

**ANNE ARUNDEL COUNTY, MARYLAND**  
**Annapolis, Maryland**

**MANAGEMENT LETTER**  
**June 30, 2010**

Teresa Sutherland, CPA  
County Auditor  
Anne Arundel County  
Office of the County Auditor

The Honorable Members of the County Council  
The Honorable County Executive John Leopold  
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, 2010, 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. County Auditor Teresa Sutherland did not audit the Anne Arundel County Board of Education and the Anne Arundel County Retirement and Pension System, who 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 in the first paragraph 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 material weaknesses and other deficiencies 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 County's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described as 2010-1 and 2010-2 to be material weaknesses.

A significant deficiency is a deficiency, or 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 deficiencies described in Appendix A and Appendix B to be significant deficiencies.

### **2010 -1 PREPARATION OF BASIC FINANCIAL STATEMENTS IN ACCORDANCE WITH GAAP (MATERIAL WEAKNESS)**

During our audit, we noted a significant number of errors that required adjustment to properly reflect the financial activities of the County. These errors resulted from inadequate understanding of government accounting principles and inadequate review and reconciliation procedures. If these deficiencies are not corrected, the County has a continued risk that material misstatements and errors and irregularities, including fraud, could go undetected. It also increases the risk that financial decisions may be made based on inaccurate financial information that does not provide a true picture of the financial condition of the County. A more detailed summary of these deficiencies is as follows:

#### ***Application of Government Accounting Principles***

We found that the Office of Finance did not properly apply the full accrual, modified accrual, and budgetary bases of accounting to prepare the government-wide, governmental fund, and budgetary financial statements and the footnote disclosures. We also noted errors in the classifications of assets, liabilities, and net assets, and in the recognition of revenue, expenditures, encumbrances, transfers, and other financing sources and uses. Details of the significant deficiencies we noted are found in Appendix A.

#### **Inadequate Review and Reconciliation Procedures**

We noted that the Office of Finance does not have adequate review and reconciliation procedures to ensure the financial statements are fairly stated. The staff places heavy reliance on complex spreadsheets to determine financial statement amounts and related entries. However, they often do not possess an adequate understanding of the theory used to create the spreadsheets or the related formulas, and they rely on the amounts derived by the spreadsheets' formulas without comparing the amounts to financial expectations, subsidiary records, and source documents. We noted errors in the General Fund, the General County Capital Projects Fund, the Utility Fund, the Solid Waste Fund, the Reforestation Fund, and the Storm Drain Fund, the presentation of component unit financial statements, the footnote disclosures, and the Detailed Schedules of Long-Term Debt that could have been detected by the staff in the course of their duties. These errors are also described in Appendix A.

It is imperative that the Office of Finance have sufficient staff with the requisite knowledge and experience in the theory and application of government accounting principles to ensure the

County's financial statements are fairly stated and prepared in accordance with GAAP. We recommend that management provide sufficient training to the existing staff or hire additional staff with expertise in government accounting principles commensurate with the financial complexity of the County.

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 and reconciliation procedures to include reconciliations of subsidiary records to the general ledger, investigation and resolution of significant and unusual account fluctuations, and upper-level management reviews of financial statements prepared by the staff. To enhance the consistency of the application of government accounting principles among existing staff members and to provide guidance to new staff members, we recommend that the Office prepare a policies and procedures manual to which existing and new staff could refer. We are committed to working with the Office of Finance to help them develop alternative preparation methods and reconciliation procedures. We will also assist the Office of Finance in adopting new accounting standards and accounting for infrequent, complex transactions such as advance refundings of debt.

***Management's Response:***

***In response to the suggested courses of action mentioned in the auditors' comment above, we do not anticipate additional personnel being assigned in the Office of Finance at this time. However, the Office of Finance will modify the training for its management staff so that it is directed toward financial statement preparation and review. The Office is also reviewing our structure and will make changes to accomplish the recommendations proposed by the auditor regarding data compilation. For example, we are evaluating significant data collection methods and are in discussions with other Counties, based on guidance from the external auditor, to obtain better methods/processes to develop this key data. The Office is developing a policies and procedure manual and is requiring each area to document the specific work performed by that section. For future audits, the Office plans to meet with the auditors on the complex issues earlier in the audit to insure that the accounting treatment is being handled properly.***

**2010-2 INADEQUATE MONITORING OF FINANCIAL DATA PROCESSED OUTSIDE THE OFFICE OF FINANCE (MATERIAL WEAKNESS)**

Significant financial data is prepared or compiled by departments other than the Office of Finance. Our assessment of the internal controls over the departments preparing or compiling financial data outside of the Office of Finance revealed inadequate review of transactions and insufficient internal controls to identify errors timely. We have summarized the significant deficiencies we noted below, and the details of our findings and recommendations are found in Appendix B.

