

City of Stamford, Connecticut

Independent Auditors' Report on Communication of
Internal Control Related Matters Identified in the Audit

June 30, 2012

Independent Auditors' Report on Communication of Internal Control Related Matters Identified in the Audit

Board of Finance
City of Stamford, Connecticut
888 Washington Boulevard
Stamford, Connecticut 06904-2152

In planning and performing our audit of the governmental activities, the business-type activities, the discretely presented component unit, trust funds, each major fund, and the aggregate remaining fund information of the City of Stamford, Connecticut ("City") as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies, deficiencies that we consider to be control deficiencies and other observations and recommendations for strengthening internal control and/or operating efficiency. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

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 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. A significant deficiency is a deficiency, or 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.

The Exhibits set forth below and appended to this letter, include our required communications and various matters involving internal control that we identified during our audit.

- Exhibit A - Summary of communications required under generally accepted auditing standards
- Exhibit B - Deficiencies in internal control that we consider to be significant deficiencies
- Exhibit C - Control Deficiencies
- Exhibit D - Other Observations/Recommendations for Improving Internal Control and Operating Efficiency

Comments included in the Exhibits that are marked with an asterisk (“*”) are comments that were included in our letter on internal control for the year ended June 30, 2011.

Our summary of communications, as required by generally accepted auditing standards, and our findings regarding internal control related matters associated with the operations of the Water Pollution Control Authority, the Classified Employees’ Retirement Fund, the Firefighters’ Pension Trust Fund and the Custodians’ and Mechanics’ Retirement Fund of the City will be provided in separate communications.

Management’s responses included in this letter have not been subjected to the auditing procedures applied in the audit of the City’s financial statements and, accordingly, we express no opinion on them.

This report, summary of communications and addenda are intended for the information and use of the Board of Finance and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited. We will be pleased to discuss these communications in detail at your convenience, or to assist you in implementing the recommendations.

O'Connor Davies, LLP
O'Connor Davies, LLP
Stamford, Connecticut
January 25, 2013

City of Stamford, Connecticut

Exhibit A - Summary of Communications

- Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America
 - Unqualified opinion on financial statements
 - No change in scope of the audit
 - No material errors
 - Other than the matters brought to our attention, no other fraud or illegal acts identified
 - Other than the matters brought to our attention, no instances/suspicion or allegations of fraud were noted during conduct of audit
- Internal Accounting Controls
 - Reviewed to extent necessary to render our opinion on the financial statements
 - No material weaknesses noted
- Significant Accounting Policies
 - Accounting policies appear appropriate
 - Significant accounting policies included in Note 1 to the financial statements
 - No changes in accounting policies during the year
- Management's Judgments and Accounting Estimates
 - Estimates used deemed adequate
- Audit Adjustments
 - No significant unrecorded adjustments
- Other Information in Documents Containing Audited Financial Statements
 - Management's Discussion and Analysis appears reasonable
- Disagreements with Management
 - None
- Unresolved Difficulties Encountered in Performing the Audit
 - None

Exhibit A - Summary of Communications (continued)

- Consultation by Management with Other Accountants
 - None of which we were made aware
- Management Consulting Services
 - None
- Independence
 - O'Connor Davies, LLP is independent in all respects
- Irregularities or Illegal Acts
 - Other than the matters brought to our attention, nothing to report

Exhibit B - Significant Deficiencies

• **Process and Communication ***

At the commencement of our audit in mid-August, the year-end closing process was not complete. Account reconciliations and analyses had not been prepared for many accounts, and certain schedules, reconciliations and analyses had not been reviewed by supervisory personnel. In addition, as a large, complex organization, information required for financial reporting and maintaining proper internal control exists in various departments—the Tax Department, the Grants Department, Payroll, Office of Legal Affairs, Board of Education (“BOE”), etc.—within the City. This information is not always conveyed to the Controller’s Department. During our audit, many adjustments had to be made as a result of account reconciliations and analyses completed after the start of the audit or to correct errors resulting from information that was not available to the Controller’s Department through the ordinary course of business.

Among the issues noted or corrections required, many of which were commented on in 2011, were:

- The property tax receivable, overpayments account, disputed assessments and related revenue accounts are not routinely reconciled to the general ledger. The information is summarized by the Tax Department; however, the lack of communication between the Tax Department and the Controller’s Department leads to situations where the aforementioned accounts sub-ledgers are not reconciled to the general ledger.*
- Transfers to the Mill River Capital Projects Fund and the Harbor Point District, affecting the property tax accounts, were not recorded by the City.
- Schedules to support disputed tax assessments maintained by the Tax Department were not available for review by the Controller’s Department.*
- Certain of the school construction debt accounts were not reconciled and did not agree with the underlying amortization schedules.*
- Schedules of educational and other grants receivables/deferred revenues were not prepared and the related general ledger accounts had not been analyzed.*
- Because the closing process was not complete the entity-wide adjustments required for reporting in accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 34 and for completion of the Comprehensive Annual Financial Report could not be made.*
- Loan balances relating to various loan programs administered by the Community Development Program were not reflected in the general ledger.*

Exhibit B - Significant Deficiencies

• **Process and Communication** * *(Continued)*

We believe that several factors may have contributed to these issues, most significantly:

- Insufficient documentation and communication of accounting and financial reporting processes and procedures related to the year-end audit, including the lack of supervisory review as well as lack of clearly defined roles and responsibilities of each department and individuals within each department for maintaining, monitoring and sharing information.
- The lack of a well-defined and effective monthly, quarterly and annual closing process.
- The City Charter requires that the City's financial statements be prepared and submitted to the Board of Finance by September 30th of each year. Given that some of the information required for a complete and proper year-end closing is not available for as long as 60 days after year-end (i.e. August 31), the time frame to complete the year-end closing is extremely restricted.
- Some departments within the City operate independently of other departments and may not have a sufficient understanding of and/or accountability for the closing process and related accounting and reporting practices.

These conditions can have a negative impact on internal efficiencies of systems and may jeopardize effective financial reporting and internal control. We recommend that these issues be evaluated and that the appropriate corrective actions be implemented as soon as possible.

Recommendation

- An employee with the appropriate skills and background, or an outside consultant, should be tasked, on a full-time or nearly full-time basis, with identifying all key inter-departmental exchanges, developing and documenting appropriate accounting and financial reporting processes and procedures, building consensus and assigning and communicating responsibilities. The established procedures should be consistently reviewed and evaluated by an inter-departmental team of individuals, and adjustments should be made and communicated as appropriate to maintain continuous improvement over the long term.

Management Response (1.1 - Responsibility of Controller's Department):

Management agrees with the issues noted and the recommendations made. Remediative actions were begun during F2012 with the scheduling of Controller's Council meetings (meeting with all department representatives who are part of the financial reporting process, including data originators) and the creation of a Year-End Closing Schedule by the Controller's Department. The Assistant Controller will create a monthly/quarterly

Exhibit B - Significant Deficiencies

• **Process and Communication * (Continued)**

Management Response (1.1 - Responsibility of Controller's Department): (Continued)

version to use in conjunction with the balance of F2013. During that time, the Controller's Department staff's responsibilities will be revised to better align them with City's needs. Initial objective is to complete monthly closes within 45 to 60 days of each month-end.

Expected Remediation - Q3/Q4 F2013

Recommendation

- Consider amending the City Charter to allow for a more realistic year-end closing schedule given the limitations on availability of certain information required for a complete and accurate year-end close by September 30th.

Management Response (1.2- Responsibility of Controller's Department):

The City Charter was amended to provide an additional 30 days for the year end close process. The time period was extended to October 31st for subsequent years.

