MANAGEMENT LETTER

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The Honorable County Executive
The Honorable Members of the County Council
Anne Arundel County, Maryland
Annapolis, Maryland

We have completed our audit of the Anne Arundel County, Maryland (the County) financial statements as of and for the year ended June 30, 2013, and have issued our report dated December 23, 2013.

In connection with our audit engagement, we noted the following matters which we would like to bring to your attention.

A separate communication dated December 23, 2013, contains our written communication of the significant deficiency in the County's internal control. This letter does not affect our communication dated December 23, 2013.

OFFICE OF FINANCE

Journal Entry Review and Approval

We identified certain aspects of the County's journal entry review and approval process where we believe controls could be strengthened. There are currently three employees in the Office of Finance who possess system rights to initiate and approve their own journal entries. Current policy states that another employee should review and electronically approve the entries made by these individuals. In order to address the risk of these employees having the ability to initiate and approve their own entries, a compensating control was implemented whereby another employee within the Office of Finance reviews a report of journal entries made by these three employees to ensure that none of them approved their own entries. This employee reports directly to the County Controller and not to any of the three individuals possessing conflicting access rights. In reviewing a sample of journal entries made by these three employees, we noted three entries where, while the entries themselves were proper, we could not verify that another employee had reviewed the entry as required by policy. Upon further investigation of these entries, we noted that certain types of entries were being excluded from the aforementioned report as a result of an unintended override by the system. The fact that certain entries were excluded from this report lessens the effectiveness of this compensating control. We recommend that the County investigate whether placing system restrictions on these three employees that would prevent them from approving their own entries is possible. If this is not feasible, the Office of Finance should ensure that reports used in applying the compensating control described herein are complete and accurate.

Management Response:

Management agrees with this finding and is implementing an electronic solution with an upgrade to the financial system in April 2014. Journal entry approvals will be captured electronically and the system override issue identified by the auditor will be corrected, restoring the integrity of the related security reports.

OFFICE OF BUDGET AND OFFICE OF FINANCE

Internal Service Fund Deficit

It was noted that the Central Garage and Transportation Fund, one of the County's internal service funds, had a deficit net asset balance at year end. Prior to finalizing the 2012 Comprehensive Annual Financial Report (CAFR), there was also a deficit balance in this fund, however a transfer from the General Fund was booked in order to restore the fund balance. This transfer was reversed during the 2013 fiscal year. Based on our discussions with management and audit procedures performed, this deficit appears to be caused by significant increases in other post-employment benefit related costs. Based on our review of the fiscal year 2014 budget and discussions with management, there does not appear to be a plan to restore the deficit net asset balance in this fund within a reasonable period. Governmental Accounting Standards Board Statement (GASB) No. 34 defines an internal service fund as follows: Internal service funds may be used to report any activity that provides goods or services to other funds, departments, or agencies of the primary government and its component units, or to other governments, on a cost-reimbursement basis. While it is acceptable to charge internal service fund deficits back to the user funds in a systematic and rational manner over a reasonable period of time to approximate a cost-reimbursement arrangement, the County does not appear to have a plan in place to achieve this. Should this fund continue to operate with a deficit net asset balance with no plan to restore the deficit, this fund may no longer meet the definition of an internal service fund as defined in GASB 34. We recommend that management develop and implement a plan to restore the deficit net asset balance of this fund.

Management Response:

The County recently passed a bill that should result in reduced healthcare costs (Bill No. 85-13). Additionally, in fiscal year 2015 the County plans to begin budgeting to cover a portion of OPEB costs, including those costs charged to internal service funds. These efforts should dramatically reduce the current internal fund deficit. After the effects of these efforts are known, Management plans to allocate any deficit that may remain to the County's major funds.

Expenditures in Excess of Appropriations and Departmental Budget Entries and Budgetary Process

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 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: Circuit Court was $16,169 in excess of appropriations and Ethics Commission was $707 in excess of appropriations. These departments exceeded appropriations as result of a year-end pension allocation entry. The County has established a methodology for allocating pension related costs to County departments. We noted that the County did not properly follow this process during the year under audit. Based on discussions with management, pension costs from two departments (Ethics and Circuit Court) were reallocated at the direction of the Office of Budget so that these departments would still be within their legally adopted budgets. These entries were later reversed by the Office of Finance to correctly reflect that these departments did in fact have expenditures in excess of their legally adopted budgets. We recommend that established allocation procedures be followed as opposed to making entries at the direction of the Office of Budget.

Management Response:

Management agrees that allocation procedures will be followed to distribute pension costs based on the budgeted pension amounts. The Office of the Budget and the Office of Finance will coordinate with departments to deter incidents of departments spending in excess of their legally adopted budgetary limits.

