the Bond Premium Fund. After audit review, this issue was corrected for fiscal year 2011 and subsequent premiums will be recorded in the Bond Premium Fund and then transferred to the Capital Project Fund per legal requirements stated in tax law.

2011-2 INADEQUATE MONITORING OF FINANCIAL DATA PROCESSED BY THE DEPARTMENT OF PUBLIC WORKS (DPW) - UTILITIES

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

Currently, the DPW tracks revenues, deferred revenues, and related receivables using a detailed and complex spreadsheet 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 certain instances where information was incorrectly entered into the project file listing. Furthermore, there is no current process to track equivalent dwelling unit relinquishments during the year. 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.

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, in order to make this review more manageable and effective.

While we did not note any properties that were improperly excluded from tax sale, we did note the DPW and the Office of Finance lack formal procedures to ensure properties are properly taken to tax sale in accordance with the provisions of the County Code. We recommend that the Office of Finance implement clear and concise written procedures to ensure that properties are properly taken to tax sale on a timely basis.

Management's Response:

While this finding does not cite any material impact as it relates to DPW's current financial data management practices, DPW agrees that improvements can be made. The auditors correctly note that the data management needs in the Bureau of Utilities are voluminous, complex, and lack automation in some cases. 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. Finance will be utilizing its internal auditor position to coordinate this effort with DPW. Finance agrees to formally document its procedures over properties taken to tax sale, but would point out that there were no problems noted in fiscal year 2011.

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

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, and we recommended that management carefully monitor expenditures to ensure compliance with budget appropriations approved by the County Council. However, during this year's audit, we, again, noted expenditures in excess of appropriations within the both the Circuit Court and a capital project relating to construction at West Meade Elementary School. Expenditures for the Circuit Court and West Meade Elementary School exceeded appropriations by approximately $160,000 and $20,000, respectively.

We, again, recommend that the Office of the Budget, the Office of Finance, and the individual departments review their monitoring procedures to determine what improvements can be made to ensure that no department, fund or capital project's expenditures exceed its appropriations. Management should more carefully review expenditures prior to year-end to determine which departments, funds, or capital projects might need additional appropriations to avoid over-expenditures.

Management's Response:

With respect to over-expenditures in the Circuit Court, management is confident that improvements initiated by the Chief Judge during fiscal year 2012 will result in improved management of financial resources and improved monitoring of expenditures and will avoid a recurrence of previous spending problems.

With respect to the over-expenditure in the West Meade Elementary School project, this overage resulted during fiscal year 2011 budget deliberations. A County Council amendment to the fiscal year 2011 budget, recommended by the County Auditor and approved on May 20, 2010, reduced the appropriation $20,500. The County Administration opposed this amendment as it reduced the appropriation to less than what had already been expended. Since that amendment had already been opposed by the County Administration, a subsequent amendment to reverse the reduction was not proposed and the project was closed with a deficit balance.

OFFICE OF FINANCE – DEFICIT FUND BALANCES

We noted that the Central Garage and Transportation internal service fund was in a deficit position of $331,415 at June 30, 2011. We recommend that management implement procedures to correct this deficit. This fund is intended to be self-supporting. As such, if the fund deficit is not corrected on a timely basis, management may be required to record a liability within this fund for amounts paid in excess by the user funds.

Management's Response:

The Central Garage and Transportation Internal Service Fund is supported by user revenues paid for services. These revenue charges are adjusted annually to compensate for shortages and overages noted in the fund balance. Management agrees to take appropriate steps to ensure the deficit is corrected and the fund remains self-supporting.

OFFICE OF PERSONNEL – MONITORING OF HEALTH INSURANCE ADMINISTRATIVE COSTS

The County's three health insurance vendors provide insurance to the County, the Anne Arundel Community College, and the Library employees and retirees. Administrative fees are based on enrollment counts plus fixed monthly fees.

While the Office of Personnel reviews the enrollment counts per the vendors' invoices for reasonableness, they do not verify the enrollment counts to County records, and management has no procedure to verify that terminated employees are promptly removed from vendor invoices.

