

CITY OF SPRINGFIELD, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2005



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

In planning and performing our audit of the financial statements of the City of Springfield, Massachusetts for the fiscal year ended June 30, 2005, we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the City's financial statements and not to provide assurance on internal control. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control and its operation that we consider to be material weaknesses as defined above.

Our consideration of internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. In addition, because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected by the internal controls.

We also want to communicate several other matters to you that are opportunities for strengthening internal controls and operating efficiency.

The memorandum that accompanies this letter summarizes our comments and recommendations concerning the reportable conditions and other matters.

This letter does not affect our report dated February 17, 2006, on the financial statements of the City of Springfield, Massachusetts.

The accompanying comments and recommendations are intended solely for the information and use of the Finance Control Board and management of the City of Springfield, Massachusetts, and are not intended to be and should not be used by anyone other than these specified parties.

We will review the status of these comments during our next engagement. We have already discussed these comments and recommendations with various City personnel, and we will be pleased to discuss them further at your convenience, to perform any additional studies of these matters, or to assist you in implementing the recommendations.

February 17, 2006

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PRIOR YEAR COMMENTS

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The following comments and recommendations were reported in the prior year Management Letter dated December 4, 2004 by the previous independent auditors. We have only included the comments we believe remain valid.

Prior Year Reportable Condition

Reconcile Receivable Accounts to Collectors Records

Prior Year Findings

The prior year's auditors found that there was a general lack of reconciliation procedures over key receivable accounts. There required several audit adjustments to bring the variances between the Collector's balances and the general ledger to a tolerable level. The reconciliations that did occur were not timely and did not adequately document the results. The Treasurer did not maintain a summarized listing of tax liens and foreclosures and therefore the actual amounts outstanding could not be reconciled to the general ledger. The Treasurer did not maintain detailed receivable ledgers for motor vehicle excise taxes prior to 1978 while the general ledger carried a balance of \$5.3 million.

Current Status

Real Estate, Personal Property and Motor Vehicle Excise

The City was able to provide reconciliations between the detailed Collector's ledgers and the general ledger for real estate and personal property taxes within a minor overall variance.

The City was able to provide reconciliations between the detailed Collector's ledgers and the general ledger for more recent motor vehicle taxes within a minor overall variance. The City posted the prior year audit adjustment to the general ledger for the \$5.3 million in pre-1978 taxes. The City's deputy collector and outside collection agencies will continue to pursue these amounts however the likelihood of any significant collection is deemed remote.

We believe that the reportable condition for these receivable amounts has been resolved however the remaining variances need to be corrected. Management should determine the underlying reason for the differences and should take steps to correct current procedures as deemed necessary. In addition, management should develop procedures to ensure that differences are identified, researched, and resolved on a timely basis going forward.

Tax Liens

The City was able to provide a detailed listing that summarized all of the outstanding tax liens from 1950 through 2005, and at year end the detailed list was greater than the general ledger by over \$2.0 million. The variance was to be expected since there had been no previous attempt to reconcile these balances. The Treasurer's listing appears to be the best source of information to balance to and the City should consider adjusting the general ledger balance to tie to this balance. For financial statement purposes the City reserved a significant portion of the outstanding tax title amounts as not to overstate their assets.

During FY2005 the City's deputy collectors and outside collection agencies were able to collect a significant portion of the tax liens and upon review of the FY2006 activity that trend is continuing. The increased focus on collecting or abating outstanding tax liens will go a long way to resolving this issue.

We believe the reportable condition still exists for tax title at the end of FY2005. In order to ensure proper valuation of the tax title accounts, we recommend that these reconciliations be performed monthly that reconciling items be resolved promptly. In addition, we recommend that management review the reconciliations to ensure propriety and completeness

Tax Foreclosures

Similar to the prior year, the City was not able to produce a listing of the foreclosed properties and the associated balance that supported the general ledger balance. For financial statement purposes the City wrote off the general ledger balance of \$10.2 million as to not overstate their assets. This issue remains a reportable condition.

