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INDEPENDENT STATE AUDITOR'S
COMPREHENSIVE TRANSITION REPORT ON
THE FINANCIAL CONDITION OF THE
CITY OF FALL RIVER
AS OF DECEMBER 31, 2007

OFFICIAL AUDIT
REPORT
JUNE 13, 2008

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INTRODUCTION

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In response to a request from the Honorable Robert Correia upon his election as Mayor of the City of Fall River, Massachusetts, the Office of the State Auditor (OSA) initiated a comprehensive examination of the financial condition of the city as of December 31, 2007. Our audit was conducted in accordance with Chapter 11, Section 12, of the Massachusetts General Laws.

The purpose of our engagement was to provide the mayor with the status of his city's budget for the fiscal year ending June 30, 2008, including appropriations, expenditures, and obligations through December 31, 2007 and the adequacy of funding for the remaining six months of fiscal year 2008, as well as to identify financial/management issues that should be addressed in order to ensure the long-term sound management, fiscal integrity, and stability of the city. This review encompassed all of the city's fiscal activities as they relate to programs, functions, and activities.

When we initiated this audit engagement and met with the mayor and his transition team on January 15, 2008, they expressed their concerns that, based on what they had observed and reviewed of the city's financial condition, it was unauditabile. Our review confirms those conclusions. Some of the information we requested as of December 31, 2007 was unavailable, uncompiled, incomplete, inconsistent, unreconciled, or unclear. Because the city's financial transactions were not processed in a timely and accurate fashion so that its records, books, and reports are accurately prepared and presented to management, financial comparisons cannot be made, progress cannot be measured, and, more importantly, policy changes cannot be made as conditions warrant before it is too late and too costly.

To accomplish our audit, we met with and interviewed key city officials and examined all the documentation that they provided upon request. We wish to express our appreciation to these officials, the city's outside public accounting firm, and the mayor's transition team for their cooperation during our review. We also express our gratitude to the Massachusetts Department of Revenue (DOR), the Public Employees Retirement Administration Commission (PERAC), and the Department of Education (DOE) for the information they provided. Based on our analysis and the conditions we found, the city needs to take immediate steps to strengthen its financial management.

Specific steps that need to be considered by the city are in the development and implementation of a comprehensive internal control plan; revenue and expenditure budgeting and forecasting; financial reporting policies, procedures, and monitoring of all financial activities and funds (operating, enterprise, grants, trust funds and other funds); an updated capital improvement plan; cash management and debt management policies and procedures; and contingency plans to have the ability to respond to identified problems.

AUDIT RESULTS

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1. FINANCIAL MANAGEMENT SYSTEM IN CRITICAL NEED OF IMPROVEMENT

Our review revealed that the city's financial management system is inadequate and in dire need of reform. Specifically, we found that improvements were needed in the following areas: (a) Internal Control Plan not developed; (b) inaccurate, untimely, and incomplete financial recordkeeping; enterprise operation issues; and financial management and program issues. As a result of the city's inadequate financial management system and a lack of a modernized, real-time, integrated database system, city management lacked useful, comprehensive, accurate, and current information for properly managing and governing the city. It is vital for the city to implement corrective action both on the conditions noted in our report and in prior reports from its private accounting firm, the Department of Education (DOE) and the Department of Revenue (DOR). Given that this represents a monumental task to accomplish, particularly while simultaneously processing all transactions and activities associated with its day-to-day operation, the city should seek technical assistance and resources from DOR and other Commonwealth agencies as well as obtain outside services to help reconcile the city's financial records, cash, and investments.

The following is a summary of specific conditions the city needs to resolve:

- The city has not developed an Internal Control Plan, which is a formal, written document adopted and approved by management that includes the processes for planning, organizing, directing, and controlling all city operations and programs.
- The city has not developed a comprehensive corrective action plan that addresses all deficiencies identified in numerous prior audit reports, Management Letters, and reports on program performance issued by oversight agencies.
- The city is years behind in fulfilling its federal and state audit requirements. As a result, it is unable to provide reliable financial statements to state and federal funding agencies such as the Massachusetts School Building Authority, DOR, DOE, and the U.S. Department of Housing and Urban Development (HUD). This failure could result in an interruption or cessation of funding streams the city depends on for all the services it provides, including its school services. In fact, HUD has notified the city of such a possibility.
- The city has not resolved its cash and debt management issues, including reconciling bank balance records with the cash balances on the city's financial records, budgeting monthly cash needs, and documenting compliance with federal regulations concerning the timely drawing down of federal funds that are used in federally funded programs. Long-term debt problems included the monitoring of debt authorization, debt service management and financial reporting issues, and potential arbitrage resulting from investing unused bond proceeds. Revenue Anticipation Notes and Bond Anticipation Notes also effect cash management, note issuance costs and related interest expenses, as well as Moody's bond rating (Baa1).
- The city suffered investment losses on various accounts because it did not monitor the monthly returns on investments it was earning; monthly fees being

paid; losses on its trust funds, including cemetery funds; investing of unused bond proceeds; churning of accounts; reasonableness of fees paid, and proper procurement of brokerage and bank services.

- The amount claimed by the city as "free cash" (fund balances available for appropriation) does not agree with the amount certified by DOR.
- The city does not have an approved citywide cost allocation plan. Both the federal government and DOR require municipalities to adopt plans that describe systems for defining direct costs and defining the pooling of indirect administrative, overhead, and fringe benefit costs and how these costs are accumulated and allocated to city departments and projects. The lack of such a formal plan could result in questioned or disallowed costs by federal officials and distortions in the reported cost of city services.
- The city does not have a central system for collecting, controlling, and monitoring its financial information. This lack of timely and accurate information impacts numerous aspects of the city's operations, including, internal financial reporting, such as budget-to-actual revenue and expenditure data, availability of fund balances, overtime usage and inventory reporting, annual financial reporting, regulatory reporting, and public disclosures.
- The city does not have strong controls over its revenue cycles, including the billing and related collection of city-provided services, billing of taxes, and other collection efforts.
- The city does not have strong controls over its expenditure cycles, including documentation of expenses, warrant approval, preparation of payments, and controls over recurring payments.
- The city has not established a comprehensive system of budgetary controls, including the monthly comparison of approved budget to actual expenses, encumbrance management procedures, accounts payable and warrants payable reporting, the controlling of prior-year encumbrance balances, and the issuance citywide closing instructions.
- The city does not have strong procedures for procuring goods and services, managing its purchase orders system, monitoring contracts, managing the delivery of goods and services, and maintaining accurate bid files.
- The city's inventory of land, buildings and equipment, and materials and supplies is not properly accounted for and safeguarded because the city does not use its MUNIS software for inventory control, tagging of equipment, periodic comparison of records to actual inventory, and preparation of complete and useful trial balances.
- The city's enterprise operations did not include rate determinations, accurate departmental overhead rates, or billing and collecting procedures.
- The city could not provide complete and accurate data on the reporting of the settlement with its landfill operator, uses of settlement funds, and the billing and collection of daily tonnage fees.

- Multiple Single Audit issues existed, including deficiencies relating to federally funded programs, such as reporting of direct and indirect costs, inventory of equipment, safeguarding assets, monitoring sub-recipients, reporting results to oversight agencies, and documenting teacher credentials.
- Payroll issues included the accumulation and reporting of hours worked, accrued sick and vacation time usage, overtime approval and usage, Form W-2 wage reporting, Form 1099-MISC income reporting and the reporting of wage and FTE requirements to funding agencies. For instance, the city could not provide a consistent or reconciled number of employees and non-employees that agreed with the number of Form 1099-MISC or Form W-2 that were provided to the state and federal governments. In a related matter, the city was not in compliance with state and federal regulations regarding reporting taxable personal use and commuting data for city employees who were provided with city-owned vehicles.
- The city's School Department has not implemented corrective action for all issues identified in the city's last Single Audit (2005), including the establishment of a citywide cost allocation plan, financial reporting, cash management plan and inventory control system as defined in Office of Management and Budget the respective OMB Circulars. In addition, the city's School Department needs to develop a comprehensive plan for monitoring and improving school performance.

2. INFORMATION TECHNOLOGY AND MANAGEMENT NEEDS TO BE IMPROVED**29**

Our review noted various areas in the city's mission-critical Information Technology (IT) operations that could be improved. Specifically, we found that IT staffing levels and training were not sufficient; a citywide review of IT needs had not been conducted; written policies and procedures for citywide IT operations, disaster recovery and business continuity, and IT security had not been developed; and a formal IT risk assessment process had not been established. Given the city's increasing dependence on computerized IT systems to carry out its operations and to process, maintain, and report essential information, it is of the utmost importance that the systems that process, maintain, and report such data be as reliable as possible.

The following is a summary of specific conditions the city needs to resolve:

- Our review determined that all three IT departments had concerns regarding maintaining sufficient skilled staff to support their IT departments. In addition, the three IT departments expressed a need to maintain sufficient training for their staffs to keep them up-to-date with changing technology standards.
- The city needs to conduct a citywide review of the common needs of the IT departments of City Hall, the School Department, and the Police Department. Moreover, the separate IT departments need to identify budget requirements based on IT infrastructure enhancement and provision of IT services.
- No business continuity planning documents had been developed for any of the three data centers, and there were no plans for replacing out-of-date equipment and software.

- IT policies and procedures were insufficient for citywide IT functions, including: IT security, confidentiality, and maintainability, and availability requirements of IT systems and networks.
- No formal IT risk assessment process or framework was in place. Accordingly, it is unlikely that there is a sufficiently detailed understanding of IT risk across city departments or that management control practices for IT processes have sufficient control in place and in effect to prevent or detect undesired IT-related events.
- No disaster recovery or business continuity plans for the city had been developed and tested. Further, the city has not specifically identified, through risk assessment and criticality assessment, the business continuity requirements of all city departments. Accordingly, there is inadequate assurance that IT systems could be recovered in an acceptable period of time in the event of a disaster.

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INTRODUCTION

Background

In response to the request of the Honorable Robert Correia, mayor of the city of Fall River, Massachusetts upon his election, the Office of the State Auditor (OSA) initiated a comprehensive examination of the financial condition of the city as of December 31, 2007. Our audit was conducted in accordance with Chapter 11, Section 12, of the Massachusetts General Laws.

The purpose of our engagement was to provide the mayor and other city officials with the status of his city's budget for the fiscal year ending June 30, 2008, including total appropriations, expenditures, and obligations through December 31, 2007 and the adequacy of funding for the remaining six months of fiscal year 2008, as well as to identify any financial management issues that should be addressed in order to ensure the long-term sound management, fiscal integrity, and stability of the city. This review encompassed all of the city's financial activity as it relates to its various departments, functions, and activities.

To accomplish our audit, we met with and interviewed key city officials and examined all the documentation they provided at our request. We wish to express our appreciation to them as well as the city's outside public accounting firm and the mayor's transition team for their cooperation during our review. We also express our gratitude to the Massachusetts Department of Revenue (DOR), the Public Employees Retirement Administration Commission (PERAC), and the Department of Education (DOE) for the information they provided.

The city of Fall River is located on the southern shore of Massachusetts in Bristol County. The total incorporated area of the city is approximately 40 square miles, of which approximately 40 percent is undeveloped, including approximately 2,100 acres of state forest land. The city also includes 15,906 acres of land and property valued at \$1,049 billion owned by the state and the Fall River Housing Authority, which are tax exempt but for which the city should receive Payments in Lieu of Taxes (PILOT) as provided by statute. The city also includes property owned by various county, religious, nonprofit, and healthcare-affiliated institutions valued at \$197,034,950 for which it receives no tax revenue. The city employs a Mayor-Council form of government, with nine elected council members. The Director of Municipal Services, who serves at the pleasure of the mayor, directs certain day-to-day activities of the city. The City Treasurer is the Chief Financial Officer and, with

the City Auditor, performs a variety of general accounting functions, cash management duties, borrowing and investing, and other financial management and reporting duties.

The city provides an array of government services, including public education in grades K-12, police and fire protection, collection and disposal of residential solid waste, water and sewer services, street maintenance, and the management of 28 parks and recreational facilities.

In order to give perspective to the results of our audit, it is important to highlight some key and vital financial statistics of the City of Fall River.

