



MEMORANDUM

April 25, 1997

TO: County Council

FROM:  Joan M. Pedersen, Program Evaluator
Office of Legislative Oversight

SUBJECT: Internal Audits of Three Fire and Rescue Corporations

The attached OLO memorandum report summarizes the results of the internal audits performed by KPMG Peat Marwick LLP at three fire and rescue corporations. These audits were performed under a Council contract to augment the efforts of the Department of Finance to audit the corporations on a rotating basis.

As part of each review, the auditors examined and appraised the systems of internal accounting and administrative controls and their effects on the fire corporation's ability to properly account for and safeguard assets and record financial activities. The auditors discovered no improprieties in any of the corporations audited, but did note a number of practices that expose the corporations to some risk. As a result, the auditors made several recommendations for improvements in administrative and accounting controls that will enhance recordkeeping and improve management of assets and financial activities.

This report provides an overview on the kinds of findings reported by the auditors for each of the three audits and indicates the organization identified to implement the recommended improvements. The specific findings and recommendations are not included in this report because an important purpose of these internal audits is to provide the audited organization with confidential information to improve their operations and allow them the opportunity to deal internally with implementing the recommendations.

The Fire and Rescue Commission will coordinate with the Department of Finance and OLO to follow up on each of the audits and monitor implementation of the auditors recommendations. OLO will keep the MFP Committee apprised of progress.

If you have any questions regarding the audits and follow-up activities, please call me at 7-7995.

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Attachment

c: Steve Farber, Council Staff Director

Office of Legislative Oversight

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SUMMARY OF INTERNAL AUDITS OF THREE FIRE AND RESCUE CORPORATIONS

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I. BACKGROUND

On June 27, 1996, the Council approved an amendment to its contract with KPMG Peat Marwick LLP to perform agreed-upon procedure audits at three fire and rescue corporations. These audits were performed to augment the internal audit efforts of the Finance Department's Internal Auditing Section.

As part of the agreed-upon procedures, the auditors reviewed and appraised the systems of internal accounting and administrative controls and their effects on each of the fire corporation's ability to safeguard assets and properly account for and record financial activities. Recommendations resulting from these reviews assist County and fire corporation management in achieving the most efficient administration of fire and rescue financial activities.

The internal control structures adopted by an organization are often limited by cost considerations. To maintain a system of internal control so perfect as to make errors, omissions, and fraud virtually impossible would often cost more than is warranted by the threat of loss. This is particularly true for small operations, where it is not possible to separate completely the custody of assets from the functions of recording and reconciling financial activities.

Most of the fire and rescue corporations have a limited number of paid administrative staff among which to distribute administrative responsibilities and accounting activities, so it is not unusual for audit reviews to identify areas in need of internal control improvement.



An important purpose of having these audits is to identify and bring these internal control weaknesses to management's attention. Management can then reassess employee duties and responsibilities in relation to the additional controls that are recommended and make whatever changes are cost effective. These steps provide management with an opportunity to combine the highest level of internal controls that are economically feasible with the most efficient personnel complement.

II. AUTHORITY, SCOPE AND METHODOLOGY

A. Authority

Montgomery County Council Resolution No. 13-602, FY 1997 Work Program of the Office of Legislative Oversight: Part 1, adopted July 23, 1996.

B. Scope

At the Council's request, KPMG Peat Marwick LLP (Peat Marwick) conducted internal audits of three fire and rescue corporations: Bethesda, Hillandale, and Upper Montgomery. The auditors performed agreed-upon procedures in reviewing financial transactions, LOSAP certifications, and internal accounting and management controls. These three audits augmented the efforts of the Finance Department's Internal Auditing Section. The Auditing Section contracts for an internal audit of at least one fire and rescue corporation annually.

