

CITY OF EVERETT, MASSACHUSETTS

Independent Auditors' Reports Pursuant
to Governmental Auditing Standards
and The Single Audit Act Amendments of 1996

For the Year Ended June 30, 2007

TABLE OF CONTENTS

	<u>PAGE</u>
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	1
REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	3
Schedule of Expenditures of Federal Awards	6
Schedule of Findings	7



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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS

To the Mayor and City Council
City of Everett, Massachusetts

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Everett, Massachusetts, as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 28, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with

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generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs (items 07-1 through 07-5) to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiencies described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the City in a separate letter dated December 28, 2007.

This report is intended solely for the information and use of management, Mayor and City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Melanson, Heath + Company P.C.

Andover, Massachusetts
December 28, 2007



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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Mayor and City Council
City of Everett, Massachusetts

Compliance

We have audited the compliance of the City of Everett, Massachusetts, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The City's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grant agreements applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City's compliance with those requirements.

As described in item 07-6 in the accompanying schedule of findings and questioned costs, the City did not comply with eligibility requirements, which are applicable to the School Lunch Program. Compliance with such requirements is necessary, in our opinion, for the City to comply with requirements applicable to that program.

As described in item 07-7 in the accompanying schedule of findings and questioned costs, the City did not comply with various requirements, which are applicable to the Assistance to Firefighters Grant. Compliance with such requirements is necessary, in our opinion, for the City to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraphs, the City complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs of the year ended June 30, 2007.

Internal Control Over Compliance

The management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

A *control deficiency* in the City's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the City's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses as defined above.

Schedule of Expenditure of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Everett as of and for the year ended June 30, 2007, and have issued our report thereon dated December 28, 2007. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management, Mayor and City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Melanson, Heath + Company P.C.

Andover, Massachusetts
February 21, 2008

CITY OF EVERETT, MASSACHUSETTS
 Schedule of Expenditures of Federal Awards
 For the Year Ended June 30, 2007

	Federal Catalogue Number	Federal Expenditures
<u>Department of Agriculture</u>		
Passed Through Massachusetts Department of Education		
School Lunch - Food Distribution	10.550	\$ 173,297
School Lunch - School Breakfast Program	10.553	312,102
School Lunch - School Lunch Program	10.555	948,388
Total Department of Agriculture		<u>1,433,787</u>
<u>Department of Education</u>		
Passed Through Massachusetts Department of Education		
Title I	84.010	1,689,975
SPED - 94-142	84.027	1,297,742
Title VI Material Support	84.151	18,675
SPED - Early Childhood	84.173	19,618
Enhanced Education through Technology	84.318	14,244
LEP Support	84.365	118,166
Improving Teacher Quality	84.367	327,819
Total Department of Education		<u>3,486,239</u>
<u>Department of Housing and Urban Development</u>		
UDAG	14.221	42,494
Small Cities	14.228	248,954
H.O.M.E. Program	14.239	51,494
Total Department of Housing and Urban Development		<u>342,942</u>
<u>Department of Health and Human Services</u>		
Emergency Services	93.127	57,789
Total Department of Health and Human Services		<u>57,789</u>
<u>Department of Justice</u>		
Police Drug Funds	16.585	37,624
Community Oriented Policing Services	16.592	20,868
Governor's Alliance Against Drugs	16.728	32,986
Edward Byrne Memorial Justice Assistance Grant Program	16.738	42,791
Total Department of Justice		<u>134,269</u>
<u>Environmental Protection Agency</u>		
Brownfields Assessment and Clean up Cooperative Agreements	66.818	41,600
Total Environmental Protection Agency		<u>41,600</u>
<u>Federal Emergency Management Agency</u>		
Assistance to Firefighters	83.554	290,913
Total Federal Emergency Management Agency		<u>290,913</u>
<u>Department of Homeland Security</u>		
Homeland Security Information and Technology and Evaluation Program	97.066	50,242
Total Department of Homeland Security		<u>50,242</u>
Total Federal Assistance		<u>\$ 5,837,781</u>

This schedule was prepared on the modified accrual basis of accounting.

