HARFORD COUNTY, MARYLAND
Office of the County Auditor

April 19, 2013

Board of Directors
Harford Center, Inc.
4 N. Earlton Rd.
Havre de Grace, MD 21078

Dear Board Members:

In accordance with Section 214 of the Harford County Charter, we have performed an audit of the accounts under the direction of the Harford Center's recently separated Executive Director. The results of that audit, our findings and recommendations for improvement are detailed in the attached report. We would like to thank the members of management for their cooperation during the audit.

The audit found significant internal control matters that should be addressed. In particular, developing standard policies and procedures for administration is critical to ensure continuity of operations. Further, improvements in record keeping will help ensure the Center's stakeholders that the Center can meet its financial and compliance obligations.

We are concerned that the Harford Center does not maintain a copy of its financial records on-site. The bookkeeping is performed by an external bookkeeper, who also maintains the electronic accounting file. Consequently, the Center does not have immediate access to review its financial results and position. This is information that should be considered in the Center's budget process and analyzed for presentation to the Board of Directors.

While there are key processes that need to be redesigned, this period of transition may prove to be an opportunity for Harford Center to also develop new processes that will improve the Center's control over its financial resources. The audit team is available to respond to any questions you have regarding the attached report.

Sincerely,

Chrystal Brooks, CPA

Chrystal Brooks, CPA, CGFM, CIA, CISA, CGAP
County Auditor

cc: Members of the Harford County Council
Mr. David Craig, County Executive
Dr. Gerald Horn, Acting Executive Director, Harford Center, Inc.

HARFORD COUNTY, MARYLAND
Office of the County Auditor

SECTION 214 REVIEW - HARFORD CENTER, INC.

Period Covered:
07/01/2008 through 03/31/2013

Report Number: 2013-A-03

Date Issued:
04/19/2013

Audit Team:

Chrystal Brooks, CPA, CIA, CGAP, CISA, CGFM
County Auditor

Laura Tucholski, CPA, CFE
Auditor

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BACKGROUND INFORMATION

INTRODUCTION AND KEY STATISTICS

Harford Center provides day care services to approximately 120 adults with disabilities in Harford County. The not-for-profit organization is run under the oversight of a Board of Directors; while day-to-day management is the responsibility of the Executive Director. The Center is funded by the State of Maryland, Harford County and donations. Its annual expenses are approximately $2 million.

Rosemarie Lane worked for Harford Center for more than 30 years. As the Executive Director she supervised and coordinated the work of the Center, including financial management, administration and operations. Prior to Ms. Lane's separation, the Board of Directors hired a consultant to serve as Transition Coordinator. The Transition Coordinator, Dr. Gerald Horn, is currently serving as Acting Executive Director. During this period of transition, the Board and Acting Director determined that they would need assistance to determine if the Center's financial operations are in order. At the request of the Chairman of the Board of Directors, and at the discretion of the County Auditor, this project was deemed necessary and appropriate.

REVIEW OBJECTIVE, SCOPE AND METHODOLOGY

Per the Charter of Harford County, section 214, "upon the death, resignation or removal of any County officer, the County Auditor shall cause an audit and investigation to be made of any accounts maintained by the officer and by the agency The County Auditor shall report the results of this audit to the County Executive and the Council, and copies shall be made available to the public no later than three months after the ordering of the audit." In accordance with the Charter, the audit objective was to determine if all funds under the control of the Executive Director of the Harford Center (the Center) were appropriately managed and the Director's obligations were met. The scope was limited to the financial operations of Harford Center, Inc.

The audit focused on activity during the period of 07/01/2008 through 03/31/2013. Our audit procedures included interviewing personnel, observation and testing. Specifically, we sought to confirm that the accounts under Ms. Lane's control did not have unusual or inappropriate costs, Ms. Lane's physical and financial access to Harford Center resources had been revoked and that appropriate controls were in place to ensure that the Harford Center's resources were adequately protected. There may be operational compliance issues (such as licensing or DDA reporting) that, if not corrected, would have a longer term financial impact; however, operational deficiencies were beyond the scope of this review.

The audit was performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

REVIEW RESULTS

Harford Center's management is responsible for establishing and maintaining effective internal controls. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets and compliance with applicable laws, rules and regulations are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected.

We reviewed the accounting for Harford Center's 401K Plan to determine how much money needs to be contributed to the plan. Our review of the 401K Summary Plan Description, Board Minutes and accounting records indicated that the intent of the Board designated 401K contributions were unclear. The minutes do not indicate whether contributions were designed to meet the budgeted expenses or to be bonuses, above the budgeted expenses.

