

CITY OF WORCESTER, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2010



Certified Public Accountants

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To the Honorable Mayor and City Council
City of Worcester, Massachusetts

In planning and performing our audit of the financial statements of the City of Worcester, Massachusetts (City) as of and for the year ended June 30, 2010 (except for the Worcester Contributory Retirement System, which is as of and for the fiscal year ended December 31, 2009), in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, 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.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and recommendations regarding those matters. This letter does not affect our report dated October 29, 2010, on the financial statements of the City.

The City's written responses to the matters identified in our audit have not been subjected to the audit 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, the Mayor, the City Council and others within the organization and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Sullivan, Rogers & Company, LLC". The signature is written in a cursive, flowing style.

October 29, 2010

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Comments and Recommendations

Police Department Payroll

Comment

We evaluated the systems of internal control related to payroll of the Police department and identified the following deficiencies:

1. Supervisory personnel prepare and sign off on daily "Morning Reports", which serve as timesheets and are the source documents for recording the department's payroll. As part of our testing, we selected a pay period in September 2009 and identified that the "Morning Reports" for this pay period could not be located. Per inquiry of department personnel, the "Morning Reports" are shredded once a calendar year is over. This practice does not comply with the Massachusetts record retention law and does not provide an adequate audit trail. The lack of an adequate audit trail limited the amount of testing we could perform on the department's regular payroll.
2. The approval process related to overtime pay involves the preparation of "Overtime Sheets" that are signed off by supervisory personnel. The "Overtime Sheets" are the source documents for recording the department's overtime payroll. As part of our testing, we selected ten employees that were paid overtime in fiscal year 2010 and identified that the "Overtime Sheets" related to our selections could not be located. Per inquiry of department personnel, signed "Overtime Sheets" are not retained after overtime is entered into the payroll system. This practice does not comply with the Massachusetts record retention law and does not provide an adequate audit trail. The lack of an adequate audit trail caused us to be unable to perform any audit testing on the department's overtime payroll.

Recommendation

We recommend the Police department implement policies and procedures to retain all "Morning Reports" and "Overtime Sheets" for at least seven (7) years, which is in accordance with Massachusetts General Laws (MGL), Chapter 66, Section 8.

Management's Response

In 2006, the Worcester Police Department (WPD), with the assistance of the City's Technical Services Department, developed an electronic personnel time and attendance system to increase operational efficiencies and reduce paper consumption. The system requires division commanders to account for attendance of officers under their command directly into the system electronically and produces a morning report of attendance. This report is printed off and forwarded to the WPD payroll office, verified and directly interfaced into the City's payroll system. Since the system retrieves the information electronically, the WPD does not retain the printed copy beyond a calendar year. With this current annual audit of the City, the WPD was made aware that the paper copy of the morning report must be maintained. The WPD has immediately commenced maintaining the printed copy and has requested an additional enhancement to the system whereby the division commander's endorsement is obtained electronically, thus increasing efficiency, eliminating redundancy, and further reducing paper consumption.

Emergency Procurements

Comment

When certain circumstances arise, the City makes “emergency procurements” in which typical procurement procedures (ex. obtaining bids and quotes) are bypassed. Massachusetts General Laws (MGL) related to procurement (such as MGL Chapter 30B and MGL Chapter 30, Section 39M) contain provisions allowing for such procurements in an emergency.

Per inquiry of the City’s procurement personnel, the City does not have formal policies and procedures that detail all aspects of emergency procurements, such as when they can be executed, required communications with external parties, record keeping that must be documented for each emergency procurement, etc. Such a manual would define, improve and standardize procedures and eliminate inconsistencies in the processes surrounding emergency procurements.

Recommendation

We recommend the City prepare a formal, detailed policies and procedures manual that detail all aspects of emergency procurements.

Management’s Response

The City of Worcester Purchasing Office maintains a Policy and Procedures Manual, which was last updated in April 2010. Since “emergency procurement” is the exception to the majority of procurements performed by the City, “emergency procurement” procedures have never been incorporated into the manual. When applicable, “emergency procurements” are performed in compliance with MGL Chapter 30B, Chapter 30 (39M) (horizontal construction) or Chapter 149 (vertical construction) and conducted as prescribed by “internal” Purchasing procedures.

