

CITY OF MALDEN, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2017

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Honorable Mayor and Members of the City Council
City of Malden, Massachusetts
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, 2017, 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 & Associates

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
March 27, 2018

I. EVALUATION OF CITY OPERATIONS

Fiscal year 2017 continued to be a great economic year for Massachusetts as the local economy outpaced the National economy and this was felt in many Massachusetts communities whose reserves continue to rise to historical proportions.

Malden enjoyed another financially successful year as actual operating results exceeded estimated forecasts by almost \$4 million. However, we observed that the City's continued use of free cash is beginning to have an adverse impact on unassigned fund balance as this critical financial metric has dropped from over \$16.0 million in fiscal year 2015 to approximately \$10.9 million in fiscal year 2017.

This is the second year the City's unassigned fund balance has dropped despite positive operations and is beginning to possibly expose an unfortunate trend. In the prior year we alerted the City to be cautious when appropriating from free cash and we continue to do so. At some point, economic prosperity will begin to slow and this could have adverse consequences to the City if the budget has structural issues.

Continued use of process to balance the budget may drop the City into tier 3 on the Standard and Poor reserve scale and will begin to place downward pressure on the City's bond rating and we caution the City to deliberate further appropriations from reserves prior to such action in the future.

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 continue to decrease 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

Long-Term Obligations

Municipalities across the country have been hit with accounting standards in recent years that have forced the recording of significant liabilities in their respective financial statements. More specifically, pension and OPEB (Other Postemployment Benefits) obligations which for the most part have been disclosure only standards in prior years are now required to be reported in the financial statements.

So, while the City of Malden has a sound financial position on a modified accrual basis, the full accrual financial statements effective June 30, 2018 will now include a liability for pensions of almost \$100 million and a liability for OPEB over \$200 million.

The City manages its pension well, expecting to be fully funded by 2028 and currently almost 66% funded which places it in good standing when compared to other communities. However, the City has yet to make any significant attempts at addressing its OPEB liability.

The City has established a formal OPEB trust fund like many other Massachusetts municipalities, however it has yet to begin funding any portion of the liability. As we have indicated in several previous letters to management, the City should begin to include OPEB strategies in its long-term planning. Perhaps creating an OPEB planning committee would be a good start.

Changes to Single Audit Requirements

In our prior year letter to management, we notified the City that there were a number of changes made to single audits. One of the requirements under the new Uniform Guidance (the successor to the OMB A-133 compliance supplement) is that all federal award recipients are required to establish an internal control system based on a recognized internal control framework such as the Green Book or COSO.

The City is the recipient of significant federal educational awards as well as federal monies related to its CDBG operations and various other governmental grants. Many Massachusetts municipalities of similar size to the City are focusing their efforts solely at the school level, for which the MASBO provides significant guidance, including policies and procedures templates. The proper implementation of any internal control system requires coordination or resources between not only the City Auditor, but also the School Business Office and the City Treasurer.

We recommend that the City's finance team prioritize this matter to properly establish their internal control system before the start of its next series of large federal educational awards in the summer of 2018.

III. FINDINGS AND RECOMMENDATIONS

Treasurer/Collector

The City's Treasurer/Collector tendered his resignation in May 2017 to pursue other opportunities. At that time, there were several items in the prior year management letter that had not been addressed and a new finding emerged in June 2017 after the Treasurer had left and an interim Treasurer resumed those duties.

Current year comment

A. Cash Reconciliation

Cash at year-end did not reconcile with the records of the Controller; the Controller's cash was approximately \$300,000 greater than the Treasurers cash balance. Given that the interim Treasurer was not familiar with the records of the previous Treasurer the efforts to reconcile this variance presented many delays for the City.

- a. The balance sheet could not be submitted timely thus delaying the free cash process well into fiscal 2018.
- b. The Schedule A could not be prepared timely and was also delayed well into fiscal 2018.
- c. The CAFR was placed on a 90-day extension.