See Independent Auditors' Report on Schedule of Expenditures of Federal Awards.

CITY OF EVERETT, MASSACHUSETTS
 Schedule of Findings and Questioned Costs
 For the Year Ended June 30, 2007

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiencies identified that are not considered to be material weakness(es)? yes none reported

Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiencies identified that are not considered to be material weakness(es)? yes none reported

Type of auditors' report issued on compliance for major programs:

Unqualified for all major programs except School Lunch and Assistance to Firefighters, which were qualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? yes no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
10.550/10.553/10.555	National School Lunch Program
84.027	SPED 94-142
84.367	Improving Teacher Quality
83.554	Assistance to Firefighters

Dollar threshold used to distinguish between type A and type B programs: \$ 300,000

Auditee qualified as low-risk auditee? yes no

SECTION II - FINANCIAL STATEMENT FINDINGS

Finding

Finding/Noncompliance

07-1

Improve Accounting Systems (Material Weakness)

During our audit we noted the following weaknesses within the City's accounting systems, which remained unresolved as of June 30, 2007:

- The beginning balances of the capital asset records for fiscal year 2007 did not agree with the City's June 30, 2006 financial statements, and the 2007 additions did not include several significant projects. As a result, several large entries were required to correctly report capital assets and the related depreciation.
- Compensated absence (unused sick and vacation time) accounting remains decentralized and determined manually. As a result, the calculation of payments and the year end liability lack the necessary oversight and are subject to mathematical errors.
- The general ledger chart of accounts still does not include revenue and expenditure accounts for funds other than the general fund. As a result, the City posts all activity directly to fund balance accounts, complicating the review of current year activity.
- During fiscal year 2007, staff training was obtained, and as noted, the general ledger closing process was significantly timelier. However, a capital asset training program was not established.

We recommend the City address the material weaknesses noted above. Specific training should be provided in the area of capital asset accounting to provide assurance that the records are properly maintained. Additionally, timelines for centralizing and automating the accounting of compensated absences and improving the chart of accounts should be established. Corrective action on these weaknesses is required to properly report the City's financial statements in accordance with generally accepted accounting principles.

07-2

Evaluate the City's Contributions to the Internal Service Fund (Material Weakness)

The City administers a self-insured health insurance trust fund (reported as an internal service fund in the basic financial statements) authorized under Massachusetts General Laws Chapter 32B. Both the City and its employees contribute to this fund based on contribution rates established through the collective bargaining process. Actual contributions over the

Finding #

Finding/Noncompliance

past three years compared to the contributions, determined by plan participation, are as follows (reported in thousands):

	<u>Actual Contribution</u>	<u>Contribution Determined by Participation</u>	<u>Difference</u>
Fiscal 2005	\$ 8,700	\$ 10,000	\$ (1,300)
Fiscal 2006	9,570	9,199	371
Fiscal 2007	11,530	11,530	-

Fiscal 2007 contributions agreed with the amounts determined by plan participation, however, past discrepancies have not been analyzed, and if necessary, adjusted.

We recommend the City review recent trust fund activity, to ensure the equitable contributions were made by the City and its employees. Implementation of this recommendation will ensure compliance with Massachusetts General Laws Chapter 32B and collective bargaining agreements, and will provide assurance that trust fund assets, liabilities and retained earnings are equitably allocated.

07-3

Implement Internal Control Improvements (Material Weakness)

In accordance with a new generally accepted audit standard (SAS 112), which is effective for all fiscal year 2007 audits, independent auditors must now report issues (called "significant deficiencies" and "material weaknesses") to the governing body.

SAS 112 specifically requires that certain situations, if present in the municipality, must be reported as either a significant deficiency or material weakness, depending on the extent of the risk of financial statement misstatement. The governing body of the City should evaluate the cost/benefit of these issues to determine whether corrective action is warranted.

