

CITY OF BURLINGTON, VERMONT

Management Letter

For the Year Ended June 30, 2013

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MELANSON HEATH & COMPANY, PC

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT ADVISORS

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

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, 2013, 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.

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

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

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

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

Melanson, Heath + Company P.C.

Nashua, New Hampshire
February 13, 2014

General City Comment

The City of Burlington reserves the right to modify our responses based on the review, recommendations, and final approval from the Mayor, City Council, and the Board of Finance.

1. Re-Establish Monthly Reconciliations (Material Weakness)

In Fiscal Year 2013, monthly reconciliations of key general ledger accounts were not performed on a timely basis. As a result, the process of closing the year was delayed and substantial journal entries were being posted by the City through January 2014. Key reconciliations that were not performed on a regular and timely basis include:

- Bank account balance to the general ledger
- Tax receivable accounts to detail balance due reports
- Approved budget amounts to the general ledger
- Grant and capital project receivables to award notices
- Accounts payable and payroll withholding accounts to detail records
- A complete analysis of capital project activity was not performed until December 2013

When reconciliations of key accounts are not performed on a regular and timely basis, it increases the risk that errors and or irregularities could occur and go undetected as well as decreases the reliability of interim financial reports.

We recommend that the City re-establish the process of reconciling all key 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.

City's Response:

The Clerk/Treasurer's Office agrees that there is a need for monthly reconciliation. However, historically, the City has not reconciled all accounts on a monthly basis; instead reconciling on a varying schedule depending on the amount of activity of the account. Because of the change in accounting systems, most of the accounts and operations included in this finding had not been reconciled due to the lack of time and unfamiliarity of staff with the accounting system and its relational account construc-

tion. During Fiscal Year 2014, the financial assistants and senior accountants have been reconciling accounts and activities on a monthly basis and review all other accounts and activities to ensure that they are reconciled in an appropriate timeframe.

2. Segregate the Accounting and Treasury Functions and Evaluate the Department (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City consider segregating the accounting and treasury functions in order to create an environment that properly segregates the City's financial management systems and hire a consultant to assist with implementing this recommendation to help ensure that a redesigned office structure has the sufficient level of resources.

Current Year Status:

Certain additional safeguards for segregating the accounting and treasury function were implemented in the fall of 2013. However, the Clerk/Treasurer's Office did not hire a consultant to assist with the implementation of the new financial management system and now currently has a significant backlog of work that needs to be accomplished in order to complete the conversion. The following items represent the major accounting tasks that need to be accomplished in order to ensure a more timely closing process:

- Analyzing all Capital Projects for appropriate matching of revenue and expenditures
- Posting budgeted financing sources and uses to all individual capital projects
- Analyzing the expenditure charges to recent general bond issues to insure funds were expended consistent with original authorizations
- Merging two capital asset accounting systems to one comprehensive system
- Creating the ability to produce a Schedule of Expenditures of Federal Awards directly from the financial management system

Further Action Needed:

We continue to recommend 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 above tasks.

City's Response:

The City believes that the implementation of the New World system alleviates concerns about combining the accounting and treasury functions. The former system was journal-entry based, and nearly all activity was recorded in the Clerk/Treasurer's Office. With the new system, recording of transactions is decentralized to each department – purchase orders are issued by the department needing the item, and are approved by the Clerk/Treasurer's Office before issuance. A similar process is used when an invoice arrives. For revenue transactions, activity is tracked by the applicable subsystem (RecTrac, for example, in Parks and Recreation), and amounts sent for deposit in the bank are reconciled to the subsystem before being recorded into New World. Bank accounts are reconciled monthly. In addition, the City has begun to use Posi-Pay, which sends electronic copies of all checks issued each day to the bank. If a check is presented for payment to the bank that was not on the Posi-Pay listing, it is rejected and the Clerk/Treasurer's Office is notified. The City uses blank check stock that is double secured. The Clerk/Treasurers Office requires a key to enter the administrative office, and an additional key is required to access check stock secured in the safe. No wire transfers are initiated by the Assistant CAO for Finance, and all wire transfers are initiated by a Senior Account, and require additional approval from the Chief Accountant or Assistant Chief Accountant. The authority to make journal entries is held only by the Assistant CAOs and senior accountants in the Clerk/Treasurer's Office, and each journal entry is reviewed and approved by a person at a higher level of authority than the preparer. Under the New World system, the volume of journal entries has been reduced. Based upon the procedures and controls implemented in connection with the system conversion, we do not believe that the accounting and treasury functions need to be split into separate departments.

