

CITY OF BALTIMORE

STEPHANIE RAWLINGS-BLAKE, Mayor



DEPARTMENT OF AUDITS

ROBERT L. McCARTY, JR., CPA
City Auditor
100 N. Holliday Street
Room 321, City Hall
Baltimore, Maryland 21202
Telephone: 410-396-4783
Telefax: 410-545-3961

AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

December 3, 2015

Honorable Joan M. Pratt, Comptroller
And Other Members of the Board of Estimates
Henry Raymond, Director of Finance
City of Baltimore, Maryland

We have audited in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statement of governmental activities and the business type activities of the Department of Finance of the City of Baltimore, Maryland, as of and for the years ending June 30, 2010 through June 30, 2013, and the related notes to the financial statements, which collectively comprise the Department of Finance's basic financial statements, and have issued our report thereon dated December 3, 2015.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department of Finance's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Department of Finance's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department of Finance's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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. We consider the deficiency described below to be a material weakness.

Finding 1 - Lack of Controls over Financial Statement Preparation:

The Department of Finance did not initially provide accurate financial statements of the financial activity of the Department of Finance for fiscal years 2010, 2011, 2012 and 2013. During our review of the financial statements and related notes provided, we noted that the Department of Finance made numerous errors in misclassifications and footings.

The City operates on a cash receipt and disbursement basis of accounting during the year. At year-end, the City's Bureau of Accounting and Payroll Services is responsible for the manual compilation of the City-wide financial statements and agency statements in accordance with generally accepted accounting principles (GAAP). The financial statements are manually prepared using the CAFR report and the CityDynamics accounting system. Adequate controls were not in place and operating effectively over management review and reconciliation of financial statement information and preparation. Management relied on the audit process to identify and propose corrections to the financial statements.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City's financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City. Due to the manual processes used to compile financial statement information, material misstatements to the financial statements could go undetected.

Recommendation

We recommend that the Department of Finance refine the process used to complete the draft financial statements and the related notes. We further recommend that these items be timely prepared and reviewed by management. The review process should include an evaluation of the reasonableness of the financial statement line items by an individual with sufficient accounting and financial reporting experience and knowledge of the processes to detect and correct material inconsistencies and errors.

Department of Finance's Response:

The Department of Finance agrees that the preliminary financial statement submitted to the auditor for review contained some footing errors. Much of this was caused by a combination of our desire to provide information to the auditor quickly and the lack of adequate staffing to support the quadrennial audit program. As a result the Department of Finance has added staff and increased supervisory review to reduce inconsistency and errors.

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 deficiencies described below to be significant deficiencies.

Finding 2 – Lack of Controls over Payroll Account Charges:

The City's payroll account per the general ledger included third-party vendor purchase orders totaling \$382,435. These purchase orders should be charged to the City's account number

designated for contractual services instead of the City's payroll account. The Department of Audits performed testing to determine whether appropriate internal controls are functioning as documented and that time and attendance expenditures as recorded in the City's payroll database agrees to records maintained by each Bureau of the Department of Finance and the detail general ledger.

The City's Department of Finance operates in a decentralized manner with respect to maintaining time and attendance reports for each of its five (5) Bureaus. The Bureau Chief is therefore responsible for maintaining and approving accurate time and attendance records for personnel assigned to their respective Bureaus. The Department of Finance stated that these vendors are paid using payroll funds approved under the Ordinance of Estimates and should therefore be included as part of the payroll account.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City's financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City. Without adequate controls to routinely reconcile payroll and the use of the City's designated accounts, material errors could go undetected.

Recommendation

We recommend individuals working through staffing companies be charged on the City's accounts as contractual workers, not as temporary employees. Payments to third party staffing companies should not have been charged to payroll accounts.

Department of Finance's Response:

The Department of Finance agrees with the recommendation. The Department occasionally hires temporary accounting staff to meet staffing demand during busy periods. Finance chose to charge these contractual employees to a salary account. Payments for future temporary employees with a contract will be charged to contractual services. We disagree however that this finding represents a significant control deficiency. While these charges are not generated by the payroll system they are easily identified and included in any reconciliation.

Finding 3 – Lack of Controls over Payroll Documentation:

The Bureaus within the Department of Finance did not consistently adhere to the policies and procedures established by the City for the recorded time and attendance in the Enterprise E-Time System (E-time), related payroll attendance records and required supporting documentation. In several instances we could not trace the employees' time as posted to the E-Time System to the underlying supporting documentation. We noted several instances where leave posted to E-time was not supported by daily sign-in sheets and/or approved leave requests.

As part of our testing of time and attendance records, we compared these records to E-Time and found:

- 1) 92 of the employees tested (59 for fiscal year 2012 and 33 for fiscal year 2013) did not have leave or compensatory time slips on file,

- 2) 58 of the employees tested (29 for fiscal year 2012 and 29 fiscal year 2013) did not consistently sign-in and/or sign-out each day,
- 3) Leave for 21 employees tested (8 for fiscal year 2012 and 13 for fiscal year 2013) per E-time did not consistently agree to the approved leave slips, and
- 4) Leave per E-time for 6 employees tested (2 for fiscal year 2012 and 4 for fiscal year 2013) did not agree to the paystubs.

