



The Commonwealth of Massachusetts
Office of the Inspector General

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Mayor Elaine Pluta
City of Holyoke
City Hall
536 Dwight Street
Holyoke, MA 01040

Dear Mayor Pluta:

As you know, the Office of the Inspector General (OIG) previously reviewed a number of matters brought to our attention by former Mayor Michael Sullivan pertaining to the City of Holyoke's (City) Treasurer's Office. The OIG responded to these matters by issuing our findings by letter of May 4, 2007 to former City Treasurer David Donoghue.¹ In addition to the OIG's letter, the City's outside auditor Melanson Heath & Co. (MH&Co) and the Massachusetts Department of Revenue (DOR) issued reports outlining serious deficiencies in the management and activities of the Treasurer's Office between 2003 and 2009. These reports included recommendations, most of which former Treasurer Donoghue failed to adopt.

Since 2007, the OIG has periodically monitored the Treasurer's Office to determine the extent that the Treasurer addressed those findings and recommendations. Unfortunately, the Treasurer's Office under former Treasurer Donoghue remained, as one oversight agency put it, "dysfunctional," and MH&Co could not complete its audit of the City's books for Fiscal Year (FY) 2008 until 2010.

The OIG notes that despite numerous reports and yearly findings by the City's outside auditor, clear recommendations, and the pressure brought to bear on the former Treasurer by the City Council, the Mayor and others, the former Treasurer did little to remedy his office's deficiencies. These deficiencies include his failure to have an adequate accounting of City funds – a fundamental responsibility of a municipal

¹ Our findings were that under Treasurer Donoghue there was: A lack of internal controls with respect to financial reporting which could affect the City's bond rating; Payments made to vendors and a non-profit without being placed on the City's warrant articles; Lax record keeping and collection of Tax Title monies; The City Treasurer's signature stamp was not properly secured; There were late payments and related penalties for incorrect withholdings on employees Medicaid and social security; and No official hours kept by Treasurer Donoghue or his staff.

http://www.mass.gov/ig/publ/holyoke_treasurer_ltr.pdf

treasurer. A 2007 DOR report stated: "... the succession of increasingly critical management letters from the auditor [MH&Co], a harsh IG's report, and this [DOR] financial management review represent an escalation in actions intended, in part, to convey to the Treasurer the seriousness of his circumstances. To date, there is no evidence that they have captured his attention."

MH&Co's prior audit findings had including "reportable conditions" and "material weaknesses," including internal control weaknesses, since at least 2004. In 2001, a few years into Treasurer Donoghue's tenure, an employee of the Treasurer's Office had been found misappropriating funds due in large part to a lack of adequate internal controls. Mr. Donoghue made no changes in response to this theft. Six years after the theft, the 2007 DOR report found that "there is little basis, if any, to conclude that he [Donoghue] is capable of fulfilling those staff and cash management responsibilities commonly attributed to and legally required for a municipal treasurer. As a result, we are not confident that essential financial controls are consistently or effectively implemented." DOR also found the office "devoid of leadership and management, and little evidence of the Treasurer's capability or interest to initiate change."

The problems within the Treasurer's Office began to be addressed in 2010, shortly after the election of Jon Lumbra as the new City Treasurer. Based on numerous conversations with Treasurer Lumbra, the OIG believes that he has made a concerted effort to "reform" the Treasurer's Office and to address the problems long-ignored or caused by his predecessor. OIG staff met this spring with both you and Treasurer Lumbra to obtain the status of this reform effort after Treasurer Lumbra's first year in office. OIG staff reported to you in that meeting that Treasurer Lumbra had made significant progress in implementing the recommendations made by MH&Co, DOR, and the OIG and that the meeting reflected a strong spirit of cooperation between the offices of the Mayor and Treasurer.

This letter outlines the status of Treasurer Lumbra's efforts to address the issues previously identified by MH&Co, DOR and the OIG. The OIG believes that Treasurer Lumbra, with limited resources, has diligently worked towards correcting a number of problems that could have impacted the financial health of the City and that made the Treasurer's Office highly vulnerable to fraud, waste, and abuse. Treasurer Lumbra inherited a "set of books" indicative of sloppy and haphazard accounting that rendered the City's financial records unauditable for long periods of time. These books were in such a deplorable condition that they failed to provide adequate assurance that perhaps millions of dollars had not been misapplied, miscounted, or misappropriated. This letter acts to memorialize the progress made by Treasurer Lumbra in a number of areas and calls the City's attention to those issues that he is already aware of but may not have been able to address because of resource problems and other constraints.