Remediated – Nov 2012

Recommendation

- We continue to suggest that the Controller's Department develop and implement a formal year-end closing schedule that indicates specific personnel responsibilities and corresponding time requirements. Strict adherence to this schedule should be required because this will allow for the year-end work and audit preparation to be much less time-consuming and arduous process. Due dates would also be monitored so that the process stays on target for established time deadlines.

Management Response (1.3 - Responsibility of Controller's Department):

The Controller's Department has already created a Year-End Closing Schedule (as noted in issue 1.1 above) which was used to manage work flow and coordinate handoffs of audit related information for the F2012 close. As the closing progressed, some deadlines were missed and cumulative downstream impact during the F2012 year-end close process indicated that processes and communication need further improvement and refinement in advance of the F2013 year-end close.

Expected Remediation - Q4 F2013, partially addressed already but needs additional work

Exhibit B - Significant Deficiencies

• **Process and Communication * (Continued)**

Management Response (1.3 - Responsibility of Controller's Department): (Continued)

Recommendation

- Proper interim account analysis be performed on a current basis and that more complete and timely accounting files be kept. Once again, this will allow the year-end close to be less time-consuming.

Management Response (1.4a - Responsibility of Controller's Department):

Assistant Controller to work with Controller to develop monthly closing schedule (as noted above). Controller to review at the end of each month and perform quarterly financial reviews to identify areas and issues that may impact the year-end close.

Expected Remediation - Q3 F2013

Management Response (1.4b - Responsibility of Controller's Department):

Regarding the issues raised with respect to: property taxes receivable, overpayments, disputed assessments, and related revenue accounts not being reconciled to GL; disputed assessments schedule not being sent to Controller's Department for review; and, transfers for Mill River and Harbor Point not being recorded by the City, the Assistant Controller will work with the Tax Department to better understand the key informational exchanges that need to be improved. The Controller's Department notes that year-over-year Tax Department had dramatically improved the timing of the production of key reports and audit-related informational requests. Issues related to the recording and timing of adjusting journal entries will be the focus of the Assistant Controller's review.

Expected Remediation - Q4 F2013

• **Old Town Hall Redevelopment Agency ("OTHRA")***

OTHRA was created to help finance the redevelopment of the Old Town Hall in downtown Stamford. To take advantage of funds available through Federal tax credits – the New Markets Tax Credit and the Historic Tax Credit – the transaction required a very complex structure of entities. These entities include, among several others, Old Town Hall Manager, Inc. ("OTH Manager"), which is owned 99.9% by the City, and Old Town Hall QALICB, LLC ("QALICB"), which is owned 90% by OTH Manager. During the fiscal year ended June 30, 2009, the City sold the Old Town Hall property to QALICB. OTH Manager was responsible for managing the renovation of the Old Town Hall and is responsible for the overall management of the property going forward. In addition to tax credits, the project was financed by direct and indirect loans from the City.

Exhibit B - Significant Deficiencies

• **Old Town Hall Redevelopment Agency (“OTHRA”)*** *(Continued)*

In conducting our audit, we noted several accounting issues relating to OTHRA:

- Accounting entries related to OTHRA activity were not being properly recorded in the City’s accounting records. Certain transactions in the OTHRA Fund are duplicative of information that is, or should have been; recorded in the books of OTH Manager and QALICB, and interfund activity with the Capital Projects Fund and the General Fund was not reflected in the OTHRA Fund.
- Advances in the amount of \$3.9 million were made by the City to OTH Manager and QALICB in fiscal 2011 and approximately \$120K was advanced in fiscal 2012 from the General Fund in order to cover construction costs and operating deficits; however, we did not see evidence that these advances or appropriations were approved in accordance with City requirements.
- Pending claims for cost overruns by the construction contractor are delaying the receipt of a final certificate of occupancy and the New Markets and Historic Tax Credits.
- Old Town Hall Master Tenant was not billed for rent in accordance with the rental agreement. (A cumulative invoice was prepared late in fiscal 2011, and we understand that invoices are now being prepared monthly, as required.)
- The annual audits of OTH Manager and QALICB, as required by the underlying legal documents, were not performed.
- A bank account not owned by the OTHRA Fund is reflected in the fund’s accounts.

In addition to the accounting issues, there are some significant operating and strategic issues relating to OTHRA. At the time the OTHRA project was conceived, it was anticipated that, upon completion of construction, the Old Town Hall building would be leased, generating sufficient rent to cover all operating and interest / debt service costs associated with the project. It was also anticipated that the project would benefit from the in-flow of cash from the New Markets Tax Credit and the Historic Tax Credit. Unfortunately, the building was not leased during the year and, due at least in part to the delay in obtaining a final certificate of occupancy (because of the pending dispute with the contractor), the project was delayed in qualifying for the New Markets or Historic Tax Credits.

Some of the issues outlined above are due, at least in part, to the complexity of the OTHRA transaction and funding arrangements. Other issues (e.g. lack of tenants/rentals) may be attributable to the downturn in the economy and weak real estate market. Nonetheless, these are significant issues that should be addressed by management in the near term.

Exhibit B - Significant Deficiencies

• **Old Town Hall Redevelopment Agency (“OTHRA”)*** *(Continued)*

Recommendation

- City officials should seek the advice of qualified legal counsel regarding the operational and other issues related to OTHRA in order to fully understand the legal and other requirements for operating OTHRA, including any corrective actions that may now be required and the implications of noncompliance, if any, with any of those requirements.

Management Response (2.1 - Responsibility of OTHRA Board and OTHRA Liaison):

The OTHRA Board has retained legal counsel to represent its interests in the litigation matters regarding the contractor suit as well as matters regarding leases and other operational issues.

Remediated – Nov 2012

Recommendation

- A definitive decision should be made by management regarding the continued funding of OTHRA’s capital and operating deficiencies by the City. Such funding should require a loan agreement between the City and OTHRA.

Management Response (2.2 - Responsibility of OTHRA Board and OTHRA Liaison):

Management agrees with the issue noted and the recommendation made. The Board had prepared a future cash flow report indicating that by calendar year 2015 the operation will be breakeven and moving forward into profitability where there will be no need for financial support from the City.

Expected Remediation - Q4 F2013

Recommendation

- The accounting and administrative responsibilities associated with OTHRA, OTH Manager, QALICB and other related entities should be more clearly identified and assigned. If the City is to be responsible for performing certain of these tasks, those tasks should be documented in a written agreement between the City and OTH Manager.

Exhibit B - Significant Deficiencies

• **Old Town Hall Redevelopment Agency (“OTHRA”)*** *(Continued)*

Management Response (2.3 - Responsibility of OTHRA Board and OTHRA Liaison):

Management agrees with the issue noted and the recommendation made. The Senior Accountant in the Controller’s Department will work with OTHRA Liaison (and Board) to keep financial records up-to-date and in sync with Assistant Controller’s monthly closing schedule.

Expected Remediation – Q3 F2013

Recommendation

- Management should be sure that prospective tenants meet the eligibility requirements under the tax credit programs (e.g. we understand there is a limitation on the percentage of space that can be leased to not-for-profit entities).

Management Response (2.4 - Responsibility of OTHRA Board and OTHRA Liaison):

The entire space is now rented. The majority of the space is occupied by the Stamford Innovation Center, a for-profit organization, under a ten year lease, which will assure the requirement that the space be majority occupied by for-profit companies to qualify for the tax credit program.

Remediated – December 2012

• **Internal Service Fund – Risk Management**

The Risk Management Internal Service Fund reflects workers’ compensation claim liabilities, which are based upon estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported, but not settled. The length of time for which such costs must be estimated varies depending on the coverage involved. Because actual claim costs depend on such complex factors as inflation, changes in doctrines of legal liability and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency and other economic and social factors.