The Board's intentions for Ms. Lane's compensation were also unclear. She received health insurance benefits, but did not pay the employee portion of the premiums. Further, Ms. Lane had a cellular phone that was paid for by the Center. We noted the phone logs indicated significant use outside of Harford Center business hours. The Board will need to determine if this was an acceptable practice.

With regard to transactions that were approved or initiated by Ms. Lane, our procedures disclosed that Ms. Lane was unilaterally responsible for managing the Center's day-to-day finances, with little assistance from others within the organization. Consequently, her successors have had difficulty understanding Ms. Lane's processes and systems. Some documents we requested were unavailable for our review.

We found that Ms. Lane initiated nearly all check payments and most other transactions as well. We identified some problems with the accounting for petty cash.

At the Center, the Director kept track of transactions manually. However, each month, the bookkeeping for these transactions was performed by an accounting firm, Stegman and Company. The accounting firm recorded transactions as Ms. Lane determined they should be recorded, created accounting entries for payroll, performed account reconciliations and recommended adjusting transactions, as needed. The Director did not maintain a copy of the Center's accounting data on site, nor did she have access to such information. Monthly, the accounting firm would compile and provide financial statements to the Harford Center. Stegman and Company is also Harford Center's Financial Statement Auditor. This relationship with Stegman as auditor and bookkeeper is allowable under the American Institute of Certified Public Accountants (AICPA) independence guidelines, but is not ideal.

We were advised that Ms. Lane's signatory access has been removed from all Harford Center bank accounts. We additionally observed that Ms. Lane's purchase cards were returned and were advised that some of the accounts have been disabled.

We confirmed that the Center's alarm codes and Director's Office locks have been changed. However, Ms. Lane's facility keys have not been returned to Harford Center officials.

We confirmed that Ms. Lane's logical access to the Harford Center network has been disabled; however, her email address is not owned by Harford Center, so it can't be disabled by the Center staff. Likewise, all of the other Harford Center employees use external email addresses, such as AOL or Yahoo accounts, that cannot be controlled or monitored by the Harford Center.

Our conclusion, based on the evidence obtained, is that there are some deficiencies in internal controls. Except for the health insurance and cell phone matters noted above, Ms. Lane does not have any indebtedness to Harford Center.

Areas for improvement are described in greater detail in the Findings and Recommendations section of this report. Management has been advised of these audit results; their general response is below.

MANAGEMENT RESPONSE

Internal controls at the Harford Center have been strengthened. We met with bank officials, updated signature cards and emphasized our requirement of two signatures on all checks. The newly appointed Financial Assistant and Human Resources Assistant have been trained and are fully engaged in their respective areas. Plans are underway to improve communication between the Center, our Board and our accounting firm. We are in the process of improving the security of our center related email system and client files. We have expanded the responsibilities of our payroll processing vendor and will seek Board input to make our 401K plan more equitable. Details regarding the changes noted above are included in the individual responses that follow.

FINDINGS AND RECOMMENDATIONS

Finding Number: 2013-A-03.01 Retirement Plan Contributions

Liability for 401K contributions may be incorrect.

Analysis: The Harford Center's FY2012 financial statements include Accounts Payable which primarily consisted of $40,000 due to the employee 401K plan. For each of the last 4 years, 2009, 2010, 2011 and 2012, the Center has recognized a $10,000 expense for employer contributions, but has not made a related deposit. Each year, however, the Harford Center budget included $10,000 for '401K Contributions – Board' and $10,000 for '401K Contributions – County'. This means that each year, the Center recorded only half of the 401K contributions it had budgeted.

We attempted to review the County's agreement with the Harford Center and could not determine that a contractual agreement existed. Consequently, it appears that the unrecorded 'County' contribution was not required by the County. The board must determine if it wants to record and pay this additional $40,000 in contributions, as budgeted, for fiscal years 2009 through 2012.

We reviewed the Board meeting minutes from 2007 through 2013 to determine if any 401K Contribution amounts had been designated by the Board. We noted several meetings that referenced the 401K plan and used that information to determine when the Board made actual designations of contributions as opposed to regular budget approvals. We calculated that the Harford Center's Accounts Payable related to the 401K accounts should be $60,625 based on only the Board Designations.

