

CITY OF SPRINGFIELD, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2010



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 financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Springfield, Massachusetts as of and for the fiscal year ended June 30, 2010, 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, during our audit we became aware of other matters that we believe represent opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning other matters.

The City of Springfield's written responses to the comments identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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
March 18, 2011

CITY OF SPRINGFIELD, MASSACHUSETTS

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CURRENT YEAR COMMENTS

Informational Comment Repeated

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.

WORKERS' COMPENSATION MANAGEMENT

Comment

The City Treasurer's office utilizes an outside third party administrator to handle its self-insured workers' compensation activities. The Treasurer's office set up a separate checking account for the administrator's use in funding these on-going claims. During our audit we noted that the bank reconciliation associated with this account is carrying approximately \$40,000 of outstanding checks that are more than one year old.

Recommendation

In order to stay on top of these reconciling items we recommend that the Treasurer's office meets with the third party administrator to determine the current status of these outstanding checks. A process should be implemented to review these amounts on a monthly basis to identify why amounts are not clearing the bank on a timely basis.

Management's Response

The City agrees with the recommendation and is setting up a meeting with the third party administrator to review and determine the status of all outstanding checks over one year. In the future this meeting will be a regularly scheduled monthly meeting. Internally, all outstanding checks over 3 months will be researched on a monthly basis.

IMPROVE INTERNAL CONTROLS AT THE PUTNAM VOCATIONAL TECHNICAL HIGH SCHOOL

Comment

During our 2010 audit of the City we became aware of concerns over the lack of Internal Controls at the Putnam School. These matters concerned maintaining proper controls over many aspects of the School's operations; the details of which are being communicated out through a report being prepared by the City's Director of Internal Audit.

Recommendation

We recommend that the School Department assists the Director of Internal Audit in specifically identifying, describing, and resolving the internal control deficiencies noted at the Putnam School. These issues should then

be used to redefine the control structure at the school and be used as the basis for developing “best practices” for the new Vocational School currently under construction.

Management's Response

The School Department has already implemented policies and procedures to mitigate the findings contained in the Internal Auditor's report. The district has hired an accounting manager and a financial analyst for the Putnam School. The additional positions will enable Putnam to segregate custody and recording of financial transactions.

PRIOR YEAR COMMENTS – UNRESOLVED

PRIOR YEAR COMMENTS – UNRESOLVED

The following comments and recommendations were reported in the prior year Management Letter dated December 9, 2009. We have only included the comments we believe remain unresolved.

TREASURY DEPARTMENT CASH MANAGEMENT ACTIVITIES

Updated Previous Comment

In addition to other Treasury Department comments included in this letter, during our 2010 and 2009 audits 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 two fiscal years.

Continuing 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.

City's Updated 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 met with its primary banks to discuss automating the process of investing idle funds. The City has added several new banks to diversify its deposits but has determined that it is not currently cost effective to institute significant changes at this time.

Formalize Capital Asset Accounting

Updated Previous Comment

The City is maintaining its capital assets on an excel spreadsheet and has not fully implemented new 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 FY2010. 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 has acquired the MUNIS fixed asset module to record its fixed assets but has not fully implemented the program. Management is currently working on a plan to accomplish this project.

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. In addition, a financial analyst has been assigned to each City department to ensure that all City purchases are appropriately classified and capitalized.

Student Activity Funds

Updated Previous Comment

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. 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. During fiscal year 2011 the School Department identified 32 schools having Student Activity Funds. From this list 12 schools were initially selected to have independent audits performed and the School Department plans to have the remaining school funds audited within the next several years.

Treasurer's Office Operations

Updated Previous Comment

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

Updated Previous 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.

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 FY12.

Fraud Risk Assessment

Updated Previous 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 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 FY12 audit plan was recently approved by the City's Audit Committee.

Develop Written Disaster Recovery Procedures

Updated Previous Comment

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

Updated Previous 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 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

Updated Previous 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 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 three 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.