



City of Malden
Massachusetts

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July 16, 2013

Dear Members of the City Council:

I am submitting for review the 2012 Fiscal Year Management Letter from Roselli, Clark & Associates. This report includes specific findings and recommendations as well as an update of the prior year's comments. The City's responses are included within the document and are designated in blue.

The report emphasizes the fact that Malden is moving in a positive direction as we continue to increase our reserves and improve our credit rating with a positive outlook. Each finding and recommendation has been reviewed and discussed with the appropriate Department Head and the necessary action plans have been put in place. We will continue to diligently initiate and monitor all corrective measures so that we maintain our consistent progress and improvements moving forward.

The information is available in the document linked below and I welcome the opportunity to discuss the report and the City's responses with you. Please contact me at 781-397-7000 or by email at mayor@cityofmalden.org. Thank you.

Sincerely,

GARY CHRISTENSON
Mayor

CITY OF MALDEN, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2012

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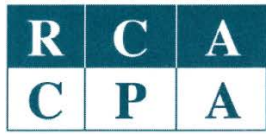
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Honorable Mayor and Members of the City Council
City of Malden, Massachusetts
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Malden, Massachusetts 02148

We have audited the financial statements of the governmental activities, the business type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Malden, Massachusetts (the "City") as of and for the year ended June 30, 2012, which collectively comprise the City's basic financial statements and have issued our report thereon dated October 22, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and

recommendations that we consider to be a significant deficiency in internal control over financial reporting. This deficiency is reported on page 16.

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.

This report is intended solely for the information and use of management, the Mayor, Members of the City Council and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
October 22, 2012

I. OVERVIEW

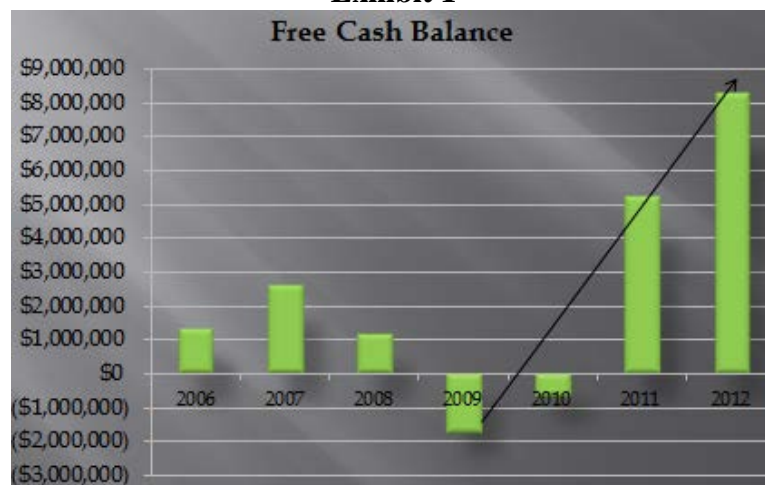
In economic terms, 2012 was a year of mixed signals for the economies of the United States as well as throughout the Commonwealth of Massachusetts. Unemployment trends showed some improvement, but still remained near historic highs. Housing, construction and other leading indicators are beginning to trend positive. Despite this, below forecast revenues for fiscal 2013 from the Commonwealth of Massachusetts, and other available data show that the economy has yet to completely emerge from the recession that has plagued the area since 2009.

This is a signal that a community must remain cautious while preparing its budget. There is a fine balance to maintaining reserves to satisfy rating metrics verse providing the Community's residents adequate levels of services. Many communities have conceded to the pressure of maintaining services in lieu of building reserves and thus are facing the consequences of those decisions, which include possible credit rating downgrades.

The City however has continued to improve upon its financial condition, a trend that began in 2010. For the third consecutive year the City has increased its reserves, which have had a correlative similar impact on free cash. Numerically, free cash has increased from a deficit position of \$2 million at the end of fiscal 2009 to over \$8 million at the end of fiscal 2012, a \$10+ million swing. In its financial statements, this translated to \$11.8 million in unassigned fund balance in the general fund.

We commend the City for taking the approach to building reserves. This is one of the key metrics by which the City's solvency is evaluated. This is important to the City since the higher the City's credit is rated by the credit agencies the cheaper it is for the City to finance capital projects. In fact the City has improved its credit rating from a no rating status during 2010 to an A1 with a positive outlook. We urge the City to continue this philosophy, as a movement to an AA3, which is the next step would prove very favorable to the City. Exhibit 1 illustrates this positive trend:

Exhibit 1



This recent surge has also allowed the City to move slightly ahead of the State average in terms of reserve ratio, which is essentially a City's unassigned fund balance divided by total general fund expenditures.

Exhibit 2 illustrates the growth in reserve ratio:

Exhibit 2

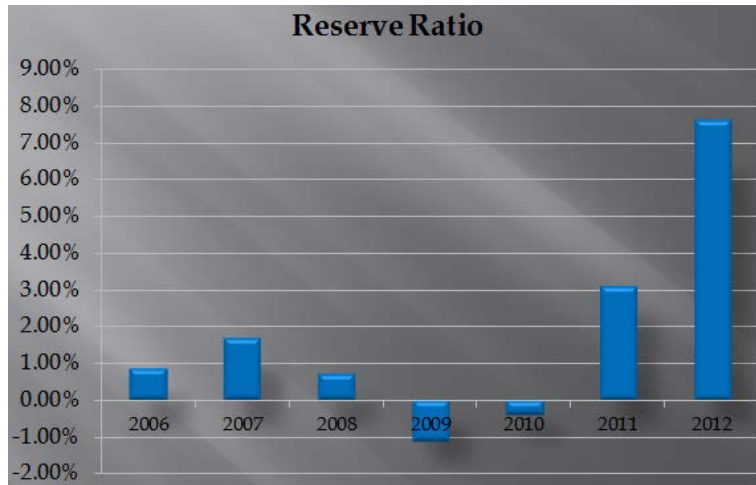
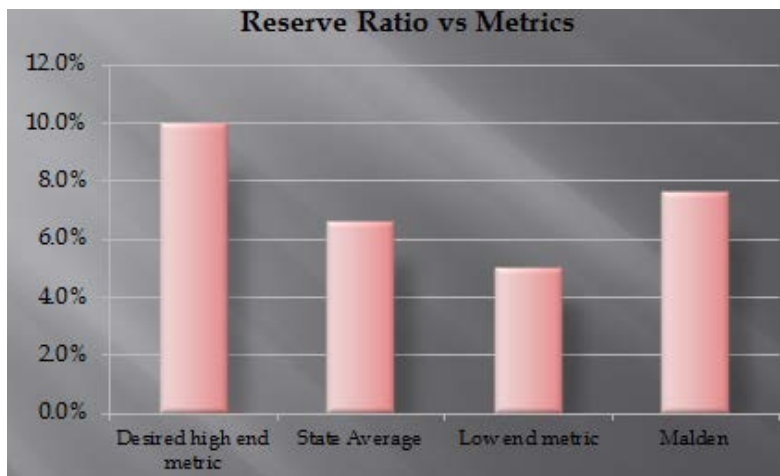