The Bureaus within the Department of Finance did not consistently maintain records that documented the employees' daily attendance and could not provide approved leave, or compensatory time and overtime earned slips to support time and attendance as recorded in E-Time. Due to historical edits, it was difficult to trace leave used, compensatory time earned and used, and overtime without the approved supporting documents listed above, to the E-Time system.

The Bureau of Revenue Collections maintained only the current year payroll records and were therefore not included in the above testing.

The City's payroll Administrative Policy (as recorded in the Administrative Manual) does not include documentation of the current payroll system (E-Time). The City's Administrative Manual, Section AM-205-10 states that "All agencies must install a positive timekeeping system for each payroll section under their supervision. A positive timekeeping system includes a contemporaneously maintained individual time record." The lack of adequate controls over payroll attendance can create the opportunity for abuse and unsubstantiated earning and usage of leave.

Recommendation

We recommend that the Department of Finance create consistent policies and procedures for all Bureaus and maintain supporting documents for the payroll leave and approved compensatory time and overtime for at least a four year period. We also recommend the updating of the payroll section of the Administrative Manual to incorporate E-time.

Department of Finance's Response

The Department of Finance agrees with the recommendations. However, the Department believes that data entered into the Enterprise E-Time system, and subsequently approved by the supervisor, was correct and this source is the official approved payroll record. Further we do not believe, and there was no evidence to suggest, that employees took leave while having time recorded as being at work. For example, leave requests and approvals were often done via email. Finance does agree that there is room for improvement in regard to standardized policies, leave documentation and sign in sheets. Going forward we shall implement standardized policies at each Bureau as recommended by the auditor to include the recordation and retention of sign in sheets and leave slips.

Finding 4 - Lack of Controls over Journal Entries:

As noted in Finding 1 above, the City's financial reporting process is heavily reliant on the recording of various manual adjustments. We noted significant deficiencies in the posting of manual journal entries as part of the Department of Finance's financial statements.

During our review of fiscal year 2010 through fiscal year 2013 Department of Finance year-end journal entries, we noted expenditures were transferred from the Special Fund accounts (Bureau of Purchases, Surplus Property and Bureau of Revenue Collections, Inspections) to the General Fund. However revenue accounts for the Special Fund transactions were not readily available and these accounts were designed to be self-supporting.

During our testing of year-end accounts payable transactions, we noted that the June 30th transactions per the agency report do not agree to the June 30th transactions per the general ledger. Year-end accounts payable transactions are manually entered into the system. As proper controls do not exist over journal entries, material misstatements to the general ledger could go undetected.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City's financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City.

Recommendation

We recommend that the Department of Finance take appropriate action to ensure that journal entries with the supporting documentation are appropriately reviewed and approved prior to posting into the City's general ledger system. We also recommend that the Department of Finance request funding for the Bureau of Purchases, Surplus Property and Bureau of Revenue Collections, Inspections expenditures.

Department of Finance Response:

The Department of Finance agrees the Special Funds in question are to be self-supporting. However, during the period under review neither of the two revenues funds matched expenditures. Accordingly, the deficits can only be written off to the general fund. This is what ultimately occurred. The Department of Finance has taken steps to improve the financial position of each of the service funds and believes that going forward these funds will not have material operating deficits.

The Department of Finance agrees that supporting documentation should be reviewed prior to being posted to the general ledger. However, in regard to the finding that certain agency payable transactions did not agree with general ledger, the Department believes these items were in support of the restatement of the 2010 Comprehensive Annual Financial Report. These adjustments were needed to align the beginning balances in 2011 with the restated 2010 ending balances. The journal entries were done with the approval of the Department of Audits, Ernst & Young and KPMG. The details of these transactions are incorporated in the external auditor's work papers.

Finding 5 - Lack of Controls over Capital Projects Awards:

The Department of Audits was unable to obtain all Board of Estimates approval for an appropriation to Capital Projects of \$10,000,000 for Project Number 901033. The total project's award, which included several purchase orders and general ledger account numbers, appear to be

\$10,767,408. The only available Board of Estimates' approval for Project Number 901033 was \$5,441,471.

There is several account numbers (using both general fund account numbers and capital project account numbers) used when posting transactions to the detail general ledger for the Department of Finance's General Ledger system. Without supporting documents (such as all Board of Estimates' approvals and Purchase Orders), it is difficult to ascertain what appropriations were approved for this system. In past years, this account was used for software created by the City. Most software now used is acquired under licenses from the vendor and are therefore not capitalized.

Due to the process used to compile the financial statements, material misstatements to agency financial statements could go undetected.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City's financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City.