***Department of Public Works – Waste Management Division (DPW)***

During our audit, we noted that DPW lacks adequate internal controls over cash receipts to ensure all receipts are deposited timely and recorded accurately in the general ledger. We also noted that DPW and the Office of Finance do not have adequate review procedures in place to ensure their calculations of the estimated liability for the landfills' closure and postclosure costs are accurate.

### ***Department of Public Works - Utilities***

During our audit, we noted that DPW and the Office of Finance lack adequate internal control procedures to ensure the accuracy and completeness of revenue, deferred revenue, and the related receivables from allocations for water and sewer capacity and front foot petition projects. We also noted that DPW and the Office of Finance lack adequate internal control procedures to ensure delinquent utility charges are collected at tax sale in accordance with County Code and management's policies.

### ***Office of Personnel***

We noted errors in the amounts compiled by the Office of Personnel and used by the Office of Finance and the County's actuary to determine the County's OPEB liability (retiree health insurance benefits).

### ***Office of Central Services***

We observed the year-end inventory counts at eight locations. We found that the internal controls were inadequate to ensure the employees who counted the inventory did so in accordance with the prescribed procedures. We also found that duties were not adequately segregated to ensure the employees counting the inventory could not both perpetrate and conceal errors and irregularities. Finally, we found errors in the inventory counts at six of the eight locations.

### ***Office of Planning and Zoning***

We found errors in the impact fees calculated and assessed by the Office of Planning and Zoning. We also noted errors in the impact fees collected by the City of Annapolis and remitted to the County for residential development within the City limits. Finally, we noted that the Office of Planning and Zoning does not have a consistent policy on how to calculate impact fees when there is a change in use or an improvement that requires the payment of impact fees.

### ***Management's Response:***

***In 2007 the Office of Finance formed a risk assessment team to evaluate similar concerns noted during that audit. This team assessed risks of all County departments. The process was comprehensive and successfully identified risks and improved communications between those departments' staff and the Office of Finance. Accordingly, a risk assessment will be performed again for the departments identified above. The reviews will be focused on insuring that the more serious issues are addressed first and will assist in establishing new processes where necessary.***

***In conjunction with the risk assessment review, a restructuring of job functions will be considered that may involve certain duties being transferred to the Office of Finance. Specifically, one function being considered is that the collection of certain significant fees at satellite locations would become the responsibility of the Office of Finance.***

### ***Other Matters***

In addition to the material weaknesses and significant deficiencies discussed above, we have the following comments and recommendations for improvement.

## **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.

During this year's audit, we, again, noted expenditures in excess of appropriations. Specifically, the Self Insurance Fund's expenditures exceeded its appropriations by \$18,332,038, the Circuit Court's expenditures exceeded its appropriations by \$95,607, and DPW (General Fund) exceeded its appropriations by \$1,052.

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:**

***The Offices of Budget and Finance will more closely monitor the fiscal year end projections with the departments to avoid a recurrence. However, the over-expenditure in the Self Insurance Fund needs an explanation. This situation occurred because of two conditions. First, the Federal government made a change during fiscal year 2010 whereby medical costs associated with a workman's compensation claim that were previously paid by Medicare once the individual became eligible for that program are now being passed back to the local governments. The effect of this condition was that the reserve for future medical claims had to be increased significantly. While the County's process is to fund changes in the reserves through each budget this was an unusual occurrence that should not happen in the future. Second, a large settlement was executed and recorded as a fiscal year 2010 transaction that had not been anticipated when the fiscal year 2010 budget was developed.***

## **OFFICE OF FINANCE – COLLATERALIZATION OF BANK DEPOSITS**

To protect the County in the event of a bank default, the Annotated Code of Maryland requires the County to collateralize cash accounts on deposit with financial institutions when the account balances exceed the FDIC insurance limit. During our audit, we noted one account that was \$498,474 more than the FDIC limit, and management did not ensure the account was appropriated collateralized. We noted in last year's management letter that this account was not adequately collateralized.

We also noted that the County's contract with Bank of America calls for the County to "sweep" deposits overnight into repurchase agreements consisting of U.S. Treasuries. Under State law, repurchase agreements are considered adequately collateralized at 100% if the agreements are held in the County's name. However, the repurchase agreements into which the County's deposits are swept are not held in the County's name; rather, the County holds a "position" in repurchase agreements that are held in the bank's name.

We noted last year that the agreement with Bank of America was not sufficient to ensure the County's deposits were adequately collateralized and protected. We recommended that management modify the agreement to require the collateralization of the repurchase agreements at 102%, and management responded that they would ensure the funds were either collateralized as deposits or swept into repurchase agreements held in the County's name collateralized at 102%. However, no changes were made during fiscal year 2010, and the repurchase agreements into which the County's deposits were swept exceeded the FDIC limit by \$2.4 million on June 30, 2010.