Treasurer Donoghue's apparent disinterest or inability to effect positive change left the Treasurer's Office in disarray and in desperate need for reform when Treasurer Lumbra took office in January 2010. The following represent the major findings, issues

and recommendations made by MH&Co, DOR and the OIG since 2004 and their status according to Treasurer Lumbra after his first year in office.

- 1) Bank Reconciliations: For many years, the Treasurer's Office failed to perform bank reconciliations and failed to reconcile the "cash book" to the general ledger. MH&Co cited this as a "reportable condition" for four years and cited this as a major reason for the City's books being unauditible. MH&Co also stated that since the Treasurer acts in a "fiduciary capacity" for Holyoke Gas and Electric and the City's retirement system, the lack of proper and timely reconciliations "raises concerns whether the Treasurer's Office is meeting its fiduciary responsibilities." The prior failure to reconcile these accounts created what appeared to be millions of dollars in missing City funds. Treasurer Lumbra has since reconciled these funds and "found" the missing funds. The missing funds resulted from accounting errors. MH&Co also stated that these accounting failures could impact the City's bond rating and its ability to receive grant awards. MH&Co also found numerous reporting and posting errors indicative of sloppy bookkeeping.

In response to MHC's finding, former Treasurer Donoghue hired temporary accounting staff from a local accounting/consulting firm, Dufault, Vann & Carella, (DVC) in June 2009 to perform account reconciliation work. This was done so that the annual audit could proceed and that the City could close its books for FY2008 and FY2009. Upon taking office, Treasurer Lumbra continued to use DVC until the reconciliation work had been completed. Lumbra also hired the DVC employee that had helped to reconcile the books as Assistant Treasurer². To the OIG's knowledge, the reconciliation work has been completed to the satisfaction of the Treasurer and MH&Co, the City's external auditor.

- 2) Bank deposits, revenue and expenditures not posted to general ledger. This condition has been corrected.
- 3) Untimely bank deposits. This condition has been corrected. The office now makes daily deposits and has adopted a remote deposit system for checks whereby checks are scanned and sent directly to the Federal Reserve Bank for processing. This speeds deposits, improves cash flow and enables the City to earn more interest on deposited funds. Under the former Treasurer, checks could remain undeposited for significant periods. In fact, Treasurer Lumbra identified uncashed checks, many years old, in the office at the start of his tenure. When questioned by the OIG for our 2007 letter regarding undeposited funds, the former Treasurer stated that he remained "too busy" to make deposits.
- 4) Vendor payments without warrant approval. This condition has been corrected.

² That employee originally worked for former Treasurer Donoghue before leaving to join DVC. While employed at DVC, that employee was assigned to assist Treasurer Lumbra in this project.

- 5) Stabilization funds not transferred correctly between accounts and earned interest unreported. This condition has been corrected.
- 6) Check stamp control. The former Treasurer failed to adequately safeguard the Treasurer's check stamp which, could have been used by unauthorized persons to fraudulently endorse City checks. This condition has been corrected.
- 7) Failure to file returns/make payment. The former Treasurer failed to file federal and state returns for meals tax revenue and employee payroll taxes. This led to potential underreporting penalties for individual employees and the possible failure to have the appropriate FICA (federal insurance contributions) payments credited to an individual employee. Treasurer Lumbra has corrected this condition. However, the City had to pay nearly \$70,000 in interest to the Internal Revenue Service. This underreporting may have also impacted employee pension earnings and other benefit calculations. Unfortunately, these may not be identified until an individual employee identifies potential benefit discrepancies for themselves upon retirement.
- 8) Chronic absenteeism and a lack of rules enforcement. This condition has been corrected.
- 9) Flawed tax title process. MH&Co identified the lack of tax title receivable reconciliation procedures to be a "reportable condition." A lack of procedures meant that the City did not have a formal process to track the status of properties placed in tax title (for non-payment of property taxes) and any payments, adjustments or interest accruals made to these accounts. As a result, Treasurer Lumbra inherited "boxes" of many years worth of tax title files that may not have been processed properly. For example, some owners may have made tax payments and therefore should have been taken out of this status, the City may not have appropriately taken title to these properties through the Registry of Deeds, and these properties (now legally City property) might still appear on the City's tax rolls as private property. As a result of counting property taken by the City as private property, the City may be improperly calculating its property tax levy limit and property tax rates. Also, taking title to these properties, the City may have missed an opportunity to sell these tax titles for revenue and to generate property taxes once these properties had been placed back into private hands.

