

CITY OF HOLYOKE, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2014

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Additional Offices:

Nashua, NH
Manchester, NH
Andover, MA
Ellsworth, ME

To the Mayor and City Council
City of Holyoke, Massachusetts

In planning and performing our audit of the basic financial statements of the City of Holyoke as of and for the year ended June 30, 2014, 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 entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that have not been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

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. Material weaknesses are noted in the table of contents and comment headings.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Significant deficiencies are noted in the table of contents and comment headings.

During our audit we also became aware of other matters that we believe represent opportunities for strengthening internal controls and operating efficiency. The recommendations that accompany this letter summarize our comments and suggestions concerning those matters.

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

The purpose of this communication, which is an integral part of our audit, is to describe for management and those charged with governance, including those overseeing the financial reporting process, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Melanson Heath

August 3, 2015

CURRENT YEAR ISSUES

1. IMPROVE CASH RECONCILIATION PROCEDURES IN TREASURER'S OFFICE (MATERIAL WEAKNESS)

Our review of processes and procedures in the Treasurer's office found several areas where improvement is needed. Specifically:

- During our testing of cash in fiscal year 2014, we found a bank account that was not reported in either the City's general ledger or the Treasurer's cash balance. The balance in the account was approximately \$40,000 at year end.

We recommend the City adjust the general ledger and Treasurer's balances to include this account.

- During our review of the Treasurer's cash book we found there were still large outstanding reconciling items from the prior fiscal year.

We recommend these items be reviewed for accuracy and the cash book be adjusted if transactions were not properly recorded.

- In our cash testing, it was brought to our attention that some school organizations maintain cash accounts using the City's Federal identification number (FID).

We recommend that the organizations' advisors be informed that all unauthorized cash accounts must be transferred to a different FID. In addition, all local banks should be reminded that accounts should not be opened under the City's identification number without appropriate City authorization.

- The City maintains over sixty bank accounts. While some City activities are required to be maintained in separate bank accounts in order to separately track funds or allocate interest, the rest are not. The maintenance, monitoring and reconciling of so many accounts is a tedious and time-consuming process.

We recommend the City consider closing accounts that are not required to be maintained separately and consolidate like accounts into one. This would help streamline the reconciliation process and improve efficiency.

City's Response:

- The Bank account was closed and the ledger updated.
- The Treasurer plans to review the items identified by the auditors and make a year-end adjusting entry to accomplish the reconciliation.

- Because of previous mismanagement the City directed the Schools to use certain City accounts for PTO/Student Activity. This allows the City to track and monitor these funds to ensure proper management and control.
- The City has condensed its number of bank accounts.

2. IMPROVE CONTROLS OVER RECEIVABLES (MATERIAL WEAKNESS)

During our review and testing of the City's detailed receivable balances we found several areas where improvements should be made:

- Real estate taxes receivable could not be reconciled to the Collector's detail records. The variance was approximately \$200,000.
- Tax lien and foreclosure receivables could not be reconciled to the Treasurer's detail records. The variances were approximately \$240,000 and \$110,000, respectively.
- Excise taxes could not be reconciled to the Collector's detail records. The variance was approximately \$200,000.
- Sewer user charges and sewer tax lien receivables could not be reconciled to the Sewer Department's detail records. The variances were approximately \$60,000 and \$50,000, respectively.
- Parking ticket receivables are not recorded in the City's general ledger nor are they reconciled to the detailed receivable balance. In addition, commitments and abatements are not provided to the City Auditor's office for inclusion in the general ledger. Control totals are not maintained or reconciled to the detailed outstanding list and general ledger. This significantly increases the risk that errors or irregularities related to parking ticket transactions may occur and go undetected.

We recommend the City record and track the receivable balances in the general ledger and reconcile the Collector's control balances to detailed balances at least quarterly.

City's Response:

We have made some progress, but work still needs to be done:

- The Tax Collector will work with the Auditor to reconcile between the Collector's control and the detailed balance due report, and make appropriate adjusting entries.
- The Treasurer is working on changing past practices in order to reconcile tax lien and foreclosure receivables.
- The conversion of all parking ticket information into a new internal records system was halted when the employee assigned to the task was terminated. We will look to see if the effort can be renewed.

3. IMPROVE CONTROLS OVER PAYROLL (MATERIAL WEAKNESS)

As noted in the prior year, we found issues during our testing of forty payroll transactions. Specifically we found the following:

- Three instances where the rate of pay per the payroll report could not be adequately supported.
- Three instances where the rate of pay per the payroll report did not agree with the authorized pay schedule.
- Four instances where timesheets were not approved by a knowledgeable individual.
- One instance where the hours per the timesheet did not agree with the hours paid to the employee.

