

CITY OF SPRINGFIELD, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2009



100 Quannapowitt Parkway
Suite 101
Wakefield, MA 01880
T. 781-914-1700
F. 781-914-1701
www.powersandsullivan.com

To the Honorable Mayor, the City Council and the Audit Committee, and Management
City of Springfield, Massachusetts

In planning and performing our audit of the basic financial statements of the City of Springfield, Massachusetts as of and for the fiscal year ended June 30, 2009, 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 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.

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 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and 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 of the City of Springfield, Massachusetts, and is not intended to be and should not be used by anyone other than these specified parties.

Wakefield, Massachusetts
December 9, 2009

CITY OF SPRINGFIELD, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2009

TABLE OF CONTENTS

PAGE

Current Year Comments

Informational Comment – GASB Statement #54	2
Financial Reporting of Compensated Absences	3
Treasury Department Cash Management Activities	3
Expenditure Testing at the School Department	4

Prior Year Comments – Unresolved

Financial Accounting Practices at the City's Retirement Office	6
Formalize Capital Asset Accounting	6
Student Activity Funds	7
Treasurer's Office Operations	8
Information Technology Auditor	8
Fraud Risk Assessment	9
Develop Written Disaster Recovery Procedures	10
Tailings	10
Financial Statement Qualifications	11
Capital and Operating Leases	11

CURRENT YEAR COMMENTS

Informational Comment

GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB) STATEMENT #54

Comment

In February 2009, the GASB issued Statement #54, *Fund Balance Reporting and Government Fund Type Definitions*, which is required to be implemented in fiscal year 2011. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund types, capital projects fund types, and permanent fund types are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

Recommendation

As it appears that this GASB Statement will significantly impact the fund balance classifications presently reported, we recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes, and to formulate plans to be used in explaining these changes to interested parties within the City and to the external users of the City's financial statements.

Management's Response

The City is aware of the new GASB Statement and has sent several staff to GFOA training on the new statement. We concur with the recommendation to ensure the change is adequately presented and explained to all stakeholders.

FINANCIAL REPORTING OF COMPENSATED ABSENCES

Comment

The City's payroll system has the capability to record and maintain accrued compensated absences. However, the information does not readily lend itself to being able to accrue a year end total liability for financial reporting purposes. The raw employee data appears to be tracking properly however the information is not being manipulated to conform to the various collective bargaining agreements and policy limitations. Considerable time was spent at year end to estimate the overall liability for financial statement purposes.

Recommendation

We recommend the City develop procedures to conform this information to facilitate reporting a complete and accurate total liability for external financial reporting purposes. We believe that the various departments have the necessary information available and that time needs to be devoted to developing a system of identifying the varying departmental obligations that conform to the collective bargaining agreements and other City policies.

Management's Response

The City recently implemented a new payroll system which should substantially reduce the time needed to estimate the accrual of employee compensated absences at year end. The City will work with all departments to develop procedures to ensure conformity with collective bargaining agreements and policy limitations.

TREASURY DEPARTMENT CASH MANAGEMENT ACTIVITIES

Comment

In addition to other Treasury Department comments included in this letter, during the 2009 audit we noted that the daily cash management procedures are not automated and rely on manual transactions to be made each day to move funds between operating and investment accounts. We noted significant un-invested balances remaining in checking accounts during the year. We did compare interest rates being earned on the checking accounts to what was available from overnight investments and noted that there was not a significant opportunity being lost during this past fiscal year.

Recommendation

We recommend that the Treasurer consider meeting with its primary banks to determine whether a cash management system is available to automate the investing of idle funds on a daily basis.

Management's Response

The City agrees with the recommendation and is actively looking to improve its short term cash management policies. As a result, the City has scheduled meetings with its primary banks to discuss automating the process of investing idle funds.