The following summarizes certain practices in the City that meet the new criteria of a material weakness.

Document Components of Internal Control:

In order to establish an effective system of internal controls, the City should document the policies, procedures and controls over key financial transactions, including cash, receivable activity, departmental receipts, purchasing, vendor disbursements, employee benefit/payroll disburse

Finding #

Finding/Noncompliance

ments, and general ledger maintenance. This documentation could be used by departments as guidance to help safeguard assets, to properly record transactions, and to provide a basis for continuing operations when turnover occurs in key financial departments. Although the City maintains certain policies and procedures, they are not complete, up to date, or distributed to all applicable departmental personnel.

Corrective Action to be Considered:

Several years ago, the Committee of Sponsoring Organizations (COSO) of the President's Council on Integrity and Efficiency published comprehensive internal control guidance that has recently been put in place by publicly traded companies as a result of Sarbanes Oxley legislation. The COSO report outlines five components of effective internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.

The City should consider implementing a written internal control framework using the COSO model. Specific software can be obtained to assist in the documentation.

Establish Internal Audit Function:

Internal audits are an important control measure to provide some assurance that procedures are actually being performed in accordance with management's assertions, and that assets actually exist and are properly safeguarded. The City historically has relied on the independent auditor to perform these functions. This reliance, however, increases the risk that errors or irregularities could occur and not be tested or detected by management. The COSO framework explicitly states that management is responsible for performing internal audits. SAS 112 requires auditors to report instances where the internal audit function is not occurring or functioning.

Corrective Action to be Considered:

The City should, as part of its documented internal control procedures, establish an internal audit function to properly monitor operations and assess risk of misstatement of the financial statement caused by either error or irregularities. While the City had an Internal Auditor during fiscal year 2007, we are not aware of any internal audits that were actually performed. Internal audits should be performed in areas noted in Comment Number 4.

Finding #

Finding/Noncompliance

07-4 Formalize Controls over Departmental Receipts and Internal Audits (Material Weakness)

During our audit we noted the following weaknesses within the City's departmental receipt systems, which remained unresolved as of June 30, 2007:

- Pre-numbered receipt book not used.
- Departmental receipt logs not maintained.
- Departmental turnover forms not preprinted/coded.
- Lack of audit trail over remittances to the Treasurer.
- Infrequent remittances to Treasurer.
- No documentation of breakdown of deposits by cash and checks.
- Lack of security of cash on hand during operating hours and overnight.
- Documentation supporting internal audits was not provided

We recommend the City establish formal policies and procedures for handling departmental receipts, and re-establish departmental internal audits to address the above-referenced deficiencies. The development of formal uniform policies and procedures, combined with periodic internal audits, will provide increased controls over departmental receipts. Specific internal audit steps should include, but not be limited to:

- Cash receipt monitoring
- Budget appropriation to actual monitoring
- Grant activity allowability
- Chapter 30B compliance
- Compliance with applicable City policies and procedures
- Trust Fund activity allowability

This will result in improved oversight, and should reduce the risk of errors or irregularities occurring and going undetected.

07-5 Improve Document Retention (Material Weakness):

The City was unable to provide us with records related to contracts, contract amendments, bid documents and other related information for many of the City's construction projects. Failure to retain records places the City at risk of disallowed costs by federal and state funding agencies and makes it difficult to assure compliance with bid and contract statutory requirements. Our firm spent a great deal of time locating and copying documents so that the City could comply with the MSBA audit requirements for the Hamilton, English and Lafayette schools. Without outside assistance the City was at risk for losing

Finding #

Finding/Noncompliance

millions of dollars in ineligible costs due to failure to provide adequate supporting documentation.

We recommend that copies of contracts (and related contract amendments) be retained in multiple locations, including the Purchasing Department, City Clerk, City Auditor, the initiating Department and the City Solicitor's office.

Bid documents should be retained in the Purchasing Department even if the bid was initiated by some other department. The Purchasing Department can not delegate the bid process to another department without the proper delegation required by MGL 30B. All related files should be retained in the Purchasing Department.