We recommend management complete an inventory of all of its foreclosed property and determine the foreclosed value in accordance with the Department of Revenue's regulations associated with each property. Once this is completed the City Auditor should review the listing and make the appropriate general ledger adjustment. We recommend that a reconciliation of the detail to the tax foreclosure control account be made at the end of each month and that any reconciling items be investigated and cleared promptly

Other Prior Year Comments

Improve Internal Controls in the City Clerk's Office

Prior Year Finding

The City's response to the prior year comment agreed with the findings and noted that they hired an independent consulting firm to perform an in-depth operational assessment of the City Clerk's Office. A detailed report is expected in FY2006. Therefore the findings remain unchanged for FY2005. The prior auditor noted the following weaknesses in internal control:

- There is a lack of proper segregation of duties.
- There are no written policies and procedures in place.
- Checks are cashed from existing cash in drawers.
- Cash turnover sheets are not forwarded to the Auditor's Office.
- Revenue reports are not provided to the Clerk's Office for verification.
- Receipts are only issued when customers request one.
- The log book is not properly maintained as cash and checks are not broken down.
- The office does not take advantage of technology and most processes are manual.
- The office was in possession of funds representing vendor bonds.

Current Status

We recommend that management eliminate these deficiencies by implementing the recommendation of the independent consultant's report obtained during FY2006.

Formalize Capital Asset Accounting

Prior Year Finding

The City is maintaining approximately \$450 million in 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 excel 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 additions, deletions, disposals or transfers relating to Governmental 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 for its Governmental Activities.

Current Status

The condition remains unchanged. 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.

Research Ownership of Basketball Hall of Fame Assets

Prior Year Finding

The City may potentially have ownership of assets located at the Basketball Hall of Fame along with some potential associated contingent liability. If the City does in fact own assets located at the Hall of Fame there is a need to account for these assets and associated liabilities on their accounting records.

Current Status

The City has not come to a determination if any assets or liabilities are the City's. We recommend that the ownership be researched by the legal department.

Improve Procedures for Departmental Receipts

Prior Year Finding

The prior year finding related to deficiencies in the Code Enforcement Department. The issuance of permits sometimes did not have the fee input until the amounts were collected, turnovers were not forwarded to the Auditor's Office, and that revenue reports were not reconciled.

Current Status

Although this finding is still valid we have found that the need to improve the controls over departmental receipts is valid throughout the City. Management does not currently have a standard set of policies and procedures on how to process, record, report and reconcile departmental receipts. In FY2005 the governmental funds had over \$40 million in departmental revenue from numerous sources.

Issues that need to be addressed across the City include:

- Physical custody of cash
- Frequency of turnover
- Accuracy of turnover
- Posting of revenue to the ledger
- Departmental receivable
- Renewal of licenses
- Collection procedures
- Intercept capabilities
- Reconciliation of activity
- Point of sale capabilities
- Centralized collections
- Automation

We are aware that management is in the process of installing new management and accounting software that does have the capability to standardize and automate departmental revenue. We recommend that management incorporate policies and procedures to take advantage of the new system for all departments of the City.

Student Activity Funds

Prior Year 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 School Business Office did not provide information on the detailed accounts to the auditors for inspection. The prior auditor recommended a separate audit of these funds be conducted.

Current Status

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.

Treasurer's Office Operations

Prior Year Findings

This finding related to the lack of resolution of items identified during the reconciliation of the bank accounts. Old outstanding checks dating back to as early as 1967 were not transferred to tailings and other reconciling items were never corrected by either the bank or the City.

Current Status

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.

At present, the City maintains over 50 checking and savings accounts. Many of the accounts were established for narrow purposes and have few transactions and small balances. We recommend that management periodically review the functions of all bank accounts to determine whether they are necessary. Only the minimum number of bank accounts consistent with operating requirements should be established. Numerous bank accounts result in complexity and inefficient administration. Time needed to record accounting transactions, as well as time and fees incurred in auditing and accounting services, could be reduced if the City eliminated or combined bank accounts when possible.

Old Receivables

Prior Year Findings

The City has not written off a large number of old receivables that have little chance of being collected. The Assessor, Collector and Auditor should determine the receivables that need to be abated in order to write off truly uncollectible receivables.

Current Status

The City is currently working with their deputy collector and outside collections agencies to pursue the collections of all possible receivables before they decide which accounts are to be abated. We recommend that the City not postpone the determination of the uncollectible accounts indefinitely but instead establish a date where they expect write off the balances.

CURRENT YEAR COMMENTS

CURRENT YEAR COMMENTS

Establish an Internal Audit Division

Comment

At present, the City does not have an internal audit function. We believe that the City has grown to a size and complexity that warrants consideration of an internal audit function. Internal auditing is an independent appraisal activity within the City for the review of accounting, financial, and other operations. The overall objective is to carry out a program of tests of the City's financial and operational activities and transactions to provide management with information about the effectiveness (and efficiency) of established accounting and operational policies, procedures, and controls, and the extent to which they are being followed. In the course of gathering such information, the reliability of accounting and other data generated within the City may be evaluated. Another objective is the prevention and detection of fraud through the performance of audit tests and procedures.