Exhibit 3 compares the City's reserve ratio to key metric ratios

Exhibit 3



Other positive financial highlights may be summarized as follows:

- The City's Health Insurance Trust Fund has a healthy fund balance designated for insurance benefits of approximately \$4.5 million. This is a result of the City's health insurance operations continuing to outperform the GIC.
- The City's Water and Sewer Enterprise Fund continues to be self-supporting. Cash basis fund balance exceeds \$1 million as of June 30, 2012. Recent rate increases should insure that this situation will continue through June 30, 2013.
- New growth measured at the end of fiscal year 2012 and disclosed in the 2013 tax recap was \$1.1 million. This exceeded expectations by \$500,000 and exemplifies the economic resurgence Malden is currently experiencing as development is beginning to gain traction.
- The City has funded over 70% of its actuarial pension liability. This places Malden near the top in terms of funded ratio as compared to retirement systems across the State. The City is expecting to be fully funded by the year 2030.
- Personal property appeals with the telecom companies were resolved. Results were better than expected.
- The High School was completed on budget and no further debt is required. The City is scheduled to receive its last reimbursement from the MSBA relative to this project before the close of fiscal 2013.
- Tax title revenue exceeded \$2 million for the third consecutive year.

City Management is beginning to understand the importance of administering the operations similar to a large corporation and the financial results are beginning to show. Maintaining this consistency is important as the City endeavors to attempt to become one of the better run communities in the Greater Boston area.

Also, on a positive note, the City continues to make diligent attempts to initiate adequate corrective action with respect to comments in prior year management letters.

While issues still exist as will be highlighted in the remainder of the letter, it is evident that the City is moving in a positive direction.

We hope the City will devote resources to address the remaining issues in this report with the same vigor, motivation and energy exemplified in these past 36 months.

II. INFORMATIONAL ITEMS

A. Other Post-Employment Benefits

Other Post-Employment Benefits (“OPEB”) has been discussed in significant detail in previous management letters. Please refer to these letters. The City’s latest actuarial study places the unfunded liability at \$178.6 million. The next actuarial study is not due until fiscal year 2014.

The credit agencies have begun to assign an allocation of the credit evaluation to the management of long-term liabilities. OPEB qualifies as such an item.

The City has become more active on the OPEB front recently. Subsequent to the close of fiscal year 2012, the City Council adopted the provisions of MGL c. 32B s. 20. This will allow the City to create a Trust such that it may begin to make contributions to decrease the unfunded liability.

In addition, the City created an OPEB Committee that consists of the City Council. The mission of this Committee is to explore funding options for OPEB. These initiatives are in the discovery stage.

On a very bright note, as previously discussed, the City has funded over 70% of its actuarial pension obligation, which places the City in a very good position relative to other retirement systems. This will leverage any future OPEB initiatives.

B. Health Insurance Mandate

As discussed in the prior year letter, Chapter 69 of the Acts of 2011, an appropriate public authority of a political subdivision which has undertaken to provide health insurance coverage to its subscribers under this chapter shall conduct an enrollment audit not less than once every 2 years. The audit shall be completed in order to ensure that members are appropriately eligible for coverage.

We understand that such an audit will be completed internally, during fiscal year 2014.

City’s Response:

A formal audit will be accomplished in Fiscal Year 2014.

C. Bond Rating

In light of the City’s intensive capital improvement initiatives, in the prior year we outlined the importance of obtaining a positive bond rating and to take steps that are within the City’s control to increase the chances of a positive result.

To that end the City has accomplished the following steps:

1. Conserved free cash. (*No appropriations have been taken from free cash since 2008 see previous discussion on free cash trends*).
2. Continues to aggressively collect revenues, thus increasing reserves. (*The City continued its aggressive pursuit of tax title resulting in over \$2 million collected during 2012.*)
3. The Controller is in the process of creating a 5 year forecast. This will be a fluent document and will greatly assist planning for future budgets.
4. The City Council adopted policies with respect to the level of reserves that will be targeted on an annual basis. These include free cash, stabilization and capital stabilization.
5. The City Council adopted OPEB legislation.

As a result of these steps and other positive economic development, the City's outlook was raised to positive. This sets the City up for a potential increase to AA3 at the next credit evaluation.

D. Regionalization Opportunities

In the prior year we discussed the need for the City to maintain an open awareness to collaborative opportunities with other communities with respect to the delivery of services. Examples of how the City has accomplished this, is through Pine Banks with the City of Melrose, and the Rivers Edge with the Cities of Everett and Medford. Presently the City has created an energy service committee and may be seeking partners in this area as the ideas evolve.

E. Deminimus Personal Property Tax Exemptions

The Assessor's office agreed with our recommendation in the prior year to exempt property tax up to a certain amount. (The MGL allows up to \$10,000 in valuation to be exempt.) After a comprehensive analysis it was determined that the most advantageous situation for the City was to exempt personal property up to \$5,000. This would eliminate 469 accounts and shift about \$25,000 to the other tax payers. The Assessor's Office has yet to recommend this to City Council for approval. We suggest this is accomplished with the 2014 tax levy.

City's Response:

We agree and will recommend that the City Council vote to accept the local option afforded by M.G.L. c. 59, §5, cl. 54 and allow for the establishment of a minimum value of \$5,000 for personal property accounts to be taxed.

F. Energy Service Company (ESCO)

In response to our energy related comments in the prior year, we were made aware by the City that they are researching numerous energy initiatives, including ESCOs, revenue sharing arrangements with power providers, green initiatives, grants, collaboration with neighboring communities and other related energy alternatives. To that end, during fiscal 2013, the City created an Energy Service Committee and in the 2013 created a dedicated position of Energy Service Director. The City expects to experience financial benefits from these endeavors in the future.

G. Red Flags Regulations

The City is addressing red flags regulations and the potential for other serious security breaches by engaging a security firm to perform a data security audit. This should be completed before the end of fiscal year 2013 and if successful and followed properly by City employees cause the City to be in compliance with the various security regulations that exist.

City's Response:

We recognize the importance of keeping information secure and a professional Data Security Audit has been completed. The plan is to implement the appropriate corrective actions that were recommended and incorporate them in a revised technology use policy.

