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Gary Christenson, Mayor

Friday, August 28, 2015

The Honorable Malden City Council
200 Pleasant Street
Malden, MA 02148

Dear Members of the City Council:

I am submitting for your review an updated 2014 Fiscal Year Management Letter from Roselli, Clark & Associates which now includes the City's responses designated in blue.

The report shows that despite our ongoing economic challenges we are meeting them head on in an effort to keep Malden moving forward. The report also notes that the level of comments and observations have decreased significantly over the past 4 years which is another indicator that we are implementing measures to maximize our financial position.

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.

The information will be made available on the City website 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,

A handwritten signature in black ink, appearing to read "Gary Christenson".

GARY CHRISTENSON
Mayor

CITY OF MALDEN, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2014

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ROSELLI, CLARK & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

500 West Cummings Park
Suite 4900
Woburn, MA 01801

Telephone: (781) 933-0073
www.roselliclark.com

Honorable Mayor and Members of the City Council
City of Malden, Massachusetts
200 Pleasant Street, Sixth Floor
Malden, Massachusetts 02148

In planning and performing our audit of the financial statements of the governmental activities, each major fund, its component units and the aggregate remaining fund information of the City of Malden, Massachusetts, (the "City") 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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

Our consideration of internal control 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.

This communication is intended solely for the information and use of management, 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 and Associates

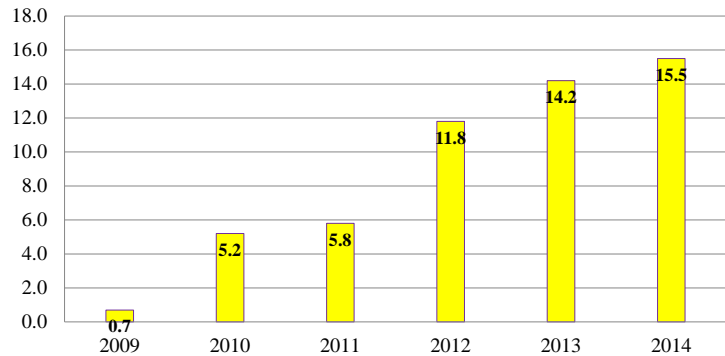
Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
December 12, 2014

I. EVALUATION OF CITY OPERATIONS

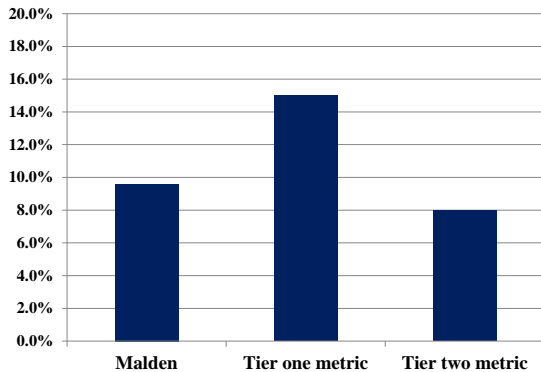
Fiscal year 2014 was a financially positive year for communities in Massachusetts. Many experienced increases to their reserve balances as average balances statewide increased to approximately 8% of general fund expenditures. In addition, unemployment rates have been reduced to pre-recession levels and a favorable mortgage market has bolstered home sales which have been robust over the past 2 years.

The City ended the fiscal year with over \$15.5 million in unassigned fund balance; an increase of \$1.4 million over the prior fiscal year and approximately \$15.0 million greater than 2009. The increase was primarily a result of budget turn backs as well as revenues, particularly permits and motor vehicle excise exceeding the 2014 forecast.

Unassigned Fund Balance (in millions)



Reserve ratio



A common budgetary flexibility test used by the rating bureaus when conducting a credit evaluation is called a reserve ratio. The ratio is calculated by adding general fund assigned and unassigned fund balances presented in the financial statements and dividing this by the general fund expenditures. 15% is considered tier one and 8% - 15% is considered tier two. The City's ratio is 9.6% which places the City in the middle range of tier two and considered strong.

These factors, in addition to the development of financial policies and procedures, improved demographics, a strong debt profile, positive economic strength and its exceptional liquidity led to an AA bond rating from Standard and Poor Financial Services and an Aa3 rating from Moody's Financial Services, the first time in the City's history it has rated in the "double A" category from either of the major credit bureaus. This is a significant accomplishment for a City that five years ago was mired in an economic slump characterized by deficits, negative reserve balances, deficient policies and credit downgrades.

The increased credit rating will allow the City to finance its infrastructure and other projects subsidized by debt at a much lower cost. So while the increased credit rating is a great accomplishment, it also carries positive economic merit.

We encourage the City to maintain this aggressive financial position and thus try to sustain the momentum it has gained over the past 5 years.

The remainder of the report is dedicated to informational items, and recommendations for improvement in control and efficiencies in operations. We urge the City to implement recommendations where appropriate and cost/beneficial to do so. In addition, it should be noted that the level of comments and observations have decreased significantly over the past 3 or 4 years and we hope the City is committed to continuing to improve upon new observations included in this report and especially those that have repeated from prior years.