Exhibit B - Significant Deficiencies

• **Internal Service Fund – Risk Management** (*Continued*)

During our audit, we noted that the City was self-insured for workers' compensation and heart and hypertension claims and had recorded a liability of approximately \$8 million for workers compensation claims at June 30, 2012. This amount recorded for the City's reported but unpaid workers' compensation claims was provided by the City's third party administrator. The City has not had an actuary calculate incurred but not reported (IBNR) claims for workers' compensation. Additionally, heart and hypertension claims for police officers and firefighters are covered, as required by State statutes. Costs associated with these risks are reported in the Risk Management Internal Service Fund which is funded by the General Fund. The heart and hypertension claim liabilities totaling approximately \$5 million are recorded at the entity-wide level and not the Risk Management Fund. This amount recorded for the City's reported but unpaid heart and hypertension claims was also provided by the City's third party administrator. The City has not had an actuary calculate incurred but not reported (IBNR) claims for heart and hypertension claims.

Recommendation

- We recommend the City engage the services of an actuary to calculate the incurred but not reported workers' compensation and heart and hypertension claims to assist in providing an evaluation of potential liability for the utilization by the City to fund the City's incurred but not reported claims liability.

Management Response (3.1 - Responsibility of Risk Management):

Management agrees with the issue noted and the recommendation made. The City's current Risk Management/Third Party Agreement ("TPA") contract expires July 1, 2013. New Request for Proposal ("RFP") for Workers' Compensation TPA has amended the scope of services which includes engaging an external actuary to review all reserves on at least an annual basis. Until July 1, 2013, quarterly audits will be completed and expenditures and reserves are being followed closely.

Expected Remediation – Q4 F2013

• **General Ledger Account Coding***

During our audit we noted several areas where the general ledger account coding structure does not provide sufficient information to properly review, reconcile, monitor and report activity.

Exhibit B - Significant Deficiencies

• **General Ledger Account Coding*** (*Continued*)

City Medical Fund

The trial balance for the City Medical Fund lacked appropriate detail for revenue and expenses. All contributions were posted to a single revenue account and certain expenses are also combined, which makes it very difficult to identify the sources of revenue and the nature of expenditures.

At a minimum, we believe the following should be separately broken out within the general ledger:

- Receipts from employee contributions
- Receipts from COBRA payments
- Reimbursements received from the Urban Renewal Commission (“URC”), grants, CDP or capital reimbursement
- Reimbursements from the Board of Education for Classified Employees
- Stop loss reimbursements
- Other miscellaneous income
- Medical insurance claims paid
- Payments to employees who opt out of the medical insurance coverage

City Medical Fund

Recommendation

- Expand the chart of accounts to provide more separation within revenue sources and expense items.

Management Response (4.1 - Responsibility of the Office of Policy and Management (“OPM”)):

Chart of accounts expanded as recommended.

Remediated – Q1 F2013

Recommendation

- Set-up proper accounts in the medical funds’ chart of accounts to properly track retiree and active employee revenues and expenditures.

Exhibit B - Significant Deficiencies

• **General Ledger Account Coding* (Continued)**

City Medical Fund (Continued)

Management Response (4.2 - Responsibility of the OPM):

Accounts have been set-up as recommended for the Medical Fund.

Remediated – Q1 F2013

OPEB Trust Revenues and Expenditures

Currently, all revenue and related costs for retiree medical benefits are accounted for as part of the City and BOE Medical Funds. The revenues and costs associated with the retiree population are flowed into and then out of these medical funds and into the Other Post Employment Benefits (“OPEB”) Pension Trust Fund. The fact that both active and retiree benefits are processed through the same fund could lead to retiree costs being misclassified as active employee costs and vice versa. The BOE Medical Fund does not currently use separate expenditure accounts for retiree costs. It relies on an employee of the BOE to manually track the costs.

OPEB Trust Revenues & Expenditures

Recommendation

- We recommend that these revenues and related costs be recorded directly in the OPEB Pension Trust Fund’s general ledger.

Management Response (4.3 - Responsibility of OPM):

Revenues and expenses are being directly recorded in the OPEB accounts.

Remediated – Q1 F2013

Recommendation

- The City’s and BOE Medical Funds’ account balances should be reconciled with the OPEB Pension Trust’s account balances when revenues and expenses are recorded to ensure all the retiree activity has been properly posted in the OPEB Pension Trust Fund.

Exhibit B - Significant Deficiencies

• **General Ledger Account Coding* (Continued)**

OPEB Trust Revenues & Expenditures (Continued)

Management Response (4.4 - Responsibility of Controller's Department):

The Controller's Department agrees that a single transfer was not properly cleared prior to the year-end closing. That amount was properly reflected in the financial statements as a due to / due from the respective funds. To the best of our knowledge, there were no other "unreconciled amounts" identified by the auditors.

Expected remediation – Completed September 2012 (Q1 F2013)

Recommendation

- The detailed costs associated with retirees should be reviewed monthly to ensure that the costs are posted correctly in the general ledgers of both the City and BOE Medical funds.

Management Response (4.5 - Responsibility of OPM):

OPM is currently reviewing costs on a monthly/quarterly basis to ensure proper accounting.

Remediated – Q2 F2013

• **Cash Management - Pooled Cash Arrangement**

While performing our audit of cash accounts, we noted that the City does not maintain separate accounts for all of the custodial cash accounts as well as the cash accounts for general operations. In this instance we would agree with the City that separate accounts require a significant amount of time be spent on the monthly accounting responsibilities and it weakens the overall cash controls due to the number of accounts maintained.

The City uses a pooled cash arrangement whereby one general operational account is used to record receipts and disbursements and account for the cash balances of several different City funds and individual general ledger accounts to track the share of the pooled cash account "owned" by each separate fund. The operating bank account of a cash flow system is the major link of internal accounting controls over cash receipts and cash disbursements; if operating activity is handled through more than one bank account, internal controls tend to be weakened. Any necessary segregation for each respective fund's activity can be accomplished through the accounting records.

Exhibit B - Significant Deficiencies

• **Cash Management - Pooled Cash Arrangement** (*Continued*)

While pooled cash arrangements are often acceptable and widely used in practice, we believe this pooled cash arrangement contributes to a lack of transparency. We believe that monies received from bonding of capital projects should be segregated from operational receipts. The co-mingling of operating receipts with bonded capital projects receipts has caused some confusion and has caused members of the Board to question the remaining amount of unspent bond proceeds. By co-mingling unexpended bond funds in the pooled cash account and in certain instances, advancing such funds to cover expenditures which are to be ultimately claimed from Federal and/or State sources, it has been difficult for the City to ascertain the remaining amount of unexpended bond funds.

In addition, as funds are loaned or advanced to the WPCA and OTHRA, the necessary receivables and payables (due from and due to accounts) are not appropriately adjusted and allow the pooled cash in those respective funds to become negative. The necessary adjustments are proposed and recorded by management only at year-end to reflect such inter-fund assets and liabilities for each respective fund. These cash advances are not expressly authorized by the Board's of Finance and Representatives.

Recommendation

- We continue to recommend that separate cash accounts be maintained for proceeds received from bonds issued for capital projects. Additionally, consideration should be given to establishing a separate capital projects fund for each year of borrowing which will help provide segregation of bond proceeds and assist in the calculation of unspent bond proceeds. Such information is needed to determine the City's investment in capital assets, net of related debt as well as recording amounts restricted for capital projects. Additionally, inter-fund loans should have prior authorization from the appropriate Boards.