Change Orders

Comment

As part of our procurement testing, we reviewed a contract for the resurfacing of various streets in the amount of \$796,424 and a related purchase order (PO) in the amount of \$796,424 in which the streets to be resurfaced were specified. We identified three (3) change orders to the contract for the resurfacing of completely different streets than the streets specified in the original PO. In addition, the change orders totaled \$1,193,000, which is approximately \$400,000 (or approximately 150%) more than what the original contract was for.

It is sound business practice to only approve change orders if they relate to a change in the scope of work of the original contract and not for completely different projects that are similar in nature to the original contract. In addition, for procurements subject to the requirements of MGL Chapter 30B, Section 13 states that a governmental body may increase the quantity of services specified in a contract, provided the increase in the total contract price does not exceed 25 percent.

By approving change orders that do not relate to a change in the scope of work of the original contract and/or exceed 25 percent of the original contract, the City is at risk of inappropriately bypassing the procurement requirements of MGL.

Recommendation

We recommend the City implement policies and procedures to approve change orders only if they relate to a change in the scope of work to the original contract and/or they do not exceed 25 percent of the original contract (if subject to MGL Chapter 30B).

Management's Response

The City employs sound business practices in bidding and awarding Public Works (street resurfacing) projects. Although these activities are not subject to the provisions of Chapter 30B (limitation of a change order in excess of 25%), the City carefully considers the current construction market conditions, the cost and time associated with bidding of additional but similar work, (street resurfacing) prior to issuing change orders. Use of existing and recent contracts for like work is often used to maximize the construction season to complete the extensive list of committed projects. As it relates to the instance in question, the City is confident that the best available price was obtained since the change orders were issued to a bid which was less than six (6) months old and for a site that was an extension of the original project location.

Health Department

Comment

We evaluated the systems of internal control related to the Health department (the department) and identified the following deficiencies:

1. We tested 12 "Receipt Detail Reports" (which serve as deposit turnover forms) related to tobacco permits and identified that none of them were signed off as having been reviewed by a supervisor prior to submission to the Treasurer/Collector's (T/C) Office. Documented supervisory reviews of deposit turnover forms provide evidence of internal controls over the accuracy and completeness of cash receipts.
2. The department maintains an automated log of permits issued. However, the log does not contain information related to amounts paid and the dates of payment. As a result, reconciliations between cash collections and the number of permits issued cannot be performed. Performance of these reconciliations provides assurance that the proper amount of cash has been collected and recorded for the permits issued by the department.

Recommendation

We recommend the department:

1. Implement policies and procedures requiring supervisory review and sign-off of deposit turnovers before they are submitted to the T/C Office
2. Fully utilize the automated log of permits issued by adding the following information to the log:
 - a. Date paid
 - b. Amount paid

We also recommend the department utilize the automated log to reconcile cash receipts to the number of permits issued on a daily basis. The reconciliations should be reviewed and signed-off by the preparer and reviewer and maintained on file.

Management's Response

As part of the standardization of departmental revenue recognition, the Treasurer's Office implemented "electronic" review and signoff procedure for all departments receiving revenues. This enhancement was implemented during the course of two fiscal years (fiscal year 2009 and fiscal year 2010). Unfortunately, the Health Department personnel did not adhere to the procedures in an attempt to ensure timely deposits to the Treasurers Office.

With regards to creating an automated log to track permits, the administration is reviewing the possibility of utilizing the Miscellaneous Receipts Module or Utilizing Microsoft Office products to develop a log of permits.

