

CITY OF BURLINGTON, VERMONT

Management Letter

For the Year Ended June 30, 2014

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To the Honorable Mayor
and City Council
City of Burlington
149 Church Street
Burlington, VT 05401

Additional Offices:
Andover, MA
Greenfield, MA
Manchester, NH
Ellsworth, ME

In planning and performing our audit of the basic financial statements of the City of Burlington, Vermont as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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

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

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

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

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

Melanson Heath

February 12, 2015

1. **Continue to Improve Monthly Reconciliations (Material Weakness)**

Prior Year Recommendation:

In the prior year, we recommended that the City re-establish the process of reconciling all key general ledger accounts on a monthly basis. Implementation of this recommendation will increase the reliability of interim financial reports and help to minimize the risk of undetected errors and or irregularities.

Current Year Status:

In fiscal year 2014, the City made significant improvements in monthly general ledger reconciliations process. As a result, the process of closing the year was approximately two months earlier than fiscal year 2013. However, during the 2014 audit process (November 2013), the City was still posting journal entries and/or evaluating fiscal year 2014 operating results in the following areas:

- Capital project fund accounting
- Inter-departmental charges
- Amounts due from BED
- Overall general fund budgetary results

Further Action Needed:

We recommend the City continue with the general ledger reconciliation improvements made during fiscal year 2014, and specifically address the above noted areas in fiscal year 2015.

City's Response:

The Office of Clerk Treasurer agrees with this finding and will specifically address the above-noted areas in fiscal year 2015.

2. **Evaluate the Clerk/Treasurer's Department**

Prior Year Recommendation:

In the prior year, we recommended that the City evaluate the Clerk/Treasurer's Office to help ensure that the office structure has the sufficient level of resources needed and establish a timeline to complete the significant backlog of work that resulted from the recent computer system conversion.

Current Year Status:

As noted in comment 1, the City made significant progress in completing many tasks that needed to be accomplished in order to ensure a more timely general ledger closing process. During fiscal year 2014, however, there were certain areas where on-going controls and system capabilities were still not fully implemented or operational. The following items represent areas where improved monitoring of accounts and major accounting tasks that still need completion:

- Implement “Project Accounting” module within the new financial management system for capital projects and grant accounting.
- Analyze all capital projects for appropriate matching of revenue and expenditures.
- Post budgets to all individual capital projects.
- Analyze the expenditure charges to recent general bond issues to ensure funds were expended consistent with original authorizations.
- Ensure all funds have balanced budgets in the monthly financial statements.
- Monitor impact fees to ensure funds are spent timely or otherwise returned.
- Create the ability to produce a Schedule of Expenditures of Federal Awards directly from the financial management system.
- Monitor specific eligibility criteria for grant and bond funded projects expenditures.
- Improve the distinction between the expendable and non-expendable portion of Cemetery Perpetual Care funds.
- Identify the allowable expenditure purposes associated with Permanent Funds (other than Cemetery Perpetual Care) and Private Purpose Funds.
- Monitor accounting and reporting of compensated absences.
- Increase timeliness of Pension Fund reconciliations.

Further Action Needed:

We recommend that the City continue to address the aforementioned issues to improve controls and better utilize the capabilities of the new accounting system.

City’s Response:

In fiscal year 2015, the Clerk/Treasurer’s Office initiated this process and created two positions: a Capital Account Billing Manager and a Central Purchaser. The

purchasing position has been filled, and the Capital Account Billing Manager position was posted for hiring in early 2015. This position will be fully responsible for capital and project accounting, budgeting, and billing processes. This will include determining funding sources, analyzing expenditures and ensuring they are appropriate, utilizing bond proceeds, and financial preparation. In addition, the Office of Clerk Treasurer will be re-organizing and is analyzing asking for authorization from the Board of Finance (BOF) and City Council to create a Certified Public Accountant Position. This position will be responsible for grant management, a Schedule of Federal Awards, determining allowable expenses for funds, oversight of the cemetery perpetual care fund, pension fund, compensated balances, and that impact fees are managed in accordance with Generally Accepted Accounting Principles (GAAP), and that overall policies and procedures are streamlined to allow for full compliance for the Single Audit.

3. Implement Regular Internal Audits (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended the Clerk/Treasurer's Office establish a schedule for periodic internal audits of departmental accounting records. This would result in improved oversight and reduce the risk of errors or irregularities occurring and going undetected.