Finally, the County has \$920,000 on deposit at year-end in a third bank account used to pay health insurance claims that was not collateralized for the amount greater than the FDIC limit. Neither the Office of Personnel nor the Office of Finance could provide us with a copy of the agreement with the bank or document why the County is not required to collateralize the amount above the FDIC limit.

We again recommend that the Controller ensure the County's deposits are adequately insured or collateralized in accordance with State law.

**Management's Response:**

***In response to the fiscal year 2009 audit, the Office of Finance negotiated with the Bank of America during fiscal year 2010 to achieve acceptable collateralization and registration of the County's deposits. It was determined that a tri-party agreement among the County, Bank of America and Bank of New York was required. To accomplish this, several new documents had to be executed and the agreements were completed on September 20, 2011 for the first account identified. Subsequent to fiscal year 2010, the sweep account was closed and all remaining deposits at the Bank of America remain in a non-interest bearing account which is currently insured 100% by the new FDIC requirements. The new FDIC requirements also now cover the health insurance account balance with no additional cost.***

**OFFICE OF FINANCE – INTEREST ON DELINQUENT ALLOCATION RESERVATION CHARGES**

The County Code requires management to assess a 10% penalty and interest at the rate of 1% a month on past due allocation reservation charges (ARC fees). During our audit, we found that the Office of Finance was assessing the 10% penalty, but not interest. The staff advised us that the MUNIS utility billing software can calculate both the penalties and the interest due. However, while the software can generate bills for the penalty, it cannot generate bills for the interest, and the Office of Finance did not generate the bills manually. When we subsequently had the Office calculate the interest due, we found management failed to bill and collect approximately \$112,000 of interest.

We recommend that management assess interest on past due ARC fees in accordance with the provisions of the County Code, whether they have to prepare bills manually or modify MUNIS to prepare the bills. We also recommend that the Office of Finance work with the Office of Law to determine whether the County can still bill and collect the \$112,000 the Office of Finance failed to assess.

**Management's Response:**

***Subsequent to fiscal year 2010, the Office of Finance determined that interest had not been charged on past due ARC fees and consulted with the Office of Law to verify that interest should be charged on these fees. A software enhancement was requested with the contractor and has now been implemented. Of the \$112,000 cited, approximately \$101,000 has been charged to two past due accounts. The remaining balances are being reviewed and investigated and the Office of Law will be contacted if assistance is needed.***

**OFFICE OF FINANCE - ALLOWANCE FOR DOUBTFUL PROPERTY TAX ACCOUNTS**

The Office of Finance calculates the allowance for doubtful property tax accounts based on the historical percentage of taxes that have been written off and the receivable balances at June 30. The calculation is a quantitative, numerical calculation that does not consider qualitative factors, such as management's judgment and known collections after year-end. Our review of this year's calculation disclosed that it resulted in a higher allowance than necessary because the year-end receivable balance included a \$4.7 million personal property tax bill that was not assessed or billed until late in the year and was unpaid on June 30. However, it was paid timely subsequent to June 30, and there was no reason to believe its collection was doubtful.

We recommend that management calculate the allowance for doubtful accounts by applying the historic write-off percentages to the receivable balances and then consider other qualitative factors, such as subsequent collections, to determine whether the calculated amount is a reasonable estimate.

**Management's Response:**

***The Office of Finance concurs and will consider qualitative factors following the quantitative calculation of future allowances.***

**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. Further, the Office of Personnel relies on the College and the Library to reimburse the County based on what each determines their respective enrollments are. The Office of Personnel does not reconcile the enrollment counts and costs from the vendors' invoices to the enrollment counts and reimbursements provided by the College or Library.

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. Also, to ensure the College and Library pay their full costs, we recommend that the County require the College and Library to reimburse the County based on

the actual amounts billed. The College and Library should verify their own enrollment counts and pursue any discrepancies with the vendors.