Management Response (5.1& 5.2 - Responsibility of Controller's Department):

Management disagrees with the observation that there is a "lack of transparency for operating vs. capital funds." Information is properly documented and accounted for, for all transactions for all funds and they are appropriately identified and coded for general ledger purposes. The General Fund will continue to advance cash to the Capital Projects Fund, as needed for properly authorized capital projects, in anticipation of replenishment by any pending new bond issuance. Additionally, there are already separate bank accounts in use for WPCA operations, OTHRA and Mill River. That said, as recommended by the Financial Policy Committee and voted on by the full Board of Finance (on January 10, 2013), the City will maintain separate bank accounts for the Capital Projects Fund (for bond proceeds), the Capital Non-recurring Fund, and the Rainy Day Fund in addition to the separate bank accounts it already maintains for the Debt Service Fund. In addition, on behalf of the SWPCA, the Administration will open a separate Capital Projects Fund bank account (for new bond proceeds) so that the funds are segregated from the City's bond proceeds.

Expected remediation – Q3 F2013

Exhibit C - Control Deficiencies (continued)

• **GASB Statement No. 34 - Entity-Wide Transactions**

Capital Asset Records

Capital assets (net of accumulated depreciation) amount to approximately \$699 million at June 30, 2012. The current year additions and deletions are a vital component of the GASB Statement No. 34 conversion of the City's fund level statements to full accrual entity-wide statements. In order to record, reconcile and depreciate the City's capital assets, a system needs to be in place in which capital asset transactions are properly recorded on a timely basis and properly segregate additions, deletions, transfers from construction in progress and transfers between funds. Extensive time was spent subsequent to year end by management and the auditors reviewing the reports and arriving at current year additions as well as properly reflecting current year depreciation expense to produce an accurate report. Certain differences related to prior year adjustments and reclassifications that were not posted to the sub-ledgers. The City's Accounting Policies and Procedures Manual doesn't adequately and consistently address the control process over the recording of capital additions, deletions and transfers or the preparing of any necessary reconciliations.

Recommendation

- Maintaining capital asset records is one of the most basic of internal controls that any organization with significant capital assets should have in place. The lack of such a record makes it difficult to ensure that the financial statements are presented fairly as well as ensuring that the proper amount of insurance is in place to protect the City against loss. We recommend that the City maintain the detailed capital asset records and reconcile these records to the general ledger on a timely basis, at least quarterly, to ensure accurate accounting for assets. Complete information for all capital assets provides excellent control for the safeguarding of these assets, which are material to the City's financial statements. The assessment and evaluation now can be made regarding the reliability of certain capital assets and the need for replacements.

Management Response (6.1 - Responsibility of Controller's Department):

The Controller's Department will implement this recommendation through the redistribution of responsibilities within the department. Upon reassignment, the control processes and procedures will be documented (and added to the City's Accounting Policies and Procedures Manual at the next revision date).

Expected remediation – Q4 F2013

Exhibit C - Control Deficiencies

• **GASB Statement No. 34 - Entity-Wide Transactions** (*Continued*)

Procedures for Disposal of Capital Assets

The City does not have a formal policy and procedure to ensure that disposals of capital assets are reported to the accounting department as they occur. This often leads to a situation where capital assets that physically exist within the City and its asset listing are completely out of synch. For the year ended June 30, 2012, the City had not recorded any deletions.

Recommendation

- A formal policy to ensure the reporting of capital asset disposals should be adopted and should include the necessary level of approval for the disposal. This information should be reported to the accounting department on a timely basis. A simple standardized form could be developed to provide adequate accounting documentation and to provide evidence of adherence to City policy.

Management Response (6.2 - Responsibility of the Director of Operations):

Management agrees with the issue noted and the recommendation made. Effective immediately, the new process is as follows:

- *Assets or equipment (trucks, equipment, tools, etc...) to be sold at auction will first be matched with the identifying asset number assigned to them by the Controller's Department at time of purchase (M. Scacco to request from J. Hussey).*
- *Items sold at auction will be reported promptly to OPM and the Controller's Department via e-mail from Operations (M. Scacco) with the identifying asset number and net sale price indicated so that the items can be identified as disposals in the City's fixed asset records (J. Hussey).*
- *Items sold for scrap will also be reported on a timely basis to the Controller's Department (J. Hussey) by Operations (M. Scacco) with their identifying asset number.*
- *For sales and disposals without identifying asset numbers, but with a disposal value in excess of \$5K, Operations (M Scacco) will make an attempt to determine the year of acquisition of the items so that the Controller's Department (J. Hussey) can make a determination if the City's fixed asset records require adjustment to reflect the disposal.*
- *The sale or disposal of City assets must be conducted and accounted for as required by the City Charter (Sec. 23-18-13).*

Expected remediation – Q3 F2013

Exhibit C - Control Deficiencies

• **General Fund**

Smith House: Financial Management Practices*

Accounts Receivable/Allowances and Deferrals:

Our audit disclosed that there is approximately \$1.73 million (net of allowance and 60 day collections) of significantly past due receivables, the majority of which pertain to the Smith House nursing facility. Although an allowance has been established, it should not preclude the City from utilizing all available collection efforts. Improved collections will increase the availability of funds and improve cash flow.

Recommendation

- The billing and collection process at the nursing facility is complex and it appears that there is not sufficient staff, or inadequately trained/qualified staff in place to effectively manage the accounts receivable process. Since collectability of these receivables is not assured, an allowance for uncollectible amounts has been established, net of collections received within the first sixty days after the end of the fiscal year. As mentioned, this should not preclude the City from utilizing all available collection efforts. The City should consider hiring additional staff to assist in the management of accounts receivable at the Smith House nursing facility. Alternatively, the City might consider outsourcing the entire billing and collection process. This comment is repeated from our prior year's letter.

Management Response (7.1 - Responsibility of Smith House Executive Director):

Management agrees with the issue noted and the recommendation made. The hiring of the Smith House Finance Manager will be completed within the first quarter of the calendar year 2013. That individual's duties will include HTE general ledger accounting and monthly financial reporting. They will have overall responsibility for billing and collections of accounts receivable, expense approval and submission to the City's accounts payable department, and interdepartmental interaction to insure payer identification for all services provided by the facility are billed accurately and reconciled accordingly. Timely assessment of potential collection issues as well as supervision of all ancillary staff involved in the Accounts Payable, Resident Trust and other areas as assigned will also be overseen by this Manager level person.

Expected remediation – Q3 F2013

Exhibit C - Control Deficiencies

• **General Fund** *(Continued)*

Smith House: Financial Management Practices* *(Continued)*

Limited Segregation of Duties:

The Smith House nursing facility is a relatively small, remote operation, with limited staff. As a result, there are several areas where the ability to adequately segregate duties is limited. A limited segregation of duties increases the risk for both errors and defalcations.

Limited segregation of duties is often a very difficult issue to deal with, as the costs of hiring additional staff can be greater than the risks associated with the limited segregation of duties. Strong budgetary controls and financial oversight are often effective in detecting operating anomalies which could be the result of errors or defalcation. Also, a City-wide Internal Audit function is another effective control.

Recommendation

- We recommend that the City review its opportunities for limiting its risk by providing for a greater segregation of duties at the Smith House nursing facility. Significant areas where we believe there is limited segregation of duties, and it should be strengthened, include:
 - Payroll processing
 - General disbursements, particularly with regard to food services, housekeeping and general supplies, where blanket purchase orders are used
 - Processing of cash receipts for insurance reimbursements and family contributions

This recommendation is repeated from our prior year's letter.

Management Response (7.2 - Responsibility of Smith House Executive Director):

The hiring of a Finance Manager and the potential hiring of a Billing Coordinator will allow for greater internal segregation of duties. It will also allow for further assistance with scrutiny of the payroll, payables and cash receipts processing. Delegation of duties and accountability to specific positions and oversight of these responsibilities will be one of the first charges for the positions noted above. Further monitoring will be conducted by the Executive Director to assure compliance.