We recommend that all pay rate changes be supported by an appropriately authorized status change notice in the employee's file. In addition, we recommend that all time cards and summaries be signed by the employee and a supervisor and a verification be done to ensure that the hours per the payroll system agree with timesheets before payment is made. This will improve controls and documented oversight over payroll.

City's Response:

The City is currently following all of the above recommendations.

4. IMPROVE TIMELINESS OF TRUST FUND CASH TRANSFERS (MATERIAL WEAKNESS)

The City's trust fund activity appears to be accounted for in the general ledger accurately; however, the ending general ledger balances do not agree with the Treasurer's trust fund cash balances. This is the result of trust fund cash disbursements being made from the City's operating funds and not being reimbursed in a timely or accurate manner.

Periodically, the Treasurer transfers money to or from the trust fund cash accounts to reimburse the operating cash account. In fiscal year 2014 these transfers were not made in a timely manner. As a result, as of June 30, 2014, the Treasurer's trust fund accounts were approximately \$860,000 more than they should have been.

We recommend that trust fund transfers be made in a timely manner and that trust fund cash balances be reconciled between the City's general ledger and Treasurer's records on a quarterly basis.

City's Response:

The Treasurer has instituted changes to the procedures for Trust Fund transfers to ensure that transfers are made at the appropriate time. The funds are now in balance.

5. IMPROVE CONTROLS OVER POLICE OUTSIDE DETAIL FUNDS (SIGNIFICANT DEFICIENCY)

The City's Police Department provides outside detail services for various purposes, the fees for which are billed and collected by the City. In accordance with a contractual agreement, the City pays the officers upon completion of the details, and not when the fees are collected. In addition, these receivables are not maintained in the City's general ledger or Collector records. As a result, there is no independent verification performed to determine whether all services have been billed and/or collected.

No police outside detail accounts receivable report was run from the Police Department's software system as of year-end, and since the system used to track the receivable is date sensitive a report must be run on the date needed to obtain accurate information. As a result, we were unable to determine the receivable balance due at year end.

Because the City has already paid the officers, unpaid fees result in a deficit in this fund at year end of approximately \$260,000. This deficit reduced the City's available free cash and represents a negative cash flow to the City. In addition, due to the age of some of these balances, a portion appears to be uncollectible. The City would need to fund (appropriate money for) any balances determined to be uncollectible.

Because this deficit negatively affects the City's cash flow and could require the City to fund any true deficits, we recommend the City implement a process to ensure collection of outside detail fees outstanding. This process should include precluding officers from scheduling outside detail for companies, individuals, or organizations whose balances are in arrears. If these balances are deemed to be uncollectible, then the invoices should be written off and the deficit funded by the City.

We also recommend the receivable be recorded in the City's general ledger and reconciled to detailed balance due reports on a monthly basis. We also recommend these receivables be recorded in the general ledger and the resulting balance reconciled to a detailed list of balances due at least quarterly.

City's Response:

The Police Department has spent considerable time analyzing the outside detail fund. The results indicate that, while there is a large balance of receivables that are considered current, the majority of the fund's deficit stems from outstanding receivables created prior to the current administration. Given the

age of those debts, the probability of collection is slim. Those balances will need to be written off and funded by the City Council. In the meantime the department will work to ensure that current clients are credit-worthy and pay their bills in a timely fashion.

6. CONSIDER LONG-TERM FINANCIAL PLAN FOR THE SEWER FUND (SIGNIFICANT DEFICIENCY)

The results of operations in the sewer fund have been trending negatively over the last several years. The following summarizes net income/(loss) for the last three fiscal years:

<u>Fiscal Year</u>	<u>Net (Loss)</u>
2012	(34,388)
2013	(1,066,341)
2014	(486,298)*

* The fiscal year 2014 net loss includes a transfer from the general fund to cover a budgeted operational deficit of \$967,786. Without the transfer, the net results of operations for fiscal year 2014 would have been \$(1,454,084).

In addition, based on a review of the City's fiscal year 2015 budget recap, the City's general fund will be subsidizing a sewer fund operational deficit of \$(1,429,750).

We recommend the City Council/Sewer Commissioners establish a five-year financial plan. This plan should include the extent to which user charges may need to increase in order to finance sewer operations and capital improvements on an ongoing basis.

City's Response:

The City studied this issue in depth in fiscal year 2014. As a result we now recognize that the deficit is not caused by inefficiencies in the Wastewater system but is the result of federally-mandated expenditures to upgrade the City's Stormwater system. Accordingly, we would like to fund those upgrades by imposing a new Stormwater fee, as has been done by other communities. This recommendation is currently being reviewed by the City Council.

7. COMPLY WITH MASSACHUSETTS GENERAL LAWS – NUMBER OF ASSESSORS (COMPLIANCE FINDING)

As noted in prior years, the City currently has two members on the Board of Assessors. Massachusetts General Law, Chapter 41, Section 24 requires that the Board of Assessors for a City consist of one, three, five, seven, or nine members.

