



November 3, 2010

To: City of Portland Finance Committee, acting as Audit Committee
Joseph E. Gray, City Manager, City of Portland, Maine
Ellen Sanborn, Finance Director, City of Portland, Maine

City of Portland Department of Public Schools Finance Committee, acting as Audit Committee
James Morse, Superintendent, Portland Public Schools
Michael Wilson, Chief Financial Officer, Portland Public Schools

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Portland, Maine (the City) as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Portland, Maine's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions in the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

Our consideration of the internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all such deficiencies have been identified. However, we identified a certain deficiency in internal control, described in the accompanying schedule of significant deficiencies and other comments (*School Department Accounting System Reconciliation*) that we consider to be a significant deficiency. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our audit, we also became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. They have been identified on the attached schedule as "Other Comments".

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This communication is intended solely for the information and use of the City of Portland Finance Committee and the Department of Public Schools Finance Committee (acting as respective Audit Committees), management of the City and the Department of Public Schools, and others within the administration. It is not intended to be and should not be used by anyone other than these specified parties.

We wish to express our appreciation for the cooperation and assistance we received from the officials and employees of the City of Portland, Maine, including the Department of Public Schools, during the course of our audit. We will review the status of these comments during our next audit engagement. We have already discussed these issues with various City and School personnel, and we will be pleased to discuss it in further detail at your convenience, or to assist you in implementing the recommendations.

Very truly yours,

A handwritten signature in cursive script, reading "Raymond Weston Ouellette". The signature is written in black ink and is positioned below the closing "Very truly yours,".

CITY OF PORTLAND, MAINE
Schedule of Significant Deficiencies and Other Comments

SIGNIFICANT DEFICIENCY

School Department Accounting System Reconciliation

The City's accounting system historically, and currently, posts all School activity in a condensed account format. The Department of Public Schools historically did not maintain a separate self-balancing double entry fund accounting system. The system, up until the 2008-2009 fiscal year, only maintained expenditure data, and did so primarily to ensure budgetary compliance. Beginning in the 2008-2009 fiscal year, the School Department created additional accounts and funds in their accounting system to accommodate a full, self-balancing double entry fund accounting system. This new chart of accounts included revenue accounts and balance sheet accounts for most funds. The fact remains however, that the City's system is relied on for proper financial accounting in compliance with generally accepted accounting principles and the School system is treated as a subsidiary ledger only, for internal use as well as State Department of Education reporting. As a result, it is imperative that these two systems are fully reconciled on a monthly basis and any differences be promptly adjusted.

During the 2009-2010 year, reconciliations, although not always done timely, were performed for the general fund, the lunch fund and the adult education fund. The grant fund was also attempted, but was not fully reconciled at the time of the audit. We commend the School Department for these efforts. Finally, it was noted that the activity of certain capital funds are not being recorded in the School Department's accounting system. Although there is some question as to whether or not this is necessary, to the extent that the State Department of Education requires the information on quarterly and year end reports, the School Department will need to make accommodations to ensure this activity is posted to their accounting system.

We recommend that beginning in 2010-2011, the School Department performs reconciliations of all funds in a timely manner and posts any necessary correcting entries as soon as they are identified. The City and the School Department should work together to determine what transactions are causing difficulties in the reconciliation process, in an effort to continue to eliminate differences and provide for a less cumbersome reconciliation process. A resolution as to the need for posting of capital funds should be sought with the State Department of Education.

Management's response:

A new position, Staff Accountant, was recently created. The person who will fill that position is a CPA and has public accounting experience. New procedures will be implemented that require, among other things, performance of the duties outlined below.

- 1. The Staff Accountant will perform cash reconciliations monthly, making sure the School Department's cash account is reconciled fully to the City's School Department cash account. The Staff Accountant will prepare any necessary correcting entries. Each month the Comptroller will review and approve the monthly cash reconciliation and any necessary correcting entries prepared by the Staff Accountant, and the approved correcting entries will be posted monthly.*
- 2. The Staff Accountant will perform reconciliations of all funds monthly, making sure the School Department's system reconciles fully with the City's system. The Staff Accountant will prepare any necessary correcting entries. Each month the Comptroller will review and approve those monthly reconciliations and any necessary correcting entries prepared by the Staff Accountant, and the approved correcting entries will be posted monthly.*

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3. *Monthly, each grant accountant will perform reconciliations of the grant funds for which the grant accountant is responsible, making sure each grant fund subledger reconciles fully with the School Department's general ledger. Each grant accountant will prepare any necessary correcting entries. Each month the Staff Accountant will review and approve those monthly reconciliations and any necessary correcting entries, and the approved correcting entries will be posted monthly.*

The Staff Accountant will review and approve all journal entries prepared by other Finance Department staff, and all approved journal entries will be posted timely. The Comptroller will review and approve any journal entry prepared by the Staff Accountant, and those approved journal entries will be posted timely.