SECTION III - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

<u>Finding #</u>	<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Cost</u>
07-6	National School Lunch (10.550) (10.553) (10.555)	<p><u>Comply with Eligibility Requirements</u></p> <p>In our sampling of 10 students selected for eligibility testing, we noted one situation whereby the student received reduced meal benefits under the program, even though the student's family household income exceeded the eligibility guidelines. The Federal National School Lunch program requires that in order for a child to be eligible, the application must prove that the child's family income and size are within the eligibility standards established by the State.</p> <p><u>Recommendation:</u> We recommend the City develop policies and procedures designed to ensure full compliance with federal eligibility regulations.</p>	Undetermined
07-7	Assistance to Firefighters (83.554)	<p><u>Comply with Equipment Management</u></p> <p>The City did not maintain records documenting the purchase of equipment, funded by the Assistance to Firefighters grant. In addition, we noted the City does not have a policy to address the disposition of capital assets, purchased through federal grant funds. Federal OMB Circular A-133 requires that the City maintain records documenting the purchase of equipment purchased with federal funds.</p> <p><u>Recommendation:</u> We recommend the City develop policies and procedures designed to ensure full compliance with federal equipment maintenance requirements.</p>	Undetermined

SECTION IV - SCHEDULE OF PRIOR YEAR FINDINGS

FINANCIAL STATEMENT FINDINGS

<u>Finding #</u>	<u>Finding/Noncompliance</u>
06-01	<u>Improve Monthly Reconciliations and Accounting Training (Material Weakness)</u> <u>Current Year Status:</u> This issue was not resolved and has been repeated as current year finding 07-1.
06-02	<u>Revise Chart of Accounts and Maintain Activity Schedules (Material Weakness)</u> <u>Current Year Status:</u> This issue was not resolved and has been repeated as current year finding 07-1.

FINDINGS AND QUESTIONED COSTS FOR FEDERAL PROGRAMS

<u>Finding #</u>	<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Cost</u>
06-3	(97.067)	<p><u>Comply with Subrecipient Regulations</u></p> <p><u>Prior Year Recommendation:</u> We recommended the City develop policies and procedures designed to ensure full compliance with federal subrecipient monitoring regulations.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved.</p>	--
06-4	(97.067)	<p><u>Improve Record Retention</u></p> <p><u>Prior Year Recommendation:</u> We recommended the City develop policies and procedures designed to ensure full compliance with federal record keeping requirements.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved.</p>	--
06-5	(97.067)	<p><u>Comply with Equipment Management</u></p> <p><u>Prior Year Recommendation:</u> We recommended the City develop policies and procedures designed to ensure full compliance with federal equipment maintenance requirements.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved for the Homeland Security grant program, but was repeated as comment 07-7 for the Assistance to Firefighters Grant program.</p>	--
06-6	(97.067)	<p><u>Comply with the Period of Availability</u></p> <p><u>Prior Year Recommendation:</u> We recommended the City develop policies and procedures designed to ensure full</p>	--

<u>Finding #</u>	<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Cost</u>
		<p>compliance with the period of availability expenditure requirement.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved.</p>	
06-7	(97.067)	<p><u>Comply with the Buy American Act</u></p> <p><u>Prior Year Recommendation:</u> We recommended the City develop policies and procedures designed to ensure full compliance with the Buy American Act.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved.</p>	--
06-8	(84.367)	<p><u>Adhere to Grant Requirements as Stipulated in the Grant Application</u></p> <p><u>Prior Year Recommendation:</u> We recommended that the City ensure that stated objectives included in the grant application be fulfilled, or the City should submit a revised application with new objectives should the original objectives need adjustment. We further recommended that the City Auditor's Office verify that the grant expenditures are in accordance with the grant agreement prior to charging expenditures to the grant.</p> <p><u>Current Year Status:</u> This issue was satisfactorily resolved.</p>	--