III. FINDINGS AND RECOMMENDATIONS (Update of Prior Year Comments)

A. Assessor's Office

The lapses in the Assessor's Office that occurred during 2011 were met with serious intervention during 2012. A meeting between the Assessor, Mayor, Controller and our firm took place early in the fall. At this meeting it was discussed what would be needed to certify the tax rate and based on this, timelines were created for the submission of material to the Controller's office and the DOR. As a result, the tax recap was submitted on November 21, twenty-three days ahead of the prior year submission.

In addition, the Assessor has made available a listing of all ATB cases in a shared file and amounts released from overlay will be approved by the Board of Assessors prior to being appropriated by the City Council.

We encourage this same level of motivation and effort in the tax rate setting process in future years.

City's Response:

The Assessor's schedule calls for completion of values by August 19, 2013, Department of Revenue review by September 16, 2013, public disclosure of values by October 29, 2013 and tax rate set by November 11, 2013. The Department of Revenue review is supposed to occur between August 27, 2013 and September 16 2013, however, we have no control over this schedule. We intend to go before the City Council November 12, 2013 for the Classification hearing and submit the recap to the Department of Revenue on November 13, 2013 and hope to have the rates approved by November 18, 2013.

B. Cleared Check Imaging Software

There is no longer an issue with accessing information on-line from the bank through the check imaging software. The longer term plan is to have two individuals the incoming Treasurer and the Assistant Treasurer have on-line access.

C. Payroll Forms

All current payroll forms are presently prepared by Harper's payroll service and no longer will be prepared by an outside consultant. In addition the City is requesting a separate FID# for the Retirement System as part of this process.

City's Response:

After evaluation, the Retirement System and the City have decided to use the same Federal Identification number because both are now utilizing Harpers Payroll Services. Federal and State tax reporting will be coordinated with said service to ensure proper and timely reporting.

D. Human Resource Software

In the prior year we discussed the possibility of implementing a human resource software package for the Human Resource Department. Currently, this high data intensive department is administered with excel schedules which are prone to errors, inaccuracies and inefficiencies. The Human Resource Department is a very important component of City Government as it administers the personnel needs of over 2,000 individuals. The City recently implemented a new payroll reporting module which we understand also has a human resource tracking function. We understand there is no cost to the City for using this module and therefore urge the City to evaluate if this will accomplish the tasks that are currently being administered in excel.

City's Response:

The City recognizes the importance of utilizing the human resources tracking function of the current software to track sick and vacation accruals, as well as offering employees a platform to inquire on payroll information. The current practice of using Excel spreadsheets is not functional given the number of employees being tracked. The City has begun discussions with Harpers, the current payroll software provider, to evaluate the Human Resources capabilities contained within the system to centralize the tracking of and reporting of employee related data. Should these capabilities fit our needs, we will look to convert data over in Fiscal Year 2014.

E. Code Enforcement and Other Revenues

The City has purchased software to help account for all fines, fees and permits. This is scheduled to be implemented for the start of Fiscal 2014. In addition to facilitating the recordkeeping for these functions, the Controller is attempting to include an inventory control aspect to the process which will facilitate the ability to reconcile revenues.

In addition, as part of the City's overall policies and procedures (see further comment below) the issue of when and how fees can be waived will be addressed.

F. Financial Policies and Procedures

The City has engaged a consultant to assist with the preparation of a financial policies and procedures manual. It is anticipated that this manual will be available in draft form prior to the close of fiscal 2013.

G. Treasurer and Collector findings

1. Poor investment yields.
2. Need to consolidate bank accounts.
3. Elimination of credit balances.

The above items will all be addressed after the new Treasurer/Collector is appointed. We will monitor this situation closely.

City's Response:

The newly appointed Treasurer will be investigating and working on these issues during the fiscal year.

H. Fraud Policy and limited internal audit process

1. Fraud policy – A fraud policy was developed and approved by the City Council November 2012.
2. Limited internal audit process – See expanded comment under current year findings.

I. Chapter 30B compliance

The City has terminated the significant contract with the cleaning company that was in violation of 30B. Internal memorandums have been sent to all department heads asserting the importance of submitting contracts to the Controller for certification of funds. Although some contracts are still being discovered that are not going through the proper protocol, compliance is improving each day as department heads are better educated. We suggest that in the instance that the Controller discovers that contracts are not in compliance, that the Controller withhold payment on the contract until compliance is achieved. In addition, these policies will be part of the financial policies and procedures manual.

City's Response:

We agree that we need to continue to ensure that all Department Heads who procure goods and services for the City comply with the requirements of

M.G.L. c. 30B. The necessary procedure and protocol to follow will be incorporated as part of the financial policies and procedures manual.

J. Appropriations from Internal Service Fund

See expanded comment under current year findings.

K. MWRA and MWPAT programs

A complete departmental review of the entire MWRA/MWPAT process was performed in the prior year. The review stemmed back to 1994 and through the present. It was discovered that numerous issues existed in the administration of the activity including posting to incorrect accounts, accounting for interest incorrectly and the lack of reconciliation procedures between the Engineering Office and the Controller. As a result of the review, entries were made to bring all balances into proper alignment in the general ledger, communication was streamlined between the Engineering Office and the Controller, and the new balances were approved by the MWRA office in Boston.

Despite this new issues arose during 2012 that are discussed under the current year finding section of the report.

We discussed this with the Controller who indicated the process has since gotten much better and significant attempts are made to reconcile and make sure charges are made to the proper accounts. Part of the issue is the complexity of these accounts and their similarity in projects and thus, this is a learning process for all involved. We will evaluate this closely for the 2013 audit.

L. School Grant Administration

In the prior year, we highlighted numerous issues that existed during 2011 with the administration of the school financial activities including but not limited to:

1. Grant administration.
2. Tardiness of completing and submitting financial reports.
3. Accounting errors.
4. Lack of reconciliations.
5. Budgeting.

Some of these findings were determined to be material weaknesses and others were significant deficiencies. A full specific detail of each finding may be reviewed in the prior year Management letter.

The current school administration took these matters head on. With the assistance of outside consultants, the following was achieved:

- All current practices and procedures relative to business office functions were reviewed;
- All grants were reviewed for accuracy and proper expenditures;
- All grants were reviewed to ensure compliance;
- Payroll was reviewed to ensure employees are being charged to the proper accounts;
- Established a clean and accurate account for all grants moving forward in the 2011-2012 school year;
- Established procedures to ensure all district grants are managed appropriately;
- Closed out all 2010-2011 budget items;
- Reworked budget for 2011-2012 school year line item by line item; and
- Worked with Central Office to build a line item budget for the 2012-2013 school year.