***Management's Response:***

***The Office of Personnel understands and agrees that the County needs to verify the enrollment counts for administrative fees. However, the limited department resources and automation has restricted the ability to properly perform this reconciliation. To resolve this finding, the Office of Personnel will meet with Office of Information Technology for assistance with this matter and will reallocate the resources needed to accomplish this reconciliation.***

***It is understood by the Office of Personnel that the County subsidizes the Library and College health costs and both entities may not pay the full costs of this coverage. This is the intention of having pooling agreements, whereby all entities benefit from the risk pool. Currently the College and the Library are paying an enrollment premium to the County for this coverage. The Library was assured by the Offices of Personnel and Budget during the 2009 pooling agreement discussions that we would continue current practices. Finally, the County is the funder of last resort for both entities so the subsidy is a part of the County's contribution to those operations.***

***The Library and the College verify their own counts. The Office of Personnel firmly believes that they should continue this practice. The Office of Personnel will meet with the Library and College and work with them to obtain the data needed to reconcile their payments made to the County.***

**COUNTYWIDE - GRANT MONITORING**

Grant monitoring is decentralized so that the departments that receive grants are responsible for monitoring grant compliance and initiating billings for reimbursement. While some of the larger departments that receive significant grant funding have a department manager who reviews the billings, most departments do not, and most have not implemented formal review and approval processes.

To ensure the accuracy and timely billing of grant reimbursements, we recommend that each department implement a formal review and approval process, including supervisory review of the billings prior to submitting the reimbursement requests to the granting agency.

***Management's Response:***

***The Office of Finance will meet with all departments to verify that the supervisory review process is implemented.***

## OFFICE OF INFORMATION TECHNOLOGY

### ***Password parameters***

Windows network password complexity setting is not enabled. In addition, AS400 password change and complexity is not enforced for administrative level users. If password settings are not properly configured, the information systems could be vulnerable to unauthorized access and result in sensitive data being compromised. We recommend that management consider implementing controls that require complex passwords.

### ***Management's Response:***

***The Office of Information Technology (OIT) will set an expiration interval for the individual IT users who log into AS400, and we will require alphanumeric passwords for all users.***

### ***Access controls***

There were inadequate controls over the management of administrative privileges and default system configurations.

- Three user accounts had special authority access privileges on AS400 that were not consistent with employees' job functions.
- Direct access to the MUNIS database was not restricted.
- Access for a terminated employee was not removed in a timely manner.
- There were six accounts that were using the default password on AS400.
- Default "Administrator" account on the Windows domain was not disabled.

Inadequate administrative privilege controls can lead to unauthorized and inappropriate access to key financial systems. This in turn could prevent the organization from detecting unauthorized data access, data updates, creation of improper accounts, and deletions of audit trails. We recommend that management consider restricting access in the system to a limited number of authorized employees per the specific job functions. Default system security credentials are publically known; therefore, management should consider changing default accounts and passwords to limit the opportunity for inappropriate access.

### ***Management's Response:***

***OIT has updated the accounts that had special authority access privileges by either disabling/deleting the account or reducing the privilege to user authority.***

***Access for OIT staff member and Munis Technical staff will be disabled when not in use. Currently, Munis Technical staff are working daily pertinent to on-going efforts for a particular project. Once completed, access will be disabled and used only when necessary.***

***OIT is reviewing and updating our process for handling account management of terminated and retired employees to ensure that unused accounts are disabled in a timely manner.***

***OIT has changed, disabled, or deleted most of the accounts that were using the default password on the AS400.***

***OIT is researching our use of the administrator' domain account, and plan to rename it as soon as we verify there are no embedded processes using it.***

The following table reflects management's progress in addressing those recommendations from the fiscal year 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 use an objective method to determine the investment rate of return assumption for OPEB.	2008	X		
3. Management should establish a trust fund for OPEB.	2008			X
4. 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	
5. Management should implement procedures to ensure revenue, deferred revenue, and related payables for Reforestation Fund fees in lieu of replanting are recognized in accordance with GAAP. 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	
6. 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	

7. Management should charge developers the actual costs of streetlight installation in accordance with the existing provisions of the County Code.	2009			X
8. 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	
9. Management should implement procedures to ensure the subsidiary records for utility and public works agreements are complete and accurate.	2009	X		
10. Management should ensure employees are paid at the rates authorized in the County Code and by their appointing authorities.	2009	X		
11. Management should investigate old accounts payable balances and determine whether they are valid payables.	2009	X		
12. Management should establish a process to review outstanding payables more timely to ensure the accuracy of the payable listings.	2009	X		
13. Management should complete its project to implement a single sign-on for all users through GroupWise and Novell eDirectory and ensure that eDirectory is configured to require passwords that meet the minimum requirements in the Information Technology Security Policy.	2009	X		

**Management's Response:**

**#1 DPW meter readings:** *The County sent letters to customers requesting that the meters be brought in for an annual reading, but legislation has not been initiated to allow penalties for non-compliance.*

**#3 OPEB trust fund:** *The County plans to establish an irrevocable trust fund for OPEB once the current economic problems subside.*

**#7 Streetlights:** *The County uses cost estimates and an inflation factor at the time a Public Works Agreement is executed to charge developers for street light installation. The ability to know actual charges is impossible to assess in advance of project completion. Since this requirement is governed by the Design Manual, DPW will modify the language to reflect the practice of estimating costs.*