Budgetary Statement Errors

During a review of the fund financial statements performed by the County Auditor's Office, errors were noted in the budgetary fund statements for certain funds. For these funds, the 2013 beginning of year budgetary fund balance differed from the ending budgetary fund balances on the fiscal year 2012 financial statements. In two instances, the Office of Finance restated the 2013 beginning budgetary fund balances because the ending fund balances reported in the 2012 CAFR were incorrect, while in the other two instances, the Office of Finance simply made errors in the 2013 beginning budgetary fund balance amounts. It was also noted that the Budget Office made data entry errors in the appropriations entered into the EnterpriseOne system. In the Grants Fund, the Budget Office understated appropriations to the Fire Department by $3,000, overstated appropriations to the Office of Planning and Zoning by $14,184, and overstated appropriations for the Office of Finance Nondepartmental by $200,000, and in the Partnership for Children, Youth and Families fund, the Budget Office overstated appropriations by $96,000. These amounts were corrected prior to the 2013 CAFR being issued.

The budgetary financial statements provide stakeholders with the results of the County's budgetary compliance, and the EnterpriseOne system is a critical monitoring tool to help management ensure it complies with legally adopted appropriations. Therefore, we recommend that the Budget Office work with the Office of Finance to ensure the appropriations entered into EnterpriseOne, from which the financial statements are compiled, are accurate, and we recommend that the Office of Finance implement procedures to ensure it accurately reconciles budgetary fund balances to GAAP fund balances to avoid the need to restate beginning budgetary fund balances.

Management Response:

In response to this finding, the Office of Finance has instituted review procedures to deter budgetary statement errors during the preparation of the annual financial statements. The Office of the Budget will ensure that the budgetary amounts uploaded into the financial record reconcile to the annual budget ordinance.

OFFICE OF LAW AND OFFICE OF FINANCE

Required Hotel Tax Distributions

The County Auditor's Office noted that the County improperly calculated the amounts of hotel tax revenue that, per the Annotated Code of Maryland, should have been distributed to the Anne Arundel County Conference and Visitors Bureau over the past four years (in the amount of $485,385 related to fiscal years 2010 through 2013) and Arts Council of Anne Arundel County over the past two years (in the amount of $51,086 related to fiscal years 2012 and 2013). This error appears to be the result of a misinterpretation of the intent of the legislation requiring the distributions. We recommend that, for any legislation having financial impact, the Office of Law work with the Department of Finance to ensure that all affected parties understand the impact of the legislation.

Management Response:

Management agrees to consult with the Office of Law concerning new financial legislation to ensure it is properly implemented. Per the legal advice issued on the law in question, the State law in question is contrary to other laws governing property tax distributions. The required distributions to the Conference and Visitors Bureau and the Arts Council have since been made in accordance with the legal advice.

PRIOR YEAR COMMENTS

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	
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.	2009		X	
5. Management should charge developers the actual costs of streetlight installation in accordance with the existing provisions of the County Code.	2009		X	
6. Management should determine the amounts received for the installation of streetlights in the Streetlight Fund that have not yet been encumbered and the	2009		X	

amounts reserved for encumbrances, and transfer any fund balance in excess of these amounts to the General Fund.				
7. 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	
8. Management should review their methodologies for compiling financial data and for reviewing the financial statements to ensure that the basic financial statements and related disclosures are complete and accurate. Management should also review supporting documentation prepared by the Office of Finance that is used to prepare the basic financial statements and related disclosures.	2012	X		
9. Management should review the financial statements to ensure the Office of Finance appropriately applied governmental accounting principles in the preparation of the County's basic financial statements, specifically in the disclosures of defeased debt.	2012	X		
10. Management should review the password setting for all County systems to ensure that they are appropriate and in accordance with County policies. Certain password parameters (password history, minimum password age, minimum password length, and password complexity) for financial and reporting systems used by the County do not conform with best practices or with County IT Security policies. This increases the risk of unauthorized access to the organization's financially significant systems and data.	2012			X

11. Management should ensure that an employee from the Office of Information Technology also review the Automated Data Processing (ADP) service organization control report (Statements on Standards for Attestation Engagements (SSAE) 16 report).	2012		X	

Management Response:

Regarding password settings, Management agrees to review settings for County systems and ensure that they are appropriate and in accordance with County IT security policies and implement corrections where needed.

During fiscal year 2014, Management implemented corrections for all other prior year comments and expects these comments to disappear from subsequent audit management letters.

Anne Arundel County, Maryland's Response to Matters Identified

The County's written responses to the matters identified in our audit were not subjected to the audit procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on them.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various County personnel, and we thank the personnel of Anne Arundel County for their courteous cooperation. We would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This communication is intended solely for the information and use of the County Executive, County Council, management, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

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Baltimore, Maryland
December 23, 2013