According to the fiscal year 2008 Tax Rate Recapitulation approved by DOR

The city is authorized to spend a total of		\$240,842,464
Consisting of state aid of	\$130,284,737	
And city receipts of	<u>47,963,880</u>	<u>178,248,617</u>
Leaving a total to be raised through property taxes of		<u>\$62,593,847</u>
Residential property taxpayers are paying a rate of \$7.67 per thousand on assessed values of	\$5,434,653,412	
Or 66.6% of the city's taxes of		\$41,683,792
Commercial, residential, and personal property taxpayers are paying a rate of \$16.31 per thousand on assessed values of	\$1,382,038,950	
Or 33.4% of the cities taxes of		<u>\$20,910,055</u>
Total tax levy		<u>\$62,593,847</u>

The city at this point in time had only \$28,500 in additional tax levy capacity, but has certified "free cash" available of \$8,288,000.

Included in the above receipts are estimated motor vehicle excise taxes of \$6,233,577 and estimated water and sewer receipts of \$19,665,912. The city does not charge for trash services, and for fiscal 2008, it has budgeted over \$8 million for solid waste costs, exclusive of related indirect, overhead, and fringe benefits.

The city had total authorized and issued debt of \$249,160,601 as of June 30, 2007. Of this total, \$217,013,601 was long-term debt and \$32,147,000 was short-term debt, which consists of anticipation notes that are payable within 12 months. The city paid a total interest on this debt of \$7,442,401 during fiscal year 2007 (see Appendix E). The city has authorized but not issued an

additional \$266,512,679 in long-term debt. The city's current bond rating by Moody's is only "Baa1," which is defined as "Lower Medium Grade" and is only one step above "Speculative."

The city's authorized spending for the 2008 fiscal year on which the tax rate is based is approximately \$241,000,000. The largest components of the budget consist of public safety (\$38,800,000), education (\$88,150,000), pensions (\$12,356,000), and employee benefits (\$35,675,000). Also, in fiscal year 2008, the city's six unions were in the last year of their three-year agreement, and the negotiated raises of 3% cost approximately \$1,000,000 per year.

The city reported a total outstanding debt as of June 30, 2007 of \$249,160,601, on which it paid interest and principal totaling \$73,987,443 that year. The city has issued refinancing Bond Anticipation Notes (BAN) since June 30, 2007 amounting to \$33,447,000. The city also has lease costs of approximately \$259,000 for equipment and space for fiscal year 2008. In this regard, the city has a process for identifying its capital projects, its Capital Improvement Plan. The five-year plan, which includes a "wish list" of items, currently describes 96 projects valued at \$24,449,236 submitted by the various city departments. The city does not detail the process by which each selected capital project is evaluated or prioritized in order to more rapidly move the projects from the potential planning stage to the more realistic implementation stage.

The city's unfunded pension liability was \$164 million as of January 1, 2006, and the required funding of future pension costs escalate from \$13,800,000 in fiscal year 2008 by approximately \$1,000,000 per year to a peak of \$42,410,533 in fiscal year 2028. In this regard, because the city's retirement system was classified as underperforming (i.e., not meeting a defined statutory funding ratio), its approximately \$400 million in retirement assets were turned over to the state's Pension Reserve Investment Trust (PRIT) Fund. The concept of the State's Municipal Partnership statute is that if the State's PRIT fund has more favorable returns than the individual, local underperforming retirement systems, the benefit of additional returns will accrue to the local systems and reduce the additional pension (tax) burden that the communities would have to bear.

Given the realities of its statutory tax levy limitations and allowing for new growth, the tax levy grew by only approximately \$3,000,000 for fiscal year 2008. The city's net state aid totaled approximately \$121,600,000, or over 50% of its budget, resulting in property tax growth by another 4% to

\$62,593,847 for the year. By way of comparison, state aid represents on average 25% of the Commonwealth's cities and towns annual budgets.

In addition, the city indicated that its employees consist of the following:

School System	1,931
Police Department	350
Fire Department	286
EMT Services	35
Water and Sewer Departments	55
Other Departments	<u>523</u>
	<u>3,180</u>

The city has established enterprise funds to control and monitor the costs and services of the water and sewer departments. Enterprise fund accounting is used to account for municipal services that operate in a manner similar to a business, where the intent is for user charges to offset a portion or the full cost of providing these services, including all direct operating costs, indirect central service overhead and administrative costs, fringe benefits, pensions, health insurance and workers compensation insurance, etc.

- The residential water rate was set on July 1, 2005 at a rate of \$1.26 per 100 cubic feet. Water Department revenues for fiscal year 2007 were \$5,833,552, with an additional \$200,000 appropriated from free cash. Expenditures for fiscal year 2007 (exclusive of debt service) totaled \$4,305,847. Debt service for fiscal year 2007 was \$1,442,580. The water rate effective January 1, 2008 was raised to \$1.34 per 100 cubic feet, with five cents of the increase applied to debt service.
- The developed areas of the city are serviced by its wastewater treatment services. The current sewer rate was set on July 20, 2004. The quarterly bills are determined by metered consumption at a rate of \$3.34 per 100 cubic feet for residential and industrial users and \$5.21 for non Fall River users. In fiscal year 2007 wastewater revenues totaled \$11,776,033, with an additional \$2,371,825 appropriated from free cash. Expenditures for fiscal year 2007 (exclusive of debt service) totaled \$8,463,924. Debt service for fiscal year 2007 was \$4,660,429.
- The city hosts a commercially operated landfill. As a result of being the host community, the city receives host fees and gets well below market rates for the city's tipping fees on trash it takes in. On May 21, 2001 the city engaged legal services to pursue litigation against a contractor for its failure to pay all amounts owed the city pursuant to the agreement dated February 10, 1989. On July 30, 2004 the city received a summary judgment in the amount of \$13 million from Bristol Superior Court. The contractor appealed the case; however, in December 2004 a settlement agreement was reached for \$11.3 million, payable in two annual

installments of \$8 million on May 2, 2005 and \$3.3 million on May 3, 2006. The language in this agreement provides for the proceeds to be reserved for future debt service payments. In fiscal year 2006, the city used \$5.3 million of the settlement to fund the city's operating budget.

- The city's public education system currently includes 27 elementary schools, four middle schools, and one central high school. The city is engaged in a major school building remodeling and construction program involving five schools with a total estimated cost of \$134,753,000. With respect to approximately \$90,000,000 of the total costs, the city has applied for and expects to receive Massachusetts School Building Authority grants equal to 90% of eligible project costs. The city expects to apply to the Massachusetts School Building Authority with respect to the Morton School project for grants equal to 80% of eligible project costs.

The following is a table of actual enrollments in the city's public schools for the year 2004 to 2006 and projected enrollments for the 2007 and 2008 school years. High School enrollments do not include students attending Diman (Greater Fall River) Regional Vocational-Technical High School.

	<u>Actual</u>			<u>Projected</u>	
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Elementary	5,621	5,765	5,165	4,957	5,053
Middle	2,805	2,732	2,655	2,538	2,460
High School	<u>2,935</u>	<u>2,701</u>	<u>2,916</u>	<u>2,797</u>	<u>3,089</u>
Totals	<u>11,361</u>	<u>11,198</u>	<u>10,736</u>	<u>10,292</u>	<u>10,602</u>

In addition, the management disclosed that in fiscal 2006, transfers were made to cover deficits of \$294,700 for fire, emergency medical services, and medical supplies expenses; \$50,000 for veterans benefits, \$25,000 for armory utilities and other costs, \$230,000 for Liquefied Natural Gas (LNG) defense; and \$290,000 for police salaries.

The city is also experiencing increased workers' compensation insurance, health care, retirement and debt service costs. The city has 29 employees out on workers' compensation dating back to 1988. The annual compensation amounts to \$138,465 per year.

Property taxes were increased and one-time revenues were used to supplement the budget to keep the city below the tax levy limit, including the use of \$5.3 million of a \$13 million settlement received from the city's landfill contractor.

Audit Scope, Objectives, and Methodology

Our review was conducted at the request of the incoming mayor of the city of Fall River. Our review and related examination was performed for the period July 1, 2007 through December 31, 2007, and was conducted in accordance with applicable generally accepted government auditing standards as issued by the Comptroller General of the United States, and included procedures and tests that we considered necessary to meet those standards. The objectives of this audit were to:

- Review and examine the city's financial management operations to determine the status of accounts, activities, and records.
- Determine whether records are complete, accurate, current, and reliable;
- Determine whether the internal control structure and environment is adequate,
- Review and examine all reports from city management, as well as related audit management letters, prepared by the city's outside accountants, and other agencies to determine what, if any, corrective action has taken place.
- Determine whether applicable laws, rules, and regulations are being complied with.
- Review the city-prepared budget-to-actual spending report for fiscal year 2008 to determine the sufficiency of funds to meet the city's obligations for the remainder of the fiscal year.

To achieve our objectives, we reviewed the city's (1) administrative and accounting procedures and internal controls; (2) budget, spending plans, and financial reports that were prepared for internal use and external reporting purposes; (3) operations for compliance with applicable laws, rules, and regulations; and (4) transactions pertaining to revenue collection, procurement, disbursements, and payroll.

To conduct our audit we first met with and had discussions with the mayor and his transition team. At that time we requested information needed in planning our review and established procedures for the ongoing receipt and request of information.

We requested the city's internal control policies and procedures to assess their adequacy. We also reviewed internally prepared financial reports and other financial activity reports to determine how management is monitoring citywide and departmental financial and programmatic activities. An element of the city's control environment is the levels of accountability established by the city's Administration and its management to confirm that its directives are being executed. Generally

Accepted Government Audit Standards (GAGAS) describe the concept of accountability as follows:

The concept of accountability for public resources is key in our nation's governing processes. Legislators, other government officials, and the public want to know whether (1) government resources are managed properly and used in compliance with laws and regulations, (2) government programs are achieving their objectives and desired outcomes, and (3) government programs are being provided efficiently, economically, and effectively. Managers of these programs are accountable to legislative bodies and the public.

In order for government managers to be accountable and for the public and their elected officials and decision-makers to know and assess their accountability, governance, and fiduciary responsibility for the use and management of public resources, activities, and functions it is absolutely essential that all the reports and information provided to them are timely, complete, and accurate. Otherwise, their utility is of limited value and benefit, and decisions are not fully informed.

We reviewed narratives prepared by various city department heads in response to questions posed by the mayor's transition team. We also reviewed the city's latest available annual audit of its financial statements for the fiscal year ended June 30, 2006, the latest annual federally mandated A-133 Single Audit for the fiscal year ended June 30, 2005, and various reviews performed by other audit entities; including any associated Management Letters that were developed as apart of those audits. (The fiscal year 2007 audits are not yet available.) We also reviewed any Corrective Action Plans prepared to correct the weaknesses disclosed in the related Management Letters.

We met with a partner from the firm that conducts the annual audit of the city's financial statements and the required A-133 Single Audit covering Federal Financial Assistance received by the city. We discussed the qualifications and exceptions in the firm's Auditor's Report on the city's financial statements, as well as issues and concerns disclosed in the related Management Letter. We also noted the lack of corrective action by the prior administration to repeated issues that were disclosed in prior audit reports. We appreciate the time and cooperation provided by the firm.

We then reviewed the report on actuarial projections and audit report prepared by the Public Employees Retirement Administration Commission (PERAC) for the year ended December 31, 2005. These reports disclosed the city's pension obligations, unfunded pension liability, and any related issues developed during PERAC's audit.

We reviewed the authorizations for the city's short- and long-term debt, documentation of sales, and the amortization schedules of bond interest and principal. We also reviewed all losses on investments or declines in asset value disclosed by the city or noted during our review of banking and investment documentation.

Since taking office, the mayor has begun taking steps to gain control of the city's finances and manage the city. The mayor's actions indicate recognition and application of the following principle:

Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to meet its mission, goals, and objectives. Internal controls include the process for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting and monitoring program performance. Internal controls also serve as the first line of defense in safeguarding assets and preventing and detecting errors, fraud, and violations of laws, regulations, and provisions of contracts and grant agreements

The mayor has appointed a Director of Municipal Services and a City Auditor, separating the position from that of the Treasurer, which was the case when the mayor took office. This action recognizes the concept of "segregation of duties," under which the City Auditor should not hold any other office involving the receipt and disbursement of money, and it should assist in the process of correcting deficiencies with the city's financial management that have been pointed out repeatedly by the city's annual audits and by its various state and federal regulatory and oversight agencies.

