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To the Board of Finance
City of Middletown, Connecticut

In planning and performing our audit of the financial statements of the City of Middletown, Connecticut (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's internal control over financial reporting (internal control) 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. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

We noted the following matters involving the internal control over financial reporting and its operation, which we offer as constructive suggestions for your consideration as part of the ongoing process of modifying and improving accounting controls and administrative practices.

Purchasing

The purchasing cycle of the Board of Education includes the issuance of purchase orders to ensure the availability of funds prior to the commitment of a purchase. This process requires a properly prepared purchase order issued to a specific vendor for specific goods or services on or before the end of the fiscal year. Once issued, this order is recorded in the budgetary records as a commitment against the appropriation anticipated in the budget preparation process for such goods and services. During the course of our audit, we reviewed the issuance and subsequent liquidation of purchase orders within the Board of Education and found the following:

- Several fiscal year 2009 purchase orders were liquidated in 2010 for an amount greater than the original purchase order amount. Purchase orders represent a specific reservation of funds and should only be liquidated to the amount of the purchase order. If in the subsequent period additional funds are required they should be charged to that years operating budget.
- The original amount of a certain purchase order was changed subsequent to year end
- We noted several instances where the date of an invoice for certain goods or services was dated prior to the issuance date of the purchase order. The purpose of a purchase order system is to determine the availability of funds prior to a commitment to purchase and therefore invoices should not be dated prior to the purchase order date.
- We noted ten instances where multiple vendors were paid against a purchase order that was properly issued during the 2009 fiscal year to one specific vendor. Although payments were made to legitimate vendors, a purchase order should only be liquidated to the original vendor on that purchase order, and, therefore, charging multiple vendors to a purchase order is improper.

- We noted that purchase orders are generated using a 99999 code meaning no specific vendor. A purchase order should only be issued to represent a specific contract or order to a particular vendor. Use of “no name” vendor purchase orders should be prohibited.

We recommend that the Board of Education review the current purchasing practices and make any required changes to eliminate these types of exceptions to the current purchasing policies and procedures.

Travel Reimbursements

During the course of our audit, we tested the employee reimbursement process related to travel expenses. Our test indicated several instances where administrative employees were paid an annual travel allowance. We were not able to find support for this type of plan within the context of the employment agreements. The employment agreements in fact called for a reimbursement of expenses not and allowance. Employees should be reimbursed mileage based on documentations submitted.

We recommend that the current employment agreements for these individual be reviewed to ensure compliance with such agreements. We also recommend that the current accounting policies and procedures for these types of reimbursements be updated to ensure that only approved plans are being reimbursed.

Bidding Procedures

Our audit of the various Board of Education expenditures indicated that many projects that fall below the bidding threshold of \$7,500 are performed each year at the various schools throughout the City. We recommend the Board of Education review the awarding of these smaller contractual amounts to see if they can be consolidated in one larger contract. This contract would require a competitive bidding process and would possibly allow for savings to the City.

Fixed Assets

Our audit of the City's and the Board of Education's fixed assets indicated that the current records are not maintained on a perpetual basis. We recommend the current accounting policies related to fixed assets be updated to require that the fixed asset records are maintained on a perpetual basis. These policies and procedures should provide the reporting of all fixed assets on a current basis including the original acquisition price, any improvements and finally the removal of any sold or disposed of fixed asset. These policies and procedures should also provide for the proper accounting treatment of construction in progress as well as the sales methods allowable for the selling of outdated or obsolete fixed assets.

General Ledger Control

General ledger control over the educational grants fund is currently maintained by the City's accounting department based on summary transactions reported by the Board of Education. In addition, general ledger control has not been established for the Cafeteria fund. Currently the Board of Education maintains detailed expenditure and revenue records for these funds and reports such transactions to the City for posting to the general ledger, where they are commingled into one fund. At year end, for financial statement purpose, significant adjusting entries are required to accurately report the operations of these funds as a monthly reconciliation of the detailed transactions and the general ledger control accounts are not performed.

We recommend that general ledger control is established for the Cafeteria fund and that procedures are established that provide for the monthly reconciliation of the detailed accounts maintained by the Board of Education and the general ledger control maintained by the City.

Financial Management System

In addition to maintaining the current financial management system, the City also utilizes a subsystem of spreadsheets that provide for the proper reporting of year-end balances in accordance with generally accepted accounting principles. This subsystem is required as the periodic reporting of financial information does not include accrual basis information.

We recommend the City review the functionality of the financial management system, the related chart of accounts and the current accounting policies and procedures to determine if the system can be modified to provide for the periodic and yearly reporting of the City's financial position in accordance with generally accepted accounting principles.

Future Standards

The Governmental Accounting Standards Board has issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The requirements of this statement are effective for financial statements for the periods beginning after June 15, 2010. The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement also establishes fund balance classifications based on the extent to which a government is restricted by constraints imposed upon the use of the resources reported in the governmental funds.

We recommend the City establish a comprehensive plan to address the various provisions and effects of the new reporting standard. The implementation date for the City is for the fiscal year ending June 30, 2011. As such, the City should develop a systematic plan that requires analysis of the constraints imposed upon the use of the various governmental fund resources to ensure proper fund classification in accordance with the new fund definition.

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This letter should be read in conjunction with our 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 dated December 30, 2010.

This communication is intended solely for the information and use of management, members of the Board of Finance, Town Council, others within the organization, federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Blum, Shapiro & Company, P.C.

December 30, 2010