In addition, we have restricted the user rights of the Assistant CAO for Finance. The Assistant CAO for Finance no longer has the New World user permissions to add, or delete users. The Assistant CAO for Administration has created the hierarchy approval process for purchase order, and/oval, invoice and check approval. This hierarchy approval process is a restricted permission from the Assistant CAO for Finance.

As it relates to the recommendation 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 above tasks, the new Chief Administrative Officer has conducted said evaluation resulting in his recommendation to the Mayor and City Council that additional positions be budgeted in Fiscal

Year 2015. One additional position, a Capital Projects Accountant, has been proposed to address the issues listed in this finding as well as the other findings in this letter.

3. Develop a More Formal Risk Assessment Process (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City implement a more formal risk assessment process that includes written identification of areas where potential fraud or material misstatements to the basic financial statements may occur, as well as how the City intends to respond to those risks, including ongoing monitoring activities. This would help minimize the risk of errors or irregularities occurring and going undetected.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend the City implement a fraud risk assessment program, including monitoring controls over any potential related party issues.

City's Response:

The City requests the Auditors provide a written sample fraud risk assessment tool that is acceptable to the firm and against which we can compare other similar tools. Once received, we will begin to plan, create, and implement the fraud risk assessment tool.

4. Document Internal Control Components (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City document its internal control procedures in accordance with the COSO model. The COSO (Committee of Sponsoring Organizations of the Treadway Commission) model is widely recognized as the standard against which organizations measure the effectiveness of their internal control systems. The COSO components of effective internal control are: Internal Environment, Objective Setting, Event Identification, Risk Assessment, Risk Response, Control Activities, Information and Communication, and Monitoring.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend the City document the components of internal control in accordance with the COSO model for the new financial management system.

City's Response:

The City requests the Auditors provide a written sample COSO model for the new financial management system that is acceptable to the firm. Once received, we will begin the planning and creation stage of implementation of COSO.

The City may seek an outside group to help in objectively assessing the City's internal controls.

5. Implement Regular Internal Audits (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended the City's Accounting 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:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend that the City perform periodic internal audits of the City's departmental accounting records.

City's Response:

The City agrees that there are internal audit procedures that can be performed by the Clerk/Treasurer Office's personnel. Internal audits have not been conducted regularly due to staffing limitations. The Chief Administrative Office and Mayor have recommended the creation of additional staff positions within the Clerk/Treasurer's Office that will create the opportunities to provide additional auditing capabilities. In addition, the implementation of the new accounting and financial software system has, in fact, reduced the amount of departmental accounting outside of the

Clerk/Treasurer's Office or provided opportunities for Clerk/Treasurer oversight of accounting and financial activities of outside departments. Further opportunities for reducing or overseeing instances of accounting or financial activities outside of the Clerk/Treasurer's Office will be explored as staff becomes more familiar with the new system and in response to findings of the risk assessments conducted at department levels.

6. Improve Monitoring of Capital Projects (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City identify causes for all negative cash balances in capital project funds and that the City use the general ledger (not spreadsheets) to maintain a complete accounting of all capital projects.

Current Year Status:

We understand that subsequent to June 30, 2013, the City began to evaluate its capital projects. However, further analysis is required to insure that the integrity of each individual project is maintained.

Further Action Needed:

We continue to recommend that the City analyze the status of each capital project to insure the individual projects are properly reported. The City should implement this recommendation prior to June 30, 2014.