In addition, the mayor has also redirected the scope of the audit of the city's School Department by an outside accounting firm, requesting a review of its policies, procedures, and internal controls; sought bids on the city's banking and financial services; contracted with an outside firm to assist the Treasurer in reconciling the city's bank accounts; closed unused bank accounts; sold investments and closed accounts that were underperforming and losing hundreds of thousands of dollars, and begun a review of the city's water and sewer rates.

AUDIT RESULTS

1. FINANCIAL MANAGEMENT SYSTEM IN CRITICAL NEED OF IMPROVEMENT

Our review revealed that the City of Fall River's financial management system is inadequate and in dire need of reform. Specifically, we found that, because the city's internal accounting; administrative; and management policies, procedures, and controls were inadequate and unreliable, the city was incapable of producing timely and accurate records, financial statements, reports, and audits. As a result of this inadequate financial management system and a lack of a modernized, real-time, integrated data base system, city management lacked useful, comprehensive, accurate, and current information for properly managing and governing the city. It is vital for the city to implement corrective action both on the conditions noted in our report and in prior reports from its private accounting firm, the Department of Education (DOE) and the Department of Revenue (DOR). Given that this represents a monumental task to accomplish, particularly while simultaneously processing all transactions and activities associated with its day-to-day operation, the city should seek technical assistance and resources from DOR and other Commonwealth agencies as well as obtain outside services to help reconcile the city's financial records, cash, and investments.

a. Internal Control Plan Not Developed

Contrary to the federal Office of Management and Budget (OMB) Circular A-133, the city has not developed citywide internal control plans or developed comprehensive, written formal policies and procedures to implement and support such plans. As a result, there is inadequate assurance that material financial transaction errors, omissions, or illegal acts would be detected. Moreover, due in part to the lack of such plans, the city has not addressed 38 of the 41 audit issues identified in prior audit reports for fiscal years 2005 and 2006. The city should develop such internal control plans, including a written indirect cost allocation plan for its enterprise operations and a written comprehensive inventory control system for its fixed assets.

Our review disclosed that the city has not adopted citywide internal control plans nor does it have comprehensive, written formal policies and procedures to implement and support such a plans. The city needs to develop and implement this formal plan from a written document adopted and approved by management that includes the processes for planning, organizing, directing and controlling all city operations, activities and programs in order to be in compliance with OMB Circular A-133. The plan should address past weaknesses indicated in prior audits and enable the city to be audit-ready to redress current weaknesses. The intent of such a plan is to reduce the level of risk in financial transactions caused by errors, omissions, or illegal acts in amounts that may occur, that would be material in relation to the financial statements, and that would not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our review of the prior audit reports from fiscal years 2005 and 2006 indicate that city management was not meeting its mission, goals, and objectives, as evidenced by a total of 41 audit results in these reports, 38 of which were repeated from prior audits. Based on the conditions we have observed, many of these issues will be repeated in the 2007 audit, which will not be available until fiscal year 2009. This demonstrates the criticality of implementing the systemic resolutions called for. A comprehensive internal control plan would mitigate the further occurrence of the repetition of audit results and improve the financial reporting and management health of the city. Our review noted salient areas of operation of the city that such a plan should address.

The city intends to expand its enterprise funds with two new enterprises, Emergency Medical Services (EMS) and sanitation. The city should create a written indirect cost allocation plan, which is subject to DOR approval, for all of its enterprise operations that identifies all relevant costs specifically and delineates the reason that the cost is considered as part of the pool of indirect costs. Further, the allocation method chosen must be adopted in advance so that there is no arbitrary or discriminatory application of these costs at year-end.

The Massachusetts Department of Revenue "Informational Guideline Release (IGR) No. 08-101 April 2008" that provides guidance to local

officials on the use of enterprise funds under Massachusetts General Law Chapter 44 Section 53 F ½ states for Indirect Costs:

Indirect cost allocation methodology – The bureau recommends that every community with an enterprise fund establish a written, internal policy regarding indirect cost allocation and should review this policy annually. The policy should be reasonable and calculated in a fair and consistent basis. Local financial officials should understand and agree on what indirect costs are appropriated budget and what percentage of these costs should be allocated to the enterprise fund.”

We also noted that the city does not have a comprehensive written inventory control system for all of its fixed assets. The city should develop a written comprehensive inventory control system utilizing a periodic or perpetual inventory system. The system should include a policy for determining the dollar value and useful life threshold for an item to be considered a fixed asset. These fixed assets should be tagged with an identifying numbered tag noting ownership of the asset and a written listing of these assets by location, department, cost, and unit should be created.

This listing should be updated and reviewed on a periodic or perpetual basis. The lack of a written listing of assets owned and valued by the city puts the city at a potential financial risk of loss, and for the replacement cost of the fixed assets without appropriate records of inventory so that accurate applicable insurance claims can be filed to reduce the financial exposure to the city in cases in which such claims may be filed, as in fire and theft.

b. Inaccurate, Untimely, and Incomplete Financial Recordkeeping

Generally Accepted Government Audit Standards (GAGAS) describes the concept of accountability as follows:

The concept of accountability for public resources is key in our nation's governing processes. Legislators, other government officials, and the public want to know whether (1) government resources are managed properly and used in compliance with laws and regulations, (2) government programs are achieving their objectives and desired outcomes, and (3) government programs are being provided efficiently, economically, and effectively. Managers of these programs are accountable to legislative bodies and the public.

In order for government managers to be accountable and for the public and their elected officials and decision-makers to fulfill their governance and fiduciary responsibilities in the use and management of public resources, activities, and functions, it is absolutely essential that all the reports and information provided to them be timely, complete, and accurate. Otherwise, their utility is of limited value and benefit and decisions are not fully informed.

When we initiated this audit engagement and met with the mayor and his transition team on January 15, 2008, they expressed their concerns that, based on what they had observed and reviewed of the city's financial condition, it was unauditible. Our review confirms those conclusions. Some of the information we requested as of December 31, 2007 was unavailable, uncompiled, incomplete, inconsistent, unreconciled, or unclear (see Appendix F). Because the city's financial transactions were not processed in a timely and accurate fashion so that its records, books, and reports are accurately prepared and presented to management, financial comparisons cannot be made, progress cannot be measured, and, more importantly, policy changes cannot be made as conditions warrant before it is too late and too costly.

In order for independent audit reports to be useful they must be timely and should be completed and issued before December 31, six months after the fiscal year ends. In order for that to occur, the city must be audit-ready. However, since the city is not audit-ready with its books closed, accounts reconciled, and its financial statements prepared in time to give its outside private accounting firm time to complete its audit work and publish its audit report and accompanying management letter, before December 31st following the fiscal year-end, then the firm must wait until the city is audit-ready in order for it to be auditible. This condition forces officials, year after to year, to try to plan for the future without audited records and reports on the city's current status. Further, and potentially more damaging, is that this uncorrected problem leaves the city vulnerable to waste, abuse, and even illegal acts that may go undetected and/or uncorrected as management balances the tasks associated with the daily operations of the city with those associated with addressing and correcting past deficiencies. It is unacceptable

for the city to not only be preparing for its fiscal year 2009 budget as fiscal year 2008 is coming to a close and its statutorily required audit for fiscal year 2007 has yet to be completed, but also to set tax rates under such circumstances.

An audit is only one of many management tools; it does not take the place of management's fulfilling its day-to-day responsibilities. Also, it is inconsistent for the auditor's role to help an auditee become "audit ready" or to reconstruct an auditee's book and records and subsequently perform an audit and opine on the records and financial statements that the auditor assisted in preparing. The financial statements are management's, not the auditor's, representations of the city's financial condition and results of its fiscal activities for the year.

The city has been notified that it is in noncompliance with federal regulations by not fulfilling audit requirements in a timely manner in regard to its federal Community Development Block Grant funds, and has been for as far back as fiscal year 2002. The city's failure in this regard could result in an interruption or cessation of the significant flow of federal funds, which amount to millions of dollars per year and are urgently needed for the city's schools, services and programs.

This is a problem for the city because its systems are not capable of providing management the information it needs to govern on a timely basis. The city cannot solve its problems alone. By way of comparison, the Commonwealth manages almost \$40 billion in spending by hundreds of agencies, departments, boards, commissions, and institutions of higher education, as well as executive, legislative, and judiciary offices and is able to close its books and have audited financial statements available by January of the succeeding year, six months after year-end closing. Such an accomplishment at the community level will require a comprehensive, joint effort of state resources and community cooperation.

Based on our audit, the city needs to reform its financial management system if it is to maintain adequate controls in order to comply with applicable laws, rules, and regulations as they pertain to the city and to assure its citizens and taxpayers that it

is managing the city's resources in the most prudent responsible, economical, effective, and timely manner. Because of the city's inefficient financial and management information system and the lack of a modern on-line, real time, integrated, data base system, it suffers from not being able to produce and provide management (the mayor and council) in a timely manner with useful, comprehensive, accurate, and current data and information with which to manage and govern the city. Moreover, management tools such as the required annual audits are not produced timely and are not useful because of the weaknesses with the system, which hinders the ability of the city to make required corrective actions for many of the conditions repeated in its audits and associated management letters over the years.

With the city now having to recognize the liability and the potential funding of the future costs of post employment health care benefits while continuing to provide municipal services including maintenance, repair and renovation of its roads, bridges, dams, buildings, and infrastructure along with its communications, vehicles and equipment needs, the city's fiscal position and its future finances become more precarious and fragile.

Furthermore, the Government Accounting Standards Board (GASB) has issued Statement Number 45 to provide more complete, reliable, and useful financial reporting information regarding the costs and financial obligations that governments incur when they provide other post employment benefits (OPEB). The most common form of post employment benefits, other than pensions are health care benefits. These benefits are a very significant commitment for many governments. The standard requires governments to report the annual OPEB costs and their unfunded actuarial accrued liabilities for past service costs.

According to the actuarial study conducted for the city:

The City of Fall River currently offers post-retirement medical, dental and life insurance benefits to all City employees who meet the eligibility criterion. As of July 1, 2007, there are 3,538 active employees and 1,801 retired employees who are recognized in this program. Coverage is for individuals and families or individuals and spouses depending on the insurer.

The cost of providing these benefits is paid by the participant and the City. Participant contributions are 25% of the annual premium rates for the medical and dental plan and \$26.52 annually towards the \$5,000 life insurance benefits. The City pays for the balance of the benefits. Medical coverage continues to the spouse after the death of the retiree when both are covered.

Under the current pay-as-you-go treatment the City expense for this program is \$16.1 million and the GASB 45 annual City expense using the 5% discount rate which assumes no pre-funding is \$102.4 million, \$86.3 million more than is currently being recognized. If the City were to pre-fund for this benefit and if the auditor allowed the use of an 8% discount rate the City has an annual GASB 45 expense of \$79.1 million which is \$63 million more than is currently being recognized under the pay-as-you-go arrangement.

At our recent meeting, we learned that for some individuals that the 25% participant contribution is further reduced by \$26.88 a month. So it appears that our participant contributions may be overstated and the City-related liability and cost may be understated.

Compounding the problem is the proposed 11.2% water rate increase to finance the costs of dam repairs and water system improvements, as well as the approximately \$10 million in additional debt to pay for cost overruns for four schools under construction.

c. Enterprise Operation Issues

The city has not conducted or engaged a comprehensive water and sewer cost and rate study and analysis to ensure that its rate structure is sufficient to accommodate all current and future costs without the need of any tax subsidy. Thus, the city lacks the information it needs to know all related costs and decide on an appropriate level of General Fund subsidy, if any. In addition, the city has not developed an up to date indirect cost allocation plan to ensure that all related costs are known and allocated to these enterprises. This is essential in order to accomplish an effective and comprehensive water and sewer cost and rate study. In this regard, the city does not operate its solid waste services as a business type enterprise, as it does its sewer and water services, and thus is not in a position to know and recognize all its associated costs and benefits.

