

CITY OF SPRINGFIELD, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2008



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To the Honorable Mayor, the City Council, the Finance Control Board, and Management
City of Springfield, Massachusetts

In planning and performing our audit of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Springfield, Massachusetts (City) as of and for the fiscal year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions 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 preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be remaining fund information prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute material weaknesses:

The failure of the School Department to record Transportation expenditures in the proper fiscal period.

We also became aware of other matters that are opportunities for strengthening internal controls and enhancing operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

This communication is intended solely for the information and use of management, and others within the City of Springfield, Massachusetts, and is not intended to be and should not be used by anyone other than these specified parties.

The City's written response to the material weaknesses and other matters identified in our audit has not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Wakefield, Massachusetts
February 18, 2009

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CURRENT YEAR COMMENTS

MATERIAL WEAKNESSES

Failure of the School Department to Record Transportation Expenditures in the Proper Fiscal Period

Comment

During the fiscal year 2008 audit and after the City's books were closed for the year then ended we were informed that approximately \$1,454,000 of transportation expenses incurred with one vendor during fiscal year 2008 had not been recoded in the City's general ledger. An audit adjustment was necessary to record these as a liability for financial statement purposes as of June 30, 2008, and the City was required to have a special vote to transfer funds from its Stabilization Fund to appropriate this amount for payment during fiscal year 2009.

This situation was apparently caused by the lack of an internal control at the School Department requiring all invoices to be recorded in the accounting system upon receipt, and by the lack of budgetary monitoring policy in this particular department (Student Transportation).

Not having these invoices recorded in the general ledger during the 2009 budget season (the spring of 2008) also significantly contributed to the School Department's inability to properly budget for its actual transportation needs in fiscal year 2009. Additional appropriations amounting to approximately \$7.5 million were required to be again transferred from Stabilization Funds after the initial 2009 budget was adopted.

Recommendation

In order to strengthen internal control over financial reporting and to improve budgetary monitoring policy we recommend that management investigate the specific causes of this situation and take immediate action to implement procedures that would preclude this from occurring in the future. Considerations should be given to decentralizing the receipt and distribution of incoming mail, including electronic receipts, enhancing accountability for approving and processing of invoices, and to strengthening policies over monthly budgetary monitoring. Where necessary policies over segregation of duties and contractual and vendor relations should be re-examined to ensure that any outside vendor relationship is not being controlled by any one individual.

City Response

The School Department immediately retained the services of the Massachusetts Association of School Business Officials (MASBO) to perform a review of school transportation and to suggest areas of improvement. They issued their report in January of 2009 and the school department immediately implemented their recommendations reducing the additional appropriation required for FY09 from \$7.5M to approximately \$4.2M. Additionally, disciplinary action was taken with the department heads involved and internal control policies and procedures have been revised and updated to ensure that a situation like this does not re-occur.

PRIOR YEAR COMMENTS – UNRESOLVED

PRIOR YEAR COMMENTS – UNRESOLVED

The following comments and recommendations were reported in the prior year Management Letter dated December 12, 2007. We have only included the comments we believe remain unresolved.

Financial Accounting Practices at the City’s Retirement Office

Previous Comment

During our recent audits of the Retirement System we’ve noted that although the System has recently implemented new accounting software many manual processes continue to be followed and the System has not re-engineered its systems to take advantage of the new technology. We also noted that certain reconciliations and financial spreadsheets are not maintained in a manner that allows management to analyze the data. In addition, we were provided with numerous copies of the Annual Report and it was difficult to ascertain which copy was the final reconciled report submitted to PERAC. Overall, the financial operations of the Retirement System appear to be inefficient and disorganized.

Management has hired various outside consultants to analyze systems and to make recommendations for improving day-to-operations, as well as to perform reconciliations and to bring the current accounting records up to date utilizing the new accounting software. As of the date of this report this process is on-going.

Continuing Recommendation

In order to strengthen internal controls and to potentially improve operational efficiencies, we recommend that management review and document the operational procedures of the Retirement System to evaluate whether management’s objectives are being met and to gain a better understanding of System’s operations. We also recommend that once the outside consultants have completed their work that management implements the recommended policies and procedures and that these new procedures and internal controls be closely monitored to ensure they function as designed.

City Response

The Retirement Board sought assistance from outside consultants and recently made significant changes to the management structure in order to strengthen internal controls and improve operating efficiencies. An implementation plan is currently being developed to address the many recommendations made by the outside consultants to improve the retirement system operations.

Formalize Capital Asset Accounting

Previous Comment

The City is maintaining its capital assets on an excel spreadsheet and has not acquired software specifically designed for capital asset maintenance. With the number and value of the assets being so significant, using a spreadsheet solution increases the possibility that the financial statements could be misstated due to an error. The City has not implemented procedures to account for and audit fixed asset activities on a timely basis. In order to maintain a complete and accurate fixed asset listing the City needs to work on developing procedures to facilitate accurate fixed asset reporting City-wide.