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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 Henderson LLP*

Baltimore, Maryland  
January 31, 2011

*Teren S. Heelan*

Annapolis, Maryland  
January 31, 2011

## Appendix A

### **We noted the following errors which are classified as significant deficiencies:**

- Failure to properly adopt full accrual, modified accrual, and budgetary bases of accounting used to prepare the government-wide, governmental fund, and budgetary financial statements, and the related reconciliations.
- Incorrect amounts reported for required footnote disclosures.
- Misclassification of net assets between restricted and unrestricted net assets.
- Misclassification of receivables and liabilities between current and noncurrent.
- Improper recognition of revenue, deferred revenue, and accrued revenue.
- Incorrect classifications of revenue, expenditures and transfers among funds.
- Improper recognition of bond premiums and refunding losses.
- Errors in the recognition of capitalized interest, accumulated depreciation, and depreciation expense in the Solid Waste Fund.
- Incorrect reporting of the Solid Waste Fund Statement of Cash Flows.
- Incorrect classification of the General Fund balance between appropriated for subsequent year's expenditures and unappropriated.
- Errors in the presentation of the Board of Education, Anne Arundel Community College, and Anne Arundel Economic Development Corporation's component unit financial statements.

### **We noted the following significant deficiencies due to the Office of Finance's inadequate review and reconciliation procedures.**

- A \$1.3 million overstatement of the liability for payroll levies. The Office of Finance identified the balance as being incorrect, and asked the Office of Personnel to reconcile the account to source documents. However, when the Office of Personnel did not reconcile the account timely, the Office of Finance prepared the financial statements with the known error.
- A \$1 million overstatement of revenue from 911 fees, a \$1.9 million understatement of revenue from ambulance fees, and a \$1.1 million understatement of Highway User revenue in the General Fund. Management was not aware that \$1.1 million of Highway User revenue due from the State since June 2009 revenues had never been collected.
- An understatement of \$339,000 of revenue from the sale of salvage material and recyclables in the Solid Waste Fund.
- Errors in the calculation of capitalized interest in the Utility Fund.
- Errors in the calculation of the employer's contributions for retiree health insurance.
- Errors in the calculation of the liability for compensated absences in fiscal year 2009 that the Office of Finance discovered and corrected by posting an adjustment in fiscal year 2010. While the Office of Finance detected their own error, the error was a result of inadequate review and reconciliation procedures in the prior year.
- Incorrect calculation of interest expense on a claim against the County for impact fees that resulted in a \$285,000 understatement of the liability.
- Errors in recording fund transfers from the Reforestation and Storm Drain Funds to the General County Capital Projects Fund.
- Errors in the footnote disclosures and Detailed Schedules of Long-Term Debt where the amounts in some footnotes and some amounts in the debt schedules did not reconcile to the related amounts in the financial statements.

## Appendix B

We noted the following significant deficiencies in the monitoring of financial data processed outside the Office of Finance.

### DEPARTMENT OF PUBLIC WORKS – WASTE MANAGEMENT DIVISION

#### *Internal Controls over Cash Receipts*

DPW sells scrap metal collected at County landfills. We noted an unexpected decline in revenue from fiscal year 2009 to fiscal year 2010, a decline that was also noticed by the Office of Finance. DPW advised us and the Office of Finance that the County collected less scrap metal to sell, and that the sales prices had declined. However, upon further investigation, we determined that although the County sells scrap metal weekly, there was no revenue posted to the general ledger for three months, and \$300,000 received from February through May 2010 was never deposited into the County's bank account. DPW said they forwarded the receipts to the Office of Finance via inter-office mail. We contacted the vendor and determined that the checks were never cashed, and the Controller advised the vendor to stop payment on the checks and reissue the checks directly to the Office of Finance.

We recommend that the Office of Finance implement procedures to ensure the safe custody and timely deposit of all cash receipts. We recommend that the Office of Finance document the procedures used by each department to process cash receipts and assess the risks of misappropriation or untimely processing. Further, we recommend that management within the departments and within the Office of Finance monitor cash receipts monthly and pursue the reasons for unexpected or unusual declines.

#### ***Management's Response:***

***DPW and the Office of Finance have met and changed the procedures for depositing scrap metal collection. The armored car service which transports the receipts from the scale house will also transport all other receipts accepted/received at the Administration Building. DPW management will verify that the collections are deposited when received. The Office of Finance will also continue to monitor this area to ensure that deposits are made each month. As of March 11, 2011, the Office of Finance has deposited \$167,663.72. The restructuring of duties previously mentioned will consider this area as part of this process.***

#### ***Landfill Closure and Postclosure Liabilities***

DPW is responsible for calculating the estimated liability for the landfill closure and postclosure costs, estimated at \$114 million. The Office of Finance reviews the calculations before recording the liabilities in the general ledger. In our audit we found errors in the department's methodology and several clerical errors in the calculations that neither DPW nor the Office of Finance found. Consequently, postclosure liabilities were overstated by \$290,000, and closure liabilities were understated by \$150,000. Similar errors have been found in the last five years' audits.