Recommendation

We recommend that the Department of Finance provide adequate documentation and reconciliations that supports transactions posted to the general ledger at the agency level for Project Number 901033.

Department of Finance Response:

The Department of Finance disagrees with this finding. The Department was unable to locate the \$10 million Board of Estimates transfer letter moving this general ledger funding from the general capital reserve account to project number 901033. However, we did provide the auditor with 2007 and 2008 Ordinance of Estimates general ledger appropriation documentation for the \$10 million and an October 2007 Board of Estimates approved general ledger (project number 901033) contract award for \$5.4 million. In addition, the Board has subsequently approved two general ledger (project number 901033) contracts in March 2015 and October 2015 totaling \$2.7 million. Finance intends to seek Board approval for the remaining \$1.9 million to complete the general ledger upgrade in the near future.

Department of Audits Response:

Appropriations were transferred to the Capital Projects account for this project in July 2007. We were not provided any further Board of Estimates' approvals under the Capital Projects account after the initial award of \$5,441,471.

Finding 6 - Lack of Controls over Internal Service Fund Balances:

The Internal Service Fund balance for Reproduction and Printing increased from a deficit \$5,333,443, as of fiscal year ending June 30, 2010, to a deficit \$7,167,165 as of fiscal year ending June 30, 2013.

<u>Beginning of Fiscal Year</u>	<u>Amount</u>	<u>End of Fiscal Year</u>	<u>Amount</u>	<u>Increase (Decrease)</u>
July 2009	\$(4,511,677)	June 2010	\$(5,333,443)	\$821,766
July 2010	(5,333,443)	June 2011	(6,628,338)	1,294,895
July 2011	(6,628,338)	June 2012	(7,164,344)	536,006
July 2012	(7,164,344)	June 2013	(7,167,165)	2,821

Although the deficit only increased by \$2,821 between fiscal year 2012 and fiscal year 2013, the deficit from prior years remain in the Internal Service Fund, therefore increasing the total deficit to \$7,167,165. It appears that controls are not adequately designed and operating effectively to ensure that service fees or contributions from other funds adequately support this fund. Due to the process used to compile the financial statements and the reliance of the City-Wide CAFR testing, material misstatements to agency financial statements could go undetected.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City’s financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City.

Recommendation

We recommend the Department of Finance properly allocate the deficit for the Internal Service Fund balance for Reproduction and Printing and review all fees for services provided.

Department of Finance’s Response:

The Department of Finance agrees with this finding. During fiscal year 2012, the Department restructured this service fund by reducing costs and improving certain efficiencies. This is reflected in a much improved FY2013 performance. The Department will continue to monitor the Reproduction and Printing service to ensure material deficits are not repeated. The Department anticipates funding the deficit with future operating surpluses and/or a phased pay down with future budget appropriations.

Finding 7 - Lack of Controls over Payroll Cost Allocation:

As part of our test of payroll, we noted that one employee assigned to the Loan and Guarantee (L&G) program, was also assigned to the City’s Capital Projects Fund and to the Comprehensive Annual Financial Report; however, 100% of their time was charged to the L&G program. A journal entry was not created at the end of the fiscal year to redistribute payroll to the various proper programs. Expenditures for the L&G program were therefore overstated each year.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City’s financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City.

Recommendation

We recommend that the Department of Finance allocate all employees' time to the proper account numbers for the actual projects worked.

Department of Finance's Response:

The Department of Finance will evaluate the above finding when the fiscal year 2017 budget is prepared.

Finding 8 - Lack of Controls over Transactions Posted to the Contractual Services Account:

During our review of transactions for contractual services for the period of fiscal year 2010 through fiscal year 2013, we found several transactions posted to the general ledger account for contractual services that were: (1) not posted correctly, (2) not made to the correct projects, and/or (3) the project was not related to the services rendered, as noted below.

1. 133 instances were posted to an incorrect expenditure account classification.

FY2010	11 instances
FY2011	27 instances
FY2012	57 instances
FY2013	38 instances

2. 96 of the 133 instances did not appear to be contractual services.

As established by the Baltimore City Charter, Article VII, Section 11(a), the Department of Finance shall keep all general accounts of the City, prepare the City's financial statements, and maintain an adequate system of accounting that, at all times, reflect the actual financial condition of the City.

Recommendation

We recommend that the Department of Finance review and obtain support for all transactions posted to contractual services, and ensure posting to the proper expenditure account classification.

Department of Finance's Response:

The Department of Finance agrees with this finding. The Department asserts that all the expenditures were appropriately authorized and procured. However, the expenditures cited by the auditor appear to be posted incorrectly. The Department shall instruct our staff to give closer attention to posting of such expenditures and ensure they are charged to the proper account classification.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of Finance's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and other agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However,

providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Department of Finance's responses to the findings identified in our audit are described above. We did not audit the Department of Finance's responses and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Robert L. McCarty, Jr.", is positioned above the printed name.

Robert L. McCarty, Jr., CPA
City Auditor