EXPENDITURE TESTING AT THE SCHOOL DEPARTMENT

Comment

While testing samples of expenditures at the School Department we noted that: 1.) there are a number of unprocessed invoices from previous fiscal years that management has not determined the status of, and 2.) we noted a situation where goods were received and signed for by a department when in fact they were not included in what was delivered on that occasion. In that first matter we discussed these unprocessed invoices with management and determined that the total of these was not material for financial statement purposes and that management needed to evaluate each of them to be sure that hadn't already been paid and that a City liability continues to exist. In the second matter the vendor had been contacted and the vendor reimbursed the City for the payment that was made for the goods not received originally.

Recommendation

In order to strengthen internal controls and improve operational efficiencies we recommend that management revisit its policies and procedures over the approval and processing of School Department invoices to ensure that systems are in place to review and reconcile the receipt and payment of all invoices being rendered to the department.

Management's Response

The School Department has revisited its payment practices to ensure invoices are properly approved and timely paid. All invoices are required to be signed and approved by the manager or principal vouching for the receipt of goods before payment is initiated by the central office. Additionally, the Department has implemented new tracking procedures to ensure invoices are promptly submitted for payment to prevent invoices remaining unpaid at year end.

PRIOR YEAR COMMENTS – UNRESOLVED

PRIOR YEAR COMMENTS – UNRESOLVED

The following comments and recommendations were reported in the prior year Management Letter dated February 18, 2009. 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’s Updated Response

In FY10, the Retirement Board implemented significant management and operational changes as recommended by consultants. Specifically, the Board acquired and placed in service new pension software to pay monthly retiree benefits and electronically collect and record employee demographics and earnings. The Board will continue improving operations in the coming year, but considers this comment resolved during fiscal year 2010.

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 FY2009. 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.

Updated City Response

The City currently uses the MUNIS fixed asset module to record its fixed assets. Additionally, the City recently updated its capital asset threshold from \$15,000 to \$25,000 which should substantially reduce the number of assets subject to capital asset accounting. Also, a financial analyst has been assigned to each City department to ensure that all City purchases are appropriately classified and capitalized.

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.

Updated City Response

The School Department is working with the Comptroller to develop policies and procedures enabling student activity funds to be replenished through the warrant process in conformity with MGL. Additionally, the School Department is considering the purchase of the MUNIS student activity module to facilitate recordkeeping and internal controls. We do want to note that certain High School student activity funds are independently audited. The School Department will evaluate the merits of expanding the use of external auditors or developing the resources in-house to improve audit coverage to all 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.

Updated City Response

The City agrees with auditor's recommendation and is continuing to utilize the MUNIS treasury management module to reconcile its bank accounts. In addition, the Treasurer is working with the Comptroller's Department to research and resolve outstanding issues identified on the bank reconciliations.

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.

Updated City Response

The City's Director of Internal Audit plans to initially outsource this function. The procurement process is expected to be completed in early FY11.

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.

Updated City Response

The Director of Internal Audit has completed the City's fraud risk assessment and developed an audit plan to mitigate the identified risks. The FY11 audit plan was recently approved by the City's Audit Committee.

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 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.

Updated City Response

The City currently is under contract with Tyler Technologies to provide off-site disaster recovery services for all Tyler products. Additionally, the City has electronic storage located off-site in an agreement with a local agency not affiliated with the City. A capital funds request has been made by the IT department to locate and build an alternate computing site that would provide for increased performance and provide for continuous up-time.

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.

Updated City Response

The City began researching the tailings account and found that a substantial number of outstanding checks were refunds of overpaid taxes. Where applicable the City has applied these taxpayer overpayments to other outstanding receivables balances owed by the taxpayers. This has substantially reduced the tailings account. The City then plans to follow the tailings procedures outlined in the MGL referred to above.

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.

Updated City Response

The City intends to meet with the component units to eliminate the financial statement qualification.

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.

Updated City Response

At the end of FY09 the City increased its capitalization policy to \$25,000 which will substantially reduce recordkeeping and reporting requirements. City departments lease copiers and printers from numerous vendors each with their own recordkeeping and reporting requirements. The City plans to consolidate these agreements into a single vendor which should substantially address this audit comment. Additionally, the City will work to implement the auditor's recommendations of using the OSD's TELP program for vehicles and other equipment purchases. The Finance Department will play an active role in managing the City's planned capital purchase program to ensure conformity with financial policies.