To ensure the County is not charged for erroneous administrative fees, we recommend that the Office of Personnel implement procedures to ensure the accuracy of the enrollment counts for County employees and retirees, including terminations.

Management's Response:

Management agrees that we should verify enrollment counts to employee records and are currently working on a monthly report to reconcile enrollment counts to the vendor's invoices.

OFFICE OF INFORMATION TECHNOLOGY

Utility Billing – MUNIS Application Implementation

There was no documentation verifying management's review of the data conversion, application customization and user security for the MUNIS Platform conversion from a mainframe environment to a client-server environment. Documentation of management's review of the data conversion, application customization and user security should be maintained to verify management's review. We recommend that the Office of Information Technology formalize a process to ensure documentation is maintained to substantiate management's review.

Management's Response:

In the future, management agrees to better document these efforts for audit verification.

The following table reflects management's progress in addressing those recommendations from the fiscal year 2010, 2009, 2008 and 2007 management letters 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	
4. Management may wish to seek a change in State and County laws to remove the time limitation within which the funds must be spent and to preclude refunds to applicants.	2009	X		
5. 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.	2009		X	
6. Management should charge developers the actual costs of streetlight installation in accordance	2009			X

with the existing provisions of the County Code.				
7. 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.	2009		X	
8. Management should ensure all of the County's deposits are adequately insured or collateralized in accordance with State law.	2010	X		
9. Management should consider applying qualitative factors, such as subsequent collections, when calculating the allowance for doubtful accounts.	2010	X		
10. Management should implement a formal review and approval process of grant reimbursement requests.	2010	X		
11. Management should enable complex password settings in accessing Windows.	2010	X		
12. Management should restrict access to MUNIS and AS400 to a limited number of authorized employees per the specific job function.	2010	X		
13. Management should implement procedures to ensure the safe custody and timely deposit of all cash receipts.	2010		X	
14. The Office of Finance and DPW staff should work together to ensure both departments understand	2010	X		

the methodology used to calculate closure and post-closure liabilities, as well as implement a review process to minimize errors.				
15. 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.	2010		X	
16. The Office of Finance and DPW should work with the Office of Law to ensure both departments understand the County Code with regards to delinquent allocation reservation charges and delinquent properties being sold at tax sale.	2010	X		
17. The Office of Finance and Office of Personnel should work together to ensure source documents are used to calculate the annual change in the Net OPEB Obligation. The Office of Finance should also implement a review and reconciliation process to ensure the census data provided to the actuary is accurate.	2010	X		
18. The Central Services Officer should review the County's inventory procedures and ensure the departments responsible for counting inventory and reconciling inventory	2010		X	

records understand and comply with procedures.				
19. The Office of Planning and Zoning should implement review procedures to ensure impact fees are being calculated correctly by the City of Annapolis.	2010		X	
20. 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.	2010		X	
21. The Office of Planning and Zoning should implement review procedures to ensure that the underlying information used in calculating impact fee amounts is correct.	2010		X	

Management's Response:

#1 DPW meter readings: Management at DPW will be pursuing legislation in fiscal year 2012 to establish a penalty for customers that fail to bring in their portable meters annually for an accurate reading. Once this penalty is established, Management should be able to enforce compliance and address this comment.

#2 OPEB trust fund: Management hopes to establish a trust fund once current economic conditions improve to make funding available. A Collaborative Benefit Working Group has been established and is meeting to address the financial implications of OPEB to the County. Recommendations are expected shortly. Changes to OPEB will be accomplished through administrative process, negotiations with the unions, and legislative changes.

#6 Streetlights: Management at DPW will be pursuing legislation in fiscal year 2012 to define amounts billed to developers as actual amounts due. Once implemented, the new legislation should enable Management to address this comment.

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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 Council, the County Executive, 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.

Clifton Gunderson LLP

Baltimore, Maryland
December 22, 2011