C. Methodology

Peat Marwick auditing staff conducted the agreed-upon internal audit procedures under the direction and oversight of Veronica Kidder, Chief of the Internal Auditing Section in the Department of Finance. OLO coordinated the conduct of the audits with the Department of Finance. The auditor's examination at the three fire and rescue corporation included the following steps:

- Selected 60 sample expenditures made from tax-supported or 508 grant funds during the one-year period July 1, 1995 to June 30, 1996 and examined evidence of verification of prices, quantities, and extensions.
- Reviewed supporting records for the sample expenditures to determine whether the documentation sufficiently demonstrated legal compliance with advertising or soliciting bids, materials or services purchased were received and agreed with contract provisions, and the expenditures were properly classified and recorded.
- Prepared a listing of all capital outlay expenditures made during the two-year period July 1, 1994 to July 1, 1996, examined the physical assets, and supporting documents, purchase orders, vouchers, contracts, and other underlying records that supported the acquisitions.

- Reviewed fixed assets records for the two-year period and determined that additions and disposals were authorized, properly classified, and recorded in the accounting records.
- Examined petty cash procedures and tested one petty cash reimbursement
- Determined the adequacy of the fire and rescue corporations' procedures for safeguarding the fuel inventory and usage and examined underlying documentation for purchases and usage per vehicle.
- Examined Length of Service Award Program (LOSAP) records and annual certifications for accuracy, completeness, and proper authorization.

A more detailed listing and description of the agreed-upon procedures performed at the three fire and rescue corporations is presented at Appendix A.

III. SUMMARY OF AUDIT FINDINGS AND RECOMMENDATIONS

The auditors provided a management letter for each of the three audits. A count of the findings and recommendations in the three management letters results in a total of 31 findings and 34 recommendations. Closer examination reveals that one of the findings in each of the three management letters carries two recommendations, the second of which is directed to the Fire and Rescue Commission (FRC) and is identical for each of the audits. Therefore, there are really 32 distinct recommendations among the three management letters.

Of the 31 findings noted in the management letters, three relate to the Bethesda Fire Department audit, 12 relate to the Hillandale Volunteer Fire Department Audit, and 16 relate to the Upper Montgomery Volunteer Fire Department audit. Of the 32 distinct recommendations, 26 are directed to managers of the individual fire and rescue corporations for action, 5 are directed to the FRC, and 1 is directed to the Department of Finance.

Table 1 (at page 5) shows additional detail on the 31 audit findings categorized by fire and rescue corporation for each area reviewed by the auditor.

Table 2 (at page 6) shows additional detail on the 32 distinct audit recommendations for each area reviewed and indicates the organization recommended by the auditors to take action.

Table 1
Auditor Findings by Area of Review

Areas Reviewed for Adequate Internal Controls, Management Practices and Procedures	Number and Types of Findings		
	Bethesda	Hillandale	Upper Montgomery
Operating expenditures	2 RC 0 MW 0 NC	4 RC 1 MW 2 NC	3 RC 1 MW 5 NC
Fixed assets and capital outlay	none	1 MW	1 MW
Cash and petty cash handling	none	1 RC	1 RC
Fuel usage and storage	1 MW	1 MW	1 MW
Length of Service Awards Program	none	2 NC	3 NC
508 Grant expenditures	none	none	1 RC
Grand Total of Findings	3	12	16
Total Findings by Type	2 RC 1 MW 0 NC	5 RC 3 MW 4 NC	5 RC 3 MW 8 NC

RC = Reportable Condition

A reportable condition represents a deficiency in the asset management or internal accounting control structures that, in the auditor's opinion, could adversely affect the organization's ability to accurately record, process, summarize, and report financial data.

MW = Material Weakness

A material weakness identifies a deficiency in one or more elements of the internal control structure that exposes the organization to a high risk that significant errors or irregularities could occur in material amounts and not be detected within a timely period by employees in the normal course of performing their assigned functions.

NC = Non-Classified

A non-classified finding notes an administrative control shortcoming or deficiency and suggests management practices and procedures that will enhance administrative functions.