As a result of these efforts the majority of the process issues have been addressed and corrected as of fiscal year 2012. However since most of this corrective effort was spearheaded by the consulting firm we caution the School and Superintendent to assure that these practices become part of the philosophy of the overall School department since in many instances similar to this, there is a tendency to revert to old practices once the consultant has ended their assignment.

In addition, the consultant has been retained as the interim School Business Manager for 2012 and 2013 but at some point this relationship will cease and the School must be prepared to conduct a diligent search for a qualified candidate to continue this philosophy.

Please review the Single Audit discussion for those issues that do remain for fiscal 2012.

City's Response:

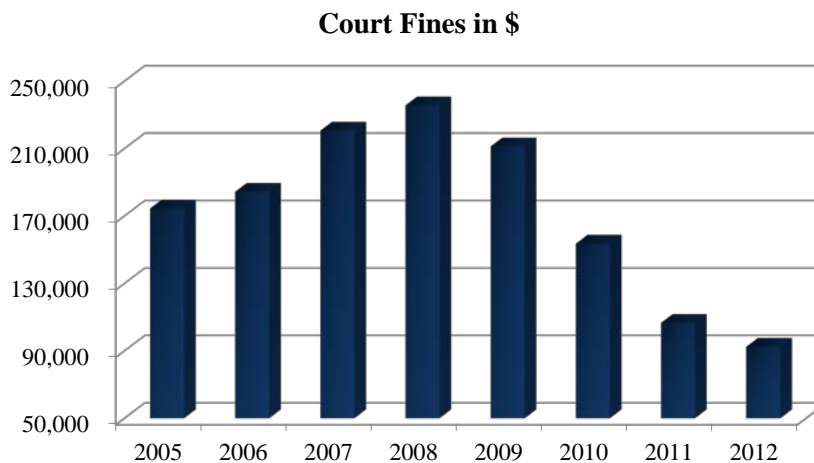
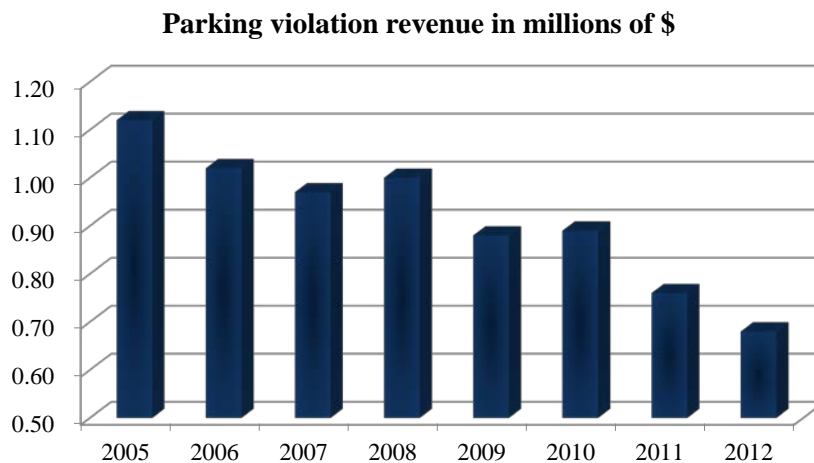
As noted, the School Department has made significant progress to rectify the numerous issues highlighted in the 2011 report. A majority of process issues have been addressed and corrected. The Department recognizes the need to hire a fulltime business manager. The School Committee will begin the process of hiring a business manager and the current consultant will remain in place until January 1, 2014.

III. FINDINGS AND RECOMMENDATIONS (Current Year Comments)

A. Parking Violations and District/Court Fines

The goal of City management is to maximize the profitability of each and every City activity. As such, the contributing revenue sources, once factored into the budget process, will in turn either lower the taxpayers' burden or increase the level and quality of service to the public. Two of the City's activities that are currently struggling to meet this objective are the City's Parking Violation Program and District/Court violations. What were once major local receipts which in aggregate were over \$1.3 million at peak will struggle to reach \$600,000 in 2013.

The following illustrations depict this adverse trend:



Parking

The City's entire parking operation is in need of a management study or review. The City has a vibrant downtown with retail and restaurants that attracts many consumers and patrons alike, is in close proximity to the Orange Line T stop which attracts

Boston based commuters and is in the process of developing an independent league baseball field which will engender a significant level of stimulus to the down town area. As such, parking should be a valuable income producing commodity for the City.

Presently, none of the down town main streets are metered; the parking violation program has become dysfunctional and the City's garages are operated outside of the City's purview by the Malden Redevelopment Authority.

The following highlight the issues on the City side:

1. Approximately 3 years ago, the City purchased hardware provided from an independent company. The goal was to streamline the process through a paperless environment and thus promote efficiency in the tagging of vehicles and subsequent collections. However the change was met with resistance by the users compounded by reliability issues with the hardware. As a result, there was a steady decline in the volume of tickets written on an annual basis.
2. For those tickets that were issued, the reporting from the system was inadequate to support the needs of the City. Consequently, follow up collections for past due tickets became very inefficient due to the inability to generate aging reports or the proper data to tag delinquent tickets at the Registry of Motor Vehicles. Because of this, the mailing of late notices ceased to exist for the past two fiscal years.

In light of the City's ability to tag parking violations with the Registry, there is simply no reason why over 90% of issued tickets won't eventually be collected in a functional system. However, due to the state of the current system in place, there are numerous delinquent tickets outstanding, the amount of which is unknown that may cause the City to have a significant revenue deficit in this account at the end of fiscal 2013.

The City is currently making best attempts to salvage collections for the current year by using the services of Kelley and Ryan. We urge the City to deploy the necessary resources to this process to mitigate the impact of this revenue shortfall in 2013. Any shortfalls may have to be made up as part of the 2014 budget, which is always a challenging process to begin with.

In addition, as previously discussed, the City should look to a reorganization of all parking related functions, perhaps consolidating these into a single department, utilizing an enterprise or similar approach. Cities of Malden's size, with revenue similar to Malden for parking, generally have the parking function isolated with dedicated management oversight.

The City should also evaluate the possibility of metering the down town area as a means to supplement the current revenue streams.

City's Response:

In June, we began utilizing state of the art handheld ticketing devices to replace the previously handwritten tickets. The City has retained the services of Kelley & Ryan to provide parking enforcement software in addition to the handheld units. Kelley & Ryan will also handle the timely mailing of notices and subsequent marking of registrations for non-payers. Efforts are currently underway to collect as much of the overdue fine revenue as is possible. The combination of all of these factors will result in a better execution of the parking enforcement function. We are also assessing parking reform and the possibility of installing parking meters in the downtown area.