Recognizing that for fiscal 2008 the city's excess tax levy capacity was only \$28,500, it is important for the city to understand how much of the tax levy is unnecessarily

funding any portion of the water and sewer enterprise costs for these business-type activities. Likewise, the city's solid waste services also have associated indirect administrative/overhead central service, pension and insurance costs that should be measured so the city can know the total cost of the service, make informed budget decisions, and determine the degree of subsidy accordingly. The cost of these enterprise operations should be determined including all direct, indirect, administrative, overhead, pension, health insurance, workers' compensation, capital projects, reserves, etc., thus allowing its officials to make an informed decision as to any subsidy or sharing of cost to be borne by the tax rate. The extent to which general government subsidizes or provides for any enterprise type costs limits the amount of taxes that could otherwise be available for vital public safety and education costs and services.

We compared the water and sewer enterprise funds schedules provided to DOR for establishing the 2008 tax rate and found that the fiscal 2007 actual and 2008 estimated revenues and the 2008 costs appropriated were not in agreement with the information presented in the approved budget. The schedules submitted to DOR included \$7,791,548 of unspecified "other" direct costs, which were concluded to be approximations of debt service costs, but it was not demonstrated what else was included. There were no indirect costs shown as being borne by the General Fund on these schedules, which are referred to as "A-2." However, in another schedule to DOR, the city portrayed Miscellaneous Non-Recurring Local Receipts of \$660,000 as a transfer to the General Fund from these enterprise funds to cover unspecified "indirect costs" that were stated to be level-funded. Obviously, indirect costs are routine, recurring, fluctuating annual costs that are associated with these operations, and should not be classified as a local receipt. We were told that the enterprise funds do not pay any overhead costs. It is also not credible that such costs as pensions, health and workers compensation insurance remain "level" from year to year. We were subsequently told that indirect costs are "lumped" in with direct expenses on the A-2 schedule. The result of these accounting and reporting scenarios is that they are counted twice: once as enterprise revenue and expense offsets and again as local receipts. This is more problematic since there

was no written indirect cost allocation plan, and therefore it is unclear whether the amount transferred is documented, supported, and responsible. Unless these unspecified indirect costs are different, then the result is that, contrary to law, the enterprise funds are subsidizing General Fund operations by at least \$660,000. Unusual accounting treatments such as these which DOR discourages make it difficult for DOR to perform a proper review, evaluation, and certification, particularly at the last minute in December in order to get tax rates approved and the tax bills mailed by December 31st for collection by February 1, 2008.

More troubling is the fact that DOR and the city are working with unaudited figures for fiscal year 2007 since the city is not audit ready and the concern for what else may go undetected. The latest audited financial statements are for fiscal year 2006 and show restricted and unrestricted available funds of approximately \$8 million, which are not recognized as available or appropriated in the schedules submitted to DOR. Therefore, questions arise as to reliability and where the city stands financially from a taxation position. Furthermore without having user rate and indirect cost studies performed, the city does not know the extent the General Fund is unnecessarily subsidizing the enterprise funds, and thus could have additional levy capacity available if they were properly accounted for, funded, and utilized. A worse case scenario, using such unorthodox accounting practices, without detailed backup documentation is that the enterprise funds could be subsidizing the General Fund possibly without DOR detection when setting the tax rate, because of the condition and status of the city's accounting system and records. These accounting practices raise questions of the city's true financial picture and whether its tax rate should in fact be otherwise.

d. Financial Management and Program Issues

Our review of the latest available audits of the city, which were the 2006 annual audit and the 2005 single audit and the accompanying management letters, noted the following significant exceptions, reportable conditions and/or material weaknesses. Many of these conditions were reported in previous audits and have not been addressed adequately. Because the city is unable to close its books in a

timely manner, fiscal years become blurred and overlap, precluding accurate accountability and timely and useful audit reports to management.

Other financial management and program issues of concern relate to:

1. The city's latest available annual audit reports for fiscal years 2005 and 2006 disclosed that the city had not reconciled its cash and investment balances during the two years. We found that this condition had yet to be addressed and that as of December 31, 2007 the city has yet to reconcile its cash and investment balances.

A footnote to the June 30, 2006 audited financial statements disclosed:

At year-end, the City's carrying amount of deposits for the primary government, private purpose trust funds and agency funds was \$59,411,587, including petty cash and the bank balance was \$65,879,459. Of the balance \$7,977,775 was covered by Federal depository Insurance and \$10,539,762 was covered by Depositor Insurance. The remaining balance of \$47,361,922 was unsecured and uncollateralized. However, the uncollateralized deposits are deposited with large regional banks and the City feels the risk of loss is minimal.

The report also disclosed that the city's General Fund had an unreconciled cash variance of \$1,500,000 and that the July 1, 2005 opening balance had an unreconciled cash variance of \$2,203,070 (see Appendix C).

On separate occasions during 2007 the city had engaged the services of two firms for the purpose of reconciling its cash and investments. The first firm attempted reconciliation for April, May, and June 2007 and was unable to deliver a complete reconciliation of cash and investment activity. The city informed us that the unreconciled variance at that time of \$416,859 represented long-standing issues that could not be resolved despite various attempts to rectify the problem. The second firm attempted to reconcile cash and investments from July through November 2007 and also was unable to deliver a complete reconciliation of cash investment activity.

We requested and were provided with several documents that were an attempt by the city to reconcile both cash and investment balances for November and December 2007. However, the reconciliations were incomplete and the spreadsheet's electronic format rendered the document unreliable. The document, which

contained information for more than 60 cash and investment accounts and all cash and investment activity for the month of November, required more than 65 columns and 600 lines to capture all the months' activity. If printed out, each month's document would be 149 pages long and still fail to reconcile book balances to bank balances for all cash and investment accounts. In addition, we found that the reconciliations did not include outstanding checks for cash and investment account balances of \$71,136,337 (November 2007) and \$73,813,647 (December 2007) as a reconciling item.

We also requested a monthly cash budget or schedule of cash flow needs to reflect the funding needs for federal programs and grants or identify what bonds and notes were due for payment. However, the city was not able to provide us with a comprehensive schedule of monthly cash needs, which should have been developed as part of its monthly reconciliation process, including its drawdowns of all funds from the federal government.

This calls into question the integrity and reliability of the city's financial management practices, its ability to identify its short term borrowing needs based on accurate cash flow analysis and the potential of incurring unnecessary and excessive interest costs. We have asked for documentation to support the need for the city's 2007 and 2008 debt issuances and did not receive any responses. During calendar year 2007 the city borrowed long-term debt totaling \$38,565,538 due and payable on July 15, 2027.

These cash reconciliation variances were attributable to errors involving omitted deposits in transit, outstanding checks, non-included bank accounts, and incomplete listing of checks issued. Along with the untimeliness of the reconciliation process, the delay in recording tax collections, and inaccurate transfers, it is impossible for the city to have and provide an accurate picture of its cash position, in a timely manner.

The management letter for the city's 2006 audit indicated that Trust Fund Investment earnings were erroneously recorded to the General Fund, improperly affecting both funds. In relation to this, we found and called into question the city's investment performance. The city experienced losses on investments and/or write-downs and experienced unfavorable returns on other accounts, costing the city hundreds of thousands of dollars. As a result the city instituted some immediate steps to stop losses and maximize its investment returns in April 2008 and will enhance its revenues by hundreds of thousands of dollars.

Our review of the city's investment activities determined that during calendar year 2007 there were five investment accounts in two financial institutions that suffered losses on transactions and also lost a portion of their asset value. In addition to these losses, several of these accounts were charged monthly or quarterly investment fees. These fees were in addition to normal transaction fees that are charged when buying and selling. The city could not provide us with a schedule detailing the cost associated with individual investment transactions during 2007. We also requested information identifying the source of funds for these various investments and were not provided with any documentation.

We inquired as to how the city procured its banking and investment service and were told that banking and investment services were not subject to the State's Procurement Law, Chapter 30B. However, the December 2004 "Banking Services Procurement Guide for Local Government Treasurers" guide issued by the state's Office of the Inspector General provides detailed instructions concerning the competitive procedures to be followed when obtaining banking and investment services.

In addition, the city could not explain why its Trust Funds, including the Cemetery Funds, were invested in speculative investments while the city's other funds were in Certificates of Deposit (CD's) or the Massachusetts Municipal Depository Trust (MMDT). The city's Trust Funds had a balance of \$2,173,387, as of December 31, 2007. City funds invested in MMDT during December 2007 earned interest totaling \$59,606.

We determined that the numerous transaction costs and losses on investments are obscured in the details of the attempted bank reconciliations and not posted to the city's ledgers.

The Management Letter for the city's 2005 audit describes issues with recording Investment Income as follows:

Investment income for certain of the Trust Funds was erroneously posted to the general ledger. In addition, GASB 31 requires the city to record unrealized gains and losses on its investments. During the fiscal year ended June 30, 2005 the city did not record adjustments to market value.

Our review of the city's investment activities determined that during calendar year 2007 there were five investment accounts in two financial institutions that suffered more than \$100,000 in losses on transactions and also lost a portion of their asset value. These accounts were active brokerage accounts that had a number of mutual funds and bond funds that needed constant attention. Some of these funds were invested in mortgage bonds that have

suffered severe losses. We were told that brokers from the investment firms made all investment decisions and that the Assistant Treasurer met with brokers quarterly to be updated on investment performance. However, there was no documentation of these meetings. We were also told that funds were only invested in A or AA rated investments, but our review determined that numerous investments were in holdings that were unrated or rated B or less.

The summary of the activity for accounts with losses follows:

- A review of one account disclosed that on the November 2007 statement there was a balance of \$1,310,583. This account was closed in December 2007. The November 2007 statement revealed that the investments in the account suffered a net loss of \$10,605. There were eight bond investments with callable options, including bonds from Maine, Iowa, and North Texas Higher Education. The losses were from various mutual fund holdings that suffered loss of market value.
- Another account had a balance of \$2,069,359 on the December 2007 statement and had holdings in 12 mutual funds that suffered declines in market value and also callable options on six Federal National Mortgage Association (FNMA) bonds.
- Another account had a balance of \$2,463,116 on the December 2007 statement. This account was charged fees of \$666 during December 2007 and suffered losses of \$1,846. The holdings of this account included six bonds from the Federal Home Loan Bank and two bonds from the Federal Farm Credit Bank.
- Another account had a balance of \$3,193,522 on its December 2007 statement. This account was closed during January 2008. The account incurred fees of \$781 during December 2007 and suffered losses of market value of \$1,904. The accounts holdings included five bonds from the Federal Home Loan Bank and two bonds from the Federal Farm Credit Bank.

Our review of the city's investment and banking services determined that a number of other issues exist, as follows:

- The city has no policy for the procurement of bank and investment services.

- The city has no investment/finance committee monitoring investments and their performance.
 - The city has no investment policies that provide guidelines on what and how to invest city funds.
 - The city has no guidelines on investing bond proceeds to avoid arbitrage issues.
 - The city has no internal monitoring of its return on investment, fees charged, or the exercising of investment options.
2. We also asked the city to identify the amount of any Payments in Lieu of Taxes (PILOT) it was receiving from all sources. The city indicated that in fiscal year 2003, the Fall River Housing Authority paid \$158,799 in PILOT but not in fiscal years 2004, 2005, 2006, 2007, and 2008 and that housing authorities do not pay unless they accumulate a surplus. This is not factually correct. In fact, Chapter 121 B, Section 16, of the General Laws provides for a city or town to determine an amount to be paid the city annually, in lieu of taxes, betterments and special assessments, in much the same manner as it does for other real estate and under the same conditions for abatement. The statute contemplates that a local public housing authority should pay a PILOT to assist with the cost of police, fire, and emergency medical services provided by the city as well as the cost of education for the children of the authority's tenants.

Furthermore, housing authorities have a PILOT expense account on their books that, if unpaid, understates their true operational costs. Thus DHCD, the Commonwealth's oversight agency is unaware of and is not subsidizing such authorities for these costs. This PILOT subsidy to the authority is basically a pass-through to the city in the form of indirect local aid to the city. The city has been unnecessarily losing these vital funds for the five years 2004 to 2008 and the city has lost almost \$800,000 of operating income. By not billing the authority, and the authority not recording and paying these obligations, DHCD is not aware of and the State is not fulfilling its obligation to the authority or the city for these subsidized costs. In addition, the city needs to research what other unknown PILOT sources and amounts the city is losing out on.

The city indicated that in fiscal year 2008 it received only \$309 in PILOT from other unknown sources. This does not seem reasonable and further demonstrates inadequate financial management and oversight.