It is unclear whether the School Department needs to post the activity of certain capital funds (namely, the CIP and the Ocean Avenue School construction), as the City conducts and posts all those activities. The School Department has sought from the State Department of Education a resolution regarding its need to post that activity to its accounting system. The State Department of Education has not yet reached a determination. If the State Department of Education concludes that, despite the fact the City conducts all the activity and posts all the activity in the City's accounting system, the School Department also needs to post that activity or post the activity in summary form, the School Department will do so.

CITY OF PORTLAND, MAINE
Schedule of Significant Deficiencies and Other Comments, Continued

OTHER COMMENTS

Use and Approval of Payroll Timesheets

During our testing of controls over payroll we noted that for some department heads and supervisors there is not always an indication of a secondary review and approval on the time reporting record. In some cases, there was not even a record of time. We recommend that all employees document their time, including department heads and supervisors, and all documentation be reviewed and approved by a superior. We recommend that the City adopt a policy with a standardized time reporting system to better document employee time. We recommend that time not be entered into the payroll system unless a time record is reviewed and approved. In some cases, the department staff assumed that the payroll edit report, which is generated after payroll entry, served as a record of employees' time. Since this report is simply an edit of what was entered by the payroll clerk, it serves only as a way to check data entry. Also, this edit should be reviewed by someone other than the person entering the data.

Approval of Edit Reports for Wage Rate Changes

We attempted to ensure as part of our testing that payroll edit reports were being reviewed and approved by a responsible official. We were unable to verify that these reports had been reviewed prior to payroll being posted as these reports were unavailable. We recommend that for all changes to employee wage rates or other status changes, changes should be reviewed, approved, and matched to supporting documentation by a responsible official other than the individual making the change. This review and approval should occur prior to processing of payroll. Approval should be indicated on the payroll edit and these reports should be retained so that approval can be verified. This review would also ensure that employees are being paid based on approved pay scales. We did note in our testing one instance in which this occurred. We discovered that the non-union pay scale had not been changed even though a cost of living increase was applied to non-union wages. We recommend that all pay scales reflect the approved pay levels for all employees in order to ensure the ability to confirm that employees are being paid appropriately.

Management's response:

We have communicated with departments to ensure the understanding of time reporting and approval requirements. Department Heads are appointed and serve at the pleasure of the City Manager, so we do not expect a supervisory approval of their weekly time; however, we have told them they need to record their time weekly, especially their time off, and provide it to their payroll clerk. We have also communicated to payroll staff that the payroll edit is not a record of time.

Edit reports for wage rate changes are the responsibility of the Human Resources Department, and we have discussed with them the need to review and indicate approval and they will set up a system to accomplish this.

Non-union pay scales were not adjusted for the FY2009 cost of living increase, at the request of the City Council. This put the salary of a few of our employees above the pay scale, as they were at the top of the scale when the COLA was paid. The scale has not been adjusted so this problem will continue until the Council adjusts it.

Posting of Airline Receipts

Our revenue test work from airline receipts for passenger facility charges revealed that currently the daily deposits do not contain enough detail to determine which airlines are making the payments and for how much. Therefore, we were not able to trace the monthly amounts from the airline's quarterly reports back to the City's revenue detail. The City should develop a system that would allow enough detail to ensure that each airline's

payment could be identified. This system would ensure that the City has been reimbursed for all monthly amounts from each individual airline as well as offer a way to verify any disputed payments.

Management's response:

Cash receipting procedures have been modified to include detail on payments by vendor. In turn these descriptions are entered into the accounting system. This allows several layers of management to review the implementation of the procedure and also allow central finance staff to monitor that implementation.