City's Response:

The City will continue to develop and refine capital project budgets through the use of the new financial management and accounting system and continue to implement project accounting for capital projects to ensure that project revenues and expenses are identified, monitored, and accounted. The Clerk/Treasurer's staff have been meeting regularly with the current Capital Improvement Project Manager and the departments most involved with capital projects to gain a better understanding of the budgeting and accounting policies and procedures and the capabilities of the financial and accounting system. In addition, the Chief Administrative Officer and Mayor have recommended the creation of additional staff position - within the Clerk/ Treasurer's Office in Fiscal Year 2015 to provide additional capital project accounting and auditing capabilities.

7. Utilize a Fixed Asset Accounting System (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City implement software to maintain the historical cost and depreciation of capital assets, and develop a written capitalization policy.

Current Year Status:

The City utilized two separate fixed asset accounting systems in fiscal 2013.

Further Action Needed:

We recommend that the two separate systems be merged to one comprehensive capital asset maintenance system. The City should implement this recommendation prior to June 30, 2014.

City's Response:

The Clerk/Treasurer's Office has replaced its Pentamation and manual systems of tracking fixed assets with the new financial management and accounting software. The City will continue to implement this solution and evaluate its effectiveness. Concurrently, the City's capitalization policy will be reviewed and updated as necessary and departments involved in capital project activity and reporting will receive training on the premise of the policy to eliminate the capitalization of minor items, as well as learn how to use Construction in Progress to accumulate all costs of a project before it is transferred into the fixed asset accounting system.

8. Analyze Expenditures of Bond Proceeds (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City analyze, in detail, the expenditures incurred and funded by the general fund bond issuances for the past two years to determine if incurred expenditures were consistent with the offering documents. We further recommended that the City strengthen the controls currently in place to provide assurance that bond proceeds are used exclusively for the purpose outlined in the offering documents.

Current Year Status:

We understand the City implemented new procedures for the accounting of bond proceeds in October 2013, however, has not yet analyzed bond issues from the prior two years to insure expenditures were consistent with the offering documents.

Further Action Needed:

We recommend that the City analyze the expenditures of bond proceeds from fiscal 2012 and 2013. The City should implement this recommendation prior to June 30, 2014.

City's Response:

The Clerk/Treasurer's Office implemented a new process in October 2013 where cash received from the bond proceeds, approved by the BOF and City Council, is deposited into a segregated bank account, to more effectively track the funds. Furthermore, all expenditures related to this bond will be recorded using the budgeted line item for which it applies and paid directly from the bond proceeds bank account. In addition, the City will depart from the use of a single capital account to capture all expenses related to bond proceeds. We will evaluate, create, and use additional general ledger accounts to better track major categories of bond expenditures. Finally, the Clerk/Treasurer's Office will perform an internal audit by randomly selecting invoices and inquiring about the expenditures. This internal audit will confirm the validity, and it would ensure that the expenditure was made for the purpose in which it was intended.

9. Redesign Vendor and Payroll Approval Process (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City redesign systems of internal control over the processing and approval of vendor and payroll transactions to incorporate the weaknesses noted below.

Vendor Issues:

- The vendor clerk should not be permitted to establish new vendors for payment in the accounting system.
- The approval for all invoices should be documented by the Clerk/Treasurer, not simply the Vendor Clerk.
- Credit card and business related travel expenditures should be reimbursed consistent with policies. It should also be noted these policies have not been updated in over 10 years.
- Budget amendment should be approved prior to incurring expenditure in excess of appropriations. (Also see Comment 14.)

- Specific eligibility criteria for grant and bond-financed projects should be formally documented.
- The taxability of employee clothing reimbursements in excess of actual costs should be evaluated.

Payroll Issues:

- Pay rates should be entered by Human Resources.
- Approved timesheets should be used for all employees.
- The approval for each payroll run should be documented by the Clerk/Treasurer, not simply the Payroll Clerks.

Current Year Status:

The above noted weaknesses remained present during most of fiscal year 2013. We understand that the City will address these items during fiscal year 2014.

Further Action Needed:

We recommend that the City follow through and insure the additional controls over vendor and payroll processing are implemented.