Continuing Recommendation

The condition remains unchanged in FY2008. We recommend that management develop and implement procedures to track additions, deletions, disposals and transfers of fixed assets so that the proper adjustments can be made to the general ledger on a timely basis. The City needs to migrate from accounting for its capital assets on excel and implement a solution designed for capital assets.

City Response

The City has recently completed recording all buildings and related fixed assets using the MUNIS fixed asset module. The remaining capital assets will be migrated to this system during the next fiscal year.

Student Activity Funds

Previous Finding

Massachusetts General Laws allow for the Schools to maintain student activity funds but places certain requirements on how they are to be managed and accounted for. The School has only partially implemented the legal requirements. The Schools do not turn over all receipts to the Treasurer and the activity accounts are not replenished through the warrant process as required by law. The prior Management Letters have recommended a separate audit of these funds be conducted.

Continuing Recommendation

The status remains unchanged. By not fully implementing the provisions the School and City is in violation of the law. From a practical standpoint, we have found that when these funds are subjected to the requirements of the law it is likely that funds are being held and spent on purposes outside the scope of the law. We have also found that many times the account detail does not reconcile to the actual cash balances. We recommend that the School comply with all provisions of the law, establish procedures on how each account is maintained, reconcile the detail accounts with the actual cash balances and provide the Auditor's Office with a full accounting of the activity and the reconciliations.

City Response

The School Department agrees with the auditor's recommendation and will work to fully implement the auditor's recommendation as soon as administratively feasible. The department currently has an independent audit for certain high school student activity funds.

Treasurer's Office Operations

Previous Finding

This finding related to the lack of resolution of items identified during the reconciliation of the bank accounts. Old outstanding checks dating back decades were not transferred to tailings and other reconciling items were never corrected on the bank reconciliations or on the City's ledgers.

Continuing Recommendation

We found the finding to still be valid. In addition, we believe the current process of how the bank accounts are reconciled is inadequate for management to be able to review them. The reconciliation does not always specifically describe the reason for the reconciling item, the format is difficult to follow and some accounts are not being reconciled at all.

We recommend a new reconciliation process be formalized that utilizes the capabilities of the new management and accounting software being installed. Any outstanding reconciling items other than the normal deposits in transit, current outstanding checks and other timing differences must be adjusted before implementation.

City Response

The City agrees with the auditor's recommendation and has begun utilizing the MUNIS treasury management module to reconcile bank accounts. In addition, the treasurer has instituted a tracking system to ensure all bank accounts are reconciled and reviewed.

Information Technology Auditor

Previous Finding

We believe that an IT auditor could play a vital role in ensuring that appropriate financial and operational controls are included in future IT systems, such as MUNIS and ADP. The IT auditor could provide a valuable internal control function by periodically testing systems controls to determine that they are effective and have not been circumvented.

Continuing Recommendation

We recommend that the City consider establishing an IT auditor position within the internal audit division or outsource this function to a qualified independent consultant. The role and responsibilities of the IT auditor should be formally defined and communicated to IT management as well as other affected user departments. The IT auditor should meet regularly with IT department representatives, user personnel, and relevant contractors during developmental projects to ensure that proper financial controls and audit trails are included in each new or modified system. These meetings would allow the IT auditor to ensure that applicable, cost beneficial controls are included in each system. The meetings would also help the IT auditor develop auditing approaches by increasing his or her understanding of the controls being adopted. We recommend that the IT auditor establish a formal, ongoing program of tests to be conducted.

City Response

The City agrees with the recommendation and will work with the Department of Internal Audit to determine the best method for implementation.

Monitoring Outside Consultant's Recommendations

Previous Finding

The City has invested in a significant number of outside consulting projects that evaluated the operations of many departments. The long-term benefit derived from these studies can only be realized if the recommendations for change are implemented and the change is sustained. After the initial changes are made sometimes there are tendencies to revert back to the old way of doing things. When that occurs the City may only realize a temporary benefit from the recommendations.

Continuing Recommendation

Although significant progress has been made in this area we continue to recommend that the City continually monitor and report on the continued compliance with the changes recommended by the consultants. This type of monitoring is an ideal project for internal auditors' department.

City Response

The City agrees with the recommendation and will work with the Department of Internal Audit to incorporate the monitoring of consultant reports in their audit plan.

Fraud Risk Assessment

Previous Finding

The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the City perform a City-wide risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the City's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

The fraud risk assessment can be informal and performed by a management-level individual who has extensive knowledge of the City that might be used in the assessment. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the City, its environment, and its processes. The fraud risk assessment process should consider the City's vulnerability to misappropriation of assets.

When conducting the self-assessment, questions such as the following can be considered:

- What individuals have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- Are there any known pressures that would motivate employees with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, management should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.
- What assets of the City are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?

- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use.
- How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running through an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.

Continuing Recommendation

The City has made significant progress in this area as well, and we continue to recommend that management develop, implement, and monitor a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation throughout the City.

City Response

The City agrees with the recommendation and will to develop, implement and monitor a fraud risk assessment program. The Department of Internal Audit has already identified areas for development and will incorporate monitoring the program in their audit plan.

Develop Written Disaster Recovery Procedures

Previous Finding

The City does not have a well defined, written disaster recovery plan. We strongly encourage management to develop and monitor the plan on a regular basis in the future. The time to make contingency plans is before disaster strikes, so that all personnel will be aware of their responsibilities in the event of an emergency situation that precludes the use of the existing facilities.

Continuing Recommendation

We recommend that management develop a disaster recovery plan for all departments that includes, but is not limited to, the following matters:

1. Location of, and access to, off-site storage.
2. A listing of all data files that would have to be obtained from the off-site storage location.
3. Identification of a backup location (name and telephone number) with similar or compatible equipment for emergency processing. Management should make arrangements for such backup with another organization, a computer vendor, or a service center. The agreement should be in writing.
4. Responsibilities of various personnel in an emergency.
5. Priority of critical applications and reporting requirements during the emergency period.

City Response

The City has a disaster recovery plan but admits the documentation could be improved. The City IT department has redundancy and off-site data storage of its primary computer programs and has a plan in place for disaster recovery in case of an emergency.

Tailings

Previous Finding

The City has a substantial number of unclaimed checks (tailings) within the bank accounts maintained by the Treasurer. A large portion of these checks are more than several years old and we are not aware of any established procedures that have attempted to resolve the reason for these checks to remain outstanding. The lack of controls and procedures places the City at risk that funds could be misappropriated.

Within Chapter 46, Section 108 of the Acts of 2003 "An Act Providing Relief and Flexibility to Municipal Officials" is a section that improved the law regulating abandoned property. This section was written with the intention to make it easier for Treasurer's to process uncashed checks which have been deemed abandoned to either return the funds to the owner or to the City's general fund.

Continuing Recommendation

We recommend that the Treasurer's office implement Chapter 46, Section 108 of the Acts of 2003 for tailings. As part of the implementation plan, the Treasurer should continually monitor and investigate all outstanding checks greater than three months old. These balances must be periodically reconciled to the general ledger.

City Response

The treasurer has studied the process of reducing the outstanding list in accordance with MGL Ch 200A, Section 9A. The City expects to begin the process next year and will take at least a year to implement. In the meantime the treasurer will make an effort to regularly review outstanding checks in accordance with the auditor's recommendation.

Financial Statement Qualifications

Previous Finding

It has been determined over the last several years that four entities qualify as Component Units in accordance with the Governmental Accounting Standards Board Statement No. 39, Determining Whether Certain Organizations Are Component Units. The financial statements are required to include the Springfield Water and Sewer Commission, the Springfield Redevelopment Authority, the Massachusetts Career Development Institute, Inc., and the Springfield Museums Association as discretely presented component units in order for the financial statements to be in accordance with accounting principles generally accepted in the United States of America.

The omission of these four entities from the basic financial statements required us to qualify our audit opinion.

Continuing Recommendation

We recommend that the City discuss with the entities the need to include their audited financial statements as discretely presented component units in order to remove the qualification.

City Response

The City will discuss this finding with the entities involved.

Capital and Operating Leases

Previous Finding

The City is required to report on the financial statements all significant capital and operating lease activity. Leases are considered debt and if the lease payments are not timely the City could be considered technically in default of these obligations. This form of financing can be complicated and the City may be at risk that they are not receiving favorable terms if there is no standard analysis being performed during the approval process. At present, there is a lack of controls over all of the City's leasing activity.

Continuing Recommendation

We believe that the City has grown to a size and complexity that warrants consideration of establishing strict leasing policies and procedures and assigning a department with the overall responsibility to approve and maintain all leases. The City should contact the Commonwealth's Operational Services Division (OSD) and take advantage of their Tax Exempt Lease Purchase (TELP) program, where applicable. The Commonwealth annually approves a master lease contract with a leasing company that has approved extremely favorable rates. A formal lease analysis should be completed and the terms should be compared to the TELP terms before a lease is approved.

The City will need to establish financial statement reporting policies and procedures in order to complete all year-end adjustments and footnote disclosures.

City Response

The City purchasing department used the favorable lease/financing terms from OSD last year for a number of large vehicle procurements across City departments. The City plans to continue this practice. There are a number of smaller lease arrangements that were approved previously that require the City to gather the information at year end for financial statement disclosure. At the end of these lease terms the purchasing department will make every effort to take advantage of the favorable terms from OSD should the City wish to procure assets using the lease financing arrangement.