

Performance Audit

***Parkwood Volunteer Fire Department
Financial Audit***

Durham County Audit Department

November 17, 2010



COUNTY OF DURHAM

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November 17, 2010

Michael M. Ruffin, County Manager:

This audit report of Parkwood Volunteer Fire Department's financial practices was spun-off from an audit of EMS Reimbursable Expenditure Reporting by Volunteer Fire Departments. That audit was to determine if Volunteer Fire Departments (VFDs) that receive EMS funds were appropriately accounting for reimbursable expenditures and if expenditures were EMS related. This audit report was spun-off because we identified issues in their financial processes that obscured the clarity of their financial position and would not be considered good business practices.

Specifically, we found that Parkwood's FY 2008 financial audit did not account for short-term debt accrued through credit cards and a revolving account with an automobile dealer. Additionally, we found that bills were not paid on time thus accruing finance charges and late fees. These situations create doubt about the reliability of the financial audit and related reports and whether best practices are employed regarding the management of revolving credit accounts.

The County's Fire Marshal, in conjunction with the County's Finance Department, is developing plans for conduct of audits and statements appropriate to provide visibility into Parkwood's financial statements. The Fire Marshal is also discussing these issues with Parkwood in order to encourage them to completely pay off credit card and other revolving bills each month

Richard Edwards
Internal Audit Director

Introduction

This performance audit of Volunteer Fire Department (VFD) expenditures was conducted pursuant to the September 12, 2005, Audit Department Charter which established the Audit Oversight Committee and Audit Department and outlines the internal auditor's primary duties. The Audit Committee authorized this audit in July 2009.

A performance audit is an engagement that provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.¹

Background

Parkwood VFD operates under a contract with the County's Fire Marshal for fire operations and the County's EMS Director for emergency medical services. Under the requirements of its contract with the County's Fire Marshal, Parkwood provides an annual financial audit.

Parkwood's 2009 budget was approximately \$ 3,805,274 made up of

- Fire District Taxes - \$ 1,571,523
- City Tax Revenue - \$214,234
- County EMS contributions - \$986,043
- Parkwood EMS collections - \$ 983,161 and
- Other - \$50,313

Its 2009 budget indicated its net assets increased by \$310,646 during the year. This means that Parkwood's revenues exceeded its liabilities by that amount.

Audit Objective

Our initial audit objectives were to determine if the Parkwood VFD was appropriately accounting for the EMS funds allocated to it by the County. Specific audit questions were:

1. Is expenditure reporting accurate and reliable?
2. Are expenditures related to EMS operations?

That audit was completed and the audit questions were answered in the November 17, 2010 Audit Report "EMS Reimbursable Expenditure Reporting by Volunteer Fire Departments." During the course of the audit we identified issues that required expansion of scope and warranted a separate report addressing them. This report addresses those issues which include (1) the validity of the financial statements and

¹ Comptroller General of the United States, *Government Auditing Standards*, Washington D.C: U.S. Governmental Accountability Office, 2007, p. 17

information, and (2) the need to improve credit card and installment account payment practices.

Scope and Methodology

Fieldwork was conducted May 19, through September 10, 2010. The County's Finance Department reviewed the 2009 financial audit for compliance with standards and to determine if it met the County's requirements for financial information. The internal auditors reviewed aspects of the 2008 and 2009 financial audit report dealing with accounts payables, especially revolving credit accounts payables. The internal auditors specifically conducted the following steps:

- Identified credit accounts with balances that carried over from FY 2008 to FY2009,
- Identified late and finance charges for accounts in FY 2008 and 2009, and
- Discussed the charges with payables with VFD representatives to obtain understanding of why they exist and how handled in external financial reports.
- Discussed these matters with other accountants to understand the appropriateness of the transactions.

Findings and conclusions

Parkwood's 2009 financial audit does not provide information necessary to allow the County's Finance Department visibility into the department's financial picture. According to the Finance Department, audit statements required for full disclosure were not included in the financial audit report. Also, debt carried over from fiscal year 2008 to 2009 as a result of unpaid credit card purchases and vehicle service and repair charges were unaccounted for in the audit. The effect of not accounting for debt is that liabilities are understated thus distorting the entity's financial position. Parkwood also incurred late fees and finance charges because it did not pay its bills timely. The effect is that taxpayer funds are used unwisely or wasted.