Establishment of an internal auditing function could result in substantial benefits to the City in terms of strengthened internal control and increased efficiency. Some benefits of an internal audit function are as follows:

- Strengthening the City's internal controls over assets and increasing the reliability of the accounting records.
- Reducing the time spent by management in the development of City procedures.
- Increasing assurance that City policies are being adhered to and that departmental procedures and controls are being reviewed objectively.
- Ensuring that each department is accounting and reporting in a consistent manner and that they are operating in accordance with management's wishes.
- Making procedural reviews to determine that the various departments are operating efficiently.
- Providing an excellent training ground for future secondary and top management positions.

Recommendation

We recommend that management evaluate the costs and potential benefits of establishing an internal audit function.

We offer the following recommendation of steps for the internal auditor, once hired, to take in setting up an internal audit function:

- Meet with the Mayor, Control Board and senior management to obtain a clear idea of their expectations for the internal auditor, including their assessment of the most significant risks the City faces and problems the auditor should address. The internal auditor would also establish his or her expectations of those parties' support of the internal audit function and that they will promote the internal audit function, and call for cooperation with it, throughout the City.
- Obtain and review the City's written policies and procedures, including those relating to management's responsibilities in managing the City.
- Identify the departments, locations, processes, and operations (including IT) that will be subject to internal audits.
- Meet with department heads and operations (including IT) managers to gain an understanding of their concerns and the risks they face.
- Meet with the independent auditors and review their communications to identify internal control issues or deficiencies they may have identified and to learn their perspective of the risks the City faces.
- Assess the internal and external risks the City faces.

- Develop a charter for internal audit that includes a description of its objectives, authority, independence, responsibility, and scope of work.
- Develop an internal audit plan, based on the risk assessment and requests from management and the Control Board.
- Develop a budget for internal audit, including personnel and travel, if necessary.
- Develop a staff training plan, if applicable.
- Establish a reporting channel and process for following up on recommendations in internal audit reports.

We believe that this blueprint can demonstrate the City’s commitment to the internal audit function, convey the City’s expectations of the internal auditor, and serve as a guide to the auditor in meeting those expectations. The City can obtain free guidance (such as sample internal audit charters) and information about resources on establishing an internal audit function from the Institute of Internal Auditors’ website at www.theiia.org (select the “guidance” tab).

Information Technology Auditor

Comment

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.

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.

Monitoring Outside Consultants Recommendations

Comment

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.

Recommendation

We recommend that the City establish a program to 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.

Proposed Audit Adjustments

Comment

The City Auditor's Office has historically posted many of the proposed audit adjustments to the ledgers without fully understanding or agreeing with the entries. During the course of the audit we found that some of these adjustments had caused variances in accounts and reconciliations. Once the FY2004 audit adjustments were unraveled and reversed the general ledger accounts were able to be reconciled with the detailed support.

Although the independent auditors can assist the City in preparing the financial statements, auditing standards require the City to take full responsibility for the financial statements. Therefore at least one senior person must be able to fully understand all components of the final statements.

We believe the work load and timing of the audit can make it difficult for that person or persons to completely review and approved the financial statements due to the internal deadlines for issuance.

Recommendation

We believe the City has several people that have the expertise to take on this role. We were satisfied that the City Auditor had a complete understanding and took ownership of the FY2005 financial statements. However, we recommend that the timing of the audit and deadlines for issuance be sufficient to allow for adequate time for a detailed review and approval of the financial statements. The City must take into consideration the other responsibilities of the staff assigned this role.

Fraud Risk Assessment

Comment

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 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, the assessor 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.

Recommendation

We recommend that management develop and implement a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation.

Develop Written Disaster Recovery Procedures

Comment

At present, 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.

Internal Control Policies and Procedures Manual

Comment

We noted that most departments do not maintain a formal internal control policy and procedures manual documenting day-to-day processing and controls. The City is at risk if critical tasks cannot be completed due to an extended or unforeseen absence. A formal internal control policy and procedures manual will assist each department head in the training of new departmental employees, thereby reducing the amount of time required away from the daily departmental operations.

