

December 1, 2011

To: City of Portland Finance Committee, acting as Audit Committee
Mark Rees, 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, 2011, 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.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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 of 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 that reads "Raymond Weston Ouellette".

CITY OF PORTLAND, MAINE
Schedule of Comments

City of Portland

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 the following: 1) all employees document their time, including department heads and supervisors; 2) all documentation be reviewed and approved by a superior; 3) the City adopt a policy with a standardized time reporting system to better document employee time; and 4) time should not be entered into the payroll system unless a time record is reviewed and approved.

Management's response:

The City does have policy that requires approval of employee time, and departments have been reminded of that policy. We have reviewed specific incidents with the departments involved and we expect compliance in the future. There were two Fire Department examples noted by the audit. It should be noted that there is an electronic approval by on duty command staff for the roster of employees who worked the day before. The HTE system keeps an audit trail of all activity on a roster, including who approved it, but this may not have been communicated to the audit team in conducting this review.

Long Outstanding Checks

In our review of cash accounts and their related reconciliations, we found many checks outstanding which were over a year old; some of which even dated back to 1999. These checks were found in the following accounts:

- Workers compensation
- School payroll
- School vendors

The amount of the outstanding checks is immaterial; however, the City should review the outstanding checks list routinely to identify such long outstanding items and should make efforts to pay the intended recipient and remove the long outstanding checks from the list. We recommend that the City obtain and review the State of Maine laws governing unclaimed property and implement policies and procedures to ensure that the City is in compliance.

Management's response - City:

It has been the City's policy to review and research stale dated checks. Any check, whether its payroll or accounts payable, is turned over to the State of Maine as unclaimed property if the intended recipient cannot be located and the payment is valid. The City has been using this practice for over five years. Unfortunately, this practice did not include the Workers Compensation checks. Going forward, the Worker Compensation checks will be part of this practice. A formal written policy will be drafted and administered in FY11 to recognize the practice and encompass the rules and timetables for the State's Unclaimed Property Law.

Management's response - School:

We will make sure we have the most updated outstanding checks list from the City, as the City does the bank reconciliations and provides the School with outstanding checks lists monthly. Stale-dated checks will be reviewed and researched. With the City's assistance where necessary, stale-dated checks will be turned over to the State of Maine as unclaimed property if the intended recipient cannot be located and the payment is valid. We also understand the City will be drafting a formal written policy in this area, which the School will use as guidance.

CITY OF PORTLAND, MAINE
Schedule of Comments, Continued

City of Portland, continued

Inventory Controls

As part of the audit, we tested procedures and valuation methods relating to inventory at various locations throughout the City. We found several issues as a result of our test work performed. Specifically, we found that physical counts of inventory at the Riverside Golf Course did not always agree to amounts recorded, and that inventory for the school nutrition program was not always valued consistently based on cost. We recommend that the City review current policies and update procedures to ensure that inventory is reconciled to physical counts on a routine basis and that costs of individual items are also reconciled to vendor invoices and other documentation regularly.

Management's response - City:

The Club House Manager has recently implemented conducting a complete inventory at the beginning of each month and noting differences. This effort will now occur monthly throughout the year, as the Club House is open throughout the year. Differences noted in the monthly inventories appear to be errors in recording sales in an incorrect category. The Manager continues to train and counsel the seasonal personnel on use of correct categories. Staff has made no adjustments to the financial system at this time and the Manager will do an inventory on Dec. 31st and will post any adjustments as needed. Other steps in response to questions about the Inventory Controls include the Manager doing periodic inventory checks (every other day) of small items including gloves and balls. The Department recently installed four (4) video cameras in the pro shop which will help prevent any possible theft.

Management's response - School:

To make sure that up-to-date prices are being used for inventory on hand, food service will do a cost update just prior to doing the year-end inventory counts.

Portland Public Schools

School Department Accounting System Reconciliation

It should be noted that significant progress was made this year with respect to reconciliation of the School Department Accounting System to the City's Accounting System. We commend the School Department and City personnel for their efforts in this area. All funds were fully reconciled with minor exceptions in capital project related activities (fund 3000 and 4000). Although there is some question as to whether or not it is necessary for the School Department to maintain these funds, 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 properly to their accounting system.

Management's response:

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 - funds 4000 and 3000, respectively), as the City conducts and posts all those activities. The State Department of Education has not yet provided a determination to the School Department in that regard. Nonetheless, the School Department has decided to post all activity to the respective fund at least on a quarterly basis beginning in fiscal year 2012, and it will request that activity from the City to allow it to do so.