Portland Public Schools

School Department Budget Compliance

State law requires that the School Committee prepare a summary budget in state required budget categories. The summary budget was approved by the School Committee on April 28, 2009. Once the budget is passed by the School Committee, authorized by the City Council, and validated by referendum vote of the citizens, it falls to the School Department's administration to track ongoing budget verses actual amounts and ensure budgetary compliance. In total, the actual expenditures were significantly less than authorized budgeted amounts; however, in reviewing state required budget category sub-totals, we noted that several individual categories were over budget. Additionally, the School Department's accounting system did not automatically generate a report that grouped individual accounts in such a way that budget compliance could be tracked. We recommend that in the current year, quarterly reports be generated summarizing total budgeted and actual expenditures by state required categories. If transfers are required, they should be approved by the School Committee in a timely manner.

Management's response:

The State budget categories group individual accounts that cross many different cost centers of the School Department, which is why the School Department's accounting system does not automatically generate a report that summarizes total budgeted and actual expenditures by the State required category. However, the School Department does use its accounting system reports generated monthly to compare actual vs. budgeted expenditures to ensure budgetary compliance. To address the State budget category issue, the School Department will use the Maine Department of Education's Budget Category Information Sheet to generate a report that groups individual accounts within the State budget categories and summarizes total budgeted and actual expenditures within those categories. Because transfers can be done any time during the fiscal year, it is unnecessary to perform this time-consuming task more frequently than twice a year to track compliance. These reports will be generated semi-annually to track budget compliance based on the State's budget categories. That will include generating a report before June 30 to determine any transfer that may be required is done during the fiscal year. Any transfers that are required based on these reports will be presented to the School Committee for approval in a timely manner.

School Department Accounting and Payroll Related Responsibilities

As part of the audit process, we provided a number of journal entries to the School Department in an effort to both correct errors and to adjust accounts to their appropriate year end balances. A number of these entries related to unrecorded accrued payroll and payroll related transactions. Although a vacancy did exist in a key payroll accounting position, we understood that the previously employed individual had been hired back on a contractual basis to prepare a number of year end schedules. However, the entries necessary to adjust and correct the accounts were not made prior to the audit because of what appeared to be some confusion as to job responsibilities and authority. Additionally, during the process of ensuring proper year end cut off, a number of issues arose

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Schedule of Significant Deficiencies and Other Comments, Continued

surrounding the posting of transactions in inappropriate periods. These issues, as well as a number of other general observations, resulted in the following conclusions and recommendations:

- The vacancy of a payroll supervisor should be addressed as soon as possible. The importance of on-going compliance in the area of payroll processing and reporting cannot be understated.
- All journal entries should be reviewed by someone (other than the preparer), who has a strong accounting background, prior to being posted into the School accounting system and prior to being provided to the City for posting at the City level.
- All general ledger accounts should be reviewed on a monthly basis to determine if balances are reasonable and can be reconciled to underlying information. Examples of this would be reconciliations of receivable and payable balances, accrued payroll accounts and payroll withholding accounts. The payroll withholding account reconciliations were historically the responsibility of positions currently vacant and, as a result, should be an immediate cause for concern.
- Anyone with responsibilities for preparation of a report (for administration, state or federal agencies, payroll administration or audit) should be provided with adequate oversight and supervision. All reports should be reviewed by someone with a strong accounting background to ensure accuracy as well as consistency with other reports.
- Job descriptions should be reviewed to ensure responsibilities are clear and overlap between jobs and job responsibilities are eliminated. The overall organization chart of the School accounting office should be reconsidered. Clear lines of authority and supervision would improve day to day operations. Those with weaker backgrounds in accounting should report to supervisors that can assist with decision making.

Management's response:

While we will continue to process payroll, all the payroll reporting compliance will be outsourced to Paychex thus obviating the need to replace the payroll supervisor.

In addition, there has been some job responsibilities realignment and the creation of the Staff Accountant position. As discussed above, the Staff Accountant is a CPA and has public accounting experience, which will provide the strong accounting background necessary for the Finance Department and the necessary assistance for those with weaker accounting backgrounds.

All journal entries not prepared by the Staff Accountant will be reviewed and approved by the Staff Accountant before they are posted and before they are provided to the City for posting in the City's system. The few journal entries prepared by the Staff Accountant will be reviewed and approved by the Comptroller before they are posted and before they are provided to the City for posting in the City's system. Communication lines between the City and the School Department finance departments have been opened to facilitate all this and there has been increased cooperation between the two in that regard.

The Staff Accountant also will review general ledger accounts monthly to determine whether balances are reasonable and can be reconciled to the underlying information. Accrued payroll accounts and payroll withholding accounts will be reconciled on a monthly basis. The Comptroller and the Chief Financial Officer will provide the necessary oversight and supervision of anyone with responsibilities for preparation of a report.