Table 2
Recommendations by Area of Review and Organization Designated to Implement

Organization Recommended by Auditors to Take Action	----- Area of Review -----						Totals
	Operating expenditures	Fixed assets and capital outlay	Cash and petty cash handling	Fuel usage and storage	LOSAP certifications	508 Grant expenditures	
Bethesda Fire Department Total = 3	2 RC 0 MW 0 NC	none	none	0 RC 1 MW 0 NC	none	none	2 RC 1 MW 0 NC
Hillandale Volunteer Fire Department Total = 12	4 RC 1 MW 2 NC	0 RC 1 MW 0 NC	1 RC 0 MW 0 NC	0 RC 1 MW 0 NC	0 RC 0 MW 2 NC	none	5 RC 3 MW 4 NC
Upper Montgomery Volunteer Fire Department Total = 11	2 RC 1 MW 1 NC	0 RC 1 MW 0 NC	1 RC 0 MW 0 NC	0 RC 1 MW 0 NC	0 RC 0 MW 3 NC	1 RC 0 MW 0 NC	4 RC 3 MW 4 NC
FRC Total = 5	0 RC 0 MW 4 NC	none	none	0 RC 1 MW * 0 NC	none	none	0 RC 1 MW 4 NC
Department of Finance Total = 1	1 RC 0 MW 0 NC	none	none	none	none	none	1 RC 0 MW 0 NC
Subtotals by Type Total = 32	9 RC 2 MW 7 NC	0 RC 2 MW 0 NC	2 RC 0 MW 0 NC	0 RC 4 MW 0 NC	0 RC 0 MW 5 NC	1 RC 0 MW 0 NC	12 RC 8 MW 12 NC

* The auditors identified a material weakness in internal control for fuel accounting and storage in each of the three management letters and recommended that the FRC establish written policies to account for fuel usage and storage to guide the fire departments.

A. The Bethesda Fire Department Audit

The auditors listed three findings and four recommendations in their management letter comments on the Bethesda Fire Department audit. Two of the findings are identified as reportable conditions and one finding is noted as a material weakness in internal control.

The two reportable conditions relate to petty cash procedures. The third condition, which is considered a material weakness, relates to inadequate fuel usage and inventory procedures. The auditors include recommendations for the fire and rescue corporation to remedy each of the internal control deficiencies noted in the management letter, including procedures needed to adequately inventory and account for fuel usage at the fire and rescue corporations. The auditors also recommend that the Fire and Rescue Commission (FRC) provide the corporations with guidance in the form of written policies to account for fuel usage and storage. The auditors believe written policies are needed to facilitate a uniform recordkeeping system among the independent fire and rescue corporations.

The FRC requested and received a formal response from administrators of the Bethesda Fire Department. The FRC will review the responses and coordinate any needed action with the Department of Finance Internal Auditing Section.

B. The Hillandale Volunteer Fire Department Audit

The auditors listed 12 findings and 13 recommendations in their management letter comments on the Hillandale Volunteer Fire Department audit. The findings relate to management and accounting control over certain operating expenditures, fixed asset inventories, cash handling procedures, fuel usage and inventory, and LOSAP certifications. Most of the auditor's findings are noted as non-classified or reportable conditions. Three of the findings identify conditions that the auditors consider material weaknesses (in the areas of fuel usage and storage, fixed asset control, and non-segregated responsibilities for handling cash and reconciling bank accounts).

The auditors recommend a number of steps and procedures the fire and rescue corporation can implement to remedy 11 of the conditions identified by the audit. The 12th recommendation relates to the Department of Finance's procedures for notifying fire corporations of monies wired into their bank accounts at year-end to ensure fire corporations are notified before the close of the fiscal year. The 13th recommendation is directed to the Fire and Rescue Commission (FRC) to provide the corporations with guidance in the form of written policies to account for fuel usage and storage.

The FRC requested and received a formal response from administrators of the Hillandale Volunteer Fire Department. The FRC will review the responses and coordinate any needed action with the Department of Finance Internal Auditing Section.