We continue to recommend the City either increase or decrease the number of Assessors on the Board to comply with Massachusetts General Laws.

City's Response:

The City is aware of the Massachusetts law regarding the composition of the Board of Assessors. The City Council appoints the board members and has discussed this violation on several occasions, the most recent discussion occurring in June 2015, but they have not acted. It may take intervention by the State to enforce compliance.

8. ENSURE COMPLETION AND RETENTION OF COMPARABILITY RECORDS – TITLE I (COMPLIANCE FINDING)

The School Department could not locate the Title I comparability documentation forms for fiscal year 2014. A school (LEA) may receive funds under Title I only if State and local funds will be used in participating schools to provide services that, taken as a whole, are at least comparable to services that the LEA is providing in schools not receiving Title I funds. A school is considered to have met the statutory comparability requirements if it has implemented measures to determine comparability.

We recommend the School Department complete, submit and retain the required comparability documentation and that measures be taken to ensure that the comparability requirements are met.

City's Response:

After years of submitting comparability documents in the same format, the School Department submission for 2014 was deemed inadequate by the federal overseers. The Department is in process of revising the documentation to meet the current interpretation of the submission standards.

9. INCLUDE ALL DISBURSEMENTS ON CITY WARRANTS

During our testing of vendor payments we found that the following disbursements bypass the City's warrant process:

- Debt service payments.
- Student activity fund replenishment requests.
- Payments deducted directly from the Collector's bank account (Deputy Collector fees, etc.).

We recommend the City treat the aforementioned disbursements in the same manner as all other City funds and include them in the normal vendor warrant procedures. This will improve oversight and control over these cash disbursements.

City's Response:

The Tax Collector has changed procedures and will submit Deputy Collector fees, etc. through the warrant process.

10. IMPROVE GRANT PROCEDURES – HOME GRANT

During our testing of procedures in the Community Development Office we noted the following issues:

Comply with Reporting Requirements

The Federal Funding Accountability and Transparency Act requires information disclosure concerning entities receiving federal awards such as federal contracts, subcontracts, grants, and subgrants. Prime recipients (the City) are required to register in the Federal Funding Accountability and Transparency Subaward Reporting System (FSRS) and report subaward data through FSRS for subawards of \$25,000 or greater. Requirements for reporting pursuant to the Federal Funding Accountability and Transparency Act are codified in the FAR interim final rule published in the Federal Register.

The City issued one subaward greater than \$25,000, however, did not register this award in the FSRS and did not report the required data related to the subawardee.

We recommend that the City register all subawards in excess of \$25,000 in the FSRS as required by the Federal Funding Accountability and Transparency Act for all applicable grants.

City's Response:

The Office of Community Development has taken steps to address this. FFAT reporting has been added to the compliance checklist for every contract.

Improve Subrecipient Monitoring

Federal requirements stipulate that grant recipients monitor the activities of their subrecipients. Monitoring activities may take various forms, including but not limited to, the following: reviewing reports submitted by the subrecipient,

performing site visits to the subrecipient to review financial and programmatic records and observe operations, arranging for agreed upon procedures engagements for certain aspects of subrecipient activities such as eligibility determinations, reviewing the subrecipient's single audit or program specific audit results, and evaluating audit findings and the subrecipient's corrective action plan.

The Holyoke Housing Authority (HHA) administers a portion of the City's HOME grant related to a Buyers Assistance Program (BAP). In administering the BAP program, HHA determines recipient eligibility and disburses grant funds. Consequently, HHA is considered a subrecipient and these HOME funds should be included in HHA's federal grant audit, but they are not.

We recommend the City establish procedures for regular fiscal monitoring of its subrecipients. We recommend that all monitoring be documented in writing and include a thorough review of the subrecipients internal controls for fiscal compliance.

City's Response:

The Office of Community Development has revised the Policy and Procedures manual for the Buyers Assistance Program. The administrator will henceforth be conducting an annual fiscal review of HHA BAP files.

Reconcile Community Development Records to General Ledger

The Community Development office tracks revenue and expenditure data on the State's Intelligent Grants Management System (IGMS). This data is also used to prepare the quarterly reports. During our testing we found that the Community Development office records have not been reconciled to the City's general ledger since the departure of the previous City Auditor in June 2014. The lack of a formalized reconciliation between grant records and the general ledger increases the risk that the general ledger and/or grant records may contain errors or omissions which may not be detected in a timely manner. In addition, inaccurate reporting of grant activity could affect the City's compliance with Federal guidelines for both cash management and reporting.

We recommend the Community Development office either obtain training on the City's financial software (Munis) or request summarized reports from the City Auditor's office monthly to enable them to reconcile the general ledger with their internal records.

