



HARFORD COUNTY, MARYLAND

Office of the County Auditor

May 30, 2014

Honorable Members of the County Council
Harford County, Maryland
212 S. Bond St., 2nd Floor
Bel Air, MD 21014

County Executive David Craig
Harford County, Maryland
220 S. Main St.
Bel Air, MD 21014

Dear Council Members and Mr. Craig:

In accordance with Section 213 of the Harford County Charter, we have performed an audit of Harford County's Debt Management Controls. 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.

We found that the controls are adequate to ensure all outstanding debt has been properly authorized, debt payments are made timely and that the County is compliant with its bond covenants. Further, we reviewed the County's debt management policy (as approved in Resolution 17-10) and confirmed that it reflects the County's current practices. However, we noted that some bond authorizations may be done through transfer requests, without clear documentation. This matter can be remediated by adding more detail to the County Council's meeting minutes.

The audit team is available to respond to any questions you have regarding the attached report.

Sincerely,

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

cc: Ms. Kathryn Hewitt, Treasurer
Ms. Pamela Meister, Council Administrator

~ Preserving Harford's past; promoting Harford's future ~





HARFORD COUNTY, MARYLAND
Office of the County Auditor

AUDIT OF DEBT MANAGEMENT CONTROLS

Period Covered:
07/01/2012 through 03/11/2014

Report Number: 2014-A-01

Date Issued:

05/30/2014

Audit Team:

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

Laura Tucholski, CPA, CFE, CRMA
Auditor

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BACKGROUND INFORMATION

INTRODUCTION

Each year, capital projects are approved by the County Council in the annual Capital Budget and Capital Improvement Plan. Typically, several projects will be financed with “Future Bonds”, as opposed to Pay-as-you-go (Paygo), Recordation or Transfer Tax or State funding. The County issues General Obligation bonds to finance general governmental projects such as libraries, schools, and public safety buildings. Bonds are also issued specifically for Water and Sewer projects. Water and Sewer bonds are issued on the full faith and credit of the County’s taxing authority, although they are paid from Water and Sewer fund income.

Generally, the County requires 4 legislative steps before bonds are issued. The steps are as follows:

1. Budget - Approval of Capital projects in the Annual Appropriation Ordinance
2. Authorization - Bill authorizing specific future debt financing for each project
3. Terms of Sale - Resolution approving the terms of the bond sale, including allocation of funds to specific projects being financed
4. Issuance - Resolution approving the sale of the bonds to a specific purchaser

Resolution 17-10 formally adopted the County’s Debt Management Policy. That document “provides guidelines for the issuance of bonds and other forms of indebtedness to finance capital improvements, equipment acquisition and other related services.” In accordance with the County Code and the Debt Management Policy, the County Treasurer is responsible for managing indebtedness. The Treasurer ensures the lowest cost of borrowing for the County by coordinating the timing, form and issuance process for the County’s borrowing and capital funding activities. The County uses Financial Advisors to assist in the debt issuance process. Debt obligations are

generally issued through a competitive sale with the contract being awarded to the bidder with the lowest true interest cost. It is the County's practice to conduct an annual bond sale. The amount borrowed is contingent upon capital project needs and the economic conditions of the bond market.

KEY STATISTICS

The County's outstanding debt as of June 30, 2013, was approximately \$580.5 million. Annual Debt Service is approximately \$70 million for fiscal year 2015. Debt Service includes the amounts necessary to pay the principal and the interest on outstanding indebtedness plus cost related to bond issuance, short-term financing, and lease financing.

This year, the County completed the sale of the Harford County, Maryland Consolidated Public Improvement Bonds, series 2014, which totaled \$40 million. Debt service for the new bonds will be approximately \$2.85 million for each of the next 20 years, with interest rates varying throughout the term.

REVIEW OBJECTIVE, SCOPE AND METHODOLOGY

The objective of this review was to ensure that Harford County has adequate controls in place to ensure all outstanding debt has been properly authorized, debt payments are made timely and that the County is compliant with its bond covenants. The scope of this review was limited to controls over debt payments and ensuring debt issued was actually authorized by legislation.

The audit focused on bonds outstanding as of March 2014 and payment activity during the period of 07/01/2012 through 03/11/2014. Our audit procedures included interviewing personnel, observation and testing. Specifically, we met with individuals within the Department of Treasury to gather an understanding of the processes for managing the debt issued by the County. Based on our understanding of the processes, we performed tests to ensure all outstanding debt was properly authorized for each capital project financed. In addition, we tested the debt service payments to ensure they were in accordance with the bond covenants.

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 County 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.

Our testing disclosed that one bond sale (Terms of Sale and Issuance) included more debt than the Authorization bills for 3 capital projects. However, those projects were related to school building construction. State law allows transfers between major categories or unexpended projects, subject to the approval of the County Council. We are satisfied that the additional funding for each project was approved by the County Council through budget transfers requested by the Board of Education.

While we were able to piece together the transfers from the County Council meeting minutes, the level of detail provided was inconsistent and the written requests were not maintained with the minutes, making it difficult to determine the specific projects involved. When we reviewed the County Council minutes for more recent meetings, we found that budget transfers did not include project names or specific amounts that were approved. The three projects in question were identified in our testing because they would have been over-bonded without the transfers; there are likely other projects with bonding authority that was transferred in this way. Additionally, Harford Community College may also have similarly situated projects. To ensure the County Council's intent is clearly documented, we recommend the Council approve budget transfers between bond-financed capital projects via resolution or ensure the meeting minutes include specific project names, numbers and transfer amounts.

We noted that the Treasurer's procedures are sufficiently designed to ensure that payments are made properly, and timely. In our opinion, based on the evidence reviewed, adequate controls are in place to ensure debt issues are authorized and payments are made in accordance with the bond covenants.

Since there are no control deficiencies to report, a management response is not required. However, management was provided an opportunity to respond to this report. The responses provided are below.

MANAGEMENT RESPONSES

From County Treasurer, Kathryn Hewitt:

Treasury welcomes this report which demonstrates that the Treasury Department achieved its goal of maintaining adequate control over the issuance and payments of debt. The issuance of debt and the repayment of debt in accordance with the bond covenants is one of the most important responsibilities that the Department handles since this process is what enables the County to build the much needed infrastructure to meet the needs of the citizens. The issuance of bonded debt is what enables us to build schools, roads, expand the water treatment plant, parks and libraries which are all vital infrastructure that are needed for a growing community. In addition to our internal efforts to manage the bond issuance process, we also call on the expertise of the external financial advisor and external bond and tax counsels. As a further testament to the handling of the issuance and management of the repayment process, the rating agencies have awarded the highest credit quality rating possible to the County's debt.

From Council Administrator, Pamela Meister:

I agree that the minutes should clearly and consistently explain items approved by the Council. While bills, resolutions, and amendments are numbered for clear identification, other items are more ambiguous. Additional efforts will be made to specifically communicate Council actions such as the Board of Education Budget Transfers.