II. INFORMATIONAL ITEMS

A. New Pension Accounting Standards

In June 2012, the GASB issued Statements No. 67, and No. 68. Both statements will materially impact the City's reporting of pension liabilities, effective fiscal year 2015. Because the calculations necessary to implement these statements will be generated by the Malden Contributory Retirement System (the System), it is imperative that the City work with the System to ensure that the information needed is available in sufficient time to be included in the City's fiscal year 2015 Basic Financial Statements.

The following areas will be impacted materially:

- Certain actuarial methods of calculating the accrued pension liability will now be mandated, instead of optional.
- The value of actuarially determined pension benefits that have been earned (by both active and non-active employees and pensioners) will now be reported as a liability in the City's Statement of Net Position and the applicable accrued costs included within the Statement of Activities.
- Enhanced and more detailed financial statement footnote disclosure relative to the pension plan will be required.
- Enhanced and more detailed required supplementary information reporting relative to the pension plan will be required.

In the event the information is not available, it will result in an adverse opinion to the financial statements, and potentially reduce the City's credit rating. Therefore we urge the City to contact the System and maintain an open line of communication regarding the timing of this information.

B. Other Postemployment Benefits

As discussed in detail in previous letters to management, the City implemented Governmental Accounting Standards Board ("GASB") Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pension Plans* ("GASB 45") several years ago. Other postemployment benefits, or OPEB, typically include health and welfare plans and other similar benefits provided to City retirees exclusive of pension benefits.

Like many of the communities in the Commonwealth, the City has yet to develop funding sources for its Other Postemployment Benefits (OPEB). While a committee consisting of the City Council has been formed, there have yet to be any productive discussions addressing the unfunded liability.

The City's unfunded liability as of the latest actuarial valuation is \$144.4 million, which is a reduction of approximately \$34 million from the prior valuation. This has been primarily the result of plan redesign; so this is a positive development in that regard. However, this is our annual reminder to management that OPEB funding discussions should become part of management's strategic long-term plans.

C. Student Activities

Recently, the Student Activity funds underwent administrative overhaul. Savings accounts were set up with the Treasurer's Office as is required under MGL and disbursements are required to be completed through the warrant process. This is a reminder that new compliance regulations have been issued by the Department of Elementary and Secondary Education that require audits to be conducted on a rotating basis and these should be completed for the District during fiscal year 2016.

D. Municipal Data Breaches

A recent large breach occurred in a local government in Massachusetts. Systems were compromised and an attempt to wire \$4 million to a foreign bank was initiated. Events such as these remind us of the importance of protecting our electronic systems from external forces. A few years ago we recommended the City conduct a security audit, which the City underwent, received a report and made numerous changes. One of the ways the City could further protect itself is by designating one computer with dedicated VPN access to its banks that has no email or web surfing capabilities to conduct all electronic banking transactions.

III. FINDINGS AND RECOMMENDATIONS

A. Fraud/Operational Risk Assessment

In each of the last 5 management letters, we have communicated to Management the important need to set up a process by which outside departments are reviewed internally from both cash handling and internal control perspectives. (This is commonly called a “risk assessment”). Such a process will help increase the probability that those departments are operating at a more optimum efficiency and decrease the probability that fraud/errors/misappropriations and irregularities occur.

In response to our comments, the City developed a fraud policy that was adopted a few years ago; and also purchased software to help account for all departmental fines, permits and fees. One of the intents of this purchase was to provide a mechanism by which the Controller’s Office could reconcile and account for revenues between the departmental records and the general ledger.

As discussed in the prior year management letter, the software installation came with glitches and the data never proved reliable to conduct accurate reconciliations. In addition, as in many other communities, limited resources within the Controller’s Office hampered efforts to schedule risk assessments, so these were not conducted.

Subsequent to the end of the fiscal year at the beginning of fiscal 2015, the City discovered alleged improprieties in a large department. This highlights more than ever the critical need to establish a risk assessment process that mitigates these risks.

The City should conduct a cost/benefit analysis and endeavor to:

1. Resolve the glitches in the software or request more training on the proper use of the software.
2. As a separate component of the Controller’s office, create an independent function whose responsibility it would be to conduct risk assessments on a rotating basis throughout the City.

City’s Response:

1. The City agrees and is working with IT and Permits, Inspections and Planning to resolve the issues with the implementation and training in the use of the Software (Energov).
2. The Controller’s Office will be expanding its operation to include risk assessments of various Departments on a rotating basis throughout the course of the year. These risk assessments will begin in fiscal year 2016.

B. Cable PEG Access Funds

The City presently accounts for public, educational and governmental (“PEG”) access fees in a *receipts reserved for appropriation* fund. Recently, the Massachusetts Department of Revenue’s legal division determined that accounting for the franchise fee portion of this arrangement in this manner to be inappropriate as these revenues are required to be reported in the City’s general fund.