3. Regarding our review of budgeted expenses, during our initial discussions with the city's new administration, we requested certain information and documentation including the city's Budget, as approved by the city Council, and a report comparing the city's Budgeted Expenditures to Actual Expenditures as of December 31, 2007. According to the Budget document approved by the city Council total funding for the city's 2007 fiscal year was \$218,475,800. This authorization included a total of \$132,475,800 for the operation of the various city departments and \$86,000,000 for the School Department. Appendix B to this report provides a Departmental breakdown of the city Council approved budget. The City Council approved a balanced budget that included projected revenues of \$219,492,281. The details of the city's projected revenues and approved tax Rate are included in Appendix A of this report. In this regard, an analysis and comparison of the expended budgets through December 31, 2007 in Appendix B demonstrates policies and accounting practices regarding the encumbering of funds that are inconsistent and contrary to municipal finance law. Specifically, as of December 31, the schools expended \$32,672,622 and encumbered \$51,372,385 whereas the rest of city government expended \$60,816,580 and encumbered \$1,715,430. Generally, an encumbrance is a reservation of funds for goods and services received but not paid for as of December 31, or for which an obligation has been incurred. This is a serious problem, which distorts and circumvents the entire budgetary and authorization process and confounds accountability and the ability to manage and govern. This practice results in blurred and overlapping fiscal years and renders the budget process meaningless, by spending funds appropriated for one year on subsequent years expenditures. These funds should ordinarily revert at year-end and become part of the "free cash" computation and certification by DOR and subject to appropriation by the city. This problem has been reported and repeated by the city's private accountants several times.

In addition to the \$218,475,800 budget authorized by the City Council, the Water Department had an operating budget of \$6,580,869, and the Sewer Department had an operating budget of \$13,085,043.

The December 31, 2007 Budget to Actual Expenditure Reports that were provided to us also raised several other issues, as follows:

- The initial report that was given to us did not agree into the total budget amount authorized by the City Council.
- The second version of the report included an inconsistent use of encumbrances by city departments. We observed that certain departments appeared to over- or under-encumber known

obligations and that the School Department encumbered significant amounts for its obligations, leaving it with smaller amounts remaining for the fiscal year. We asked the City Auditor for the city's policy on when to encumber funds, when to create an accounts payable amounts and when to create a warrant payable. We were informed that the city does not have a policy defining these three accounting principles.

- The third version of the document reporting Budgeted Expenditures to Actual Expenditures as of December 31, 2007 included expenses through November 30, 2007 and not December 31, 2007.
- A fourth version of the document reporting Budgeted Expenditures to Actual Expenditures as of December 31, 2007 was presented to us on April 24, 2007.

As previously pointed out, the city is trying to prepare for its fiscal year 2009 budget but is lacking an audit for fiscal year 2007, and its fiscal year 2008 books are not up to date and do not provide reliable data with which the mayor and the council can make informed judgments and decisions, which impacts the city's ability to effectively manage and set proper tax rates for its taxpayers.

4. We requested an aged list of receivables for real estate taxes, boat and automobile excise taxes, personal property taxes, water and sewer bills, and property in tax title. The list indicated that over \$46 million was owed the city, dating back over 10 years. Obviously, it is critical for the city's fiscal health and solvency to be more diligent in its collection activity.
5. We requested and were provided information regarding city personnel who have the use of over 100 city-owned passenger cars or light pick-up trucks. Although the reports were incomplete, the limited information provided indicated that at least 16 employees do not qualify for exempt reporting status (e.g., law enforcement), but have the daily use of such vehicles and are allowed to commute to and from their homes and work in addition to their use on city business. We also inquired whether, exclusive of public safety employees, the city includes personal use and commuting as other compensation on their Form W-2 for reporting to the federal and state revenue authorities. We were informed that, contrary to state and federal tax codes, the city does not report personal use of and commuting in city-owned vehicles as a fringe benefit for its non-law enforcement employees. Characterizing such use as "on call", "24/7," or "emergency" does not create an exemption. The city's failure in this regard results in unreported income and the loss of

- tax revenue and could expose the city to potential fines and penalties.
6. We asked the city to provide us with an analysis of city employees by Department. We were informed that as of December 31, 2007 there were 3,180 employees. We were told previously that the number of employees as of December 31, 2007 was 3,172. We were also provided with the number included in a prospectus related to a recent refinancing and the number did not agree with other numbers provided with the same document. However, we also asked the city to provide us with a recap of the total number of Form W-2s that were issued for 2007 and it showed that 4,109 W-2s were issued. The difference of 929 appears unreasonable since the city would have had to replace 929 employees due to retirement or other forms of separation. Although we requested a breakdown of the number of union, non-union, part-time, provisional, probationary, and 1099-type contracted help or labor, we were not provided with such information. This calls into question the accuracy and reliability of the city's information, internal controls, and payroll system itself.
 7. The city does not record or provide sufficient information for the amount of earned and accrued sick and vacation leave for its employees. Therefore, the extent of this liability is not disclosed on the city's financial statements. It is important that the city knows and reports this liability. Without this information, the city is unable to effectively manage its finances adequately. We have reviewed the reports provided to us for the liability for this compensable leave for fiscal year 2007; however, the information is incomplete and unreliable. The new City Auditor indicated that, although the balances for individual employees in each department were not being properly accounted for, measures were being implemented to address the problem.
 8. This city did not provide necessary information regarding the credit quality ratings issued by rating agencies and average maturities for Pension Trust Fund investments. Government Accounting Standards require that such information be disclosed.
 9. As previously indicated, the city was not able to provide us with any schedule of monthly cash needs that should be developed as part of its monthly reconciliation process, including its drawdowns of funds from the federal government. The lack of a comprehensive process for determining cash needs distorts the city's ability to accurately predict the amounts needed for short-term debt and distorts the actual costs of the debt to the city. The outstanding balance of short-term debt, Revenue Anticipation Notes and Bond Anticipation Notes as of June 30, 2007 was \$32,147,000.

10. The Massachusetts Office of Educational Quality and Accountability (OEQA) examined the Fall River Public School District and issued a report in March 2004. The report, titled, "School District Examination Report: Fall River Public Schools," indicated that the Fall River School District was among the lower-performing system in the Commonwealth. The significant financial issues of the review included:

- The district does not meet the standard of having a budget process that is clear and well documented, as well as integrating the District's Improvement Plan.
- The district does not meet the standard of implementing a review process to determine the cost-effectiveness of all its programs, initiatives, and activities as part of its budget process.
- The district does not meet the standard of preparing and submitting required local, state, and federal financial and audit reports in a timely manner.
- The district does not have procedures and systems to ensure that budget decisions include a review of related student performance data.

On May 10, 2004, the Fall River School System was informed that the state's Education Management Audit Council had voted to place the system on its watch list. The correspondence detailed specific aspects of its process, including the development of a Corrective Action Plan. As a result of the review, the OEQA assigned a monitor to the district.

We reviewed the report's findings as well as the resulting Corrective Action Plan with the school district's Chief Financial Officer. Corrective actions that were taken included upgrades to the Student Information System and the city's MUNIS Accounting System. After reviewing the actions taken by the district, OEQA took the district off its watch list on April 9, 2007.

Recommendation

It is important that the city implement corrective action on the issues noted in this report and on the numerous accumulated reportable conditions, findings,

exceptions and deficiencies noted in the library of prior reports from its private accounting firm, the DOE, DOR, etc., that remain to be resolved.

We recognize that to do so is an extremely difficult task to accomplish while also attending to the daily tasks of processing all the transactions and activities associated with operating the city.

To accomplish this the city should seek technical assistance and resources from DOR as well as consider recruiting outside assistance to correct all its deficiencies, as the mayor has in taking the initiative to obtain outside services to reconcile the city's cash and investments. If the city does not receive assistance and take these measures, it will always be behind on correcting its problems.

The city should prepare and adopt a written internal control plan on a citywide basis. A control plan is a high level summarization, on a citywide basis, as the result of a risk assessment of the controls used by the city to mitigate those risks. The necessary support mechanism for this high level summary, are a set of written citywide policies and procedures for the various operations the city performs and manages. A citywide risk assessment is the identification and analysis of the risks that could prevent the city from reaching its goals and objectives. This identification and analysis forms the basis for determining how the risks should be managed and the written policies and procedures for each operation of the city will reflect the evaluation. However, the establishment of the city's mission and goals is a precondition to any risk assessment.

The mayor should designate an individual within his office to implement this plan as part of a management, budget and accountability unit with the first priority of ensuring the city is audit ready and that all the resources of a new Department of Community Finance are dedicated to reaching this goal every year in order to be able to improve management through program evaluation. The timely reporting of the city's financial condition through the audit process is the first step in the financial management evaluation process.

Other issues that should be addressed immediately include the following:

- Conduct an internal review of investment performance relative to losses experienced and determine options available for recovery. In this regard, the State Attorney General's Office should be contacted to conduct an investigation to determine whether it is possible to recover any funds for the losses it suffered from deceptive investment practices by investment firms.
- A Revenue Enhancement Committee, chaired by the mayor or his designee, should be established. The committee should regularly monitor and manage the city's cash and investments following the guide issued by the state's Office of the Inspector General for the purpose of maximizing return and avoid the loss of principle, this should include timely reconciliation of all accounts. Moreover, the committee should conduct a comprehensive cost and rate study for its water, sewer and solid waste services and determine the extent of subsidy, if any, the tax base should bear. This study needs to include all costs, direct and indirect. In this regard, the city must develop written responsible indirect cost allocation plan that must be updated periodically. In conjunction with this study, a determination should be made as to the completeness and reasonableness of the system to detect any users who are not paying for appropriate usage either because of faulty meters or illegal evasion. The city should then decide whether it should convert its solid waste service to an enterprise fund operation. In addition the committee should determine whether all entities are paying the correct annual PILOT payments to the city; institute procedures to collect past-due delinquent revenues for real estate taxes, motor vehicle and boat excise taxes, and water and sewer bills; and develop and implement strong and effective collection policies to reduce the city's taxes and bills receivable and property going into tax title.
- A Capital Project/Debt Management Committee, chaired by the mayor or his designee, should be established to identify and prioritize the city's long-term fixed asset and infrastructure needs and determine a capability and schedule of funding.
- The mayor should direct the new City Auditor to establish formalized internal control policies and procedures that include procedures to ensure that all parcels are taxed and all utility users are billed. Moreover, these two separate functions should be periodically reconciled with each other to determine the existence of any untaxed or unbilled parcels or properties. The City Auditor should also establish control procedures regarding the use of city vehicles, mileage logs, gasoline consumption, and personal use reporting.

However, we also recognize that correcting these issues on an individual departmental basis has limited benefit and does not address the issues that may remain undetected because of the nature of an audit.

It is therefore essential that in addition to the corrective actions recommended above the city's overall problems be addressed systemically once, for Fall River, and

for all communities across the Commonwealth who are finding themselves in similar situations. A systemic statewide solution will in the long-term relieve the strain on the state oversight agencies as well as help struggling communities begin to manage their community and finances in a business like fashion.

Since communities are regulated, overseen, and monitored by state agencies such as DOR, DOE, and DHCD, it is essential that the Commonwealth provide them with adequate resources and technical assistance. DOR, for example, could be reviewing local reports and data on-line and in real time, and providing the necessary technical assistance so that it can approve property valuations and tax rates without delay based on complete, accurate, and reliable data. Since DOR already has authority in this regard under Chapter 44, Section 36, of the General Laws, it could take the lead on such an enhanced initiative. A system could also be devised to capture property sales value information from the counties so that values and tax rates are more current than the system now in place, in which the tax rate set for fiscal 2008 is based on calendar year 2006 sales for values established as of January 2007.

Such an undertaking would require strong leadership and cooperation of the Legislature, DOR, DOE, DHCD, the Executive Office for Administration and Finance, and a select group from the associations of local assessors, accountants, auditors, treasurers, and public accounting firms, with demonstrated expertise in municipal accounting.

2. INFORMATION TECHNOLOGY AND MANAGEMENT NEEDS TO BE IMPROVED

Our review noted various areas in the city's mission-critical Information Technology (IT) operations that could be improved. Specifically, we found that IT staffing levels and training were not sufficient; a citywide review of IT needs had not been conducted; written policies and procedures for citywide IT operations, disaster recovery and business continuity, and IT security had not been developed; and a formal IT risk assessment process had not been established. Given the city's increasing dependence on computerized IT systems to carry out its operations and to process, maintain, and report essential information, it is of the utmost

importance that the systems that process, maintain, and report such data be as reliable as possible.