Taken together, these shortcomings create a lack of confidence in the financial audit thus diminishing reasonable assurance that financial statements are accurate and reliable. Also, not paying bills timely, events that result in additional expense, demonstrates a need for additional controls over financial practices.

Debts unaccounted for in the financial statements

The 2008 audit report statement of assets and liabilities showed an accounts payable balance of \$1,456. However, a review of billing statements for automotive maintenance and repair, and one credit card account identified a combined outstanding balance of \$17.4K at the end of June, 2008. These were bills that were not paid in total when they were due and their balances remained outstanding after the beginning of fiscal year 2009. These outstanding balances; short-term debt or current liabilities, were not shown in the financial statement thus understating the entity's liabilities.

We did not attempt to determine the total extent of understated liabilities. Our goal, after discovering that bills were not paid was to determine if payable balances were

carried over from year to year and if the liability was accounted for in the audit. When we discovered they were not accounted for, we asked the bookkeeper why these debts were not included in the audit report. She stated that such debts do not have to be reported under the modified cash accounting method. However, other accountants we consulted with disagreed with this reasoning, stating that such debt should be short-term and therefore, addressed in the current liabilities section of the financial statements.

Because these debts are not shown, we believe the audit does not properly reflect the financial position of the entity, which renders the financial information unreliable.

Late fees and finance charge assessments

We identified bills that were not paid timely resulting in finance and late charges. We randomly selected and reviewed 25 monthly statements generated in fiscal years 2008 through 2010 representing nine accounts. For those statements, Parkwood's late charges amounted to \$1,064 and finance charges amounted to \$2,157 for a total of \$3,220 in late fees and finance charges. Although there is nothing illegal about accumulating and paying these fees, they do not appear to be in accordance with best business practices while generating unnecessary expenditures for taxpayers. When asked why bills were not paid off as they occurred and why some were paid late, the fire chief responded that they sometimes have hard times and cash flow problems.

The County does not allow for revolving accounts to accumulate balances. The practice in the County is to pay entire amounts as the bills become due and payable. This practice eliminates unnecessary cost to taxpayers and also maintains established budgets. Unpaid revolving charges imply budget overspending, especially when unpaid balances are carried into the succeeding fiscal year. Based upon practices of most government entities and the close financial relationship the VFD has with the County, this practice of not paying credit card and other bills timely and in total when the invoice is received, due and payable, should be discontinued.

Financial audit does not meet requirements of the County's Finance Department

The County's Finance Department acting as consultants in this audit reviewed Parkwood's FY 2009 financial audit. The Finance Department's review identified several instances in which the audit did not meet its requirements. Some of the shortcomings and additional information needs were:

- Audited statement did not include a statement of cash flows,
- All net assets are inappropriately listed as "unrestricted,"
- Sales and gasoline tax revenues are not being allocated as revenue sources for EMS expenditures per the Revenue and Expense Report, and
- Notes and statements for complete understanding of financial position were not included in the audit report.

The full explanation of the problems surfaced by the Finance Department including recommendations can be found in Appendix 1.

The Finance Department and the Fire Marshal have met to discuss the shortcomings of VFD financial audits. They are currently working on a plan to assure that future audits meet the requirements of the Finance Department.

Conclusions and Recommendations

Current practices for financial responsibility and accountability needs improvement. Accounts payables should be accounted for so as not to distort the entity's financial position and bills should be paid in full when due to avoid unnecessary cost to taxpayers. Additionally, audit reports should meet the requirements for full disclosure, providing a mechanism by which the financial position is transparent to reviewers and users of the information.

To correct these deficiencies, we recommend the Fire Marshal:

1. Exercise his authority to demand audits that meet contract requirements.
2. Assist, in cooperation with the Finance Department, the VFDs to understand what information is required in audits in order to provide the appropriate visibility of financial condition.
3. Reach an agreement with the Finance Department to review audit reports.
4. Encourage payments of installment and revolving debt when it is due and payable.