Student Activity Funds

Comment

Student Activity Fund Checking Accounts

We identified the following deficiencies related to the School Department's student activity fund checking accounts (checking accounts):

1. Each of the checking accounts was initially established with a starting balance of \$25,000. As a result, each of the checking accounts' reconciled bank balances should be \$25,000 at the end of each month. We identified that none of the checking accounts' reconciled balances as of June 30, 2010 equaled \$25,000. The following table summarizes each accounts' reconciled balance as of June 30, 2010:

<u>School</u>	<u>Initial Funding</u>	<u>Reconciled Balance June 30, 2010</u>	<u>Variance</u>
Sullivan Middle	\$ 25,000	\$ 139	\$ 24,861
Accelerated Learning Lab	25,000	806	24,194
Worcester East Middle	25,000	832	24,168
Forest Grove Middle	25,000	1,706	23,294
North High	25,000	3,846	21,154
South High	25,000	5,013	19,987
Burncoat High	25,000	8,818	16,182
Burncoat Middle	25,000	14,691	10,309
Doherty High	25,000	17,835	7,165
Vocational	25,000	21,611	3,389

The variances identified above could be caused by the following reasons:

- The reconciliations may not be including a reconciling item for "transfers in transit", which would represent amounts that have been disbursed from the checking account, but not yet reimbursed by the related student activity agency account
- The checking accounts may not have been appropriately reimbursed from the agency accounts
- Accounting errors may have created "unidentified" variances

Whatever the cause, the variances indicate the checking accounts are not being properly maintained and reconciled.

2. One (1) of the ten checking account reconciliations (Vocational School) did not have signatures indicating that supervisory personnel reviewed them. The lack of supervisory review signatures was also reported in the prior year Management Letter.

Proper internal controls require supervisory reviews of bank reconciliations to reduce the potential for errors, omissions and other irregularities that could occur and go undetected.

3. Three (3) of the ten checking account reconciliations (Forest Grove Middle, Burncoat High and the Vocational School) were not prepared using the reconciliation form developed by the School Department to standardize the reconciliation preparation and review process. This creates inconsistencies in the checking account reconciliations and does not provide the School Department with all of the standard information they require in reviewing the accuracy and completeness of the reconciliations.

Compliance with MGL Chapter 71, Section 47

MGL Chapter 71, Section 47, which establishes various guidelines related to student activity funds, states the following:

“There shall be an annual audit of the student activity funds which shall be conducted in accordance with procedures as agreed upon between the school committee and the auditor based upon guidelines issued by the department of education.”

An annual audit (internal or external) or agreed upon procedures on each of the Worcester Public Schools’ student activity funds is not being performed. To our knowledge, the City has ten schools with student activity funds. During the past six (6) fiscal years, we have performed three (3) separate evaluations of the internal controls of three (3) individual schools as part of the City’s annual audit. We are not aware of any other audits or agreed upon procedures that have been performed in the past 6 fiscal years other than the evaluations we have conducted.

Based upon the MGL requirement, inherent risks associated with student activity funds and the results of our three evaluations over the past 6 fiscal years, we believe the performance of annual audits or agreed-upon procedures on each of the Worcester Public Schools’ student activity funds would be prudent.

This comment was also reported in the prior year Management Letter.

Recommendation

Student Activity Fund Checking Accounts

We recommend the School Department:

1. Investigate the variances between the \$25,000 initial funding amounts and the reconciled checking account balances and take appropriate actions as deemed necessary.
2. Implement procedures to require all checking account reconciliations be reviewed and approved by supervisory personnel
3. Implement procedures to require all checking account reconciliations be prepared using the standard reconciliation forms

Compliance with MGL Chapter 71, Section 47

We recommend the Worcester Public Schools comply with the requirements of MGL Chapter 71, Section 47 by having annual audits or agreed-upon procedures performed on each school’s student activity funds.

Management's Response

The Worcester Public Schools (WPS) with assistance from the City Treasurer's and Auditor's Office(s), shall research and identify the variances between the initial funding amounts and the respective reconciled cash balances. Where the respective variances are identified as previous unreimbursed expenditures from the respective Student Activity Funds, the WPS shall seek reimbursements. If the variances are determined to be accounting errors, the appropriate correcting entries shall be pursued.

Records of the WPS indicate only one month (December 2009) the reconciliation was not signed, although the monthly summary was signed by the principal. But in any event the WPS shall ensure that all monthly reconciliations are reviewed and approved by the respective supervisory personnel. As it relates to form of the reconciliations, although standardization of format does provide consistency, some schools have opted to reconcile their account on the bank provided reconciliation which accompanies the bank statement. The WPS shall review the possibility of standardizing the reconciliations.