We recommend that the Office of Finance and DPW staff work together to ensure they understand the methodology used to calculate the liabilities. Further, we recommend that both departments implement review procedures to minimize errors.

**Management's Response:**

***DPW and the Office of Finance are meeting to establish a written methodology to ensure accurate calculations of both landfill closure and postclosure costs and that an adequate review process exists.***

**DEPARTMENT OF PUBLIC WORKS - UTILITIES**

***Calculations of Deferred Revenue, Revenue, and Related Receivables from Front Foot Assessments and Capital Facility Connection Charges***

DPW and the Office of Finance work together to determine revenue, deferred revenue, and the related receivables from allocations for water and sewer capacity and front foot petition projects. We found multiple errors in the calculations by both departments, resulting in a net \$798,500 overstatement of revenue, \$3,896,500 overstatement of deferred revenue, and \$4,695,000 overstatement of noncurrent receivables. The errors we found were:

- DPW understated revenue by \$367,500 related to capital facility reservation and deferral fees for a project that received sketch plan approval in fiscal year 2010.
- DPW overstated deferred revenue from capital facility connection fees by \$415,000 for a project that had not yet entered into a utility agreement.
- DPW used the wrong number of wastewater equivalent dwelling units for one project, overstating deferred revenue from capital facility connection fees by \$758,000 and revenue from capital facility reservation and deferral fees by \$103,500.
- The Office of Finance overstated deferred revenue by \$362,500 and revenue by \$810,000 for a front foot project that was not released for service.
- The Office of Finance did not reduce deferred revenue by \$1,841,000 and revenue by \$252,000 for three properties sold at tax sale.
- The Office of Finance did not reduce noncurrent receivables and deferred revenue by \$520,000 for capital facility connection fees whose collection is doubtful because the developer is in bankruptcy.

Errors have been also noted in prior years related to the calculations of revenue, deferred revenue, and the related receivables from front foot assessments and allocations. Management does not adequately review the staff's work, and the two departments do not effectively communicate with each other to ensure the final amounts are correct. We recommend that the departments establish written procedures to follow in preparing their calculations, including review checklists to help ensure the calculations are accurate. We again recommend that the two departments work together to ensure the transactions are accurate and reported on the financial statements in accordance with GAAP.

**Management's Response:**

***DPW Utilities works with 2,000 allocated accounts. Management reviews the year-end reports several times to ensure that the reports are as accurate as can be. The above finding identified three clerical mistakes by DPW. Much of the updating of information is manual. The allocation dates are typed in when we receive the paper letter of allocation. The utility agreement information is in a separate Oracle database that does not interface***

***with the allocation system. We review the agreement database, but the titles of the agreements do not always match the project names, and there are no project numbers in the Oracle database to assist with the matching. We then manually add the PWA or UA number to the UAS system. Catching changes to allocated units at final plat creates another challenge.***

***There are many data systems involved in the development process. MST, the major subdivision tracking system, is updated by P&Z and I&P. PIPS, the permit tracking system, is updated by I&P and Utilities; UAS, the Utility Allocation system, is updated by Utilities. The agreements database is updated by I&P. There are a number of other stand-alone spreadsheet systems. Some of the systems interface data at certain times but not at other times. Some systems do not communicate at all with the other systems. If the systems were interfaced, multiple entries of the same data would not have to occur and less human error would occur.***

***The Office of Finance will develop written procedures, including checklists, which will be used to verify the accuracy of this data. These procedures will also consider the functions performed by DPW and be provided to the auditors for review.***

#### ***Delinquent Utility Charges and Tax Sale***

The County Code requires management to collect utility charges that are delinquent on December 31 and remain unpaid via tax sale. We noted three errors related to properties with delinquent utility charges and tax sale. The three errors are described below:

#### ***Unauthorized Payment Plan***

DPW allowed a developer with delinquent allocation reservation charges to enter into a deferred payment arrangement that was not authorized in the County Code. To prevent employees from unlawfully obligating the County, Section 405 of the County Charter requires the County Executive or his designee to execute all agreements, and § 526 requires the County Attorney to approve all agreements for legal form and sufficiency. The agreement DPW entered into was neither signed by the County Executive or his designee nor approved by the Office of Law for legal form and sufficiency.