City's Response:

The City does not agree with this finding for Fiscal Year 2013. Based upon this finding in the last year's audit, the City put measures in place in 2013 as recommended. Specifically, the accounts payable clerk (vendor clerk) is no longer permitted to establish new vendors without a secondary level of approval. All accounts payable batches require a second approval. Credit card and travel expenditures are reimbursed in accordance to policy. Budget amendments are being applied throughout the year, contrary to the past practice. Grant and bond eligibility are documented and taxability of allowances continue to be evaluated. In addition, department pay rates are entered and audited by the Human Resources Department. Timesheets are required of all employees and payroll batches require a second level of approval. The City does agree that the past practice of procuring goods and services without an approved and valid Purchase Order does occur; however, a policy statement will be distributed to mitigate the risk of occurrence.

10. Review Practice of Extending the Useful Life of Capital Assets (Material Weakness)

Prior Year Recommendation:

In the prior year, we recommended that the City review the practice of extending the useful life of capital assets to ensure it is consistent with generally accepted accounting principles (GAAP). As part of this review, the City should evaluate the original useful lives assigned to other major capital assets, such as building and improvements for possible impairments. This will help assure that capital assets are being depreciated over their useful lives and in accordance with GAAP.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We recommend that, in conjunction with merging the multiple capital assets system (as noted in comment 7), the City implement this recommendation by June 30, 2014.

City's Response:

In connection with the implementation of an automated fixed asset accounting system and review of our capitalization policy, we will clarify what factors must be considered to justify a change in the remaining life of a fixed asset. This clarification will be documented as an amendment to our existing fixed asset policy and procedures.

11. Improve Controls over CEDO Special Revenue Fund Activities (Significant Deficiency)

Prior Year Recommendation:

In the prior year, we recommended the City (1) reevaluate the job responsibilities of the Assistant Finance Director to assure an adequate segregation of duties exists, (2) discontinue the use of manual checks, (3) post all receipts and disbursements in the general ledger immediately, (4) record receivable activity in general ledger throughout the year, and (5) perform regular monthly reconciliations of general ledger receivable activity. This would improve controls over CEDO activity and improve the accuracy of general ledger records.

We also recommended the CEDO fund chart of accounts segregate "loans received in advance" from "deferred revenue", and discontinue the tracking of loan allowances in

a separate fund 3001, but instead track with the applicable general ledger receivable accounts. This would simplify the accounting and reconciling of general ledger receivable and corresponding deferred revenue accounts.

Current Year Status:

Several prior year recommendations over CEDO Special Revenue Funds were implemented; however, the items noted above have not yet been implemented.

Further Action Needed:

We continue to recommend that the City implement the aforementioned CEDO recommendations.

City's Response:

All bank accounts previously managed by CEDO have been transferred to the Clerk/Treasurer's Office effective December 1, 2013. All check stock for these accounts is maintained in the Clerk/Treasurer's Office. All accounting of the various programs and funding under CEDO have been incorporated into the City's new financial management and accounting system. Purchasing, Accounts Payable, and Accounts Receivable functionality has also been incorporated into the City's new financial management and accounting system allowing for immediate posting of encumbrances, expenses, revenue, assets, and liabilities. All transactions require hierarchal approvals of CEDO and Clerk/Treasurer personnel. The City plans on reviewing and, where identified, revamping of CEDO's Chart of Accounts, including loans received in advance and deferred revenue to better reflect program expense and revenue activity. CEDO is currently performing monthly reconciliations of general ledger activity to ensure accuracy and improve internal controls.

12. Prepare Monthly Financial Statements

Prior Year Recommendation:

In the prior year, we recommend that the City prepare (or produce from New World systems) monthly financial statements, including actual revenue and expenditures/expense compared with budgets. This will aid management and those charged with governance in assessing current year operating results and respond to changing circumstances.

Current Year Status:

Monthly budget performance reporting for department heads began with the period ended December 31, 2012.

Further Action Needed:

We recommend that the City expand the reporting to department heads and those charged with governance, to include special revenue and capital project funds trial balances and, where applicable, life to date reporting on activities.