With regards to implementing audits of the respective Student Activity accounts, WPS shall engage the City's independent auditors and devise a scope of services and schedule to provide annual independent reviews on an ongoing basis.

Real Estate and Personal Property and Motor Vehicle Excise Tax Exemptions and Abatements

Comment

During our testing and internal controls evaluation of real estate and personal property and motor vehicle excise tax exemptions and abatements, we identified the following deficiencies:

1. 14 of the 25 real estate and personal property tax exemptions we tested did not contain approval signatures on the exemption application. Approved exemption applications should be signed by the appropriate City official(s) to provide evidence that the exemption is authorized and in compliance with MGL.

The lack of approval signatures on exemption applications was also reported in the prior year Management Letter.

2. Exemptions excluded from each motor vehicle excise tax commitment were reviewed and reconciled to the Assessor's database. However, the review and reconciliation process was not formally documented. Documented reviews of motor vehicle excise tax exemptions would provide evidence that the exemptions are appropriate and in compliance with MGL.

Recommendation

We recommend the City implement policies and procedures requiring approval signatures on real estate and personal property tax exemption and abatement applications. Each exemption and abatement application must be filed as a permanent record for a minimum of seven (7) years, as required by MGL.

We recommend the City implement policies and procedures requiring documentation of the reconciliation and approval process for motor vehicle excise tax exemptions.

Management's Response

In fiscal year 2010, the Assessors Office implemented procedures requiring supervisory signoffs on both exemptions and abatements. Additionally, record retention procedures were also implemented. Because of the timing of hiring a new Assessor and the implementation of the procedures, some exemptions had already been granted without obtaining supervisory signoffs.

Accounts Receivable Reconciliations

Comment

At June 30, 2010, the following accounts receivable variances exist between the general ledger and Collector and departmental balances:

<u>Accounts Receivable</u>	<u>Variance</u>
Real estate taxes	\$ 88,012
Special assessments	44,733
Sewer user charges	9,611
Water liens	9,555
Water user charges	5,260
Tax liens	4,518
Sewer liens	4,323
Parking tickets	2,584
Police off-duty details	1,780
Water backflow	246
Motor vehicle excise taxes	184
Personal property taxes	149

The City made significant improvements from fiscal year 2009 to fiscal year 2010 in reducing the variances in several accounts receivable balances.

While the variances identified above were immaterial to the City's audited financial statements, proper internal controls require accounts receivable to be reconciled timely to provide assurance that transactions have been properly recorded.

Recommendation

We recommend the City implement policies and procedures to investigate and resolve all variances between accounts receivable balances of the general ledger and Collector (and other departments) monthly.

Management's Response

As noted in the comment, the variances identified are immaterial in amount to the City's financial statements, but in fact are variances predominantly from prior fiscal years. During fiscal year 2010, the Treasurer's Office reduced the receivable variance by 57% from the previous fiscal year. In fiscal year 2011, the Treasurer's Office shall identify the residual variances and adjust the City's records accordingly.

Authorized and Unissued Debt

Comment

At June 30, 2010, the City has several old borrowing authorizations for which debt has not been issued and the authorizations have not been rescinded. This matter was also reported in the prior year Management Letter.

As a frame of reference, the following table summarizes authorized and unissued borrowing authorizations greater than two (2) years old as of June 30, 2010:

<u>Fiscal Year of Loan Authorization</u>	<u>Authorized and Unissued Debt Balance</u>
1987	\$ 400
1994	230,000
1995	78,000
1996	330,500
1998	4,041,500
1999	2,000
2000	225,000
2001	1,060,000
2002	12,122,000
2003	887,688
2004	2,420,000
2005	6,140,000
2006	73,940,937
2007	106,533,000
2008	6,850,000
Sub-total - Greater than 2 years old	<u>214,861,025</u>
Total at June 30, 2010	<u>259,872,000</u>
Percentage of total greater than 2 years old	<u>82.7%</u>

While some of the authorized and unissued debt identified above relates to projects the City is still planning to undertake (for example, a majority of the fiscal year 2006 authorized and unissued debt relates to the CitySquare project), there may be authorized and unissued balances for projects the City no longer intends to borrow money for. While the City is allowed to use old borrowing authorizations to fund new projects similar to the original purpose of the authorizations, the new projects might not meet the intent of the original authorizations.