It is not clear, from the minutes, if the Board Designations were to be applied to the budgeted expense or to be considered additional expense. If the amounts are additional contributions, the Center would need to increase its Accounts Payable to $100,625. Further, if the Board decides to additionally pay the 'County' contributions, the related Accounts Payable would increase to $140,625. In any of the above scenarios, the Board will need to determine how to allocate the contributions between past and present plan participants.

Prior to beginning this project, Harford Center employees determined that some 2012 and 2013 employee withholdings had also not been forwarded to the Plan Administrator. Those amounts were paid, with lost earnings, prior to completion of this audit.

SUMMARY OF 401K BOARD APPROVALS

	2009	2010	2011	2012	**TOTAL**
Approved Budget					
County	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
Board	10,000	10,000	10,000	10,000	$ 40,000
Board Designations					$ -
Per 6/16/10 meeting, 5% of an employee's salary		20,625			$ 20,625
Per 6/15/11 meeting, compensation to program staff for a onetime bonus, with bonus for the 401K accounts.			40,000		$ 40,000
TOTAL BOARD APPROVED	**$ 20,000**	**$ 40,625**	**$ 60,000**	**$ 20,000**	**$ 140,625**
Recorded Expense and Payable	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 40,000
POTENTIAL OPTIONS					
All Amounts Approved	$ 20,000	$ 40,625	$ 60,000	$ 20,000	$ 140,625
Recorded Expenses plus Board Designations as bonuses	$ 10,000	$ 30,625	$ 50,000	$ 10,000	$ 100,625
Board Designations as Budgeted Expenses	$ -	$ 20,625	$ 40,000	$ -	$ 60,625

Recommendation: We recommend the Harford Center Board make an official designation of funds for 401K contributions annually. These amounts and detailed Board intentions should be reflected in the Board minutes.

Management Response: The recommendation is accepted and will be presented to the Board for their consideration. In addition, it is our intention to have a Financial Assistant begin keeping internal records and a log of disbursement of funds.

Expected Completion Date: 05/15/2013

Finding Number: 2013-A-03.02 Outsourced Bookkeeping

The Auditor's independence is threatened.

Analysis: The Harford Center's financial statement auditor also provides bookkeeping and monthly financial statement compilation services. The Harford Center sends lists of its transaction information to the Auditor for recording in an accounting system. Generally, Harford Center is responsible for determining the allocation of expenses and revenue and approving transactions for posting in the accounting system. However, Harford Center management does not have direct access to the financial records.

The relationship with Stegman as auditor and bookkeeper is allowable under the American Institute of Certified Public Accountants (AICPA) independence guidelines, but is not preferable. There are several requirements that must be met before these services may be performed. Among them, per the General Requirements for Performing Nonattest Services,

> “Before performing nonattest service, the member should determine that the client has agreed to: … Oversee the service, by designating an individual, preferably within senior management who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services."

We did confirm that the Director approved the engagement letter indicating that management had accepted the required responsibility for this engagement. However, we are not confident that Harford Center meets the requirement of sufficient knowledge to oversee the services being performed. The organization could develop this knowledge, by sending its Financial Assistant to a collegiate Introductory Accounting course or a similar course for small business owners.

Per the Generally Accepted Government Auditing Standards, this relationship creates a “Self-review threat - the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit”. Potential safeguards to the threat would be “having a professional staff member who was not a member of the audit team review the work performed” or “discussing independence issues with those charged with governance of the entity”. Based on discussion with some Board Members, it does not appear that the Board was fully aware of the potential independence issues. While the Harford Center is not a publicly traded company, it is worth noting that the SEC rules generally prohibit this relationship.

The Harford Center pays approximately $325 per month (or $3,575 per year) for the non-audit services. Harford Center's accounting is uncomplicated and similar to many small businesses; it is likely that the Harford Center could perform the bookkeeping services internally with limited additional training. The accounting software used by the auditor is widely, commercially distributed. By having a local version of its accounting records, Harford Center would have its financial information more readily available. Additionally, Harford Center may gain the ability to download banking and payroll transactions, automate some bill payments and standardize State, County and Client billing.

Recommendation: We recommend the Harford Center internalize its accounting activities to streamline transaction recordkeeping, bill payment and invoicing processes. Further, we recommend that the Board consider requiring a certain number of Board members to have a financial background.

Management Response: The Harford Center will purchase a copy of the accounting software used by the accounting firm. The financial assistant will begin keeping a set of accounting records that will be parallel to those the accounting firm keeps and their staff has agreed to help us in this endeavor. After the completion of our contract with the accounting firm, bookkeeping activities will remain in-house.