It is incumbent upon the Treasurer to work with the City Collector, City Assessor and DOR to remedy this matter in an expeditious manner. The City must recognize its obligation to give the Treasurer the resources he needs to clear up this lingering issue.

According to Treasurer Lumbra, he is not "comfortable" with any of the tax title takings before 2007. He and his staff have reviewed the takings since 2007 to ensure that they had been done properly. Treasurer Lumbra did find that a number of tax payments made by property owners during the tax title process had not been

deposited by the former Treasurer. Lumbra deposited all checks found in the Treasurer's office.

- 10) Untimely trust account transfers. This condition has been corrected.
- 11) Lack of internal controls. Significant lapses in internal controls within the Treasurer's Office as reported by MH&Co have, for the most part, been resolved. With the resources available, Treasurer Lumbra has made major improvements and has corrected the MH&Co identified "material weaknesses" that "increased risk that errors or irregularities could occur and go undetected."
- 12) Manual checks. The OIG notes that one area in need of additional control is the issuance of manual checks by the Treasurer. Treasurer Lumbra stated that he needs to issue a small number of manual checks (about 12) per year. The former Treasurer issued significantly more. Having one person with unilateral control of checks that grant access to significant sums is vulnerable to fraud, waste, and abuse. The Treasurer explained the need for manual checks and the OIG does not dispute the need or explanation offered. However, the OIG suggests that the issuance of manual checks be governed by a written procedure and as an additional control, either the Mayor or City Auditor should be required to co-sign these checks. If one or both are unavailable, for example in an emergency when a manual check must be issued, then as soon as practicable the Treasurer should notify both the Mayor and Auditor that a manual check has been issued and the Mayor or the Auditor should provide post-issuance approval.
- 13) City employees requested the suspension of payroll tax withholding for certain pay-periods to boost their take-home pay. Apparently, some (but not all) City employees could ask the former Treasurer to halt the withholding of payroll taxes for certain pay periods. This appears to have been an informal, poorly documented process highly vulnerable to abuse. In effect, this practice gave a salary increase to certain employees. This practice has been discontinued and Treasurer Lumbra has looked into whether any employees benefitted unjustly from this practice. Treasurer Lumbra informed us that he has only identified one City employee who had his withholding suspended for a year. The others had withholding stopped for "a week here or there". Treasurer Lumbra assured this office that the City did not pay any taxes for any City employee who had their withholding taxes suspended. Those City employees are liable to the IRS for any taxes that they failed to pay.
- 14) The City issued IRS Form 1099's and W2 forms to certain City employees. The former Treasurer paid employees who had full-time employment with the City and also had an additional part-time or seasonal work with separate paychecks. The former Treasurer also issued 1099 forms to those employees for their part-time positions in addition to the W2 forms for their full time position. An employee who receives a 1099 form has not had taxes taken out of their paychecks.

Treasurer Lumbra gave an example of a teacher employed by the Tree Department during the summer. Instead of including the pay earned from the Tree Department on the employee's annual W2 from the City and withholding taxes, the employee received a 1099 from the Tree Department as well a W2 from the School Department.

This practice appears to have violated federal tax regulations, altered the tax withholding status of employees, was vulnerable to fraud, waste and abuse, and may have violated the State Ethics Law (M.G.L. c.268A) regarding dual employment with the same public employer. Under Treasurer Lumbra, this practice has been discontinued and employees now receive a single W2 form for all City employment. However, this practice may still violate State Ethics Law and City employees who hold two or more appointed City positions are encouraged to contact the state Ethics Commission and request guidance from the Commission.