C. The Upper Montgomery Volunteer Fire Department Audit

The auditors listed 16 findings and 17 recommendations in their management letter comments on the Hillandale Volunteer Fire Department audit. The findings relate to management and accounting control over certain operating expenditures, fixed asset inventories, cash handling procedures, fuel usage and inventory, LOSAP certifications, and 508 Grant expenditures. Most of the auditor's findings are noted as reportable conditions or are unclassified. Three of the findings identify conditions that the auditors consider material weaknesses (in the areas of fuel usage and storage, fixed asset control, and non-segregated responsibilities for handling cash and reconciling bank accounts).

The auditors recommend a number of steps and procedures the fire corporation can implement to remedy 12 of the conditions identified by the audit. Five recommendations are directed to the Fire and Rescue Commission (FRC). Four of these recommendations relate to purchasing procedures and spending guidelines, and the final recommendation relates to fuel usage and storage. The auditors recommend that the FRC provide the corporations with guidance in the form of written policies to account for fuel usage and storage.

The FRC requested and received a formal response from administrators of the Upper Montgomery Volunteer Fire Department. The FRC will review the responses and coordinate any needed action with the Department of Finance Internal Auditing Section.

IV. FOLLOW-UP ACTIVITIES

Review and follow-up on the auditor's findings and recommendations related to the fire and rescue corporations will be handled by the County's Fire and Rescue Commission and coordinated with OLO and the Finance Department's Internal Auditing Section. OLO will update the Council's Management and Fiscal Policy Committee from time to time on progress being made by the fire and rescue corporations in implementing the auditor's recommendations.

OLO will also consult with Department of Finance and FRC administrators on the findings and recommendations directed to them and apprise the Management and Fiscal Policy Committee of their progress in implementing the auditor's recommendations.

**AGREED-UPON PROCEDURES PERFORMED BY AUDITOR
KPMG PEAT MARWICK LLP**

Operating Expenditures

1. Selected a sample of 60 expenditures made during the period July 1, 1995 to June 30, 1996 by the following selection process.
 - (a) Selected all expenditures in excess of \$1,000 including "508" expenditures, unless such expenditures were repetitive in nature.
 - (b) Scanned the check register and selected expenditures of an unusual nature, to related parties, or which could be questionable or subject to personal use or abuse.
 - (c) Selected expenditures for professional and legal fees unless such expenditures were repetitive in nature.
 - (d) Randomly selected expenditures made throughout the year. The size of this sample was dependent upon the number of items selected in steps a, b, and c.
 - (e) Read the Board minutes for approval of expenditures.

2. Performed the following procedures with respect to the sample of 60 expenditures.
 - (a) Obtained vouchers, contracts, or other supporting documentation and compared them with the disbursements journal.
 - (b) Examined purchase orders for proper preparation and authorization.
 - (c) Examined evidence of verification of prices, quantities, and extensions.
 - (d) Examined evidence for receipt of goods or services.
 - (e) Questioned the propriety of materials or services purchased.
 - (f) Determined that the fire corporation did not pay tax on any purchase pursuant with Federal and State laws.
 - (g) Examined, where applicable, evidence of legal compliance by advertising or soliciting bids.
 - (h) Examined approval for payment and cancellation of the original invoice.
 - (i) Determined whether account classifications were reasonable.
 - (j) Determined, where applicable, that materials or services purchased agreed with contract provisions.

- (k) Verified the existence of vendors and determined whether any of the vendors were fire corporation employees or volunteers.
 - (l) Obtained the canceled check and compared it to the disbursements journal and supporting documents and examined the endorsement.
3. Determined when encumbrances which had been established as of July 1, 1995 were ultimately paid or canceled.

Capital Outlay

- 1. Prepared a listing of all capital outlay expenditures during the period July 1, 1994 to June 30, 1996.
- 2. Inquired of appropriate officials and determined the basis of recording additions to and retirements of property and equipment and differentiating between repairs and maintenance and additions and improvements.
- 3. Obtained fixed assets records, determined that additions had been added, and reviewed the adequacy of these records.
- 4. Verified that disposals of fixed assets were authorized and recorded.