Appendix 1
Finance Department's Opinion of Weaknesses in Parkwood VFD Financial Information
Provided by: Susan Tezai, CPA
Deputy Finance Director
Durham County Government

Condition 1:

The audited financial statements of Parkwood Volunteer Fire Department Inc. (Parkwood) does not include the statement of cash flows for the financial reporting of not-for-profits per the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958, Not-For-Profit Entities, Subtopic 205, Presentation of Financial Statements.

Criteria:

As an incorporated not-for-profit volunteer fire district (VFD), Parkwood is required by the FASB to adhere to ASC Topic 958, Not-For-Profit Entities, Subtopic 205, Presentation of Financial Statements for financial reporting. In general, ASC Topic 958 Subtopic 205 requires financial statements of not-for-profit organizations to include a statement of financial position (formerly a balance sheet), a statement of activities (formerly a statement of revenue and expenses and a statement of changes in fund balances), and a statement of cash flows and accompanying notes to the financial statements.

Effect:

In reviewing the audited financial statements of Parkwood, there is no statement of cash flows. According to FASB ASC Topic 958 Subtopic 205, a statement of cash flows is required. The statement of cash flows is to provide information to the external user of how the not-for-profit obtains and spends cash, its borrowing and repayment of borrowing, and its investing and other factors that may affect its liquidity. In excluding this statement, the County (external user) cannot see the cash activity (e.g., inflows and outflows for operating, investing and financing activities) that occurred during the year which is one of the main purposes for requiring financial reporting of the VFDs.

Condition 2:

The net assets are listed as all unrestricted in the statement of financial position (e.g., Statement of Assets, Liabilities and Net Assets) in Parkwood's audited financial statements.

Criteria:

Per FASB ASC Topic 958 Subtopic 205, the financial statements should report net assets in three groups: permanently restricted, temporarily restricted and unrestricted. The County has an agreement with Parkwood for the provision of emergency medical services (EMS) (Agreement for Paramedic Coverage) that is separate from the fire services provided as a volunteer fire department. The funds for this agreement are from the County's General Fund with their purpose being restricted solely for these services. If any balances of these funds remain, then, they should be reported in the net assets as being temporarily restricted for the funding of EMS paramedic services.

Effect:

By commingling the funding sources and reporting them as one unrestricted net assets balance, the County cannot see the balance of the EMS paramedic services funds as they are carried forward, when applicable (e.g., funding exceeded EMS expenditures/expenses). In addition, Parkwood cannot track and monitor these separate funding sources to ensure that the EMS paramedic services funding is not used for fire protection whose funding source is a service district (G.S. 153A-300) and/or rural fire protection tax district (G.S. 69-25.5).

Condition 3:

The sales tax and gasoline tax revenues are not being allocated as a revenue source for EMS expenditures per the Revenue and Expense Report provided quarterly to the EMS Director per the EMS Agreement for Paramedic Coverage.

Criteria:

In the EMS Agreement for Paramedic Coverage, an itemized Revenue and Expense Report detailing EMS related expenses and revenues is required to be submitted quarterly to the EMS Director. In this report, the expenses are listed by natural classification (e.g., salaries and benefits, fuel, office supplies, medical supplies, etc.) and revenues are listed by source (e.g., Durham County, transport fees, donations, fund raisers, etc.) with a net gain or (loss). Per the audited financial statements, Parkwood receives sales tax and gasoline tax refunds; however, previously submitted reports show no portion of these revenues as being allocated as funding sources for EMS expenditures.

Effect:

The revenue sources for EMS expenditures are understated on the schedule provided to the EMS Director per the Agreement for Paramedic Coverage, and these revenue sources are applied 100% to funding the fire protection services.

Requested additional information:

Additional schedules the County requests to be included in the notes to the financial statements:

Schedule of capital asset activity for the fiscal year to include beginning balances, increases, decreases and ending balances by asset type (Note C, Property and Equipment). The schedule should be separated by non-depreciable and depreciable capital assets. The depreciable capital assets should be reported in the schedule at full value by asset type, the accumulated depreciation by asset type and a total for depreciable capital assets net of accumulated depreciation.

In the EMS Agreement for Paramedic Coverage, the County can and does buy capital assets upon BOCC approval during the annual budget process. Therefore, the County wants to see capital asset activity that occurred during the fiscal year. In Parkwood's current reporting format, only year- end capital asset balances by type are reported.