There are three independent IT organizations (City Hall, the School Department, and the Police Department) maintaining separate data centers in the city. The operation of the city's financial management system by the City Hall's IT department, from a business operations perspective, is mission critical. Our review, which included an analysis and evaluation of staffing, budget, strategic planning, documented policies and procedures, staff training, and the degree of oversight of the IT management structure, determined that the following areas of IT operations needed improvement:

- Our review determined that all three IT departments had concerns regarding maintaining sufficient skilled staff to support their IT departments. The School Department had the largest IT staff with 13 positions, followed by the Police Department with five positions, and the City Hall IT Department with three positions. Given the need to modernize and support the city's IT infrastructure, provide IT services, and be able to address staff shortages in these areas due to sickness or vacation, the City Hall IT Department's staffing levels appear to be deficient. In addition, the three IT departments expressed a need to maintain sufficient training for their staffs to keep them up-to-date with changing technology standards.
- We determined that a citywide review of the common needs of the IT departments of City Hall, the School Department, and the Police Department is needed. Moreover, the separate IT departments need to identify budget requirements based on IT infrastructure enhancement and provision of IT services.
- Our review determined that there is no business continuity planning documents for any of the three data centers and that there are no plans for replacing out-of-date equipment and software. Although the School Department's website has a 52-page technology plan that addresses the school's current status, mission, and goals, there is no such extensive planning in the other IT departments.
- Our review determined that IT policies and procedures were insufficient for citywide IT functions, including: IT security, confidentiality, and maintainability, and availability requirements of IT systems and networks.
- Our review determined that there is no formal IT risk assessment process or framework in place. Accordingly, it is unlikely that there is a sufficiently detailed understanding of IT risk across city departments or that management

control practices for IT processes have sufficient control in place and in effect to prevent or detect undesired IT-related events.

Our review also determined that there is no documented disaster recovery or business continuity plan for the city that has been tested. The city does not have a designated alternate processing site and has not conducted any scripted disaster recovery tests. Further, it has not specifically identified, through risk assessment and criticality assessment, the business continuity requirements of all city departments. Accordingly, there is inadequate assurance that IT systems could be recovered in an acceptable period of time in the event of a disaster.

Recommendation

The city should:

- Conduct a citywide review of the common needs of its IT units, including the various IT functions within City Hall, the School Department, and the Police Department. This review should determine the near-term and long-term IT infrastructure and network enhancements and up-grades that are needed and identify IT staffing needs.
- Develop written policies and procedures for its citywide IT operations that define and describe various IT functions, including: IT security, data confidentiality, system maintainability, and availability requirements.
- Conduct a citywide risk assessment to determine whether sufficient IT controls and management controls are in place to detect and prevent undesired IT-related events.
- Develop written policies and procedures for disaster recovery or business continuity of its IT operations. The city should designate an alternate site to utilize during an IT emergency or disaster. Further, the city should conduct a scripted disaster recovery test of its various IT functions.
- Explore ways in which it could use technology to make its functions more useful, economical, and efficient for both management and its citizens.

APPENDIX A
Taxes Authorized

	<u>FY 2008</u>	<u>FY 2007</u>	<u>FY 2006</u>	<u>FY 2005</u>
Gross Amount to Be Raised				
Appropriations	\$ 229,770,877	\$ 224,200,159	\$209,904,265	\$ 197,645,504
Other Local Expenditures	1,382,256	1,746,784	2,111,768	2,478,113
State and County Charges	8,614,854	7,634,200	7,433,989	7,132,492
Overlay Reserve	<u>1,074,476</u>	<u>966,480</u>	<u>1,012,742</u>	<u>1,000,557</u>
Total Gross Amount to Be Raised	<u>\$ 240,842,463</u>	<u>\$ 234,547,623</u>	<u>\$220,462,764</u>	<u>\$ 208,256,666</u>
Less: Estimated Receipts and Other Revenue				
Estimated Receipts from State	\$ 130,284,737	\$ 128,322,220	\$122,452,296	\$ 116,225,296
Estimated Receipts-Local	42,859,973	41,461,250	\$ 37,332,183	35,024,307
Available Funds Appropriated:				
Free Cash	-	423,663	1,698,428	5,035,302
Other Available Funds	4,003,907	4,215,735	5,338,450	234,506
Free Cash and Other Revenues Used to Reduce Tax Rate	<u>1,100,000</u>	<u>1,466,666</u>	<u>1,833,334</u>	<u>2,200,000</u>
Total Estimated Receipts and Revenues	<u>\$ 178,248,617</u>	<u>\$ 175,889,534</u>	<u>\$168,654,691</u>	<u>\$ 158,719,411</u>
Net Amount to Be Raised (Tax Levy)	<u>\$ 62,593,846</u>	<u>\$ 58,658,089</u>	<u>\$ 51,808,073</u>	<u>\$ 49,537,255</u>
Property Valuation (000)				
Tax Rate per \$1,000 of Valuation:				
Residential	\$ 7.67	\$ 7.18	\$ 6.83	\$ 7.61
Commercial/Industrial/Personal	16.31	16.37	16.52	19.50
<u>Average Single Family Tax Bill 2007 (DOR Local Services)</u>				
Assessed Value-City of Fall River	\$ 2,303,018,000.00			
Number of Residential Parcels	8,539			
Average Value	269,589.00			
Tax Rate	7.67			
Single Family Tax Bill	2,068.00			
Statewide Rank (303 cities and towns in survey)	289			

APPENDIX B

Comparison of Budgets and Expenditures as of
December 31, 2007 for the Fiscal Year Ended June 30,
2008

<u>Department/Function</u>	<u>Budgeted Expense</u>	<u>Actual Expense</u>	<u>Encumbered</u>	<u>Available Balance</u>
City Council Salaries	\$210,394	\$99,464	-	\$110,930
City Council Expenses	2,754	480	-	2,274
Mayor's Office Salaries	320,874	166,241	-	154,633
Mayor's Office Expenses	19,208	15,610	-	3,598
Mayor's Office Civic Celebration Exp.	750	-	-	750
Reserve Fund Expenses	86,044	-	-	86,044
Auditor's Office Salaries	330,998	168,470	-	162,528
Auditor's Office Expenses	131,200	17,081	17,554	96,565
Purchasing Department Salaries	133,022	62,983	-	70,039
Purchasing Department Expenses	776	379	-	397
Purchasing Department Capital	30,000	3,838	-	26,162
Purchasing City-Wide Expenses	75,578	29,005	2,527	44,046
Assessor's Office Salaries	323,444	154,054	-	169,390
Assessor's Office Expenses	56,350	15,171	10,534	30,645
Treasurer's Office Salaries	257,093	134,586	-	122,507
Treasurer's Office Expenses	94,328	26,334	(3,311)	71,305
Collector's Office Salaries	289,324	140,134	-	149,190
Collector's Office Expenses	35,395	12,058	-	23,337
Law Department Salaries	271,014	143,364	-	127,650
Law Department Expenses	491,436	426,657	1,293	63,486
Personnel Department Salaries	215,240	94,392	-	120,848
Personnel Department Expense	101,050	54,242	-	46,808
Computer Room Salaries	161,643	77,572	-	84,071
Computer Room Expenses	378,672	276,024	80,954	21,694
Computer Room Capital	50,000	15,795	10,000	24,205
Mailroom Salaries	33,947	16,882	-	17,065
Mailroom Expenses	231,000	75,981	17,502	137,517
Print Shop Salaries	48,467	22,016	-	26,451
Switchboard Salaries	65,488	32,540	-	32,948
Switchboard Expenses	230,000	109,007	-	120,993
City Clerk Salaries	249,759	118,899	-	130,860
City Clerk Expenses	31,300	13,894	261	17,145
Election Commission Salaries	238,908	129,576	-	109,332
Election Commission Expenses	74,900	46,842	-	28,058
Planning Department Salaries	160,523	79,375	-	81,148
Planning Department Expenses	55,625	21,032	22	34,571
Engineering Division Salaries	177,459	75,311	-	102,148
Engineering Division Expenses	1,800	620	-	1,180
Conservation Commission Salaries	51,513	23,715	-	27,798
Conservation Commission Expenses	1,445	85	-	1,360

APPENDIX B (Continued)

<u>Department/Function</u>	<u>Budgeted Expense</u>	<u>Actual Expense</u>	<u>Encumbered</u>	<u>Available Balance</u>
License Board Salaries	36,752	18,106	-	18,646
License Board Expenses	3,245	858	-	2,387
Police Department Salaries	19,236,716	9,542,858	-	9,693,858
Police Department Expenses	809,991	430,064	67,125	312,802
Traffic & Parking Salaries	-	846	-	(846)
Traffic & Parking Expenses	2,258	143	-	2,115
School Traffic Salaries	223,650	60,761	-	162,889
School Traffic Expenses	903	-	-	903
Traffic & Parking Salaries	274,242	132,323	-	141,919
Traffic & Parking Expenses	106,677	42,218	15,667	48,792
Parking Maintenance Salaries	30,253	14,914	-	15,339
Parking Maintenance Expenses	11,739	785	6,452	4,502
Environmental Police Salaries	216,471	100,895	-	115,576
Animal Control Salaries	115,500	52,959	-	62,541
Animal Control Expenses	72,000	13,111	26,885	32,004
Fire Department Salaries	15,002,813	7,315,747	-	7,687,066
Fire Department Expenses	520,973	197,027	29,123	294,823
Fire Department Out-of-State Travel	1,500	185	-	1,315
Fire Department Capital Expenses	20,000	20,000	-	-
Emergency Medical Services Salaries	1,966,152	993,774	-	972,378
Emergency Medical Services Exp.	163,021	83,879	24,163	54,979
Emergency Management Salaries	10,000	5,000	-	5,000
Emergency Management Expenses	5,000	1,558	883	2,559
Code Enforcement Salaries	447,751	219,218	-	228,533
Code Enforcement Expenses	10,908	6,252	102	4,554
Harbormaster Salaries	2,500	1,250	-	1,250
Harbormaster Expenses	5,500	-	390	5,110
School Retirement Contribution	3,064,521	1,723,294	-	1,341,227
School Debt Principal	5,010,000	480,000	-	4,530,000
School Debt Interest	3,795,031	2,541,963	-	1,253,068
School Temporary Loan Interest	793,440	-	-	793,440
Regional Vocational High School	2,165,552	1,195,967	-	969,585
Bristol Agricultural School	75,100	-	-	75,100
Padula Payback	366,667	-	-	366,667
Highways Solid Waste Salaries	3,541,232	1,697,155	-	1,844,077
Highways Solid Waste Expenses	3,475,930	1,386,542	1,227,192	862,196
Highways Solid Waste Capital Exp.	49,762	19,762	-	30,000
Building Division Salaries	527,827	262,277	-	265,550
Building Division Expenses	620,943	285,335	61,647	273,961
Building Division Capital Expenses	75,000	39,643	3,698	31,659
Snow Removal Salaries	55,000	44,544	-	10,456
Snow Removal Expenses	271,243	137,198	18,447	115,598
Sanitary Inspection Salaries	190,039	90,362	-	99,677

Appendix B (Continued)