Expected remediation – Q3 F2013

Exhibit C - Control Deficiencies

• **Component Unit - Urban Redevelopment Commission (“URC”)**

Accounting and Financial Reporting*

Receivables/Payables with the City:

During our audit procedures, we identified several receivables and payables between the URC and the City. Per our inquiries of management of both the URC and the City, neither could provide an explanation or supporting documentation as to what comprises certain balances.

Recommendation

- We recommend that the City and the URC undertake investigations to determine what these balances represent, come to a mutual understanding of the composition of these balances, and formulate a resolution as to how these balances are to be settled. This recommendation is repeated from our prior year’s letter.

Management Response (8.1 - Responsibility of URC):

Management agrees with the issue noted and the recommendation made. URC representative has provided historical prospective and supporting documentation for balances related to this issue to the Controller’s Department (and to external auditors). URC will work with Controller’s Department to document balances and make adjustments as needed.

Expected remediation – Q4 F2013

Account Balances and Supporting Documentation:

During our audit procedures, we identified several accounts on the URC’s balance sheet that management was unable to provide sufficient explanation or documentation. These accounts include land, escrow accounts payable and deferred grants revenue. While management provided us a list of the property held, it could not provide us with the acquisition costs. This comment is repeated from our prior year’s letter.

Recommendation

- We recommend that the City and the URC determine what land acquisition costs are captured in their land account and if the balance currently presented is an accurate representation of those costs; for whom this escrow account is being held, and if the funds should be returned to them, continue to be held, or be released from restriction for the URC to utilize; and determine what the deferred revenue pertains to and if it should have been recognized, will be recognized at a future point in time, or does it need to be returned to the party issuing the grant.

Exhibit C - Control Deficiencies

- **Component Unit - Urban Redevelopment Commission (“URC”) (Continued)**

Accounting and Financial Reporting* (Continued)

Account Balances and Supporting Documentation: (Continued)

Management Response (8.2, 8.3, & 8.4 - Responsibility of URC):

Management agrees with the issue noted and the recommendation made. A URC representative has provided historical prospective and supporting documentation for balances related to this issue to the Controller's Department (and to external auditors). URC will work with Controller's Department to document balances and make adjustments as needed.

Expected remediation – Q4 F2013

- **City - Wide**

Fund Deficits

Deficits place a financial burden upon a municipality. They are either created by expenditures in excess of budgetary provisions or revenue shortfalls. The effects of deficits are varied but their initial impact will generally be felt on cash flow. The financial statements of the City reflect deficits in the following funds.

Internal Service:	
Risk Management	\$ 2,470,779
Disputed Assessments	30,740
Parking	692,162

These deficits coupled with the economic volatility associated State and Federal funding and increases in litigation and insurance costs will require the City to consider a variety of options in balancing future budgets. Management has communicated to us that they intend to cover these deficits with year-end surplus generated in the General Fund.

Recommendation

- We suggest that the City continue to monitor its operations to ensure that these deficits are reduced or eliminated.

Management Response (9.1 - Responsibility of OPM):

Fund balances are being monitored throughout the year and Management has committed the necessary funding from year-end General Fund surplus.

Exhibit C - Control Deficiencies

• **City - Wide** (*Continued*)

Parking Fund

Policies and Procedures Regarding Additional Appropriations

In June 2012, the Board of Finance approved an appropriation of \$176,500 for additional expenditures for the Parking Fund. The Office of Policy and Management advised the Board of Finance that the appropriation amount was needed in order to pay for additional hours of operation due to the extension of garage hours. The budget was amended for this additional appropriation and the amount was accrued and charged to the 2011-2012 fiscal year. The bill was subsequently paid on July 3, 2012. On July 9th, 2012 it was presented to the Board of Representatives which did not approve such funding at that time.

Recommendation

- Since amendments to the budget and payment of expenditures involves the approval of both the Board of Finance and the Board of Representatives, such additional appropriation should not have been recorded in the books and records and such payment should not have been made in July 2012, in accordance with the City's policies and procedures. Such appropriation was presented again to the Board of Representatives on August 6, 2012 and was approved at that time.

Management Response (9.2 - Responsibility of OPM):

Except for the specific instance as noted above in the Parking Fund and the extension of the operation of the garages, expenditures are not made without sufficient revenues or appropriately approved funding.

Remediated – N/A

Journal Entry Authorization and Support

In addition to the numerous cash receipts and disbursements that get posted each year to the accounting records, a significant amount of journal entries are also processed by accounting personnel. These journal entries, or adjustments, can range from minor to material amounts. During the audit, it was noted that certain journal entries do not appear to be signed off and approved by the Controller or supervisory personnel. In many instances, the accountant prepares the journal entry and also signs-off on the entry.

Exhibit C - Control Deficiencies

• **City - Wide** *(Continued)*

Journal Entry Authorization and Support *(Continued)*

Recommendation

- We recommend that procedures be implemented whereby all journal entries evidence the fact of supervisory approval. The City can set different approval parameters based upon the materiality of the adjustment.

Management Response (10.1 - Responsibility of Controller's Department):

The Assistant Controller is responsible for reviewing and approving all journal entries. During the course of the year-end close, the Assistant Controller may take on the task of preparing a specific journal to keep the close moving forward. If the Controller is not available, the Assistant Controller may not get the entry reviewed and approved prior to having it entered. Going forward, the Assistant Controller will seek out the Controller (or the Director of Administration, if needed) for a separate and timely written approval in accordance with established policies.

Expected remediation – Q4 F2013

• **Allocation and Approval of Bond Proceeds**

The City utilizes a Debt Service Fund to account for the redemption of principal and interest on long-term debt. The funding for such repayments comes from charges to the various operating funds, primarily the General Fund. The charges to each fund are based on an allocation provided by a third party financial institution and approved by the City. Such allocations have been modified to coincide with the useful life of the asset acquired with the bond proceeds.

During our audit, we noted in certain instances that proceeds have been advanced to cover expenditures for capital projects which are to be funded, in part, with Federal and/or State aid. Such Federal or State grants are claimed for on a cost reimbursement basis meaning that the funds have to be spent in order to be claimed for reimbursement. Such tracking of these advanced funds is not occurring between the Controller's Department and the Grants Department.

In addition, the City has, in the current year, issued Special Obligation Tax Increment Revenue Bonds for the Mill River capital project for which the City does not have an adequate process in place to record such transactions. Adjustments were necessary to record such financial activity, the related capital outlay expended, reimbursement to the City for the Mill River capital projects expenditures originally financed by general obligation bonds, debt service costs incurred in the current year as well as the recording of capital and debt service restrictions all of which related to the Mill River Corridor project.

Exhibit C - Control Deficiencies

• **Allocation and Approval of Bond Proceeds** *(Continued)*

Recommendation

- We continue to suggest that the City perform a comprehensive review of the debt service allocations prepared by the third party financial institution.

Management Response (11.1 - Responsibility of OPM):

The City is already allocating at the time of debt issuance. The City started allocating project specific bonds in FY 2010/2011 and will continue to do so for future bond issues. The City does not agree that a retroactive review of the allocation of debt service based on past practice of cash flow financing will yield any value.

Remediated – N/A

Recommendation

- The City must include a tracking mechanism for Federal and/or State grants to determine if in fact the total amounts of Federal and/or State grants have been claimed for and received.

Management Response (11.2 - Responsibility of OPM):

The Assistant Controller will be working with the Grants Department to track Federal and State grants filed and received.

Expected remediation - Q4 F2013

Recommendation

- We recommend that the City implement a checklist whereby such activity relating to the Special Obligation Tax Increment Revenue Bonds is recorded properly in accordance with governmental auditing standards. A tremendous amount of time was devoted to dissect the co-mingled accounts and transactions, suggests that the City perform a comprehensive review of the debt service allocations prepared by the third party financial institution.