Current Year Status:

During fiscal year 2014, the City performed examinations of certain transactional cycles including banking, accounts payable and purchasing.

Further Action Needed:

We recommend that the City expand on the internal audits that began in fiscal year 2014 and build a more robust schedule of audits including (but not limited to):

- Billing cycles
- Departmental receipts
- Vendor monitoring
- Payroll

City's Response:

In September 2014, the City of Burlington implemented the Committee of Sponsoring Organization of the Treadway Committee (COSO) model, which established a

framework for internal control. Implementing the COSO model was fully supported by the BOF, City Council, and top management. The COSO model is now part of our culture at the City, and part of our daily work life. This model extensively safeguards our cash and assets. In addition, the BOF and City Council approved the creation of an external audit committee. Once members are appointed, this Committee will work with the BOF to utilize and fully deploy the COSO model, and establish a schedule for periodic internal audits of departmental accounting records.

4. **Restrict Ability to Edit Payroll Rates (Material Weakness)**

Our walk-through testing of the City's payroll processing disclosed that individuals other than the Human Resources Department have access and the ability to edit the payroll rates. As a result, unauthorized changes could be made increasing possibility of errors or irregularities occurring and going undetected.

We recommend that the City restrict the access to edit the payroll rates to the Human Resources Department. This will reduce the risk of errors or irregularities occurring and going undetected.

City's Response:

Pay rate changes require a Change of Status (COS) form before any employee's pay rate changes are entered into the payroll system. This form must be filled out and approved by the Department Manager, Human Resources, and the Payroll Office. Due to requirements in the City's union contracts, the payroll team must have the ability to make changes to rates of pay to account for longevity pay, shift differentials, certifications, and annual Cost Of Living Allowances (COLA). The payroll staff must have this ability to ensure timely disbursement of the weekly payroll. Additionally, all paystubs will show rates of pay for all hours worked to reduce the risk of pay rates being paid without proper authorization beginning January 1, 2015. This will result in a detailed record, audit trail of rates paid, and a record of any changes to rates of pay. The Payroll Manager and Assistant CAO will develop an automated weekly pay rate report to further reduce the risk associated with human error and fraud. This will be reviewed and signed off by the Human Resource Office and Office of Clerk Treasurer. These changes will ensure that the rates paid are authorized and in good standing.

5. Continue to Segregate Cash Reconciliation Duties (Material Weakness)

A significant portion of the bank account reconciliations are being performed by an individual that also is involved in creating and posting journal entries and is authorized to make wire transfers. As a result, a lack of segregation of duties exists that increases the risk that errors or irregularities could occur and go undetected.

We recommend that the City segregate the job responsibilities noted above so that the individual responsible for bank account reconciliations is restricted from posting journal entries and authorizing bank wire transfers. This would result in improved oversight and reduce the risk of errors or irregularities occurring and going undetected.

City's Response:

The Office of Clerk Treasurer has used the expertise of Amy Mailloux, Vice President, Treasury Advisor at Keybank, to ensure that a segregation of duties exists and to ensure that posting of journal entries and all authorized wire transfers have a level of security and clear segregation of approval. Formal meetings with Keybank began on July 22, 2013, and they included expertise and feedback from other banking partners. The review process was a formal six-month review process. They formally mapped out and analyzed our work flows. The review identified five areas to focus on including ACH wires, positive pay to prevent check fraud, check issuance practices, and use of a procurement card for better purchasing control. With each of these items, they reviewed the process, identified the risks, and evaluated recommendations to mitigate the risks. They determined that no wire transfers will be initiated by the Assistant CAO for Finance, but rather by a Senior Accountant. They require additional approval from the Chief Accountant or Assistant Chief Accountant. The authority to make journal entries is held only by the Assistant CAO and senior accountants in the Clerk/Treasurer's Office. Each journal entry is reviewed and approved by a person at a higher level of authority than the preparer. Based upon these procedures and the mitigating controls implemented we have significant oversight, have reduced the risk of errors or irregularities, and have significantly reduced the probability of fraud.

6. Formalize a Fund Balance/Net Position Policy

Prior Year Recommendation:

In the prior year, we recommended that the City formalize a fund balance/net position policy to provide guidance over the areas noted below. This will help the City

achieve desired fund balance/net position levels and consistent financial statement classifications.