<u>Department/Function</u>	<u>Budgeted Expense</u>	<u>Actual Expense</u>	<u>Encumbered</u>	<u>Available Balance</u>
Sanitary Inspection Expenses	2,706	2,089	-	617
Health-Minimum Housing Salaries	87,968	44,396	-	43,572
Weights and Measures Salaries	46,188	22,459	-	23,729
Weights and Measures Expenses	1,063	524	-	539
Medical Inspections - Schools Salaries	278,273	152,211	-	126,062
Medical Inspections - Schools Exp.	2,625	487	-	2,138
Health All Other Salaries	35,031	17,666	-	17,365
Preventive Care Expenses	1,462	974	-	488
Health Administration Salaries	121,761	83,725	-	38,036
Health Administration Expenses	205,425	35,235	23,404	146,786
Council On Aging Salaries	292,216	154,847	-	137,369
Council On Aging Expenses	78,323	56,620	17,960	3,743
Veterans Benefits Salaries	188,308	93,075	-	95,233
Veterans Benefits Expenses	1,625,800	908,685	128	716,987
Library Salaries	677,266	323,916	-	353,350
Library Expenses	348,572	146,433	16,413	185,726
Armory Commission Expenses	51,741	7,234	-	44,507
Cemeteries Salaries	329,547	133,683	-	195,864
Cemeteries Expenses	29,596	8,032	3,387	18,177
Trees Expenses	6,105	1,046	-	5,059
Trees Capital Expenses	100,000	24,400	-	75,600
Parks Salaries	756,364	381,962	-	374,402
Parks Expenses	216,299	88,963	3,875	123,461
Recreation Salaries	47,625	38,337	-	9,288
Recreation Expenses	62,102	627	2,668	58,807
Civic Celebration Expenses	33,396	1,714	-	31,682
City Debt Other Principal Expense	2,750,000	1,890,000	-	860,000
City Debt Other Interest Expense	1,186,569	967,544	-	219,025
City Debt Other Leases	431,250	308,551	28,485	94,214
Cherry Sheet Assessments	8,422,934	546,173	-	7,876,761
Retirement Board Medicare Match	-	3,669	-	(3,669)
Retirement Contributions	9,252,192	4,431,328	-	4,820,864
Pensions	39,056	(1,367)	-	40,423
Workman's Compensation	235,000	107,040	-	127,960
Workman's Comp. Medical Exp.	500,000	95,124	-	404,876
Unemployment Payments	82,000	46,527	-	35,473
Medicare Match	460,000	194,853	-	265,147
Employees Group Insurance Expense	33,200,000	16,845,656	-	16,354,344
Claims and Damages	670,000	242,936	-	427,064
Property Insurance	450,000	290,044	-	159,956
Liability Insurance	78,514	60,680	-	17,834
Subtotal City Departments	<u>\$132,475,800</u>	<u>\$60,816,580</u>	<u>\$1,715,430</u>	<u>\$69,943,790</u>

Appendix B (Continued)

**Comparison of Budgets and Expenditures as of
December 31, 2007 for the Fiscal Year Ended
June 30, 2008**

School Department

<u>Department/Function</u>	<u>Budgeted Expense</u>	<u>Actual Expense</u>	<u>Encumbered</u>	<u>Available Balance</u>
Profession Salaries	\$56,810,757	\$20,416,074	\$35,567,395	\$827,288
Clerical Salaries	1,214,271	681,770	691,475	(158,974)
Other Salaries	11,047,437	5,638,947	5,036,310	372,180
Contractual Services	14,743,734	4,891,974	9,585,219	266,541
Supplies and Materials	1,856,351	932,068	362,969	561,314
Other Expenses	109,450	55,497	41,680	12,273
Environmental Contracts	<u>218,000</u>	<u>56,292</u>	<u>90,337</u>	<u>71,371</u>
Subtotal	<u>\$86,000,000</u>	<u>\$32,672,622</u>	<u>\$51,375,385</u>	<u>\$1,951,993</u>
 Total City-Wide Budget	 <u>\$218,475,800.</u>	 <u>\$93,489,202</u>	 <u>\$53,090,815</u>	 <u>\$71,895,783</u>

APPENDIX C *AS REPORTED IN THE LATEST FISCAL YEAR 2006 ANNUAL AUDIT**Balance Sheet****CITY OF FALL RIVER, MASSACHUSETTS**

Balance Sheet

Governmental Funds

June 30, 2006

	<u>General Fund</u>	<u>Stabilization</u>	<u>Public Parks & Open Space Improvements</u>	<u>Nonmajor Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS					
Cash and investments	\$ 8,454,613	\$ 2,281,415	\$ 2,739,140	\$ 34,837,818	\$ 48,312,986
Receivables:					
Real estate and personal property taxes	4,402,409				4,402,409
Tax liens and foreclosures	1,727,486				1,727,486
Motor vehicle and boat excise	3,025,585				3,025,585
Other excise	63,943				63,943
Intergovernmental	944,840			10,406,679	11,351,519
Loans receivable				9,808,266	9,808,266
Notes receivable				818,808	818,808
Departmental and other	3,431,184			186,285	3,617,469
Due from other funds	<u>5,164,369</u>			<u>4,830</u>	<u>5,169,199</u>
Total assets	<u>\$ 27,214,429</u>	<u>\$ 2,281,415</u>	<u>\$ 2,739,140</u>	<u>\$ 56,062,686</u>	<u>\$ 88,297,670</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Warrants payable	\$ 1,311,728	\$	\$ 1,310,665	\$ 1,451,524	\$ 4,073,917
Accounts payable and accrued expenses	4,416,414		804,595	1,770,538	6,991,547
Notes payable			12,924,350	34,520,650	47,445,000
Retainage payable			772,123	729,400	1,501,523
Due to other governments				592,109	592,109
Due to other funds	705			38,027	38,732
Other liabilities	567,381				567,381
Deferred revenue	<u>10,935,815</u>			<u>14,252,096</u>	<u>25,187,911</u>
Total liabilities	<u>17,232,043</u>		<u>15,811,733</u>	<u>53,354,344</u>	<u>86,398,120</u>
Fund balances:					
Reserved for:					
Encumbrances	1,030,225				1,030,225
Debt service	330,220				330,220
Stabilization		2,281,415			2,281,415
Petty cash	14,225				14,225
Designated for:					
Authorized deacher deferral	(1,833,334)				(1,833,334)
Unreconciled cash difference	1,500,000				1,500,000
Appropriation deficit	159,328				159,328
Unreserved	8,781,722		(13,072,593)		(4,290,871)
Undesignated, reported in nonmajor:					
Special revenue funds				15,244,826	15,244,826
Permanent funds				2,477,880	2,477,880
Capital project funds				<u>(15,014,364)</u>	<u>(15,014,364)</u>
Total fund balances	<u>9,982,386</u>	<u>2,281,415</u>	<u>(13,072,593)</u>	<u>2,708,342</u>	<u>1,899,550</u>
Total liabilities and fund balances	<u>\$ 27,214,429</u>	<u>\$ 2,281,415</u>	<u>\$ 2,739,140</u>	<u>\$ 56,062,686</u>	<u>\$ 88,297,670</u>

APPENDIX D *AS REPORTED IN THE LATEST FISCAL YEAR 2006 ANNUAL AUDIT**CITY OF FALL RIVER, MASSACHUSETTS**

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

For the Year Ended June 30, 2006

	General Fund	Stabilization	Public Parks & Open Space Improvements	Nonmajor Governmental Funds	Total Governmental Funds
REVENUE					
Real estate and personal property taxes	\$ 50,012,386	\$	\$	\$	\$ 50,012,386
Motor vehicle and other excise taxes	6,108,641				6,108,641
Penalties and interest on taxes	871,179				871,179
Licenses and permits	1,491,134				1,491,134
Fines and forfeitures	1,041,599				1,041,599
Investment income	1,004,973	57,159		89,229	1,151,361
Intergovernmental:					
Capital grants	6,795,837			438,275	7,234,112
Operating grants	133,490,085			35,280,621	168,770,706
Charges for services	4,916,667				4,916,667
Payments in lieu of taxes	107,078				107,078
Miscellaneous	3,386,089			6,351,154	9,737,243
Total revenues	209,225,668	57,159		42,159,279	251,442,106
EXPENDITURES					
General government	4,558,213	7,992		249,741	4,815,946
Public safety	33,851,726			948,326	34,800,052
Education	102,120,272			28,253,865	130,374,137
Public works	8,407,834			9,278,937	17,686,771
Community and economic development	746,685			11,234,738	11,981,423
Health and human services	3,861,270			232,153	4,093,423
Culture and recreation	1,381,862		11,019,919	836,906	13,238,687
Pension benefits	9,994,284				9,994,284
Property and liability insurance	502,514				502,514
Health and other insurance	32,010,333				32,010,333
Claims and judgments	774,106				774,106
State and county charges	7,270,225				7,270,225
Debt service:					
Principal payments	5,175,000			200,000	5,375,000
Interest and fiscal charges	5,101,640			105,435	5,207,075
Total expenditures	215,755,964	7,992	11,019,919	51,340,101	278,123,976
Excess (deficiency) of revenues over expenditures	(6,530,296)	49,167	(11,019,919)	(9,180,822)	(26,681,870)
OTHER FINANCING SOURCES (USES)					
Proceeds from long-term borrowing				(2,500,936)	(2,500,936)
Transfers in	6,571,759			2,991,367	9,563,126
Transfers out	(669,901)		(384,594)	(7,390,259)	(8,444,754)
Total other financing sources and uses	5,901,858		(384,594)	(6,899,828)	(1,382,564)
Net change in fund balances	(628,438)	49,167	(11,404,513)	(16,080,650)	(28,064,434)
Fund balances-beginning, restated	10,610,824	2,232,248	(1,668,080)	18,788,992	29,963,984
Fund balances-ending	\$ 9,982,386	\$ 2,281,415	\$ (13,072,593)	\$ 2,708,342	\$ 1,899,550

APPENDIX E

City of Fall River					
Bonds Authorized and Issued					
FY 2007					
	Outstanding	New Debt	Debt	Outstanding	Interest Paid
Inside the Debt Limit	July 1, 2006	Issued	Retired	June 30, 2007	FY 2007
Buildings	\$ 9,830,000	\$ 2,545,000	\$ 840,000	\$ 11,535,000	\$ 523,047
School Buildings	5,620,000	10,300,000	395,000	15,525,000	491,097
School-All Other	2,619,000	-	120,000	2,499,000	130,488
Sewer	4,779,760	750,000	448,895	5,080,865	162,667
Other Inside	1,032,000	14,900,000	65,000	15,867,000	391,831
Sub-total Inside Limit	<u>\$ 23,880,760</u>	<u>\$28,495,000</u>	<u>\$ 1,868,895</u>	<u>\$ 50,506,865</u>	<u>\$1,699,130</u>
Long Term Debt					
Outside the Debt Limit					
School Buildings	\$ 64,009,000	-	\$ 3,835,000	\$ 60,174,000	\$3,170,956
Sewer	78,094,375	\$ 6,125,538	1,996,144	82,223,769	1,809,827
Water	18,478,271	3,945,000	1,314,304	21,108,967	569,283
Other Outside	3,220,000	-	220,000	3,000,000	193,205
Sub-total Outside the Limit	<u>\$163,801,646</u>	<u>\$10,070,538</u>	<u>\$ 7,365,448</u>	<u>\$166,506,736</u>	<u>\$5,743,271</u>
Total Long Tern Debt	<u>\$187,682,406</u>	<u>\$38,565,538</u>	<u>\$ 9,234,343</u>	<u>\$217,013,601</u>	<u>\$7,442,401</u>
Short Term					
Revenue Anticipation Notes					
School Buildings	\$ 27,400,000	\$39,100,000	\$35,668,000	\$ 30,832,000	\$1,072,332
Sewer	4,100,000	865,000	4,100,000	865,000	161,783
Water	1,945,000	-	1,945,000	-	7,699
Other	14,000,000	450,000	14,000,000	450,000	355,885
Sub-total Short Term Notes	<u>\$ 47,445,000</u>	<u>\$40,415,000</u>	<u>\$55,713,000</u>	<u>\$ 32,147,000</u>	<u>\$1,597,699</u>
Total Of All Debt	<u>\$235,127,406</u>	<u>\$78,980,538</u>	<u>\$64,947,343</u>	<u>\$249,160,601</u>	<u>\$9,040,100</u>