Expected Completion Date: 07/01/2013

Finding Number: 2013-A-03.03 Administrative Policies and Procedures

The Harford Center does not have documented administrative policies and procedures.

Analysis: One of the essential job functions of the Director is "Manage agency financial, budgetary and procurement functions." Currently, administrative functions are not detailed and consequently, during this period of transition, it is difficult for the new leadership to determine what events have taken place or to even locate some documents.

For example, we requested a list of all of the salary changes for our review period. We were only able to locate the changes from the current fiscal year and there was no supporting documentation for approval of the changes. Based on discussion with employees, we determined that the changes were based on position changes, not raises. However, this prevented us from confirming that older pay changes were made appropriately. Additionally, we were unable to locate supporting documents for two FY2011 transactions and payroll summary reports prior to FY2013. One of the 2013 transactions we reviewed was overpaid, but we could not find support to indicate that a credit was given by the vendor.

Each of the above matters could be addressed by developing standard procedures for documentation and record retention.

Recommendation: We recommend Harford Center develop administrative policies and procedures. Procedures should address, at a minimum, cash handling, invoicing, bill payment, accounting procedures, purchase card procedures, vending machine management, contractor agreements, employee reimbursements, cell phones, human resources change documentation, DDA compliance, document management and document retention requirements.

Management Response: There are policies and procedures for various areas that have been developed for the Harford Center. However, the policies and procedures are sometimes inconsistent, include varying amount of detail and are not held in one place or compiled into one document. Particular weaknesses are the policies and procedures for financial management. With guidance from the Board, a plan will be developed by June 30, 2013 and a comprehensive set of policies and procedures will be created by September 30, 2013. Once this is accomplished the policies and procedures will be made available to staff, as appropriate, for their work assignments and training opportunities will be provided.

Expected Completion Date: 09/30/2013

Finding Number: 2013-A-03.04 Petty Cash Accounting

Petty Cash accounting is incorrect.

Analysis: In a prior audit, the Board was advised of "several instances where checks were made payable to the executive director for expenses that were incurred on behalf of the Center by another employee. The excess cash from such transactions is typically kept in an envelope attached to the receipts." In the current audit, we found that this practice ended after the auditor's recommendation; however, it appears that petty cash is still accounted for incorrectly. Each month a check was written to petty cash for $100 and petty cash transactions were adjusted up or down to total $100 for the month. For the 4.5 years of receipts tested, this resulted in a net of approximately $160.00 being attributed to various expense accounts inappropriately. This amount is ultimately missing from Petty Cash. Over several years, this amount is immaterial; however, this practice represents a consistent error in accounting.

We counted the current petty cash and found that it currently includes $114.92. The amount exceeds the expected amount because amounts of cash have been found in the Director's office. Cash whose source could be identified was deposited in the bank and cash from undetermined sources was added to the petty cash fund.

Recommendation: We recommend petty cash only be replenished up to the amount of verifiable transactions and that the accounting reflect expenses actually incurred.

Management Response: Recommendation has been accepted and implemented effective April 1, 2013.

Expected Completion Date: 04/01/2013

Finding Number: 2013-A-03.05 Purchase Accounts

The Harford Center maintains purchase accounts with multiple stores and a PayPal account.

Analysis: From the U.S. Government Accounting Office publication GAO-03-678G, "The potential for fraudulent, improper, and abusive purchases in a purchase card program should be viewed by management as a risk of significant financial loss, possibly resulting in operational inefficiency and impairment of mission readiness."

The Harford Center has purchase card accounts with the Home Depot and Wal-Mart, in addition to a general Visa branded credit account. All of these accounts are used to purchase supplies and materials for the Center. As the number of purchase card programs and cardholders increases, the time required to adequately monitor the accounts also increases. The administrative burden, however, can be reduced by utilizing one consolidated purchase card program. Even if additional cardholders are required, the administration is simplified when one bank is paid instead of several.

We also identified a PayPal account associated with the Harford Center. We confirmed that the account had never been used and withdrawals can only be made to the Harford Center checking account.

Recommendation: We recommend management close store-specific credit accounts and exclusively use its Visa account whenever possible. We further recommend that the Harford Center immediately change the password and security questions for the PayPal account or close the account altogether.

Management Response: The PayPal account has been closed. By April 20, 2013 the Home Depot and Wal-Mart credit accounts will be closed. Our intention is to have one VISA account with cards assigned to specific individuals.