Recommendation

We recommend that each department head develop an internal control policy and procedures manual that includes proper reviews and approvals by management. The document should be written with sufficient detail to allow a new employee the ability to complete the task by reviewing its respective directions. This document should be updated for any system or policy changes. A master manual of all procedures should be maintained and stored in a secure location. In addition, all department heads should be familiar with all policies and procedures within their office and be able to complete all necessary tasks in order to sufficiently train employees.

The City should consider using the new MUNIS documentation as a primary source of how all processes are documented.

Tailings

Comment

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 several years old and we are not aware of any established procedures that have attempted to resolve the reason for these checks that remain outstanding. The balance is not reconciled to the amount carried on the general ledger. 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.

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.

Credit Balances in Receivable Ledgers

Comment

The Collector's detail real estate and personal property tax receivable ledgers included over \$2 million in credit balances in receivables. These balances can come from a variety of different transactions including mispostings

of receipts, overpayments and abatements not recorded properly. Historically these balances have not been investigated and many have remained for years.

By not adjusting these amounts the total receivable previously reported was understated and the potential liability for refunds are understated. The lack of following proper reconciliation procedures increases the possibility for misstatement either through error or a misappropriation of funds.

Recommendation

We recommend that Collector analyze the components of the credit balances to determine if the amounts were created due to mispostings or overpayments. All mispostings need to be corrected in the detailed ledgers. The remaining amounts should be either refunded to the taxpayer or considered abandoned property where it would be treated similar to the tailings above.

Require Employees to Take Vacations

Comment

City employees are not required to take an annual, uninterrupted, one-week or longer vacations. Requiring annual vacations is an important internal control function designed to help an employer to detect errors, inefficiencies, and irregularities; to provide management with a means of cross-training employees; and to help prevent employee burnout and the resulting inefficiencies. Additionally, it is important to require another person to perform the absent employee's duties while he or she is on vacation.

Recommendation

We recommend that the City consider implementing a policy requiring all employees to take an annual, uninterrupted vacation and that the policy be enforced.

Statement No. 45 of the Governmental Accounting Standards Board

Comment

In July of 2004, the Governmental Accounting Standards Board (the GASB) issued Statement No. 45 Accounting and Financial Reporting for Postemployment Benefits Other than Pensions. This Statement improves the relevance and usefulness of financial reporting by (a) requiring a systematic, accrual-basis measurement and recognition of other postemployment benefits (OPEB) cost over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. The projection of benefits should include all benefits covered by the current substantive plan (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs

between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the healthcare cost trend rate for postemployment healthcare plans, be guided by applicable actuarial standards. Failure to obtain an actuarial valuation will result in a qualification to the independent auditors' opinion on the basic financial statements.

Net OPEB obligations, if any, including amounts associated with under or over contributions from governmental funds, should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

An employer's net OPEB obligation is defined as the cumulative difference between annual OPEB cost and the employer's contributions to a plan, including the OPEB liability or asset at transition, if any. (Because retroactive application of the measurement requirements of this Statement is not required, for most employers the OPEB liability at the beginning of the transition year will be zero.) An employer with a net OPEB obligation is required to measure annual OPEB cost equal to (a) the annual required contribution (ARC), (b) one year's interest on the net OPEB obligation, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under or over contributions.

This Statement generally provides for prospective implementation. This means that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. The City is required to implement this statement in fiscal 2008 although earlier implementation is encouraged.

Recommendation

We recommend that management take a proactive approach to the planning and implementation of GASB Statement No.45. The most important consideration in the planning process is obtaining an actuarial valuation.

Workers Compensation Liability

Comment

The City was not aware that all long-term liabilities for any claims that incurred prior to June 30 had to be either disclosed or included as a liability on the financial statements. The estimated liability for both FY04 and FY05 was approximately \$8 million. A prior period adjustment was required to the financial statements to correct the FY04 error. Since the City had never prepared this estimated liability for financial reporting purposes before it was one of the latest adjustments calculated and was difficult for the City to prepare.

Recommendation

The City should document the process to estimate the workers compensation liability in order prepare a consistent year end financial statement accrual on a timely basis.

Preparation of the Schedule of Federal Awards

Comment

The City is responsible for preparing the Schedule of Expenditures of Federal Awards (SEFA) each year as part of the Single Audit requirements. The SEFA is required to list the amounts of all federal funds expended by the City and indicated whether it was a direct award, a pass-through award, the pass-through entity, the correct Catalog of Federal Domestic Assistance Number (CFDA) and the program title. The City expends over \$70 million in federal funds each year from a variety of programs. The accounting ledgers are set up to track the federal funds separate from other funds however we found some federal and state grants recorded in the wrong funds.