City's Response:

The Office of Community Development bookkeeper will be trained on the Munis system and will develop summary reports monthly to reconcile with OCD records.

11. DEVELOP A MORE FORMAL RISK ASSESSMENT PROCESS

The City informally performs its own risk assessment for possible fraud or material misstatement through various policies and procedures and regular reviews of trends in the financial statements. Risk assessment is a management function designed to identify where an organization may be vulnerable to errors and/or irregularities. A complete risk assessment process involves a written description of risk areas identified by those charged with governance (management and elected officials) and a description of how the organization intends on responding to the risks.

We recommend that the City implement a more formal risk assessment process that includes internal audits and written identification of areas where potential fraud or material misstatements to the basic financial statements may occur. Regular department head meetings could be used as a starting point for documenting risk assessment discussions and assessments.

In evaluating risk areas, particular consideration should be given to situations where a single employee is responsible for performing most or all accounting responsibilities, since this could create opportunities for fraud to occur and go undetected. The City should evaluate major transactional cycles in all applicable departments to ensure an adequate segregation of duties exists. If staffing levels do not permit an adequate segregation of duties, the City should provide additional oversight, which should include review and documented sign-off of the key accounting records.

We also recommend the City establish a formal employee fraud policy or consider establishing a fraud hotline to provide staff with guidance in the event they observe or suspect fraud in the work place.

City's Response:

The City agrees with the significance of this item. It will be referred to the incoming City Auditor to develop an appropriate process.

12. OTHER ISSUES

Current Year

Resolve Reimbursement Request Issue

During our review of the capital project funds we found an instance where a reimbursement request was made in May 2014 to the Massachusetts School Building Authority (MSBA) for \$764,647 for Dean Tech science lab renovations. In June, the City only received \$488,462 of that request. After further inquiry it was determined that the MSBA had denied part of the City's request for reimbursement of computers. As of audit fieldwork in May 2015, this issue was still not resolved and it is still unknown if the City will receive the funds to cover the purchase already made.

We recommend the City continue to pursue this issue to determine if the costs will be reimbursed or will need to be funded by another source.

City's Response:

The School Department is continuing to pursue the reimbursement of computer purchases as part of this project.

Monitor Capital Project Fund Budgets

The City's general ledger reflects capital project funds which are funded by debt authorizations that have not yet been issued. During our testing we found one instance where the authorized budget was not entered in the City's general ledger.

We recommend the City record capital project fund budget authorizations as soon as they are voted by the City Council. This will reduce the risk of over-expenditures occurring and going undetected.

City's Response:

The Acting City Auditor agrees with this recommendation but is deferring a final decision to the incoming City Auditor.

Clarify Allowable Uses of Excess Fire SAFER Grant Funds

The Fire Department requests SAFER grant funds for certain firefighters' salaries and fringe benefits. The salary amounts requested are based on actual costs; the fringe benefit amounts are based on the amount budgeted per firefighter; however, the actual fringe benefit costs charged to the grant are less than the amount budgeted, resulting in a surplus (\$84,326 as of June 30, 2014) in the grant fund. The Fire Department anticipates using this surplus to fund these firefighters' salaries once the grant expires, however, it is unclear whether this is allowable under the terms of the grant.

We recommend the Fire Department clarify the allowability of this surplus, and its intended use, with the grantor agency.

City's Response:

The Fire Department contacted FEMA and determined that this use of funds is allowable under the terms of the grant.

Prior Year

Implement Regular Departmental Internal Audits

Currently, the City does not perform regular departmental internal audits. Internal audits compliment the annual independent audit and provide important oversight over departmental accounting records throughout the year.

We continue to recommend the City Auditor's office establish a schedule for periodic internal audits of the City's departmental accounting records. This will result in improved oversight and should reduce the risk of errors or irregularities from occurring and going undetected.

City's Response:

The Office of the Auditor reviews and approves every disbursement or receipt for both substantive transaction details and compliance with the various applicable accounting regulations, laws and policies. When a transaction triggers the need for further review, such review, or audit, is conducted. Current resources do not allow for regular audits of this nature.

Investigate Individual Fund Balances

In prior years, we have recommended that the City review inactive special revenue and capital project funds. There are numerous special revenue and capital project funds with balances that have not reported any activity in the past few years.

We continue to recommend that the City take action to dispose of the inactive special revenue and capital project funds.

City's Response:

All fund balances are reviewed by the City Auditor at least annually. Issues regarding dormancy, deficit or surplus balances are reviewed with the respective department head holding oversight responsibility. Based on the results of these reviews an appropriate action plan is devised. In fiscal year 2015 more than two dozen funds were closed out as a result of these reviews.

PRIOR YEAR ISSUES

All other prior year issues have been satisfactorily resolved or modified and repeated as current year issues.