Job descriptions have been reviewed. There has been a realignment of job responsibilities. The overall organization chart was reconsidered and revised to reflect the Chief Financial Officer coming on board and the realignment of job responsibilities.

Additional accounting procedures will be developed and implemented over the year, which also will assist to develop a stronger Finance Department.

School Department Title 1A Program

One of the federally funded programs tested at the Department of Public Schools was the Title 1A program. The objective of this program is to improve teaching and learning of children who are at risk of not meeting challenging academic standards and who reside in areas with high concentrations of children from low-income families. We noted several areas relating to this program in which improvements could be made, as follows:

- The application for the program, which is part of an overall “No Child Left Behind” application, and is due in August of each year, was not filed until December 8, 2009. Every effort should be made to file this application in a timely manner.
- The application for the program, which is part of an overall “No Child Left Behind” application, includes a request for disbursement of funds schedule. This schedule is used by the State of Maine in determining when checks should be disbursed to the School Department to reimburse for expenditures made in the program. In the case of the Title 1A basic disadvantaged program and the Title 1A basic disadvantaged program ARRA, no funds were requested until July and August of 2010 even though the planned program expenditures were for September 2009 through June of 2010. This resulted in over \$4 million being owed to the City of Portland for these two programs as of June 30, 2010.
- The performance report, which is part of an overall “No Child Left Behind” performance report, reported expenditures amounts and carryover amounts that had not been reconciled to the related grant summary reports derived from the fund accounting system of the School Department.
- The School Department was found to have teachers that were not in compliance with Title 1A program requirements relating to highly qualified teachers. Out of a total sample of 40 tested, two were found not to be in compliance with the highly qualified teacher requirements. The School Department should set goals to achieve compliance in this area.

Management’s response:

With respect to the application deadline, the School Department will continue to work on meeting deadlines. To help with that, the State has assigned us new NCLB consultants. We have an agreement with the State Department of Education to submit financial information on time and follow-up with a narrative later. We also changed the fiscal year for this fund to mirror the School Department’s fiscal year, which will help with compliance.

With added accounting capacity for the new fiscal year, we hope to receive disbursements on a more regular schedule.

The expenditures and carryover amounts will be reconciled to the related grant summary reports derived from the fund accounting system of the Finance Department monthly, as discussed above. Those reconciliations will be reviewed and approved by the Staff Accountant.

The School Department has recently designated a staff person who is familiar with the highly qualified teacher requirements. We have developed a plan to get all teachers at Title 1A schools to meet the Federal highly qualified teacher requirements.

Activity Funds at Various School Locations

As part of our annual audit, we selected six schools on a rotational basis and performed certain procedures with respect to the individual student activity funds. These procedures included gaining an understanding of the internal control procedures, and performing certain control and substantive testing. During this year’s audit, we

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performed tests at the following locations: Casco Bay High School, Deering High School, Portland High School, King Middle School, Nathan Clifford, and Peaks Island School.

We provided the School Department administration with complete results of our tests by location. In general, testing revealed that Schools are not consistently applying a number of critical internal controls procedures. In the case of backup for cash disbursements, we noted a number of instances in which insufficient backup or no backup was maintained. Out of the total 189 transactions tested, we noted 20 exceptions. In the case of cash received, pre-numbered receipt books are not being maintained at all locations. In some cases it was difficult to determine what receipts made up specific deposits. We also noted one case in which there was a lack of segregation between the accounting duties and the individual having check signing authority. Finally, at one High School, the reconciled cash balance exceeded the amounts that could be attributed to each activity or group.

We recommend that an individual from the School Department's business office continue the practice of periodically performing visits at the various activity fund locations to review whether controls are being consistently applied. We also recommend creating a system-wide policy for internal controls and record-keeping for the various activity funds. If problems persist at individual locations, additional training may be necessary.

In addition to the control weaknesses and recommendations noted above, we noted several cases in which the activity account bank statements being received had cut off dates other than at month end. We recommend that in these cases, the fund administrators contact the banking institutions and request specifically a month end statement. This becomes especially important in trying to gather information at year end for reporting in the City's comprehensive annual financial report.

Management's response:

The Finance Department will continue the practice of testing internal controls at the various activity fund locations to determine whether the controls are being consistently applied. The Finance Department will consider developing system-wide internal control and recordkeeping procedures. We also will look into obtaining month-end bank statements.