Recommendation

We recommend the City implement policies and procedures to periodically review unissued borrowing authorizations and to rescind authorizations for projects the City no longer intends to borrow money for.

Management's Response

Loan orders and capital projects are not like general fund appropriations, which expire annually. Capital projects generally span multiple fiscal years and thus loan orders can generally be older than two years old. Although carrying authorized and unissued loans on the City's financial statements does not have adverse effects to the City's overall financial statements, the administration shall review all outstanding loan orders annually with the submission of the five year capital improvement program and will recommend rescissions of any loan order which it determines not be required.

City Clerk

Comment

We evaluated the systems of internal control related to the City Clerk department (the department) and identified there is no formal financial policies and procedure manual that details the financial operations of the department. This matter was also reported in the prior year Management Letter.

Such a manual would define, improve and standardize procedures and eliminate inconsistencies in the processes surrounding the financial activities of the department. It would also enhance the ability to train and supervise new staff in the event of employee turnover.

Recommendation

We recommend the department prepare a formal, detailed financial policies and procedures manual that details all aspects and internal controls of its financial operations.

Management's Response

A financial policies and procedures manual is in process of being developed that will encompass all aspects of the processes connected to the revenue collection operations of the City Clerk's Office.

Library

Comment

We evaluated the systems of internal control related to the Library and identified the following deficiencies:

1. All Library employees have access to customer account balances in the Library's financial software program (C/W MARS). As a result, customer account balances may be accessed by unauthorized personnel.
2. Deposit turnovers are not reviewed prior to submission to the Treasurer/Collector's Office (T/C). Supervisory reviews of deposit turnovers reduce the potential for human error and asset misappropriation.

These matters were also reported in the prior year Management Letter.

Recommendation

We recommend the Library:

1. Implement policies and procedures to mitigate the risk of unauthorized access to customer accounts
2. Implement policies and procedures requiring supervisory review and sign-off of deposit turnovers before they are submitted to the T/C

Management's Response

The Worcester Public Library, as part of a shared computer system (C/W/MARS) has limitations in terms of restricting user access. The City will once again attempt to request enhancements in terms of restricting user access. As part of the standardization of departmental revenue recognition, the Treasurer's Office implemented "electronic" review and signoff procedure for all departments receiving revenues. This enhancement was implemented during the course of two fiscal years (fiscal year 2009 and fiscal year 2010). Unfortunately, the Library personnel did not adhere to the procedures in an attempt to ensure timely deposits to the Treasurer's Office.

New Accounting and Financial Reporting Requirements for Fund Balances

Comment

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. 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 to clarify 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 will be made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with loans receivable. 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.

Governments will also be 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 will be required.

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

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type 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.

Implementation of this statement will improve financial reporting by:

- Providing fund balance categories and classifications that will be more easily understood
- Eliminating the *reserved* component of fund balance in favor of a *restricted* classification to enhance the consistency between information reported in the government-wide statements and information reported in the governmental funds financial statements
- Requiring governments to classify amounts consistently, regardless of the fund type or column in which they are reported
- Providing disclosures to give users information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified
- Reducing uncertainty about which resources can or should be reported in the respective governmental fund types

Given the significance of fund balance amounts (both quantitatively and qualitatively), the fund balance reporting under the new standard will have a significant impact on the City's financial statements.

The City's required implementation date of GASB Statement No. 54 is fiscal year 2011.

Recommendation

We recommend management continue to familiarize itself with GASB Statement No. 54 to prepare for its implementation. We would be pleased to assist the City with its preparation for implementing the new standards.

Management's Response

It is our intention to become completely familiar with GASB 54 and implement it in the City's fiscal year 2011 Comprehensive Annual Financial Report.