- 15) Improper investments. The former Treasurer may have violated M.G.L. c.44, §55B and municipal banking regulations by improperly investing City funds in low interest, high-risk investments that may have lost money for the City and that cost the city tens of thousands of dollars in unnecessary investment fees. Treasurer Lumbra has consolidated investments and continues to move funds to appropriate investment vehicles. Treasurer Lumbra should ensure that the investment process is transparent, is in the City's best interests, and wherever appropriate, be subject to open and fair procurement practices.
- 16) Suspended or abated interest on tax liens. Without adequate documentation, the former Treasurer suspended or abated interest for taxpayers. The total dollar value impact of these actions is unknown. This practice has been discontinued. However, the Treasurer maintains the authority to adjust interest under certain conditions. The OIG recommends that the Treasurer's Office develop written procedures for adjusting interest payments for taxpayers that includes documenting the reason for the adjustment and having at least one other City official, such as the City Auditor, approve the transaction. Interest adjustments should be reported to the City Auditor at least monthly and these transactions should be included in any transaction sampling/verification conducted by the City's external auditor.
- 17) The former Treasurer may have failed to make timely bond payments adding interest to City debt and jeopardizing the City's credit rating. To the OIG's knowledge, all payments are up to date and being made on-time by Treasurer Lumbra.
- 18) The former Treasurer may have improperly used the Treasurer's Office credit card. According to Treasurer Lumbra, this card had been canceled, all balances have been paid and the former Treasurer has reimbursed the City for any improper purchases with the City credit card.

- 19) The former Treasurer routinely "bounced" City checks costing the City between \$20,000 and \$40,000 annually. The City paid numerous unnecessary bank fees and charges in addition to forgoing earned interest due to poor account management and the failure to deposit City revenue collections in a timely and routine manner. Treasurer Lumbra has changed these practices saving the City tens of thousands of dollars yearly.
- 20) City insurance policies may have been canceled for non-payment of premiums. According to Treasurer Lumbra, all policies are active and payments are up to date.
- 21) The Treasurer maintained an unnecessarily high number of bank accounts with some earning little or no interest, some inactive, some being charged fees unnecessarily. Treasurer Lumbra has closed or consolidated unneeded accounts.
- 22) Treasurer's Office employees are not bonded. Only the Treasurer and one other employee of the Treasurer's Office are bonded. The OIG recommends that all Treasurer's office employees be bonded and undergo criminal background checks by the City police department.

The OIG commends Treasurer Lumbra's efforts and hopes that he can complete the task of addressing all former and current issues facing the Treasurer's Office. Because of the City's continuing financial concerns, it may be difficult for the City to allocate appropriate funds to support his continuing reform efforts. However, there appears to be support that the City can lend to the Treasurer that may only require minimal funding or no funding at all.

For example, the treasurer should continue to work to reduce the risk potential for fraud, waste, and abuse. The OIG encourages the City to implement an anti-fraud program that involves written policies and procedures for all departments (including the Treasurer's Office). These should include developing an internal control plan, drafting a code of conduct/fraud policy for employees that includes a fraud response plan, providing ethics and anti-fraud training for staff, expanding the yearly external audit to include an in-depth review (or fraud risk assessment) of a randomly selected department each year, and referring evidence of fraud or abuse to the OIG or another oversight agency.

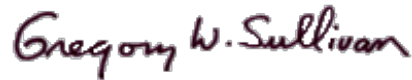
DOR had also recommended that the Mayor and City Council create and appoint an Audit Committee composed of appointees from the general public and the adoption of a City ordinance to create a Financial Team chaired by the Mayor and composed of major department heads. This Team could actively improve communications and coordination between departments regarding City finance issues. DOR also recommended that the City conduct a "systematic review of job descriptions" within City government to begin with the Treasurer's Office. This review could help ensure that the job descriptions and titles within the Treasurer's Office can meet the demands of and the strengthened accountability structure within the office. The Treasurer will be unable

to implement all necessary changes if he is impeded by out dated or insufficient job descriptions and a lack of qualified staff.

The Treasurer's Office should: 1) draft written policies and procedures; 2) review City investments and the procurement methods used to obtain investment services; 3) Identify all parcels taken by the City for tax title, properly record them on the City rolls, work with the City Tax Collector, Assessor, and Auditor to sell as many of these parcels as possible so that the City can again collect tax revenue from them; 4) work with the City Collector, City Auditor and other departments to ensure that cash collections made throughout the City by other departments or City vendors are effectively monitored and controlled; and 5) develop appropriate control, ethics, and anti-fraud policies.

I thank Mayor Pluta, Treasurer Lumbra, and their staff(s) for their cooperation and assistance during our review. If the OIG can be of further assistance or if you have any questions or concerns please do not hesitate to contact Senior Investigator Eric Knight.

Sincerely,

A handwritten signature in black ink that reads "Gregory W. Sullivan". The signature is written in a cursive, slightly slanted style.

Gregory W. Sullivan
Inspector General

cc: Jon Lumbra, City Treasurer
Joseph McGiverin, City Council President
Brian Smith, City Auditor
Melanson Health & Co.
Gerard Perry, Department of Revenue