A formal fund balance policy should include (but not limited to) the following:

- Specify required/desired level of unassigned fund balance and unrestricted net position.
- Specify prioritization of use of fund balance amounts when multiple sources are used for one project, grant or activity (i.e., general fund monies are appropriated to partially fund a capital project, or a grant match).
- Specify the body or official authorized to make assignments of fund balance and define time constraints on each assignment.
- Distinguish between encumbrances (commitments related to contracts not yet performed and orders not yet filled) and other assignments (previously called designations).
- Define any approval process for modifying existing assignments.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend that the City implement a comprehensive fund balance policy.

City's Response:

On December 1, 2014, the Chief Administrative Officer provided a proposed change to City of Burlington Charter Section § 65. The recommended language, if enacted into the City Charter, would specify the body or official authorized to make assignments of fund balance, define time constraints on each assignment, and would clearly define the purpose and use of the fund.

In addition, the Clerk/Treasurer's Office accepts the recommendation to implement a comprehensive fund balance policy and will implement it in January 2015.

7. Consider Pension Specific Software

Prior Year Recommendation:

In the prior year, we recommended the City consider automating (or at a minimum scanning) the member files and member ledger, and retaining a copy offsite. Automating the records may improve efficiencies, and retaining files offsite will help assure critical information is not lost in the event of a facility disaster.

Current Year Status:

During fiscal year 2014, the City scanned all membership files to create a backup and built a database to automate many of the prior manual functions.

Further Action Needed:

We recommend that the City consider software that is specifically designed to maintain membership data of public pension system.

City's Response:

The City has considered software that is specifically designed to maintain membership data to further automate the pension tracking. The Office of Clerk Treasurer contemplated several software packages, but found the price tag to migrate the existing data, train staff, purchase user licenses, and annual maintenance support to be cost prohibitive at this time. The City will continue to work to improve the database that was built in the past year to allow for greater automation.

8. Separate CEDO Grants and Operating Activities and Fund the Deficit

The CEDO fund now includes activities that are not funded by operating grants, and the City's monthly financial statements do not reflect a funding source (i.e., a budget revenue source) for various CEDO operating costs. As a result, a draw on the general fund cash reserves was required, and a deficit exists in the CEDO fund.

We recommend that the City separate the grant and operating activities of CEDO. Specifically, we recommend that grant activity remain in a special revenue fund and the operating activity be accounted for as a department within the City's general fund. We further recommend that a plan to permanently fund the CEDO deficit be developed and implemented.

City's Response:

Historically, the Community Economic Development Office (CEDO) has relied on the General Fund's sweep account to cover its unfunded operating costs with the expectation of repayment from an accounts receivable to CEDO.

The Office of Clerk Treasurer elected not to separate the grant and operating activities of CEDO realizing the transition was a major undertaking, and had risk. In fiscal year 2013-2014, the Clerk/Treasurer's began work on a number of notable projects to address the accounting system, tracking fixed assets, tracking retirement data, transitioning to a new payroll timekeeping system, and accepting credit cards. They did not believe it would be wise to begin work on separating grant and operating activities at that time. With those projects completed, the Clerk/Treasurer's Office is well-positioned to implement the separation of the grant and operating activities of CEDO, and ensure all grant activity remains in a special revenue fund in fiscal year 2016. Additionally, there is a plan in place for fiscal year 2015 to fund any shortfall in CEDO operating expenses, and a plan was developed to address this for fiscal year 2016.

9. Accelerate Request for Reimbursements and Evaluate Receivables

Requests for reimbursement of grant funds are not always performed on a timely basis. As a result, the period of time that CEDO funds temporarily borrow general city cash is extended in some cases up to six months. We recommend that the City submit monthly requests for reimbursements to grantor agencies in order to expedite reimbursement.

Also the CEDO fund has numerous receivables including accrued interest, as well as an estimated allowance for those receivables deemed uncollectable. Because several large receivables are approaching maturing, we recommend that the City undertake a more rigorous review of its estimated allowance for uncollectable receivables. We further recommend that the City determine what, if any, grantor restrictions exist on the maturing receivables.

City's Response:

The timing on drawdowns appears to be consistent with many municipalities and grantor agencies. In fiscal year 2015, CEDO will prepare monthly reimbursement requests for its two largest programs, LEAD Hazard Control Grant and the

Community Development Block Grant. It should be noted that quarterly reporting requirements for grants are adhered to, and a drawdown is completed at that time.