CITY OF PORTLAND, MAINE
Schedule of Comments, Continued

Portland Public Schools, continued

School Department Budget Compliance

State law requires that the School Committee prepare a summary budget in state required budget categories. 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. It is clear that the School Department was tracking budget variances in 2011. Although the total School Department budget was not exceeded, we noted one cost center ended the year with expenditures in excess of budgeted amounts, even after allowable transfers were made. We understand that this was due primarily to a shift in the planned use of federal Jobs Bill funds.

Management's response:

As the above comment notes, there was a sufficient budget amount overall to cover the budget overage in the Regular Instruction cost center. However, Maine law, and the School Board's vote pursuant to that law, limits transfers to "not more than 5% of the total appropriation for any cost center to another cost center or among other cost centers" Consequently, the School Department was unable to transfer from available funds budgeted in other cost centers a sufficient amount to cover the over budgeted amount in the Regular Instruction cost center. That would not have happened but for a conscious and purposeful management decision to use federal Jobs Bill funds to pay wages and benefits of custodians, rather than of teachers. That decision optimized use of federal Jobs Bill funds and saved the School Department in excess of \$300,000 for fiscal years 2011 and 2012 combined (the two years over which the funds are available).

School Department Reconciliation of Payroll Withholding Accounts

The School Department maintains a number of payroll liability accounts on the general ledger for fund 1000 (general fund). These accounts are utilized when posting the payroll, to track liabilities related to payroll taxes, benefits and other various items that may be withheld from employees pay. The amounts are carried as liability until such time the School Department satisfies the liability (makes payment). The most significant of these liability accounts relate to the Maine Public Employees Retirement System (MPERS) and Health Insurance. We noted that these accounts were not being reconciled to underlying detail. We recommend that these reconciliations be performed each time a payment is made, but no less often than monthly. Any adjustments necessary to correct the accounts should be posted promptly.

Management's response:

With added accounting capacity, we anticipate that the payroll liability accounts will be reconciled to underlying detail at least monthly, and that any necessary adjustments will be posted promptly.

School Department Federal Program Compliance

Federally funded programs tested at the Department of Public Schools included the Title 1A program and the Local Entitlement program. Our tests revealed two areas in which controls could be strengthened with respect to these programs, as follows:

- Title 1A - The performance report, which is part of an overall "No Child Left Behind" performance report, reported expenditures amounts and carryover amounts that were inconsistent from amounts per the general ledger (fund accounting) system of the School Department. We would recommend that prior to submission of this report, a complete reconciliation be performed which details differences between amounts reported and the amounts per the fund accounting system. The reasons for the differences should be explained on the reconciliations.
- Title 1A and Local Entitlement - The requests for funds, which for 2011 was accomplished through the application process, resulted in excess cash on hand for these two programs for certain periods during the year. We understand the State of Maine has moved to a reimbursement system that should eliminate this issue in the future.

CITY OF PORTLAND, MAINE
Schedule of Comments, Continued

Portland Public Schools, continued

School Department Federal Program Compliance, Continued

Management's response:

The performance report for Title IA was completed with guidance from the Maine Department of Education. The primary differences between expenditures and carryover amounts reported in the performance report and those per the general ledger system resulted from amounts that the Maine Department of Education approved beyond the FY11 Title IA allocation. These expenditures will be reimbursed by Maine DOE. In the future, expenses for activities outside the scope of the original grant award will be captured in a separate project and fund (i.e., in Title I Program Improvement, fund 2310).

In addition, Grant and Grant Accounting Controls & Procedures were implemented in the latter part of FY11. Among other things, those procedures require monthly reconciliations of the project subsidiary ledger to the general ledger for the particular funds, which are being performed and currently are up-to-date. Those reconciliations detail any differences between amounts in the project subsidiary ledger and amounts in the general ledger for the particular funds and contain explanations of any differences. Any necessary adjustments resulting from the reconciliations are promptly made. The foregoing accomplishes the recommended reconciliations, as the performance report is prepared based on data in the project subsidiary ledger. Also, using the Maine Department of Education's new reimbursement system, invoices for expenses in all NCLB funds will be submitted only after the project subsidiary ledger for those funds are reconciled and any resulting necessary adjustments are made.

Due to the influx of Title IA ARRA funds, those funds were expended prior to Title IA funds, creating a situation of excess cash on hand at certain points during the year. These funds will be expended and requested via the new Maine DOE reimbursement system. As Maine DOE has moved to a reimbursement system, there will no longer be excess funds on hand for Title IA and Local Entitlement programs.