Expected Completion Date: 04/20/2013

Finding Number: 2013-A-03.06 Email Account and File Security

Email accounts and network file access are not appropriately secured.

Analysis: Email accounts for Harford Center employees are either Yahoo or AOL accounts. This is problematic because the Center has no control over these accounts. For example, the Center cannot control the complexity requirements for account passwords; it cannot disable an account that is no longer needed or monitor the activity of the account for proper use. There is some potential that confidential client information may be sent through unsecure means or that former employees may send emails that appear to be official Harford Center business. Currently, the Director's email account is active and is still used to communicate with her.

We also noted that all employees share a network drive for data storage. Network storage is an important tool to ensure data is properly backed up on a regular basis. However, the files and folders on the Harford Center's drive are accessible by all users. Confidential information, such as client files, should not be stored in a shared area.

Recommendation: We recommend the Harford Center centralize its email system on a domain that is unique to the organization. We further recommend management consider how to best segregate confidential information to those with a business need to know.

Management Response: We are seeking bids on a computer system server for the Harford Center. We have received bids from Dell and met with local computer consultants on April 11, 2013. We have explored the cost of and capabilities of using "cloud" based storage services as an alternative to a server. We continue to research to determine if we can password protect our current client folders on our existing network.

Expected Completion Date: 05/31/2013

Finding Number: 2013-A-03.07 Budget to Actual Analysis

Budget figures are not necessarily relevant when compared to actual results.

Analysis: We reviewed the budget and actual financial results for Harford Center for fiscal years 2009 through 2013. While the budget remained stable from year to year and actual results remained stable from year to year, the organization's results and budget varied significantly from one another.

Some budget categories that should be straightforward to estimate were not logically represented in the budget. As an example, payroll taxes are budgeted at approximately 10% of payroll costs instead of the legally mandated 7.65%. In another example, Harford Center identifies, as revenue, amounts that are paid by Harford County directly to the State, but does not include those amounts in its budget. Further, fundraising activities are not reflected in Harford Center's approved budget.

Without relevant data to use in its analysis, the Board may not make informed decisions about the Center's operations.

Recommendation: We recommend Harford Center review and revise its budget figures each year to ensure that its projections will be relevant. Additionally, Board members should consider the budget when analyzing the Center's financial results.

Management Response: As noted in an earlier response, the Harford Center will purchase the same software the accounting firm currently uses and begin keeping parallel financial records. We will seek input from the accounting firm regarding budget categories. This will allow for accurate, monthly reconciliation of financial records that will be made available to Board members. Monthly accounting and logical, consistent categories will simplify the annual projections.

Expected Completion Date: 05/31/2013

Finding Number: 2013-A-03.08 Director's Compensation

The Director received compensation above her regular salary.

Analysis: In our review of the Director's salary, we noted that her pay rate has remained consistent since 2011 and that the pay rate substantially agrees to other documentation of employee salaries. However, we noted that the Director was enrolled in the Center's health and vision insurance plans, but did not have premiums withheld from her pay. There is a standard amount withheld from other employees' pay for these benefits.

We also noted that the Director’s function required her to regularly attend the Board meetings and prepare documents for the meetings. However, she was also paid to record the meeting minutes. This is allowable under the Harford Center Bylaws; however, the Board Secretary function may be consistent with functions the Director ordinarily performs.

Finally, we reviewed phone records and confirmed that a Harford Center cell phone was assigned to Ms. Lane. The Board should determine what level of monthly service is appropriate and what level of personal cell phone use is permissible.

Recommendation: We recommend the Board consider whether the unpaid insurance premiums and phone charges were part of the Director's compensation and whether to discontinue phone accounts with high service costs. We additionally recommend the Board update the Director's position description to indicate specific tasks that must be accomplished for success and consider incorporating the role of Board Secretary into the position description.

Management Response: The recommendations are acknowledged. Management has provided detail to the Board Chairperson and will be available at the next Board Meeting on April 17, 2013 to provide information to the full board to facilitate decisions on these issues. There was no justification for expanded cell phone services. The two cell phone accounts noted above ($29.99 and $60.57) have been shut down and the cell phones returned to the Human Resources Assistant.

Expected Completion Date: 04/17/2013

Other completion dates will be determined based on Board action.

Auditor Note: We confirmed that service has been discontinued for both of the cellular accounts in question, as noted in the Management Response.