Petty Cash

- 1. Determined the number of petty cash transactions and reimbursements during the period July 1, 1995 to June 30, 1996. One petty cash disbursement made during that time period was selected and we performed the following procedures.
 - (a) Noted that all receipts supporting disbursements were submitted.
 - (b) Determined if sales tax was paid beyond unavoidable sales tax on small miscellaneous purchases of \$20 or less, pursuant with Federal and State laws.
 - (c) Compared the total amount of disbursement to supporting documentation.
 - (d) Examined approval for payment of the reimbursement.
 - (e) Examined supporting documentation for the expenditures.
 - (f) Determined that the petty cash balance did not exceed the allowable limit.

Fuel Usage and Inventory

- 1. Read the fire corporation procedures for safeguarding fuel inventory and usage.
- 2. Obtained invoices for all fuel purchased and determined the quantity of fuel purchased.

3. Obtained fuel records to test the fuel usage per the credit card billing to the type of vehicle for reasonableness.

Length of Service Award Program (LOSAP)

1. Determined that the responsibility for proper accumulation and recording of all LOSAP records and annual certification forms had been assigned.
2. Obtained a summary sheet of points earned, and tested the accuracy of the fire corporation's summarization method by counting LOSAP data and comparing our counts to the summaries for each category of points earned.
3. Performed the following procedures on a sample of 10 volunteers who qualified for LOSAP credit and 5 volunteers who did not qualify for credit for the year ended December 31, 1995.

- (a) Examined the annual certification for accuracy, completeness and proper authorization.
- (b) Determined that LOSAP points awarded were not in excess of the maximum for each category.
- (c) Performed the following procedures for LOSAP credit given for training courses.
 - ◆ Verified attendance at these courses against attendance records at the fire corporation or other supporting evidence of course completion.
 - ◆ Determined that the training course was on a list of courses approved by the County for LOSAP credit.
- (d) Performed the following procedures for LOSAP credit given for drills.
 - ◆ Agreed attendance at drills to monthly training reports.
 - ◆ Examined these records for completeness and approval.
 - ◆ Verified that each drill lasted a minimum of two hours.
- (e) Performed the following procedures for LOSAP credit given for sleep-ins and standbys:
 - ◆ Agreed attendance at sleep-ins and standbys to attendance records.
 - ◆ Examined these records for completeness and approval.
 - ◆ Verified that each sleep-in lasted a minimum of eight hours and that each stand-by lasted a minimum of four hours.
 - ◆ Verified that standby is considered ready status.

- (f) Performed the following procedures for LOSAP credit given for elected/ appointed positions.
 - ◆ Verified that the position for which LOSAP credit was awarded is a position approved by the County for LOSAP credit by comparing the position listed on the Annual Certification to the 1995 LOSAP List of Appointed Positions obtained from the FRC.
 - ◆ Verified the awarding of LOSAP credit for these positions by examining the organizational charts maintained by the fire corporation.
- (g) Performed the following procedures for LOSAP credit given for meetings.
 - ◆ Agreed attendance at meetings to sign-in sheets, minutes of meetings, or log book sign-ins.
 - ◆ Examined the sign-in sheets for completeness and approval.
- (h) Performed the following procedures for LOSAP credit given for responses:
 - ◆ Determined the total responses by the fire corporation in order to calculate the minimum number of responses needed by an individual in order to be awarded LOSAP credit.
 - ◆ Verified the response credit awarded to volunteer members by tallying from incident reports the number of responses of those members indicated as responding to the call.
 - ◆ Reviewed the incident reports for purpose of response, number of volunteers responding, and names of personnel responding.
- (i) Determined that LOSAP credit given for military service had not exceeded six years per individual.

Cash

1. Determined how funds were spent, reviewed for excess cash balances, and investigated spending of unspent funds at end of budget period.
2. Reviewed monthly bank statements to determine that the cash balances did not exceed the \$100,000 Federal Insurance limit. Determined that collateralization arrangements were made to secure the funds if cash balances did exceed \$100,000,
3. Determined whether County funds were commingled with funds from private sources.
4. Traced monthly revenue to timely deposit per the bank statement for the period July 1, 1995 through June 30, 1996.