Court Fines

District court fines have dropped off significantly in the last 7 years. The City is not responsible for collecting court fines (mainly moving violations), as these are remitted by the Commonwealth. As such the only apparent reason for the diminished amount of revenue is less tickets being issued. Given that the City's demographics have not changed in the last 7 years and people's driving habits don't change in such a short period of time, the City should evaluate the cause for the diminished level of violations.

City's Response:

There may be a multitude of reasons for the reduced level of violations and we plan to investigate the possible causes and consider potential remedies.

B. Uninsured and Uncollateralized Deposits

As of June 30, 2012 the City had over \$43 million in its various bank accounts. Approximately \$1.3 million was insured through the Federal Deposit Insurance Commission and the remainder, about \$40.7 million was neither insured nor collateralized. While the amount of bank failures has stabilized since 2008/2009 this is a significant amount of cash exposed to custodial credit risk. Currently, many communities are collateralizing deposits. This comes with a minor reduction in yield, however yields are presently so low that this would be a minor cost in light of the safety secured. We suggest the in-coming Treasurer evaluate this as part of the overall changes that will be addressed.

City's Response:

Safety of the City's invested funds is the most important factor in deciding investment options. The Treasurer has a policy of investing only in well capitalized and

profitable banks that have a history and proven record of sound decision making as determined through bank rating agencies, such as Veribanc. This rating agency ranks the banks based on various ratios and are used by the Treasurer to decide which banks are worthy of City deposits.

C. MSBA Reimbursements

As previously discussed, the City has recently completed construction of a major renovation of its High School facility. The City qualified to receive 90% reimbursements of all eligible costs. As part of the close out process, we attempted to reconcile the activity per the general ledger to the activity as reflected on the MSBA web site. We determined that in 2006, over \$600,000 of costs had been classified as ineligible. We discussed this with the Controller who engaged us to perform a comprehensive review of the entire project. Resultant of this we discovered that the records submitted to the MSBA had never been reconciled to the general ledger records; further after numerous discussions with personnel at the MSBA, we discovered that the \$600,000 in ineligible costs had been disqualified because they were not supported by invoices and that an approximate additional \$300,000 in costs included on the general ledger had never been submitted. The Controller directed his staff to pull all records from the archives and resultant of this the City was able to submit and receive reimbursement for almost all \$900,000 of costs that may otherwise have been overlooked. *As part of this process it was also discovered that an invoice for \$20,000 was paid to the same vendor twice. This was an invoice for cleaning services performed by the City's cleaning company. It was paid as part of a payment to the lead architect firm and also directly to the cleaning company.* We suggest the City make best efforts to recover these funds from the cleaning company. These issues with the High School illustrate the importance of reconciliations. The general ledger is the final book of entry and all external records should be required to be reconciled back to the general ledger as part of an internal control process.

City's Response:

We agree that these issues demonstrate the importance of reconciliations. A comprehensive review of the entire High School project was conducted and we cooperated with any action recommended. Additionally, a letter was sent to the architectural firm that received the double payment in an effort to recover the monies mistakenly paid.

D. Payroll Processing (Significant Deficiency)

Financial reporting and information systems should be designed and implemented to reliably process financial transactions.

The City implemented a new general ledger software system in fiscal year 2011, which utilized an expanded chart of accounts. The existing payroll system was still

programmed with corresponding links to the older chart of accounts, which caused problems for the payroll clerks attempting to code employees to the appropriate accounts. As a result, there were many instances of employees assigned to federal and state grants that were initially charged to incorrect accounts in the general ledger, requiring significant allocation adjustments to properly charge the grant funds. This caused the School to contract with consultants to review payroll activity and propose the appropriate adjustments.

Resultant of this process was a change to its payroll service provider. The conversion to both a new financial software provider and a new payroll service provider has strained the resources of the individual tasked with processing the City's payroll and thus has monopolized a significant amount of resources. In addition, this conversion has been met with numerous challenges, inefficiencies and further inaccuracies requiring further studies and time from consultants to correct.

Central to the overall issue is the City's payroll division, unlike most communities, reports directly to the Executive Office, instead of to the Treasurer or Controller. We recommend the City upgrade its payroll function to a division under the supervision of the Treasurer's Office. As part of the reorganization, the City should consider adding staff to allow for cross-training and coverage for scheduled and unforeseen absences of the division's employees.

City's Response:

The Payroll function has been transferred to the Treasurer's Office. Problems that have plagued the payroll process have been identified and corrections made. We will continue to work with all departments to put in place policies and procedures that enhance all aspects of payroll.

E. MWRA/MWPAT

Federal compliance issues

The City submitted the same vendor invoices for reimbursement on two separate federal awards, despite the requirement that allowable costs should only be submitted once for federal reimbursement.

This was caused because the construction project had multiple funding sources and the reimbursement request submitted for CFDA #66.468 was not reconciled to paid invoices reflected on the general ledger. As a result the City received funds in excess of their cash needs.

This has resulted in questioned costs of \$970,000. This further supports the need for reconciliations of this very complicated area of accounting. In the meantime, the City should submit project invoices in the amount of the questioned costs to the

Massachusetts Water Pollution Abatement Trust that have not yet been submitted for reimbursement. This will support the excess funds that have already been received.

We discussed this with the Controller who indicated the process has since gotten much better and significant attempts are made to reconcile and make sure charges are made to the proper accounts. Part of the issue is the complexity of these accounts and their similarity in projects and thus, this is a learning process for all involved. We will evaluate this closely for the 2013 audit.

Banking

As part of the agreement with the MWRA to accept the City's adjusted balances, the City was directed to make the necessary transfers from the dedicated bank accounts to reflect the same balances that are in the general ledger for those accounts. In doing so, interest earnings would be properly reflected in the future. These transfers have yet to be made in the banking records and we suggest these are made promptly by the incoming Treasurer.

City's Response:

The Treasurer is investigating this matter and will take the corrective actions necessary.

F. Centralize Information Technology

Presently, the City, Police, and School all have their own Information Technology Functions. While the differing needs of each of these departments require that each department have their own dedicated resources, the City can take steps to ensure that this structure doesn't lead to inefficiencies that might otherwise be eliminated in a centralized structure.

The City should consider:

1. Centralizing purchasing for the three departments to ensure best pricing is being received and to make sure the City is receiving the full benefit of bulk purchasing.
2. Creating a formalized, regular communication process amongst the three IT leaders to start to develop consistent approaches to things such as inventory tracking, data backup, security, etc.
3. Encouraging the three IT leaders to proactively work together to centralize any functions that are replicated across the three departments.