Management Response (11.3 - Responsibility of Controller's Department):

As noted above, the Assistant Controller will be working with Controller to develop monthly closing schedule. The checklist will be developed and incorporated into the monthly closing schedule going forward.

Expected remediation – Q4 F2013

Exhibit C - Control Deficiencies

• **Capital Projects Fund**

Project Length Schedule from Inception

Governments often acquire or construct major capital facilities that either help the government provide services to its citizens or serve the needs of citizens directly. In either case, a financial reporting vehicle is needed to demonstrate compliance with legal and contractual provisions and to compile certain cost data which may span several fiscal years. The Capital Projects Fund provides such a mechanism.

Many governments establish an annual capital improvement program and include the program in their annual operating budget, while others adopt project length budgets for their projects and rely on mechanisms such as bond indentures to ensure proper control over expenditures. No matter which method is chosen, governments need to ensure that budgetary compliance is demonstrated in their financial reports.

Annual appropriation budgets for capital projects or project-length budgets should be included in the presentation of a government's Capital Projects Fund in compliance with generally accepted accounting principles. This project length schedule should include the budget, expenditures to date, revenues received by type, inclusive of Federal and State grants, to date and fund balance.

Recommendation

- Our audit disclosed that the tracking of capital projects as described above has begun in conjunction with the debt administration process. We continue to recommend that the City prepare the recommended schedules for all City capital projects to demonstrate compliance with legal and budgetary constraints as well as the City Charter. Given that the City has a tremendous amount of capital projects that are current and may span over several years, consideration should be given to creating a full-time project management function to oversee the City's capital projects.

Management Response (12.1 - Responsibility of OPM):

OPM works closely with Bond Counsel to properly identify all capital allocations and the expenditures of those allocations to ensure full compliance with all legal requirements. OPM will prepare schedules prospectively in conjunction with quarterly capital spending beginning with the report for Q1 F2013.

Expected remediation – Q2 F2013

Exhibit C - Control Deficiencies

• **Capital Projects Fund** (*Continued*)

Retainage Payable*

Retainage payable, which represents amounts withheld from contractors for completed work pending satisfactory approval of their phase of a construction project, should be classified as expenditures and recorded on the books of account simultaneously with the payment to the contractor.

Our audit of the Capital Projects Fund disclosed that this process is not being adhered to and retainages are not being recorded in a timely manner. We also noted that the year-end adjustment to the retainage payable liability in the amount of \$1.1 million was recorded to one expenditure code rather than to the specific expenditure line items of the individual capital projects to which they relate.

Recommendation

- Retainage payable amounts should be recorded simultaneously with the accounts payable process to reflect the total costs of a capital project at any given time during the fiscal year.

Management Response (12.2 - Responsibility of Controller's Department):

Comment was applicable to prior fiscal year. Retainage payable schedules are updated quarterly (since Q2 F2012) and reviewed by the Assistant Controller.

Remediated – Q2 F2012

Accounts Receivable, Amounts Due from State and Related Deferred Revenue

During our testing of accounts receivable and related deferred revenue, we noted certain capital projects for which expenditures were incurred and grants filed for reimbursement, however, the respective accounts receivable/revenue accruals were not recorded.

Recommendation

- The management of accounts within the general ledger is essential to accurate financial reporting. Proper internal controls should be in place to provide for accurate and timely reconciliation of account balances to subsidiary records.

Exhibit C - Control Deficiencies

• **Capital Projects Fund (Continued)**

Accounts Receivable, Amounts Due from State and Related Deferred Revenue (Continued)

Management Response (12.3 - Responsibility of Grants Department):

Management agrees with issues noted and the recommendations made. The Grants Office will provide a monthly report within 30 days of each month-end to the Controller's Department of grant applications filed, including highlighting new applications files and any changes in applications that were previously reported. The Controller's Department will issue a quarterly report of federal and state revenue received to be used by the Grants Department to reconcile grant accounts to the general ledger. The Director of Administration will be asked to notify all City departments that reimbursement requests for and/or receipt of federal and state funding must be reported to the Grants Department for inclusion in their monthly report.

Expected remediation – Q3 F2013

• **Application of Bond Proceeds and Federal/State Grants**

There appears to be a communication gap between the Controller's Department (Finance) and the Grants Department regarding the application of bond proceeds along with Federal and State grant funding. The Controller's Department has stated that bond proceeds are to be used first when funding a capital project, however, during our testing of capital projects, we determined that the Grants Department also files for reimbursement on projects which were originally approved and for which expenditures have been incurred without notifying the Controller's Department. A tremendous amount of time was spent in the analysis of capital projects which were funded in part with bond proceeds and Federal and State grants.

Recommendation

- We recommend that the Controller's Department establish a clear written policy as to how each capital projects funds are to be spent and in what order. The Grant's Department needs to notify the Controller's Department when such claims for reimbursement of Federal and/or State aid are filed so that the Department can properly account for them through the general ledger. This will enable the City to properly track capital projects, account for all revenue sources and related receivables/deferred revenue and enable the City to account for all spent and unspent bond proceeds.

Exhibit C - Control Deficiencies

- **Application of Bond Proceeds and Federal/State Grants** *(Continued)*

Management Response (12.4 - Responsibility of Grants Department):

Management agrees with the issues noted and the recommendations made. The Grants Department will provide a monthly report as noted above (ID #12.3) and meet with OPM each quarter to update the funding sources for capital projects based on changes in the monthly report. The Controller's Department will update the general ledger as needed to adjust receivables or other general ledger accounts.

Expected remediation – Q3 F2013

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **Enhancing Internal Control**

Control Environment

The control environment sets the tone of an entity and influences the control consciousness of its people. The control environment is the foundation for all other components of internal control and provides structure and discipline. Among the important elements of the control environment are the attitude, awareness, and actions of management, as well as those charged with governance, concerning internal control. As a large organization with multiple locations and diversified activities, we believe there are important steps that can be taken to enhance the control environment within the City, particularly during these challenging economic times.

Enhancing the Reporting Mechanism for Fraud and Abuse*

Internal reporting channels, such as department heads open-door policies and through standardized complaint forms, have been found to be effective. Hotline or whistleblower provisions have been found to perform better for anonymous tips. In the prior year, we were advised that a formal mechanism (“employee hotline”) was in the process of being implemented and we believe that it is essential to this process that any communications from employees are completely confidential – to protect them from potential reprisals – and that their comments are discretely handled and communicated to the boards or the audit committee, perhaps through an independent third party. We have not seen such mechanism implemented as of yet.

Recommendation

- We recommend that the City continue to enhance its reporting mechanism for fraud, abuse and misconduct. We strongly suggest that an updated and comprehensive evaluation of the current reporting mechanism for fraud, abuse and misconduct would be of great benefit to the City.

Management Response (13.1 - Responsibility of Director of Administration):

Management agrees with this recommendation. Whistleblower hotline will be established and communicated to City employees and residents in the near future.

Expected Remediation – February 2013 (Q3 F2013)

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Enhancing Internal Control** (*Continued*)

*Enhancing the Internal Audit Function**

Presently, the City's Internal Audit function is performed by one employee within the Controller's Department. We believe that an expanded and enhanced Internal Audit function would provide substantial benefits to the City in improving operational efficiency, preventing and detecting fraud and enhancing internal control.

Recommendation

- We recommend that the City re-establish an Internal Audit function. A written, risk-based audit plan covering all aspects of the City's operations should be developed and carried out on a cyclical basis.