Finally, in March 2018, after an extensive review of every transaction in June, the Controller discovered that a wire transfer made in June 2017 to the MWRA for a sewer assessment was not reported to the Controller's Office by the Treasurer's Office in the amount of approximately \$300,000.

Once this correction was made the records were in balance and the City was finally able to complete and submit all its reports.

The reconciliation of cash is a critical component of internal control; this should be completed monthly. We understand the challenges involved when transitioning from old Treasurer to interim Treasurer to new Treasurer, therefore we believe this is an isolated incidence since cash has balanced every month since fiscal year 2013 when the previous Treasurer was appointed. However, the new Treasurer should be aware of the importance of balancing with the Controller's Office every month.

City's Response:

The City acknowledges that the reconciliation of cash is a critical internal control and that it should be done monthly. This practice will be continued now that a newly appointed Treasurer is in place.

B. Investment Earnings

The New Treasurer should review all City bank accounts to determine if the City is taking most advantage of its available cash and maximizing its yield/safety goals; a quick scan of the rates of return on many of the banks show very low yields that could be increased without sacrificing safety.

City's Response:

The newly appointed Treasurer is reviewing all City bank accounts and has already made changes in order to maximize yields while maintaining safety goals.

Prior year comments – Treasurer/Collector

A. Withholding Accounts

The City currently does not reconcile its payroll withholding accounts. Several errors were discovered during our audit of these accounts as follows:

1. Cobra Health Insurance Payments – The City uses a withholding account to record payments received from former employees who still participate in the City's Health Insurance plan.

These employees are offered this insurance by law but must pay 100% of the premium. The cost of this insurance should be paid from this withholding account but, instead, it is paid from the City's health insurance appropriation. The amount accumulated in this account is estimated to be about \$70,000 at the end of fiscal year 2017 when it should be closer to zero.

2. Life Insurance/Long term disability – A number of errors were discovered in the life insurance and long-term disability accounts; the combined balances which also should be close to zero were about \$23,000 at June 30, 2017.

The withholding accounts are accounts that should be reconciled at the end of each month; their accuracy or lack thereof effects the City's cash balances. As such the City should establish a process that accomplishes this, and the new Treasurer should be aware of the need to complete this reconciliation with the Controller's Office.

City's Response:

The City acknowledges the importance of reconciling its payroll withholding accounts and has already taken steps to rectify the errors stated above. The balance in the withholding account was transferred to the Health Insurance Trust and the Treasurer and Controller are working to ensure these accounts are reconciled monthly.

B. Abandoned Property

Years ago, the City elected to treat abandoned property under MGL Chapter 200 Section A. This statute allows the City, through an advertising process, to revert abandoned property back to the City's Treasury if the abandoned property is not claimed within 1 year of advertisement.

The City's general ledger abandoned property account has not been updated in 4 years and has had the same balance in the general ledger account of approximately \$390,000 yet the total of the list on the Treasurer's website is about \$100,000 and has not been updated since fiscal year 2016.

We suggest the City update its abandoned property accounts by completing the following procedures:

1. Adjust the current outstanding balance of the abandoned property balances in the general ledger and record this as miscellaneous revenue in fiscal 2018.
2. Review items that meet the definition of abandoned that have yet to be advertised and apply the procedures required under MGL Chapter 200 Section A.

Once these procedures have been completed, the City will be up to date in its abandoned property accounts.

City's Response:

The City agrees that the abandoned property account has not been updated and will adjust the current outstanding balance by recording it as miscellaneous revenue for FY2018. In the current fiscal year, the City plans on advertising its abandoned property and applying the procedures set forth in M.G.L. chapter 200, section A.

C. Personal Property Receivable Balance

Currently the City's general ledger includes a balance for personal property tax for fiscal year 2013 of about \$94,000 while the Collector's balance is approximately \$29,000. This variance has been maintained for a few years while the Collector investigated it. It was finally discovered that an error in the commitment process back in fiscal year 2013 was the major contributor to this error.