While a completely centralized approach may be out of reach for organizational reasons, the city should look to take steps to attempt to gain as many of the benefits of

a centralized approach as possible through increased communication and centralizing key common elements such as purchasing.

City's Response:

In Fiscal Year 2014, the City's IT Director will evaluate the possibility of collaboration with IT professionals within the school and public safety departments for the potential of more efficient operations.

G. Limited Internal Audit Process

We discovered that there is no reconciliation process between those departments that handle cash (i.e. building permits, dog licenses, school lunch etc.) with either the Treasurer or Controller's records. While these revenues are not as significant as the overall revenues, there should still be a process by which these departments are held accountable.

Some large municipalities have established an internal audit position that would establish as one of their duties, procedures to hold cash handling departments accountable. However, the City has chosen not to create an autonomous, internal audit function therefore the City should consider following the provisions of Chapter 41 of the MGL that allows the Controller or equivalent position the ability to examine books and records of any department on a periodic basis, and at least once on an annual basis.

Based on this, we suggest that the Controller internally cycle audit the cash handling departments. A different department should be chosen each month, and the cash handling for that month should be reconciled independently. For example, in the area of dog licenses, the number of licenses issued multiplied by the amount per sticker should be reconciled back to the cash turned over to the Treasurer and recorded in the general ledger.

The City's new software discussed under code enforcement could prove beneficial in this process if an inventory control module is available.

Alternately, the City could choose to include as part of the audit process 2 to 3 departmental cash handling audits per year and cycle these each year so that at the end of a 5 year period most cash handling areas have been reviewed.

Such a process could provide an excellent deterrent against fraud.

City's Response:

We agree and the City intends to make this a focus. The plan includes an internal audit process that starts with a focus on reconciling cash received by the various

departments to that which is received by the Treasurer's office, supported by monthly management reporting from these same departments.

H. Net School Spending

For the first time since the Education Reform Act went into effect in 1993, the City failed to meet the net school spending mandates of the Department of Elementary and Secondary Education. The preliminary deficit is \$3.7 million however this amount does not appear accurate as some major components of the calculation appear to have been omitted. We understand that the Controller's Office has engaged a consultant to review the indirect costs associated with this complex calculation and some disputes have arisen between the amounts submitted by the School and those the consultant is calculating. In any regard it appears that the City will ultimately end up in a deficit position although it should be lower than the \$3.7 million currently submitted. This is a reminder that once the deficit exceeds 5% of the Foundation Budget, (\$84M in 2014), the City will be required to fund this as part of the setting of the tax rate.

City's Response:

The School Department has made major progress in identifying indirect costs as they relate to the Department. After meeting with the City, the School Department made adjustments to the indirect costs which brought the deficit down to \$2,818,565. The actual deficit going forward could change. The Department will continue to work on identifying actual costs that the City pays on behalf of the School Department and make sure that these costs are captured and accounted for accurately moving forward.

I. Evaluation of Local Fees and Other Sources

As the City prepares to compile its 2014 budget the City should be conscious that local revenues are an important part of the budget process. (See previous discussion under parking violations and court fines.) Currently many fees for many services have gone unchanged for a number of years, maybe even decades. The City should begin the process of surveying nearby communities to determine what other communities charge for specific services. This will assist the City in making a meaningful evaluation on whether current service fees may be increased.

In addition, the City should begin to challenge previous methods of calculating significant revenue streams. For example, Assessors have recently been granted subpoena power for them or a representative to enter businesses and require all records pertaining to personal property acquisitions and additions and determine if personal property tax amounts should be adjusted (a personal property audit). We have seen other Cities use this power with significant positive results regarding the assessment of personal property taxes.

City's Response:

We agree and the goal is to work with all City departments to benchmark the City's various revenue streams against other communities to determine those areas where the City may be outside of the norm. This effort has already begun with a potential personal property tax audit to identify instances where the personal property valuation may not be accurate.

J. Internal Service Fund

The DOR is beginning to annually require from Cities and Towns who are self-insured a breakdown of the amount of fund balance that belongs to the City and the amount belonging to the employee. This is particularly important in Malden's case since the City continues to appropriate annually from its internal service fund in order to balance its budget. In addition, the analysis is made more complicated in Malden's situation because the City uses its Internal Service Fund to account for other benefits that are not self-insured related. We suggest the City review this account and eliminate those items such as life insurance, dental and other benefits and account for those through separate funds. Also, while the City is performing this procedure, set up separate accounts for the employee and employer portion of the self-insured fund.

Lastly, we discovered the dedicated bank account balance does not agree to the general ledger balance. The in-coming Treasurer should make best attempts to bring the dedicated bank balance and the general ledger balance into alignment. Since cash is in agreement in total, this could be accomplished through proper bank transfers.

City's Response:

The Treasurer is reviewing these matters and will implement the corrective action necessary.

K. Creation of a Strategic Management Position

The City has walked a fine line in attempts to balance its annual budget while at the same time maintaining an adequate reserve balance. In recent years, the City's revenues have failed to maintain pace with the City's expenditures and thus has resulted in non-recurring revenue sources to balance the operating budget. This phenomenon is becoming tighter and tighter each year.

In order to help mitigate this, the City should begin its budget plan for the subsequent year immediately upon adoption of the current year budget. This will allow the City an additional 8 months to strategically balance the budget. This can be accommodated through the development of a strategic management position A

substantial portion of this report has been devoted to the analysis and enhancement of revenues. It would be the specific task of this position to research these and other revenue enhancement and cost saving initiatives. We are confident that if this position were created, the savings would far outweigh the costs. In addition, such a position could also pave the way to combining this with the functions of an internal audit as previously discussed.

This individual could also co-ordinate monthly meetings with other similar communities in the greater Boston area and share ideas about what works and what doesn't in their respective communities.

City's Response:

We agree with this recommendation and the City has already begun taking a strategic and proactive approach to the FY 2015 budget. A Strategic Management Position has been created to specifically focus in these areas. This will entail individual meetings with the various departments with the goal being the identification of innovative opportunities, making sure existing revenue sources are being maximized, and looking for opportunities to manage expenses more effectively. The results of these efforts will then be reported to the City's financial leadership team.

L. School Grant Issues

ARRA and Education Jobs Act

The School is required to submit quarterly Section 1512 ARRA reporting data to the pass-through agency during the grant year. Despite this requirement, the School Department was only able to provide evidence that one of these quarterly reports were filed during the fiscal year.

This was primarily a result of turnover in key school grant financial positions.

The School Department should ascertain which quarterly Section 1512 ARRA reports have yet to be filed and compile the necessary data to complete the required filings. It is imperative that these quarterly reports are filed timely in future grant years.