Schedule of long-term debt activity by type of debt (e.g., installment notes payable, etc.) to include beginning balances, increases, decreases and ending balances (Note D, Long-Term Debt)

Inclusion of this schedule provides the external user (County) the ability to see debt activity for the fiscal year.

If Parkwood chooses not to incorporate these schedules in the audited financial statements, then, upon submission of the audited financial statements to the County per the contract for services, the County requests audit work papers regarding the fixed asset and long-term debt activity be included.

Additional information the County requests to be included in the notes to the financial statements:

Currently, Parkwood reports the note payables (Note D, Long-Term Debt) separately to include what the note is secured with which all are currently secured with equipment. The County requests that the notes include what type of equipment is securing the note (e.g., fire or EMS; vehicles, radio equipment, etc.).

Per the notes to the financial statements, the capital leases are for EMS equipment. The County requests that this note (Note E) include a description of the type of equipment under the capital leases (e.g., radio, monitor, etc).

If Parkwood chooses not to incorporate this additional information in the notes to the financial statements, then, upon submission of the audited financial statements to the County per the contract for services, the County requests the information regarding the assets securing debt and the assets being purchased by capital lease be included.

Additional statements the County requests to be included in the audited financial report:

The County requests the inclusion of additional statements in the audited financial report besides GAAP Statements:

- Balance sheet
- Statement of revenue and expenses
- Statement of changes in fund balances
(These statements were the required statements prior to SFAS No. 117 which is now superseded by FASB ACS Topic 958 Subtopic 205.)

FASB ACS Topic 958 Paragraph 958-205-05-7:

The Not-for-Profit Entities Topic does not use the terms fund balance or changes in fund balances because in current practice those terms are commonly used to refer to individual groups of assets and related liabilities rather than to an entity's net assets or changes in net assets taken as a whole. While reporting by fund groups is not a necessary part of external financial reporting, paragraph 958-205-45-3 does not preclude providing disaggregated information by fund groups.

FASB ACS Topic 958 Paragraph 958-205-45-3:

Reporting by fund groups is not a necessary part of external financial reporting; however, this Subtopic does not preclude providing disaggregated information by fund groups.

The County requests that the revenues and expenditures be separated on the financial statements as to what pertained to EMS per the EMS agreement and what pertained to fire per the service district (G.S. 153A-300) and/or rural fire protection tax district (G.S. 69-25.5). If Parkwood chooses not to report revenues and expenditures as to fire and EMS in the audited financial statements, then, upon submission of these audited financial statements to the County per the contract for services, the County requests audit work papers regarding the fire revenues and expenditures and EMS revenues and expenditures be included.

Other:

Annual audit and audited financial statements:

The Fire Protection and EMS Services Contract and Agreement between Parkwood and the County includes the requirement that the fire department will present to the County Commissioners an annual audit by a certified public accountant (CPA) firm which shall be in conformity with Generally Accepted Accounting Principals. However, the EMS Agreement for Paramedic Coverage does not include this stipulation. For consistency, this requirement needs to be incorporated into the EMS Agreement for Paramedic Coverage.

Department of State Treasure, Local Government Commission's (LGC) Documentation:

Budgeting and Accounting for Rural Fire Protection Districts

Contracts with Incorporated Volunteer Fire Departments

As stated above, many boards or commissions will contract with an incorporated volunteer fire department. Article 3A is silent as to the specific provisions of these contracts, and therefore the following discussion of contractual elements is merely a list of suggestions. The county attorney can draft a contract that will best meet the needs of the districts. He and the board or commission may wish to consider the following:

5) In conjunction with the annual audit, the parties may want to draft a provision specifying minimum accounting procedures to be used by the volunteer fire department. The parties should agree on how funds received from the county will be accounted for by the department. In this regard, it is important to recognize that many volunteer fire departments receive, in addition to contractual payments from a fire protection district, revenue from private donations and other fundraising activities. The parties should discuss, and perhaps include in the contract, how these funds should be accounted for and reported on. In all negotiations on these matters, the board administering the fire district should not lose sight of the important role that community support plays in the success of a volunteer fire department.