School Department Food Services Cash Receipts Process

Over a year ago, the Portland Public Schools Food Services program instituted a new "point of sale" system for tracking lunch sales and receipts. It is currently being used at all but a few very small lunch locations (island schools, etc.). As a result, the cash ups done at the individual school kitchens can generally be successfully reconciled to the daily reports of cash receipts provided by the point of sale system. The individual kitchens (schools) turn over their receipts to the central kitchen who in turn re-counts the individual school amounts, re-bags the cash and checks and prepares a deposit which is transported to banking institutions via a Brinks truck pick up on Mondays, Wednesdays and Fridays. We would recommend the second counting of the deposits be eliminated and that the deposit bags be sealed at the individual school locations and not re-opened and re-counted. Each school location would prepare their own deposit and seal them in appropriate banking deposit bags. Sealed bags could still be collected from the central kitchen location and deposited via the Brinks truck on the designated days. This change would result in the following important safeguards and benefits:

- Accountability can be maintained at the individual school level.
- The point of sale system can be utilized as intended to ensure proper deposit totals.
- The assistant food services director, who maintains the records of receipts and is responsible for the reporting of receipts, would not have direct access to the cash receipts (providing for more appropriate segregation of duties).
- The individual currently being utilized to re-count the cash receipts would have a considerable amount of additional time to assist with other important record maintenance functions.

CITY OF PORTLAND, MAINE
Schedule of Comments, Continued

Portland Public Schools, continued

School Department Food Services Cash Receipts Process, continued

In addition, it was noted that for several months during the year, no cash receipts were recorded in the school departments accounting system for food services. More recently, the recording of the food services revenue has been done with a monthly journal entry. Since deposits are made three times a week, we recommend that the recording of receipts correspond to the individual deposit amounts, or, at a minimum, be prepared for posting on a weekly basis. At year end, proper cut off should be achieved by recording any accounts receivables that are due from the State of Maine or other third parties. One individual at the School Finance Office should be charged with monitoring the posting of school lunch activity to ensure amounts are being posted promptly, are reasonable, and are consistent with budgetary expectations.

Management's response:

With excellent support from City Finance and our bank, we expect to eliminate the second counting of deposits by late October 2011. Beginning at the same time, the deposit bags will be sealed at the individual school locations and not re-opened and recounted, with each school location preparing its own deposit and sealing them in appropriate banking deposit bags.

By eliminating the second count of cash, a staff person will be reassigned and trained to handle deposit reconciliation both to the point of sale system and the bank on-line statement on a weekly basis. Report of Receipts will be prepared for posting on a weekly basis, as recommended. The Budget Manager will be monitoring the posting of school lunch activity and make sure amounts are reasonable and consistent with budgetary expectations, and are being posted promptly.

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 performed tests at the following locations: Deering High School, Portland High School, Presumpscot School, Lyseth School, East End Community School and Lincoln.

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 187 transactions tested, we noted 26 instances in which no invoice was available. 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 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.

CITY OF PORTLAND, MAINE
Schedule of Comments, Continued

Portland Public Schools, continued

Activity Funds at Various School Locations, continued

Management's response:

Reconciliations of Activity Funds Bank Accounts and Other Control Procedures were implemented toward the latter part of FY11. Among other things, those procedures require each location with any activity fund to designate a responsible person who is responsible for obtaining and maintaining backup documentation and performing monthly bank reconciliations. They also create system-wide internal control procedures for activity funds that must be followed. The former Comptroller was charged with the responsibility to perform internal audits of the activity fund locations to make sure the mandatory procedures are being followed and controls are being applied consistently. However, the former Comptroller resigned near the end of FY11 and, as a result, those internal audits had not been performed. The Finance Department intends to fill that vacant position within the next several months, which will permit the internal audits to be performed. In the meantime, the Budget Manager currently is overseeing activity fund locations and their compliance with the implemented procedures. We expect that the implemented procedures, together with internal audits and training where necessary, will cure the noted deficiencies.

Over the past year, month-end bank statements were requested and received for most of the activity fund accounts. The Finance Department believes there are three remaining activity account bank statements without month-end cut off dates. We will look into obtaining month-end bank statements for those remaining three activity fund accounts.

School Department - Purchase Order System Considerations

In testing backup for disbursements at the School Department, we noted that in some instances, purchase orders are actually created after receipt of the related invoice. Our testing revealed that this was commonly done for small amounts, such as employee reimbursement for classroom or meeting supplies, and less commonly occurred for larger items such as student consultation services. We would suggest that the School Department reconsider its policy with respect to purchase orders, clarifying when they are necessary, and whether alternatives could be considered for small purchases, such as employee reimbursements. Preparing a purchase order after an invoice has been received defeats the purpose of having the purchase order in the first place – that being having the purchase pre-approved - and administratively creates unnecessary work.

Management response:

Once the controller position is filled, the Finance Department intends to review the purchasing system procedures and revise those procedures where necessary. Among other things, we plan to clarify when purchase orders are necessary and to consider alternatives for small purchases and thereby eliminate any unnecessary work.