We suggest the amount is adjusted in the general ledger to equal the Collector's balance. All other variances in aggregate are not material.

It appears these final three items were not addressed due to the untimely resignation of the Treasurer/Collector. We hope the City will research and make these adjustments prior to the close of the books in fiscal year 2018.

City's Response:

The City agrees and will adjust the general ledger to equal that of the Collector's balance.

Fraud/Operational Risk Assessment (Update)

As we have done in each of our last 8 management letters we continue to advise Management to establish an internal audit process that would include risk assessment of all cash handling activities.

The most practical manner to accommodate such a process would be to establish a position within the Controller's Office that is dedicated to the design and implementation of internal control at the department level, as well as rotating risk assessment procedures of all cash handling activities. The MGL allows the Accountant or equivalent (Controller) this ability.

Reorganizing the Controller's Office by creating an internal control function, and creating a separate purchasing office, may be the most efficient manner of accomplishing this. While there would be additional costs completing this reorganization, it will give the City added comfort that cash handling departments are being reviewed periodically. It also allows the City to separate the Controller and Purchasing function as those are often considered incompatible functions.

Currently, in lieu of an internal control function, the City continues to direct the Firm to audit departments on a rotating annual basis.

The following audits were completed in the last two years:

1. Recreation Department
2. City Clerk
3. Police Details

The issues outlined in the **Recreation Department** review have been resolved.

With respect to the **City Clerk**; those cash handling processes were identified as the most severe and left the City exposed to high risk. The prior City Clerk retired shortly after this review and a new City Clerk was appointed; due to this transition and the transition in the Treasurer's Office, none of the recommendations we reported have been addressed. We hope that the new City Clerk and New City Treasurer work together to implement the changes recommended in our review.

The issues identified with **Police Details** are complex and will require planning amongst the Treasurer, Controller and Police Department. Those recommendations have yet to be implemented or addressed.

City's Response:

It is a goal of both the new Treasurer and the new City Clerk to work toward implementing the recommendations contained within this review. Additionally, the City has been working in collaboration with the Police Department to determine what the best solution is moving forward. A Request for Proposal (RFP) has been issued to see if there are outside vendors capable of administering the 3rd party off-duty detail system. The City is in the process of evaluating the responses received with the Police Department.

District/Court Fines (Update)

In the prior year we reported that District traffic fines had been reduced to under \$30,000. The Police Department provided a response that incorporated the safety sacrifices of increasing enforcement. Based on that response we indicate that this comment is a policy decision and not report this in the future but also report that District traffic fines were \$26,000 during fiscal 2017.

Health Insurance Trust (Update)

In the prior two years we alerted the City to a trend in its Health Insurance Trust Fund. The fund was established about 25 years ago that allowed the City to self-manage its exposure to the risks associated with health insurance. For years it appeared this was the most affordable and efficient way the City could provide insurance to its employees.

The City began a practice in 2010 in which it reduced its health insurance appropriation in lieu of building reserves in the Health Insurance Trust. This practice worked well through fiscal year 2014 as the operating results for those years were positive and the funds used were replenished annually.

However, the last 3 years have proved challenging for the Health Insurance Trust. Operating results have not been favorable and fiscal year 2017 ended with a deficit balance of approximately \$400,000.

We urge the City to monitor this situation closely and work together with its benefits consultant. Health insurance trust funds carry with them the highest degree of risk of most municipal activities due to their unpredictable nature and not having adequate reserves in this fund could adversely impact the General Fund.

City's Response:

The City has closely monitored the Health Insurance Trust in light of the deficit that occurred in FY2017. The City also adopted sections 21-23 of M.G.L. Chapter 32B and negotiated certain benefit changes that has helped the performance of the Health Insurance Trust. It is anticipated that there will be a surplus in the Trust for FY2018.