At DPW's instruction, the Office of Finance removed the property from tax sale. Had the County collected the past due fees at tax sale, the County would have recovered \$500,000 in allocation reservation charges and \$1,100,000 of capital facility deferral fees. The developer is currently in default on the alternative payment arrangement.

#### ***Management's Response:***

***Anne Arundel County Code § 13-5-809(d) provides that in accordance with written policy of the Department of Public Works, the Office of Finance may establish payment plans for the payment of any usage charges, penalties, and turnoff fees. Allocation reservation charges were initially interpreted as usage charges. Accordingly, a payment plan for one project that had delinquent ARC fees was allowed by DPW that would otherwise go to tax sale. However, since it was determined that the ARC fees are not considered usage charges, this policy will be discontinued.***

Delinquent charges not collected at tax sale

When a property has delinquent allocation reservation charges, the unpaid balance of the allocation reservation charges plus capital facility deferral fees become immediately due and payable. During our audit, we found that the Office of Finance did not assess or collect \$158,000 of capital facility deferral fees that were due and payable at tax sale. Both DPW and the Office of Finance advised us that they did not know they were supposed to collect these fees.

**Management's Response:**

***DPW and the Office of Finance met with the Office of Law to determine what the County Code would allow when a delinquent ARC account was put in tax sale. As a result of the inconsistency in the Code regarding the ARC fees, fees due at tax sale, and the lack of lapsing of the allocation, Bill No. 5-11 was drafted to clarify this situation.***

Errors in account information DPW provided to the Office of Finance

A developer was delinquent in paying allocation reservation charges on multiple properties with multiple tax account numbers. However, DPW set up the allocation reservation charges for the multiple accounts under only one tax account in the Utility Allocation System; therefore, the Office of Finance thought only one account was delinquent. According to DPW, when they discovered the error the day before tax sale, the Office of Law advised them to pull the property from tax sale because the capital facility deferral fees on the other accounts had not been included in the amounts to be collected. Consequently, the County did not collect \$27,000 of allocation reservation charges and \$62,600 of capital facility deferral fees at tax sale, and the developer is still in default.

We recommend that DPW and the Office of Finance work with the Office of Law to ensure that they understand the requirements of the County Code. DPW should not enter into alternative payment arrangements not permitted by the County Code, and the Controller, not DPW, should determine whether delinquent accounts should be collected at tax sale.

To ensure the completeness of tax accounts with utility charges, DPW should enter properties into the Utility Allocation System (UAS) under their individual tax account numbers, and they should review the data they already entered into the UAS to ensure that no other multiple tax accounts were entered under only one tax account number.

**Management's Response:**

***As a temporary solution for ARC fees assigned to one tax account, the delinquent ARC fees will be allocated equally among each property account for the tax sale in 2011. In the future, DPW will advise the Office of Finance of any tax accounts associated with an allocation so that they may bill each account as deemed appropriate.***

## OFFICE OF PERSONNEL

### ***Other Post-employment Benefits (OPEB)***

The Office of Personnel compiles and provides to the Office of Finance the amounts paid for retiree medical expenses and the prescription rebates received that offset those costs. The Office of Finance uses these amounts to determine the increase in the County's net OPEB obligation.

During fiscal year 2010, the Office of Finance discovered errors in the data provided in fiscal year 2009, so they worked with the Office of Personnel to determine the correct amounts for both fiscal years 2009 and 2010. When the Office of Finance subsequently provided the information to us, we found errors in both the revised fiscal year 2009 amounts and in the fiscal year 2010 amounts.

The Office of Personnel also provides census data to the County's actuary that the actuary uses to determine the County's OPEB obligations. During our audit, we noted two errors in the census data provided to the County's actuary to calculate OPEB liabilities.

We recommend that the Office of Personnel and the Office of Finance work together to ensure they understand what source documents are needed to compile the appropriate data, how to group expense and rebate data by retiree group, and how to derive accurate calculations of the employers' contributions for other post-employment benefits. We also recommend that the Office of Finance implement procedures to review the data provided by the Office of Personnel for accuracy and reasonableness. Finally, we recommend that the Office of Personnel implement review and reconciliation procedures to ensure the data provided to the actuary is accurate.