The City prepared a draft SEFA for us that required a significant number of adjustments to it. The Auditor's Office maintained a Grant Book that had copies of all of the grants which we were able to use to correct the errors however it took a significant amount of time to correct the schedule. The completion of this document is of critical importance to us as all major grants must be tested. If we cannot plan in advance what grants are to be tested we may miss auditing a major grant and it will delay the completion of the audit.

Recommendation

We recommend the City prepare the SEFA for inclusion in the federal compliance report in accordance with the Single Audit Act. We will meet with your staff to plan for its proper preparation.

Financial Statement Qualifications

Comment

It has been determined over the last several years that three 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 and the Massachusetts Career Development Institute, Inc. 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 three entities from the basic financial statements required us to qualify our audit opinion.

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.

Capital and Operating Leases

Comment

The City is required to report on the basic 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.

Recommendation

We believe that the City has grown to a size and complexity that warrants consideration of establishing a 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. 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.

School Lunch and Breakfast Program

Comment

The School Lunch and Breakfast Program receives a significant source of funding from state and federal grants. In order to be eligible for these grants the School must comply with operating and reporting requirements established by the Commonwealth of Massachusetts Department of Revenue. Below we have listed the deficiencies.

School Verification of Eligibility

The federal and state regulations require the School to complete a process each year that selects certain applications for free and reduced meals and verify the accuracy of the applications. The methodology allowed for the verification is in the federal publication Eligibility Guidance for School Meals Manual. The School used the focused sampling methodology. The Manual requires when this methodology is used the selection of applications for verifications must be taken from error prone applications. The School could not substantiate that the applications selected were error prone as defined in the Manual.

Even though the applications selected were not from an error prone population, the actual results of the verification process had 72% of the applicants not responding and 86% of the applicants benefits were either terminated or reduced. The results of the process along with not using an error prone sample would suggest a larger sample should have been drawn.

Severe Needs Breakfast

The School System meets the federal and Department of Education requirements that will allow the School to be considered a Severe Need School District that can allow a higher rate of reimbursement for this program. The School met all of the reporting requirements for the federal reimbursement.

In addition to the federal reimbursement the DOE allows for an additional state reimbursement grant if the actual average cost of breakfast served each month is in excess of the federal rate. Each month the School can submit form FP-6B – Report of Average Cost of Breakfasts for that additional reimbursement. The DOE requires each "school must provide documentation of the costs to receive this additional state reimbursement." The school could not provide documentation that supported the actual costs reported to the DOE. The School received

approximately \$143,000 in reimbursements during FY2005 in which we question the School's eligibility for reimbursement.

Inventory

The School informed us that they periodically count inventory but does not have a schedule of when it is done, how much is at each school and the warehouse and does not value it. They were not able to provide us with any perpetual inventory records. There is no reconciliation between the actual count and the inventory records at the schools and warehouse. Federal and state regulations require the following:

- *Physical Inventory* – Distributing and sub distributing agencies shall take a physical inventory of all storage facilities. Such inventory shall be reconciled annually with the storage facility's inventory records and maintained on file by the agency that contracted with or maintained the storage facility. Corrective action shall be taken immediately on all deficiencies and inventory discrepancies and the results of the corrective action forwarded to the distributing agency (7 CFR Section 250.14(e)).

The School's lack of internal controls over inventory increases the risk of misappropriation of assets.

Suspension and Debarment Controls

Federal and state regulations require all contracts contain language where the vendor certifies that they have not been suspended or debarred. In addition, School staff are required to verify that the vendor's certification is correct.

Recommendations

The School needs to document all applications selected for verification be from an error prone population and comply with the requirements and sampling techniques defined in the Eligibility Guidance for Scholl Meals Manual.

The School must establish a system to calculate the actual monthly average cost for breakfast that provides documents and allocations that supports the amounts reported on form FP-6.

The School must comply with the federal and state regulations on inventory control. They need to establish formal perpetual inventory recordkeeping, take periodic counts and reconcile the actual accounts to the perpetual records.

The City should implement procedures that complete a search the federal website for Excluded Parties List System www.epls.arnet.gov to check for any person or company that has been debarred.