APPENDIX F

Responses to Items Requested During Audits December 31, 2007

		YES/NO	Inadequate
1.	Comparison of budget to actual for all funds as of December 31, 2007, listing total budget, expenditures as of December 31, 2007, and balances available. Both Income and Expenses.	YES	Three attempts. Document received April 25, 2008
2.	Identify all projected budget shortfalls through June 30, 2008 and planned resolutions. Both Income and Expenses.	YES	An analysis was provided projecting October 31, 2007 data through the FY to June 30, 2008.
3.	Indicate the last month for which cash has been reconciled, the variances and problems reconciling.	NO	
4.	Has the city determined the liability for compensated absences? If not, what plans have been made to do so? Consider requesting all departments to identify and document the obligation.	NO	Some data was received but the Treasurer is not sure if all employees are included.
5.	A copy of the city's "Tax Rate Recapitulation" for fiscal year 2008, with all accompanying support schedules.	YES	
6.	Aged receivables due as of December 31, 2007, Gross and Net of Reserve for Uncollectible separately for Real Estate Taxes, Vehicle Excise Taxes, Boat Licenses, Water and Sewer, Tax Title and Personal Property	YES	Data was received but the Gross and Doubtful Accounts were not provided.
7.	Summary of all Tax Incentive Finance Agreements, Fiscal Terms and Conditions?	YES	
8.	Balance of BFI Settlement Funds available?	YES	Fund should be depleted by 2009.
9.	Source of "Payment in Lieu of Taxes", Amount, basis for and frequency of payment?	YES	
10.	Aged Loans Receivable as of 12/31/07 gross and net amounts due, Source of Funds for housing and capital assistance loans?	YES	
11.	Is there a Community Development Department as part of the city?	YES	
12.	Total number of city employees for each category: union, non-union, part-time, provisional?	YES	We were provided with three different analyses that varied and in one instance the details did not agree with total.
13.	Status of all collective bargaining agreements?	YES	
14.	Employee share of Health Insurance, Pension?	YES	

APPENDIX F (Continued)

15.	Unfunded Pension Liability Target date for full funding?	YES	
16.	Workers Compensation Insurance Costs, Rating, Number of Employees out due to on the job causes?	YES	
17.	Latest Management Letter associated with fiscal year audit. We will be requesting further information as we proceed?	YES	Management Letter for the 2006 audit was received February 26, 2008. The 2007 audit has not been performed.
18.	Identify the amount of Restricted Net Assets as of June 30, 2007 and December 31, 2007 and the nature of the restriction?	YES	Data that was received was incomplete. Request for additional data was not provided.
19.	Do the proprietary, business type, water and sewer enterprise fund costs include all indirect, administrative, overhead, Pension, Health, Worker's Compensation, Medicare, fringe benefits related to these operations but paid by other funds. If not, why and how much does this amount to?	NO	The city does not have a methodology to allocate cost that is in compliance with DOR or OMB regulations.
20.	What is the nature of Claims and Judgment Payable?	YES	
21.	In the Pension Trust Fund what is the nature of the receivables due from Employer, Employee and Other, and what is the Gross amount due, not net of uncollectible allowance, and why is the amount uncollectible?	YES	
22.	What is the status of corrective action on issues noted in the Management Letter associated with the latest audit of the city?	YES	There is a corrective action plan that has not been forwarded to federal funding agencies for approval.
23.	Copy of 2008 Tax Recap approved by DOR. The one provided is not approved by DOR?	YES	
24.	Copy of 2007 Tax Recap approved by DOR?	YES	
25.	Are water and sewer rates billed on a sliding scale that is reduced as volume increases, or are they flat rates?	YES	
26.	Please provide a the listing of all bank accounts by account number, purpose, and contact people controlling the cash and investment accounts?	YES	Listing was incomplete. This was a finding in the last audit that was performed.
27.	Please provide us with the Accounts Receivable Detail Report in a database format (Excel or Access) as opposed to the word pad format that it was originally provided?	YES	An EXCEL listing was received on April 24, 2008 but its accuracy was questioned.
28.	Any worksheets documenting most recent water rate. Any study undertaken to determine the city's annual water consumption and/ or annual water output?	NO	No usage studies have been made.
29.	Worksheets documenting most recent sewer rate. Any study undertaken to determine the city's	NO	No studies have been made.

APPENDIX F (Continued)

	annual sewer consumption/ treatment?		
30.	Any water/sewer study comparing cost of operations versus revenue generated, i.e. is there a revenue shortfall or not?	NO	There is no comparison of actual cost to operate to revenues received.
31.	Any citywide or Departmental internal control plans, policies or documentation?	NO	
32.	Any citywide or Departmental risk assessment that has been performed?	NO	We received an insurance risk worksheet but an assessment of risk needed to establish an internal control plan has not been undertaken.
33.	Any citywide or Departmental Cost Allocation Plan?	NO	
34.	Any policies and procedures used for determining programmatic cash needs and drawing down necessary Federal funds?	NO	There is no policy that would comply with federal regulations.
35.	Any citywide Capital Projects Plan?	YES	
36.	Any policies and procedures for determining programmatic cash needs and drawing down necessary federal funds, i.e. cash flow analysis?	YES	
37.	Provide a copy of latest Audit Report and Management Letter for the Fall River School System?	YES	The last Single Audit of the School District was for the fiscal year ended June 30, 2005.
38.	Please indicate the number of properties delinquent on their taxes that had (a) liens placed against title, and (b) placed into tax foreclosure and the amount of taxes related to each group in fiscal year 2007?	NO	The city could not provide this report as of June 30, 2007.
39.	Provide the balances for the above information as of December 31, 2007?	YES	We were provided two reports as of December 31, 2007.
40.	Provide any and all cash flow documents to support any borrowing during calendar year 2007?	YES	
41.	Provide us with copies of all payroll manuals, as well as any additional payroll policies and procedures?	YES	
42.	Provide us with a summary of the number of city employees, by Department as of December 31, 2007?	YES	We were provided with three different analyses that varied and in one instance the details did not agree with total.
43.	Provide us with a copy of the last payroll run for December 2007?	YES	

APPENDIX F (Continued)

44.	Have inspections been performed on the city's dams and bridges? If yes, as of what date? Has the estimated cost to repair these structures been determined? If yes, what is the total and as of what date?	YES	
45.	If the dams and bridges were inspected did an engineer perform the inspection?	YES	
46.	Was a total cost to repair dams and bridges determined by professional engineers? If yes, what is the total?	YES	
47.	What is the estimated total cost and who is paying for the repairs in and around city Hall and over the Highway?	YES	
48.	Are there any State or Federal Highway funds used or allocated to the city Hall repair project?	YES	
49.	Are all city departments using the city's MUNIS software to inventory and control land, buildings and equipment? If yes, could you provide us with copies of inventory reports for land, buildings and equipment as of December 31, 2007?	NO	
50.	If the city is not using MUNIS to safeguard assets, what systems are in place to safeguard assets? Could you provide us with copies of any and all inventory reports for land, buildings and equipment as of December 31, 2007?	NO	Not all Departments use MUNIS. We were given several listings from individual departments.
51.	Are all city-owned assets tagged with an identifying reference number? Is that number included in the Departmental inventory records? Are all city-owned assets compared to inventory reports at least once a year to confirm existence and to account variances? If yes, we will need any correspondence or adjusting entries that may support this periodic comparison?	NO	
52.	Could you provide us with any and all policies and procedures that the city's many Departments have adopted for safeguarding all tools, building supplies, plumbing supplies, landscape supplies, automotive supplies and gasoline. Could you provide us with copies of any and all usage reports or inventory reports for these items as of December 31, 2007?	NO	
53.	Could you provide us with copies of all policies and procedures for processing encumbrances, accounts payable and warrants payable?	NO	There are no policies.
54.	Could you provide us with a copy of the year-end closing instructions for the year ending June 30, 2007?	NO	

APPENDIX F (Continued)

55.	Is there a Finance Committee that periodically reviews the cost of the city's various checking accounts? If yes, could you provide a listing of the Committee's members, any minutes from meetings and any reports that they have produced? Also, to whom does the Committee report its findings and recommendations?	NO	There is no Finance Committee.
56.	Is there a Finance Committee that periodically reviews the cost and performance of the city's various investments? If yes, could we have a copy of any reports or correspondence that has been produced during calendar year 2007?	NO	The Treasurer makes all investment decisions.
57.	When making decisions concerning investment activities; such as rolling over Certificates of Deposit, exercising put/call options, or closing investment accounts, who makes those decisions and what standards are used in making those decisions?	NO	
58.	When procuring new checking accounts or investment opportunities does a Finance Committee develop the procurement guidelines or does Treasurer conduct these procurements? By the Department utilizing those services? Who makes the final selection?	NO	The Treasurer was under the impression that these services were not subject to the Bid Law.
59.	When procuring the services of any investment advisors, bond councils or brokers are there procurement guidelines that must be followed? If yes, could we have copies of the guidelines?	NO	The Treasurer was under the impression that these services were not subject to the Bid Law.
60.	Are automatic clearing house fees (ACH) and electronic transfer fees (EFT) periodically reviewed? If yes, who performs this review?	NO	
61.	Has the city reviewed its investment practices in consideration of investments losses it has incurred? Are there any new restrictions on the type of investment vehicle that the city can utilize? For example, are there restrictions on investing in mortgage bank securities, collateralized debt obligations, interest rate swaps or investing in options of any sort? If yes, can we have copies of any reviews performed or any new guidelines or restrictions adopted?	NO	There is no policy restricting how and what can be invested.
62.	Can you provide a worksheet detailing the operating revenues and operating costs of the city's ambulance service and emergency medical technicians during the year ending December 31, 2007?	NO	We were provided with a worksheet that was incomplete.
63.	Can you provide a worksheet detailing the Medicaid billings and related amounts receivable prepared by the school department for the year ending December 31, 2007?	YES	
64.	What is the acreage and dollar value of all tax-exempt (State, County, Authority, Religious, HealthCare, etc.) land within the borders of the City of Fall River?	YES	

APPENDIX F (Continued)

65.	What is the annual dollar value of the Payments in Lieu of Taxes (PILOT) received and from what sources are these payments received, including payments from the Fall River Housing Authority?	YES	
66.	Please provide us with a recap of the total number of W-2's and 1099's issued by the city for calendar year 2007. Also include the total paid for W-2 employees and for 1009 non-employees/contractors?	NO	The city could not tell us how many Form 1099's were issued for the 2007 tax year.
67.	Could you confirm if you have closed both UBS Investment/ Brokerage accounts? If yes, could you provide us with the dates that the accounts were closed out and copies of the final statements?	YES	One UBS account was closed and the second account is still open.
68.	Do you have an analysis of all investment losses and loss of market value that city investment accounts incurred? If yes, could provide us with copies?	YES	We were provided with a brief analysis that disclosed losses resulting from the sale of investments.
69.	Could you provide us with copies of the settlement sheets for all short term bonds issued during 2006 and 2007? These sheets would summarize all charges, discounts and premiums charged against the bond proceeds?	YES	

APPENDIX G

Federal and State Grants as of December 31, 2007

<u>Grant/Program</u>	<u>Budget</u>	<u>Expenses</u>	<u>Encumbrances</u>	<u>Balance Remaining</u>
SPED 94-142	\$ 3,008,512	\$ 608,510	\$ 60,166	\$ 2,339,836
Reading First FY08	469,100	84,524	14,267	370,309
Title V	36,831	18,383	1,076	17,372
Title I	5,902,738	1,042,013	490,417	4,370,308
Title IIA	1,088,474	200,648	195,865	691,961
Title III FY08	131,791	15,218	170	116,403
Title II Enhanced Ed	55,128	328	2,413	52,387
Title IV Drug Free Schools	116,718	29,079	-	87,639
McKinney	20,000	1,895	2,449	15,656
Perkins Occupational Ed	161,319	20,580	6,697	134,042
SPED Early Childhood	81,017	3,470	148	77,399
21st Century FY08	75,000	38,149	12,923	23,928
SPED Middle Read	16,520	-	-	16,520
Title I Distribution	35,000	-	-	35,000
SPED Program Improvement	62,577	6,929	11,250	44,398
Project Focus Academy	-	(7,220)	-	7,220
CPC Grant FY08	1,493,860	533,969	378,255	581,636
Kindergarten Grant	514,600	156,823	806	356,971
Mental Health Grant	77,939	12,865	39,295	25,779
Mass. Early Literacy	96,300	22,604	4,126	69,570
Expanded Day FY08	2,008,500	666,255	10,068	1,332,177
Enhanced School Health	192,522	51,023	352	141,147
Silber Reading Grant	186,830	52,564	3,054	131,212
After School	50,000	3,368	-	46,632
Expanded Planning Grant	11,000	-	3,150	7,850
Support Underperforming Schools	170,020	15,760	26,916	127,344
Academic Support	<u>156,500</u>	<u>22,357</u>	<u>-</u>	<u>134,143</u>
	<u>\$ 16,218,796</u>	<u>\$3,600,094</u>	<u>\$ 1,263,863</u>	<u>\$ 11,354,839</u>