### ***Management's Response:***

***The Office of Personnel began tracking retiree data in 2008 as a result of the implementation of GASB 45. This process involved pulling vendor payment data and separating it by active employees and retirees and then by Library, College, and County government. In 2009, the billing process was changed from self-bill billing to paying claims weekly. This reporting has continued to evolve throughout the years as we perfect the reporting process and work with vendors to receive appropriate summary data. At present this is a manual process that needs to be modified so that the vendors can supply the data in consistent format. The Office of Personnel and the Office of Finance will meet to compile source documents needed and share this process with the County auditor.***

***Regarding the census data, when the data was pulled it did not include anyone with benefit changes during that month. The Office of Personnel contacted the County's actuary and were advised that this was immaterial and would not change the outcome. The Office of Personnel will manually enter any employees that make changes during the month the report is pulled each year.***

## OFFICE OF CENTRAL SERVICES - INVENTORY

Article 8, § 2-101 of the county Code requires the Central Services Officer or his designee to prepare inventory procedures to be observed by County agencies, including periodic physical inventory counts. We went to eight locations to observe the year-end inventory counts and test the departments' inventory procedures. The results of our test procedures included the following:

- At two DPW locations, supervisors did not provide written inventory instructions or review the instructions with the individuals counting the inventory. At one of the two locations, the employee performing the count did not use inventory tags or the CASSWORKS inventory system as specified in the instructions.
- At four DPW and one Central Garage location, the employees counting the inventory regularly have access to the inventory, which would allow the employees to both perpetrate and conceal errors or irregularities in inventory.
- At six DPW locations, the employees' inventory counts were not correct for 27 of 190 (14%) items counted, including one item improperly excluded from inventory valued at \$284,000. The other 26 errors were less than \$5,000 in total.

We recommend that the Central Services Officer review the County's inventory procedures and ensure the departments responsible for counting inventory and reconciling the inventory records understand and comply with the procedures. The procedures should segregate duties so that employees who have access to the inventory are prohibited from performing the inventory counts.

### ***Management's Response:***

***The Office of Central Services agrees with the auditors' findings and will work closely with all County Department to be in compliance with the annual inventory requirements in Article 8 of the County Code. Specifically the Office will ensure that personnel performing the inventory count not have regular daily access to the inventory, and that all personnel involved are fully advised and review inventory policy and procedures prior to the actual inventory being initiated.***

## OFFICE OF PLANNING AND ZONING – IMPACT FEE CALCULATIONS

In previous audits errors were identified in the calculations of impact fees, and recommendations were made that the Office of Planning and Zoning implement review procedures to ensure the calculations are accurate and that they document their reviews. While the department advised us that they have implemented review procedures, their reviews are not documented, and we again found errors. In our sample of 40 permits, the Office used the wrong square footage for three permits, and they used the wrong impact fee rates for three permits. Consequently, they assessed \$119,000 more in impact fees than they should have.

We also noted errors in the impact fees collected by the City of Annapolis and remitted to the County for residential development within the City limits. The County accepts the fees from the City without reviewing the related permit information or the City's calculation of the fees collected. In fiscal year 2010, the City assessed \$13,700 of impact fees on four permits. We

reviewed the calculations and determined the City assessed \$4,200 (31%) more than was proper.

Finally, we noted that the Office of Planning and Zoning does not have a consistent policy on how to calculate impact fees when there is a change in use or an improvement that requires the payment of impact fees. Section 17-11-203(b) of the County Code requires an applicant to pay impact fees on the net increase in impacts attributable to a change of use or improvement. The increase is calculated by subtracting the impact fees attributable to the previously existing use or improvement from the impact fees attributable to the new use or improvement. During our audit, three of the 40 applications we tested were for a change of use or improvement, and the Office calculated the net increase in three different ways.

- For one permit, the Office subtracted the fees for the previous use *using the rates in effect when the original permit was applied for* from the fees on the new use *using the rates in effect when the original permit was applied for*, not the current rates.
- For a second permit, the Office subtracted the fees for the previous use *using the rates in effect one year after the original permit was applied for* from the fees on the new use *using the current rates*.
- In the third instance, the Office subtracted the fees for the previous use *using the current rates* from the fees on the new use *using the current rates*, even though no impact fees were paid on the original application.

We again recommend that the Office of Planning and Zoning implement review procedures to ensure the staff is calculating impact fees to be assessed accurately. The Office should also review the City's impact fee calculations for accuracy. These reviews should be documented. We also recommend that the Office adopt a consistent policy with respect to calculating the impact fees due when there is a change in use or improvement, seeking advice from the Office of Law to interpret the County Code provisions if necessary.

***Management's Response:***

***The Office of Planning and Zoning has in place procedures and policies that are designed to enhance the accuracy of impact fee calculations. These policies and procedures are established in writing in the Office's Policy and Procedures Manual with which all reviewers must comply. Human error does occur, and through the hierarchy of review, the Office will pursue all due diligence to ensure the accuracy of impact fees calculated. Much of the issue of the discrepancies with the City of Annapolis centered on the city not having the most current fee rates and criteria for impact fee calculations that the county has adopted. The Office has now established a procedure whereby the City of Annapolis will automatically received updates when the fee rates change.***