After a number of legal challenges, the Massachusetts legislature passed a law effective January 15, 2015 that permits municipalities to maintain all funds related to Cable PEG access in a *receipts reserved for appropriation* fund only upon successful local option vote at a City Council meeting authorizing such a *receipts reserved for appropriation* fund.

If the City Council Meeting does not authorize this legislation by the end of fiscal year 2016, the City will be forced to transfer those funds related to franchise fees into the general fund at the close of fiscal year 2016 and account for the franchise fee portion of the PEG access activity in the general fund. While the amount of the franchise fee is the smaller of the two components of the fees, the City should determine the most beneficial approach for these funds and act accordingly.

City's Response:

The City agrees with this recommendation and will request that the City Council authorize the applicable legislation before the end of fiscal year 2016.

C. Payroll Withholding Accounts

In the prior year we recommended that in order for the City to better analyze its self-insurance funds that it segregate those withholdings such as dental, life and other benefits that do not relate to the self-insurance from the Trust. The City accomplished this during fiscal year 2014. However we determined that these withholdings are not being reconciled properly as numerous coding errors occurred during the year that caused deficits in some accounts and surpluses in other.

Withholding accounts should be reviewed monthly to determine if their corresponding balances relate properly to the amounts owed. Deficits should be analyzed and resolved promptly.

City's Response:

The City agrees that the payroll deduction withholding accounts need to be reviewed to identify deficits and to reconcile differences. The dental and life insurance withholding accounts were created in fiscal year 2014 to isolate the payroll deductions from the Health Claims Trust funds. During the year, staff members were acclimating to the new accounting method and, in the process, may have inadvertently entered the wrong account numbers.

Moving forward, accounts will be monitored by both the Treasurer's and Controller's offices to ensure receipts are properly credited and premiums are charged correctly.

D. Human Resource Software (repeated from prior year)

In the prior three years we discussed the possibility of the City 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's payroll reporting module 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:

As the City continues to take steps to maximize the full functionality of the Harpers payroll suite of products we expect issues such as this to be further addressed in the ensuing improved processes and procedures.

E. Centralize Information Technology (repeated from prior year)

As reported in the prior year, the School, City and Police all maintain dedicated Information Technology functions. We recommended that efforts should be made to consolidate these in order to create efficiencies in critical areas. We understand that it would be difficult to consolidate the operations of these specialized areas. However areas such as purchasing, inventory, backup, security and overlapping processes should be evaluated to determine if there are economies of scale or possible redundancies within the three systems.

City's Response:

The City acknowledges the importance of centralizing the Informational Technology function and is working towards evaluating overlapping processes and achieving collaboration amongst departments.

F. Life Insurance Withholdings

Per our review of the payroll withholding accounts, (see above) we discovered that the life insurance withholding account was in deficit. Upon further review, we determined that the City was still paying benefits for individuals who had died or moved on with no funding source thus a deficit was created. This highlights the importance of establishing a monthly reconciliation procedure as indicated above. Had a monthly reconciliation procedure been in place, errors such as these that inherently occur would be discovered in a much more timely fashion.

City's Response:

As noted in the finding, the payroll deductions for Life, Dental and Health insurances need to be reconciled to the current membership list to ensure that employees and retirees are actually paying for the benefits. The Payroll Department will provide the Human Resources Department with a list of payroll deductions at least quarterly to compare to the membership list. This will help identify employees that are not contributing but should be. However, the deficit in the account is mostly related to Section C above, where dental premiums were actually charged to the life insurance withholding account or vice versa.

G. Evaluation of Revenue Opportunities

The City has been very active in evaluating additional revenue sources to support its annual operating budget; these include increases to parking, motor vehicle demand charges, local option meal excise tax, casino mitigation and numerous other minor areas.

Ambulance Services - One area that we have observed in other communities that may be worth evaluating is the City's ambulance needs. Municipalities have the right of first refusal with respect to ambulance services and many large cities administer their own ambulance department and use the fees to offset the costs of the ambulance service and other related budget costs. Presently, ambulance services are performed by one company for most of the greater Boston cities including Malden. We suggest the City communicate with surrounding cities and determine if there is a more beneficial solution to the City's ambulance needs.

Nursing Home Licenses – The City still owns more than 60 nursing home licenses related to the now defunct McFadden Manor. These have no value to the City in their current state since the City no longer operates such a facility; however a market for these licenses may exist since the number issued by the Commonwealth is finite. We suggest the City evaluate the sale of these “assets” by potentially using a broker to find an interested party.

City Response:

The City is open to all suggestions that maximize revenues; we will endeavor to survey and evaluate Cities in the Commonwealth that approximate Malden in size and demographics who currently operate municipal ambulatory services. We do not believe that the economics of a municipally administered ambulatory service make for a compelling case at this juncture however we will make a more informed decision upon completion of our survey and analysis.

We have also completed the initial phase of exploring the liquidation of City owned nursing bed licenses. We anticipate that the fiscal benefit of this endeavor will be reflected in the fiscal year 2016 results.