Title I

Federal cash management guidelines require that procedures be implemented to minimize the time elapsing between the drawdown and disbursement of federal funds.

The School Department requested its final drawdown, totaling \$932,549, nearly three months prior to the end of the grant period. As a result, a portion (\$212,954) of this drawdown was never expended and was returned to the Commonwealth five months after its receipt with the filing of the Final Financial Report.

By overstating the amount of grant expenditures on the final request for funds, the School Department requested the entire amount remaining to be paid under the grant award rather than an amount required to meet immediate cash needs.

The School Department should plan to obligate its Title I awards by the end of the grant period. However, when it is apparent that monies will not be fully obligated, only the amount of anticipated expenditures should be requested as a drawdown.

City's Response:

Due to a transition in staffing last year, the Department was without a Title I Director from July 1 to October 2012. The School Department acknowledges that during this transitional time period there were issues with closing out the final Title I grant. To rectify this situation the district hired a Title I Director and restructured the role to just work with the Title I grant. As a result of this change, we have instituted tighter controls on the grant procedures. It is now a practice that the Title I Director work closely with the grant manager and the interim Business Manager to ensure all grant activities are completed appropriately and in a timely manner.

Twenty First Century

The United States tax regulations specifically state a set of criteria which is designed to guide entities in determining whether or not service providing individuals should be compensated as employees or independent contractors. Based upon this set of criteria, it was determined that, with respect to the Twenty First Century grant, not all service providing individuals may have qualified as independent contractors and should have instead been compensated as employees of the City. This continues a finding of at least 5 years.

As a result, an incorrect determination of service providing individuals as independent contractors instead of employees has resulted in non-compliant compensation reporting.

The grant program should evaluate its current compensation methods and policies to determine what changes need to be made in order to ensure that individuals paid from grant funds for services rendered are being done so in compliance with United States tax regulations.

City's Response:

The Department has made major progress in administering payroll for school employees working under this grant. The concerns with regard to payment as independent contractors have been alleviated. It has been decided that all Twenty First

Century Grant activities and personnel will fall under the jurisdiction of the School Department starting July 1, 2013.

M. Student Activities

A student activity account shall be used for monies raised by students or student organizations and which will be expended by those students or student organizations for their benefit. Monies deposited to a student activity account are governed by Massachusetts General Law (“MGL”) Chapter 66 of the Acts of 1996, as well as the policies of the School Committee. These provisions include procedures with respect to (1) the establishment of an interest bearing bank account and a checking account through the involvement of the City Treasurer, (2) certain disbursement procedures, and (3) auditing and reporting requirements. This discussion will assist the School to gain further compliance with the applicable laws and regulations.

It should be noted, that we were alerted to the fact that the long-time administrator of these funds had passed away during the year. We were also alerted to the fact that because a new individual who was not familiar with the process was now in charge of these funds, that the possibility of errors had increased. We adjusted our procedures with these assertions in mind and urge the City to provide adequate training and assistance to the new administrator in assuring that the errors noted are not repeated in the future.

Policies and Procedures Considerations

In July 2008, the Malden High School drafted a set of guidelines to govern the accounting and financial controls of its Student Activities. These guidelines were drafted utilizing the guidelines set forth by MASBO. At the time of this report, these guidelines had not yet been finalized. Upon review of these drafted guidelines, we determined that they are in need of further customization, in order to satisfy the needs of the High School accounts. These draft guidelines lack sufficient detail to effectively establish objectives for the individual class accounts, clubs and organizations. In addition, these draft guidelines do not sufficiently delineate individual authorization levels or limits for School personnel and students and are insufficient in other compliance areas such as policies for the payment to students for services such as summer teaching or student tutoring and procedures in place to ensure that such compensation and reporting is in compliance with the Internal Revenue Code.

Standardized policies and procedures (*including forms*) should be established and clearly communicated that establish control procedures surrounding the:

- initial authorization, annual approval and termination of class accounts, clubs and organizations;
- receipt and handling of cash receipts;
- turnover procedures between the individual clubs and organizations to their school and the subsequent timely turnover from the school to the City;
- disbursement of cash to third parties, including vendors, students and parents;
- reimbursement of monies paid by students, teachers and advisors for student activities;
- purchase and custody of equipment;
- recording of transactions into an accounting system (including the use of pre-numbered receipts or similar controls);
- the timely reconciliation of bank accounts to the information contained in the accounting system;
- requirements to issue IRS Forms 1099's to third parties; and
- the periodic (i.e., monthly or quarterly) reporting of this financial information to all stakeholders (i.e., High School Principal and class/club advisors and officers).

The implementation of policies and procedures is a key element in any set of internal controls. Formal policies and procedures as well as the use of standardized forms to document the approval of disbursements and the turnover of cash collections are necessary to provide the administrators of the individual Student Activities guidance and would better ensure that disbursements made from Student Activity accounts are authorized and used for their intended purpose and that student monies are adequately safeguarded. In addition, in the event of personnel turnover, formal policies and procedures (as well as periodic trainings) provides a good basis for the new Student Activity fund administrator.

Personnel

In 1992, the Committee of Sponsoring Organizations, or COSO, of the Treadway Committee documented what is widely interpreted as the authoritative guidance regarding internal controls over financial reporting in the United States of America. The objective of these new guidelines was, among other things, to provide organizations with tools to improve the quality of financial reporting by focusing on the organization's management and internal controls. The COSO guidance suggests that a sound internal control system regularly assesses the authority and responsibility assigned to its employees, has a commitment to training these employees and assigns employees with roles and responsibilities within their competencies.

Currently, the High School uses a single administrative assistant to administer and maintain its Student Activity funds. We recommend that the School cross train one or

more individuals to process day-to-day transactions and generate financial reports for their Student Activity funds. The individuals selected should receive the necessary training to better assure that Student Activity funds are adequately safeguarded and financial reporting is timely and accurate.

In addition, the Malden High School has indicated in draft policies for Student Activities that the High School should secure fidelity bonds in the amount of \$25,000 to cover no less than fifty-five (55) employees. In accordance with Massachusetts statute "...the principal designated to operate and control such Student Activity Checking Account shall give bond to the municipality or district in such amount as the treasurer shall determine to secure the principal's faithful performance of his duties in connection with such account." We recommend that Malden secure a fidelity bond as soon as possible to mitigate the risk of a loss of Student Activity funds.

Bank Reconciliations

MASBO recommends in its *Student Activity Account Guidelines for Massachusetts School Districts* that, at a minimum, bank reconciliations be performed quarterly. In addition, MASBO recommends that copies of these quarterly bank reconciliations be provided to the school business administrator, the school committee and the student officers and teacher advisors of the individual clubs and organizations.