Management Response (13.2 - Responsibility of Director of Administration):

Management agrees with this recommendation. An Internal Auditor was hired in July of 2012. Risk-based annual audit planning process will commence in Q3 F2013 (in collaboration with the Board of Finance, Legal / HR, and Controller's Office). Hiring additional audit resources, with the approval of the Boards, may follow based on the risk assessment.

Expected remediation – Q4 F2013 for Risk-Based Audit Plan

*Training on Code of Conduct**

The City has a Code of Conduct that is required to be followed by employees. However, to be effective, a Code of Conduct must be well communicated to, and understood by, those expected to adhere to it. Thus, we recommend that the City conduct training for new employees during which they can ask questions about provisions of the code. Periodically thereafter, there should be refresher training for existing employees. The training should be specific and relevant to the employees' levels and duties so that they will understand how the code applies to them. For example, the frequency and details of training might differ for supervisory versus nonsupervisory personnel, or for accounting versus non-accounting personnel.

Recommendation

- New employees should be required to sign an acknowledgment of their responsibility to adhere to the Code of Conduct at the time of their employment. Existing employees (particularly those in sensitive positions such as senior management, department heads, and those handling accounting functions of any type of cash)

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **Enhancing Internal Control** (*Continued*)

*Training on Code of Conduct** (Continued)

should periodically (preferably annually) reconfirm their understanding of, and responsibility to adhere to, the code; that they have complied with it; and that they are not aware of any unreported violations.

Management Response (13.3 - Responsibility of Director of Administration):

Ethics training will be offered to City employees in sensitive positions such as senior management, department heads, and those handling accounting functions in the near future. Directors and managers will be trained first. The program will be rolled out to rank and file employees over time. Fire and Police will receive customized training - but no time frame has been established as of yet for their training.

Expected remediation – Q4 F2013 for Ethics Training for City Directors and Managers

- **General Accounting Transactions**

Capital Lease – Recycling Trucks

In 2007, the City entered into a lease agreement for recycling trucks. The lease qualified for accounting purposes to be recorded as a capital lease. The principal and interest obligations for this lease should be accounted for in the Debt Service Fund and be funded by a budgeted transfer out of the General Fund, instead of being charged to a contracted services appropriation account in the General Fund.

Recommendation

- We recommend that the City record this obligation in a manner similar to other bonded indebtedness. That is, the amount of principal and interest on this obligation should be budgeted and recorded as a transfer out of the General Fund and the principal and interest payments reflected in the Debt Service Fund.

Management Response (14.1 - Responsibility of Controller's Department):

Management agrees with recommendation and will make the necessary adjustments before the end of F2013.

Expected remediation – Q4 F2013

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **General Accounting Transactions** (*Continued*)

Board of Education (“BOE”) Medical Funds – Defined Employees

We noted that the BOE reimburses the City Medical Fund for certain defined employees who are covered by the City Medical Fund. Instead of the BOE sending the funds directly to the City Medical Fund, the funds are first transferred to the BOE Medical Fund and then from there to the City Medical Fund. This extra step artificially inflates the BOE Medical fund’s revenues and expenses.

Recommendation

- We recommend that the defined employee’s medical costs be directly charged to the City’s Medical Fund.

Management Response (14.2 - Responsibility of Board of Education):

Management agrees with recommendation and will make the recommended changes to simplify the accounting (using separate journal entries) to add transparency before the end of F2013.

Expected remediation – Q4 F2013

- **Cash Management**

Interest Allocation

The City’s accounting software system automatically allocates interest income based on the ending cash balances in each fund. During 2012, it was noted that the Mill River Capital Projects Fund, with a cash balance of approximately \$3 million, the Non-Recurring Capital Projects Fund, with a cash balance of \$2.8 million, the Rainy Day Fund, with a cash balance of approximately \$13.9 million and the Town Aid Highway Fund with a cash balance of approximately \$260,000, had very little or no interest allocated for the entire year.

Recommendation

- Although the overall interest income may not be significant due to the current low interest rate environment, we recommend that the City allocate interest earning based on a consistent methodology.

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **Cash Management** (*Continued*)

Interest Allocation (*Continued*)

Management Response (14.3 - Responsibility of Controller's Department):

Management agrees with recommendation and will make the recommended changes before the end of F2013.

Expected remediation – Q4 F2013

Resolve Outstanding Checks

It has been the City's policy to transfer checks outstanding over one year to a liability account for unclaimed checks entitled - stale dated checks. These balances have aggregated \$286,282 and \$131,013 respectfully for the years ended June 30, 2012 and 2011. We also noted outstanding payroll checks totaling approximately \$155,000 that have been outstanding in excess of one year.

There is currently no formal policy in place to cancel these amounts and return the amounts to the fund which was originally charged or to send stop payment notices when necessary.

Recommendation

- We recommend that the City develop and put in place a formal policy that creates a standard procedure to account for stale dated checks. Although reconciling items are moved to a liability account for control purposes and to facilitate preparation of monthly bank reconciliations, these items should be reviewed regarding whether they should be written off with proper approvals and appropriate stop orders placed with the financial institutions. Supervisory personnel should be notified when payroll checks are outstanding in excess of one year so that proper action can be taken. Additionally, the City must determine if the funds are owed to the State in the form of unclaimed funds.

Management Response (15.1 - Responsibility of Controller's Department):

Management agrees with recommendation and will implement the recommended changes beginning in F2014.

Expected remediation – Q1 F2014

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Cash Management** (*Continued*)

Bank Accounts*

When the City opens or closes a bank account, no formal Board action is taken to acknowledge this activity.

Recommendation

- We recommend that the Board of Finance authorize all accounts that are opened or closed during the year by passage of a formal resolution.

Management Response (15.2 - Responsibility of Controller's Department):

Management agrees with recommendation and will implement the recommended changes before the end of F2013.

Expected remediation – Q4 F2013

Separate Bank Accounts

Capital Non-Recurring Fund

Connecticut General Statutes 7-361 require that all money accumulated in the Capital Non-recurring Fund, together with all interest, is to be deposited in a separate bank account. With the exception of a segregated cash account of approximately \$72,000 of the \$2.8 million in the fund, the City has co-mingled these funds as part of their pooled cash.

Recommendation

- We suggest that the City segregate the total accumulated monies in this fund in accordance with Connecticut General Statutes.

Management Response (15.3a - Responsibility of Controller's Department):

Management agrees with recommendation and will make the recommended changes before the end of Q3 F2013.

Expected remediation – Q3 F2013

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Cash Management** (*Continued*)

Separate Bank Accounts (*Continued*)

Rainy Day Fund

The Rainy Day Fund is used to accumulate fund balance. Per City Charter, the Mayor can direct that a surplus from the prior fiscal year be transferred into this fund and in subsequent years, direct that it be expended for any lawful purpose. These accumulated funds are to be used only in an emergency or extraordinary situation.

Recommendation

- All transfers and expenditures from the Rainy Day Fund require the approval of the Board of Finance and the Board of Representatives and it would be the City's policy to establish a separate bank account to account for the accumulated fund balance in the Rainy Day Fund. As such, the Board of Finance has given consideration to segregating these funds into their own bank account rather than being part of the pooled cash.

Management Response (15.3b - Responsibility of Controller's Department):

Management agrees with recommendation and will make the recommended changes before the end of Q3 F2013.

Expected remediation – Q3 F2013

Check Signing Authorization

As part of our audit procedures, our standard bank confirmation testing revealed that persons known to have left employment of the City remain on the bank records as authorized signors. Only current employees should be responsible for such an important control over cash disbursements.

Recommendation

- In an effort to maintain strong internal controls, we suggest that the City periodically check the authorized check-signer listing on the bank records and, if necessary, update the list.

Management Response (15.4 - Responsibility of Controller's Department):

Management agrees with recommendation and will make the recommended changes beginning in F2014.