City's Response:

Monthly, the City is reporting expenses and revenue to department heads, members of the Board of Finance and City Council. The content of these reports has also been expanded to allow for performance comparisons to the prior year. Written reports are provided to Department Heads with direction to review and offer comment on deviations from expected budgeted revenue and expenses. At the direction of the Chief Administrative Officer, a customized on-line report is provided to the Board of Finance and the City Council. Comments received from Department Head review are also provided to the Board of Finance and City Council.

13. Review Future Cash Flow of Burlington Community Development Corporation

Prior Year Recommendation:

In the prior year, we recommended that the City fully review the cash flow projection for the Burlington Community Development Corporation, and if necessary, begin planning for corrective action.

Current Year Status:

We understand that the City has begun to discuss ways to address this issue.

Further Action Needed:

We recommend the City continue to review cash flows, particularly to plan for the balloon payment which is scheduled for fiscal year 2021.

City's Response:

The Chief Administrative Officer and the finance team are currently reviewing the expected cash flows of the Burlington Community Development Corporation to include assessment of existing contracts and forthcoming obligations. Upon

completion, suggested strategies will be shared with the BCDC Board and ultimately, the Board of Finance and City Council.

14. 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:

The City has begun a review of all restricted and reserved funds and fund balances to ensure proper classification in the City's financial statements and to ensure that the appropriate cash is identified for each. Once completed, the City will develop a comprehensive policy with respect to the desired level of available fund balance,

which will also include the prioritization of the use of various funding sources, and define the approval process for establishing assigned and committed fund balance amounts.

15. Improve Controls over Church Street Marketplace Fund

Prior Year Recommendation:

In the prior year, we recommended the City reevaluate the job responsibilities in the Church Street Marketplace fund, and at a minimum, improve the documented oversight of customer billings, adjustments, and collections. We also recommended the Department document the reconciliation of revenues to the general ledger on a quarterly basis.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend that the City reevaluate the job responsibilities in the Church Street Marketplace fund, and at a minimum, improve the documented oversight of customer billings, adjustments, and collections.

City's Response:

The billing and collection of all Church Street Marketplace fees have been transferred to the Clerk/Treasurer's Office and incorporated into the City's new financial management and accounting system effective in FY 2014. This is designed to improve documented oversight of customer billings, adjustments and collections and allow for easier reconciliation by the CSMP. The CSMP has contracted with an accountant to assist the department in the reconciliation process and provide expertise, education and guidance to the CSMP Board and the Director on the finances of the CSMP and its internal controls. In addition, the Assistant Chief Administration Officer for Administration meets regularly with the Director of the CSMP and the contract accountant to review financial activity of the CSMP, as well as streamline processes and procedures. Lastly, the Church Street Marketplace has hired a part-time Certified Public Accountant.

16. Reconcile Pension Fund General Ledger

Prior Year Recommendation:

In the prior year, we recommended the City establish procedures to reconcile the pension fund detail member contributions report, pensions paid report, and refunds paid report to applicable general ledger revenue and expense control accounts on a quarterly basis. This will improve oversight and will help assure the accuracy of the general ledger information.

Current Year Status:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend that the City reconcile the detail member contributions report, pensions paid report, and refunds paid report to applicable general ledger revenue and expense control accounts on a quarterly basis.

City's Response:

The delayed implementation and incorporation of the Retirement Fund into the City's new accounting and financial management software has hampered the recommendation for quarterly reconciliations. A change in personnel in FY 2014 has caused a further delay in these reconciliations for FY 2014. However, a complete reconciliation was completed in December 2013. It is the City's intent to perform this reconciliation on a quarterly basis upon appointment of a permanent replacement for the Retirement Coordinator.

17. Automate Pension Fund Member Files

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:

This recommendation has not yet been implemented.

Further Action Needed:

We continue to recommend that the City automate the member files and member ledger, and retain a copy offsite.

City's Response:

The Clerk/Treasurer's Office is currently meeting with outside vendors to explore options to automate the tracking of pension data inclusive of, but not limited to, the tracking of retirement data elements, files, calculations, benefit payments, and tax reporting compliance.