RECOMMENDATION: It is Finance's recommendation that the LGC's recommended practice above be included in both the Fire Protection and EMS Services Contract and Agreement for the Special Tax District and the EMS Agreement for Paramedic Coverage for the General Fund going forward.

The County's Finance Department representative reviewed the audit and other financial documents provided by the VFDs. During the review, the representative saw several areas in which the financial information provided by the VFD did not meet the objective of an audit...acceptable visibility into the financial transactions of the entity. In her analysis of Parkwood, the VFD that provided an audit with an opinion, the Finance Department representative found:

- The audited financial statements of Parkwood Volunteer Fire Department Inc. (Parkwood) does not include the statement of cash flows for the financial reporting of not-for-profits per the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958, Not-For-Profit Entities, Subtopic 205, Presentation of Financial Statements.
- The net assets are listed as all unrestricted in the statement of financial position (e.g., Statement of Assets, Liabilities and Net Assets) in Parkwood's audited financial statements.
- The sales tax and gasoline tax revenues are not being allocated as a revenue source for EMS expenditures per the Revenue and Expense Report provided quarterly to the EMS Director per the EMS Agreement for Paramedic Coverage.

Additionally, the representative found that other useful financial information was not included in the audit or audit statements.

Appendix 2
Audit Response – Jeff Batten, Fire Marshal



COUNTY OF DURHAM
Office Of The Fire Marshal
Division Of Emergency Management

Jeffrey L. Batten
Fire Marshal / Emergency Management Director

October 19, 2010

Mr. Richard Edwards, Internal Audit Director
County of Durham
200 East Main Street
Durham NC 27701

Dear Mr. Edwards:

SUBJECT: Performance Audit—Parkwood Volunteer Fire Department Financial Audit

Per your request, I have reviewed the above-mentioned document and I will address the '*Conclusion and Recommendation*' section located on page 5 of the document.

To correct these deficiencies, we recommend the Fire Marshal:

1. *Exercise his authority to demand audits that meet the requirements of contract.*

In response, I will work with the Durham County Finance Department to ensure that the financial reporting provided to Durham County by the Parkwood Volunteer Fire Department meets the intent of the fire contracts that Durham County has with the service provider. I have already met several times with Susan Tezai, Deputy Finance Director for Durham County for guidance in her capacity as a CPA, to ensure compliance with an annual audit requirement per her interpretation. This audit is required for financial reporting per the Financial Accounting Standards Board (FASB), Accounting Standards Codification (ASC), Topic 958, "*Not-for-Profits Entities, Subtopic 205, Presentation of Financial Statements.*"

2. *Assist, in cooperation with the Finance Department, the VFDs to understand what information is required in audits to provide the proper visibility.*

I will provide Parkwood the requested information needed by the Durham County Finance Department to be fully compliant with audit requirements. If requested by Parkwood, the Durham County Finance Department will provide further guidance and assistance to Parkwood Volunteer Fire Department to ensure that their audits meet the necessary financial standards.

3. *Reach an agreement with the Finance Department to review audit reports within a reasonable time after they are received.*

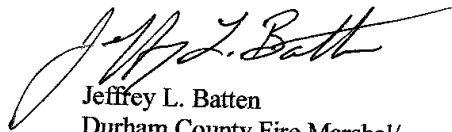
A formal agreement will be developed with the Durham County Finance Department to review and to provide formal documents to this office of their review. I will work with the Durham County Finance Department to ensure this process is completed by them in a reasonable timeframe after receiving the audit from Parkwood VFD.

October 19, 2010
Mr. Richard Edwards
Page 2

4. *Encourage payments of installment and revolving debt when it is due and payable.*
I will work with the senior management of Parkwood VFD in an attempt to develop better business practices consistent with Durham County Government standards for debt payment. I have already begun conversations with the Parkwood VFD Fire Chief to resolve this issue. The Fire Chief has made a verbal commitment to me to not only address this issue, but to address all of the issues raised during this performance audit. He will ensure that, when there is a follow up on this performance audit by Durham County, Parkwood VFD will have made great strides to resolve the issues.

Should you require further information, please feel free to contact me.

Sincerely,



Jeffrey L. Batten
Durham County Fire Marshal/
Emergency Management Director