Expected remediation – Q1 F2014

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **Continuing Emphasis on Governance**

Document Retention

The time period for which a City's routine accounting and financial documents should be retained needs to be established so that important documentation could be kept at hand, in the context of the cost-benefit considerations of storing such information over time. In today's environment, regulators and other interested parties may be concerned, for a variety of reasons, about the availability of the City's historical accounting and financial information.

Recommendation

- We recommend that the City formally assigns to a specific representative the sole authority to delete, destroy, or discard the City's documents, based on the established policy's guidelines for the type of documentation to be maintained and the time frame for maintaining it.

Management Response (16.1 - Responsibility of Legal Affairs):

Management agrees with recommendation and will make the recommended changes beginning in F2014.

Expected remediation – Q1 F2014

- **Transaction Cycles**

Payroll Cycle Review Findings

As part of our audit of the City's financial statements, we review, evaluate and perform walkthroughs with respect to the real property tax, payroll, purchasing and cash receipts cycles. Our walk-throughs for the current year indicated the following:

Through our inquiry and interview process, we noted that overtime throughout the City had reached excessive levels. The City's overtime policy explicitly states that overtime must be properly documented. During the course of our audit, we noted that a procedure was in place for the approval of overtime with the appropriate supervisory sign-off, but we were not able to substantiate the work performed during the overtime period, since there was no description of the work performed on file. This was the case in the departments tested which included Operations (Department of Public Works), Department of Recreation and the Police Department. We also noted that many individuals/department heads had the authority to approve overtime. We further noted that several BOE employee files were not updated with the current salary information.

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Transaction Cycles** (*Continued*)

Payroll Cycle Review Findings (Continued)

Recommendation

- We recommend that the City and Board of Education designate appropriate parties to certify payroll. The certification of payroll will provide a level of internal control and accountability. The certification should include the necessary signatures and information/documentation including certain testwork (on a sample basis) to support the payroll. Any overtime worked should include a description of the work performed and why it was needed, along with the proper approval. The City should also consider limiting the number of individuals having the authority to approve overtime.

Recommendation

- To improve internal control over the payroll process, we recommend that the City:
 - Train timekeepers/department heads on better methods of ensuring that proper documentation is on file for all timesheets, overtime, and annual leave and sick leave forms.
 - Establish a methodology for employee file maintenance and related physical safeguards and assign responsibility for these matters to the appropriate employee.
 - Develop a standard checklist to ensure that all personnel files contain appropriate supporting documentation. Consider a periodic unannounced review of existing files to determine the completeness and accuracy of file data.
 - Reinforce established procedures for employee terminations to ensure that they are processed timely.

Management Response (17.1 & 17.2 - Responsibility of Controller's Department (Lead) OPM, Payroll, and Board of Education):

While Management agrees that processes and controls around overtime need to be improved, we do not necessarily agree that the implementation of the recommendations made will address the issues and get at the root cause of this problem. Management believes that a broader understanding of current processes is required before the appropriate remediative activities can be identified.

Expected remediation – Q2 F2014

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

- **Transaction Cycles** (*Continued*)

Concentration of Payroll Responsibilities

Our audit testing of payroll procedures disclosed that one employee in the accounting department for the City and one employee for the Board of Education is essentially performing the complete payroll process. This is contrary to the establishment of strong internal controls regarding segregation of responsibilities.

Recommendation

- While we clearly understand the limitations in obtaining an adequate segregation of duties with a small staff, we recommend that the Director or Controller or Internal Audit Manager, or an employee chosen by the Director, should periodically review the payroll for both the City and the Board of Education on a surprise basis. This review should include which employees are listed on payroll, amounts at which they are paid, reasonableness of withholdings, and the assurance that all related payroll taxes are being paid.

Management Response (17.3 - Responsibility of Controller's Department):

Management has already initiated a review of current payroll procedures by Internal Audit, including extensive testing of transaction data for anomalies, using data mining software. The testing must be revised as it is rolled out across different departments and functional areas because of the procedures involved in capturing time work, getting it approved, and processing it through the payroll department. The progress of that review is reported regularly to the Audit Committee of the Board of Finance. Surprise audits, though proven a good deterrent to fraud, can still miss anomalies that would be detected by the more thorough current review of all transaction data during a given time period that is currently underway.

Expected remediation – Q4 F2013

- **Board of Education (BOE) Items**

Personnel Records / Software – Board of Education*

The recording and maintaining of sick time for Board of Education (“BOE”) employees is tracked manually in an Excel spreadsheet. While we concur that this information must be kept current, such a manual process is very time consuming and inefficient. The City uses an automated system (i.e. Kronos) to record the actual time taken during the year for each employee, but there is no tracking mechanism for prior year’s balances.

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Board of Education (BOE) Items** *(Continued)*

Personnel Records / Software – Board of Education* (Continued)

Recommendation

- We recommend that the City investigate the reasons for the use of non-integrated programs for recording employee's accrued time and address the difficulties in the integration of these systems into one summarized report. This is an area that needs to be kept up to date to avoid the possibility of improperly calculated sick time payouts. We further recommend that the City/BOE implement an automated system that can roll forward prior year's unused sick time, as well as track current year sick time earned and taken for each employee.

Management Response (18.1 - Responsibility of Board of Education):

BOE is aware of the limitations of the existing system and will be formulating plans to update it. In the interim, manual efforts will be used to keep the data current and accurate. The long term plan is to implement the proper software (in one to two years); meanwhile, a quarterly review of such information will be instituted by the Board of Education Finance Director and the results of each review will be reported to the Controller's Department.

Expected remediation – On-going

Student Activity Clubs - Club accounts with negative balances*

During our audit of the various schools' student activity funds, we noted that several clubs had a negative balance at the end of the fiscal year. This comment is repeated from our prior year's letter.

Recommendation

- We suggest that the cash receipts and disbursements of each club be closely monitored. Policies and procedures should be in place to prevent a club's account from going into a negative position. Existing negative balances should be investigated and a determination made as to the cause, a plan as to how to rectify the shortage and how to prevent such an occurrence in the future.

Management Response (18.2 - Responsibility of Board of Education):

A new policy (3447R) for this was approved on July 7, 2011 and was effective immediately. Management reviews are held on a quarterly basis to ensure compliance.

Remediated – July 2011

Exhibit D - Other Observations/Recommendations for Improving Internal Control and/or Operating Efficiency

• **Board of Education (BOE) Items** *(Continued)*

Student Activity Clubs - Inactive clubs*

We noted that several clubs had no financial activity during the current fiscal year. These funds should revert to the account of the general student organization or the student council and be expended in accordance with that organization's constitution.

Recommendation

- We suggest that a determination of the status of the clubs with no financial activity be made to determine the proper disposition of funds.

Management Response (18.3 - Responsibility of Board of Education):

On July 7, 2011, policy 3447R was amended to address this issue and class accounts will revert to the school General Fund after the five year class reunion. This will be effective immediately.

Remediated – July 2011

Student Activity Funds - Preparation and timeliness of reports

During our audit, the student activity funds reports were not provided to us in a timely fashion, resulting in delays in the audit process. Additionally, certain student activity reports opening balances did not match the closing balances presented in the prior year audited financial statements. We were advised that with the use of quickbooks, certain checks that are voided revert back to the year they were issued resulting in such differences.

Recommendation

- All schools should provide the finance personnel at the Board of Education with monthly student activity reports. This will ensure that all student activity funds are monitored and reviewed in accordance with the City's Accounting Policies and Procedures Manual and that any discrepancies are resolved in a timely manner.

Management Response (18.4 - Responsibility of Board of Education):

BOE has implemented the recommendation and now runs month activity reports using Quickbooks.

Remediated – July 2011