We observed that the Student Activity bank account was not reconciled in fiscal year 2012. The reconciliation process is essential to ensuring that the financial activity reported in the Quicken system is accurate. Because this reconciliation process was not completed, there were many posting errors relative to club deposits as well as checks issued. Furthermore, automated transactions by the bank such as check fees were not recorded in Quicken in fiscal year 2012.

We recommend that the Student Activity bank account be reconciled on a monthly basis and such reconciliations, including supporting schedules like outstanding check lists, be maintained in the Student Activity records. At a minimum, the School Business Manager, in accordance with the draft policy and procedures, should review the quarterly bank reconciliations and evidence his/her review with a signature on these reconciliations.

Excess Cash Balances

The average month-end cash balance in the non-interest bearing Student Activity checking account was \$74,915 during fiscal year 2012. While bank interest yields are not significant at this time, the maintenance of such high cash balances in a non-interest bearing bank account is an inefficient use of the students' excess cash.

Furthermore, this depository account is not maintained by the City Treasurer in accordance with MGL Chapter 66. Accordingly the School is out of compliance with this regulation. We recommend that the Malden High School work with the City Treasurer to transfer these funds into an interest-bearing account that is controlled by the City Treasurer. When needed, funds would be transferred from this depository account into the Student Activity checking account, which is maintained by the Malden High School in accordance with MGL Chapter 66.

Authorized Check Signers

We observed that there was only one authorized check signer on the Malden High School Student Activity bank account. The MASBO guidance would suggest that a designee of the principal as a check signer is permissible if it is specifically approved by the School Committee. We recommend that the Malden High School take the appropriate actions with the School Committee and its bank to add an additional individual as an authorized check signer. In addition, if possible, the High School administrative assistant tasked with managing the day-to-day operations of Student Activities should be given “read-only” rights to the bank accounts to facilitate her review and oversight of the Malden High School Student Activities.

Form W-9's and Information Security

The Malden High School has been very diligent in obtaining form W-9's from its vendors in compliance with IRS regulations. However, these forms are being attached to vendor invoices, which are filed together with all deposit and disbursement documentation in monthly folders. This form of organization makes it very difficult to reference the form W-9's for year-end tax compliance purposes and the issuance of forms 1099's. We recommend that form W-9's be maintained separately from the disbursement records in alphabetical order in a binder that can be easily referenced. Furthermore, it's important to note that form W-9's for individuals and sole proprietorships often have an individual's name, address and social security number. Documents containing such important personal information must be protected in accordance with federal and state information security laws and regulations.

Sales Taxes

Student activity accounts are not subject to Massachusetts sales tax. We observed six instances in which reimbursements made to individuals includes sales taxes and one instance where a vendor assessed sales taxes, which were paid by the High School. Although insignificant in amount, we recommend that all invoices be reviewed closely to ensure that sales taxes are not paid using Student Activity monies.

Mispostings to the Quicken System

In connection with the agreed upon procedures outlined in Schedule I, we observed the following mispostings to cash receipts in fiscal year 2012:

- A \$2,050 deposit in July 2011 was recorded twice in the Quicken system;
- Five deposits made during the course of the fiscal year totaling \$4,886 were not recorded in the Quicken system;
- A \$2,992 deposit in December 2011 was erroneously recorded in the Quicken system as \$2,292;
- Two deposits totaling \$10,146 were erroneously coded to the wrong club/organization in the Quicken system; and
- A deposit for \$450 in June 2012 was erroneously recorded as a withdrawal in the Quicken system.

We observed the following mispostings to cash disbursements in fiscal year 2012:

- Four checks totaling \$1,257 were not recorded in the Quicken system;
- Automated disbursements for check orders and insufficient check returns were not recorded in the Quicken system; and
- A check for \$450 was erroneously recorded as a deposit in the Quicken system (see above).

These mispostings should have been identified and corrected as part of the monthly bank reconciliation process. However, as identified in Finding 3, none of the bank accounts were reconciled in fiscal year 2012.

Cash Disbursement Processing

We were unable to locate any supporting documentation for eight recorded disbursements totaling \$4,755. This was expected since we were made aware of the high likelihood that there would be missing documentation at the onset of this engagement due to the passing of the administrative assistant that was responsible for Student Activities. We understand that a new administrative assistant has been trained on Student Activities. We recommend that this new administrative assistant review the closing files each month versus the check register to ensure that all documentation is retained in the files.

We observed two disbursements totaling \$225 to be an inappropriate use of Student Activity Funds. Both payments were made for food and refreshments where the invoices references teachers-only events. In accordance with MGL, the Student Activity accounts are to be used “for the express purpose of conducting student activities.” Therefore, the use of these funds from an unrestricted fund within the High School Student Activity accounts is inappropriate. The High School should take

the appropriate steps to ensure that such disbursements are not made from student funds.

In addition, there were five checks issued in fiscal year 2012 in the aggregate amount of \$8,979 where a vendor invoice or other supporting document was not attached to a “green sheet” in support of the disbursement. As in all organizations, there will be times in which documents are misplaced or lost. We recommend that the High School document the loss of such documents and attach this documentation to the “green sheet” as evidence that the lack of supporting documentation was reviewed and the payment approved based on the day-to-day knowledge of the Malden High School Principal.

Class Accounts after Graduation

MASBO recommends that, because graduates are no longer students, monies for classes that have graduated cannot legally be kept in student activity accounts. We observed that there were several graduated classes with balances exceeding \$9,222 at June 30, 2012. Note that this figure does not include the Class of 2012; it is reasonable to assume that some disbursements may be made after a class is graduated for the late processing of vendor invoices.

The draft policies and procedures require that all class monies be returned to the officers of the class within ninety days after graduation. We recommend that the Malden High School endeavor on a process to ensure compliance with its internal policies and the MASBO recommendations.

City’s Response:

The School Department acknowledges this to be an area in need of improvement and has taken the following steps to ensure compliance with M.G.L. c. 66 as well as with School Committee policies:

- The interim Business Manager has met with the recently appointed Treasurer to begin the process of creating two separate accounts for student activity funds. The City Treasurer is the only person who can create the savings and checking accounts needed to manage the funds.
- Upon the establishment of these accounts there will be training at the school level to support proper management of these accounts. The training will include, but not be limited to: accessing a drawdown account, establishing and maintaining proper record keeping, submitting requests for funds, and maintaining proper back-up of all transitions.

- There will also be standardized policies and procedures implemented based on the recommendations made in this report.
- Personnel will be identified by the building principal to manage this account. The building principals will be given the responsibility of ensuring that the student activity account is managed properly.

It is the goal of the district to implement a new policy by October 1, 2013.