

**STATE OF NEW JERSEY
DEPARTMENT OF COMMUNITY AFFAIRS
DIVISION OF LOCAL GOVERNMENT SERVICES**

CITY OF PATERSON

**INTERNAL CONTROL AND STATUTORY/REGULATORY
COMPLIANCE REVIEW**

April 1, 2009

**McEnerney, Brady & Company, LLC*293 Eisenhower Parkway, Suite 270, Livingston, N.J. 07039
Tel. (973) 535-2880*Fax (973)535-5893**

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McENERNEY, BRADY & COMPANY, LLC

Certified Public Accountants * A Limited Liability Company

Francis M. McEnerney, CPA, RMA
Edmond P. Brady, CPA
John L. Ezyske, CPA, RMA

April 1, 2009

State of New Jersey
Department of Community Affairs
Division of Local Government Services
Trenton, New Jersey

This report presents the results of our performance audit (“audit”) of the City of Paterson (“City”). Our audit was conducted in accordance with the standards applicable to performance audits contained in *Generally Accepted Government Auditing Standards* (“GAGAS”), issued by the Comptroller General of the United States of America.

Audit Objectives

The objectives of the audit were to (1) identify potential internal control deficiencies and provide recommendations for correcting those deficiencies, (2) identify findings of noncompliance with statutory and regulatory compliance, and (3) identify and provide efficiencies or procedures that could lead to cost savings and possible revenue enhancements for the City.

Audit Scope

In order to achieve the first objective enumerated above, we prepared detailed system descriptions documenting controls as outlined in the Request for Qualifications (“RFQ”) of the City’s purchasing/expenditure and the payroll/human resource functions for the State Fiscal Year (“SFY”) 2008. With the resulting information, we utilized various sampling techniques to further analysis the data, review supporting documentation, perform inquires, and identify any potential outliers or anomalies. In addition, the City’s processes included in the scope of our audit related to the assessment of internal controls, revenues, cash receipts, purchasing, cash disbursements, payroll, human resources, fixed assets, risk management, information technology, and general operations.

To meet the second objective we expanded our scope outlined for the first objective to include attributes associated with statutory and regulatory issues provided in the RFQ to identify any potential noncompliance.

The third objective was achieved by obtaining information throughout the entire process and making assessments that may lead to cost saving opportunities or revenue enhancements.

Audit Methodology

The audit methodology encompassed three phases: (1) planning, (2) information, extraction, gathering, analysis, and validation and (3) reporting.

Audit Observations

Observations related to internal controls, cost savings, and related outliers were noted during our audit. The observations and related recommendations were presented to the City and the State of New Jersey, Department of Community Affairs, Division of Local Government Services.

City of Paterson Response

The City of Paterson's response to this performance audit is included in the following section entitled City Responses (see pages 51 to 53).

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ENGAGEMENT SUMMARY

STATE OF NEW JERSEY
DEPARTMENT OF COMMUNITY AFFAIRS
DIVISION OF LOCAL GOVERNMENT SERVICES
CITY OF PATERSON
INTERNAL CONTROL AND STATUTORY/REGULATORY
COMPLIANCE REVIEWS

ENGAGEMENT SUMMARY

The following summary highlights our findings within the three (3) categories described in our executive summary. The details in support of the following are included in the detailed section of this report.

Cost Savings and Possible Revenue Enhancements

- The revenue generated by the sewer user charges is not sufficient to cover the costs of operation. A cost of service study should be performed to ensure that the rates in effect are sufficient and that the billing methodology is equitable.
- Consideration should be given to establish a sewer enterprise fund to properly account for the financial activity of the Sewer Operation.
- Miscellaneous fees ordinances should be reviewed on a regular basis in order to properly reflect fees that correlate with the cost associated with the services provided.
- Tax title liens should be reviewed and all necessary actions taken to return to the active tax rolls.
- Certain Miscellaneous Revenue Not Anticipated (“MRNA”) items appear readily identifiable for anticipation in the City’s budget.

- There are capital projects and grants that have little or no activity that should be reviewed and properly disposed.
- Consideration should be given to establishing the practice of employee contributions for health benefits.
- Parking violation enforcement should be increased.
- Consideration should be given to reviewing the Parking Authority for possible consolidation into the City's operation as an enterprise fund.
- The City maintains an unallocated receipt account of approximately \$223,000 which should be reviewed and included as income.

Statutory and Regulatory Findings

- The SFY 2007 Annual Report of Audit was rendered subsequent to the December 31, 2007, and the SFY 2008 was not rendered as of this report date.
- The SFY 2009 Budget was introduced and public hearing held with State revenues being anticipated as held harmless and appropriations at levels based upon legislation not enacted at time of introduction.
- The cash management plan should be reviewed on a regular basis and include reference to obtaining the Governmental Unit Deposit Protection Act certificate from depositories.
- A complete physical inventory of fixed assets should be taken to determine whether the fixed assets recorded still exist.
- Various trust funds are not supported by Dedication by Riders.

Internal Controls

- The Internal Auditor reports directly to the Acting Director of Finance and not to an audit committee established within the governing body.
- The organizational chart excludes the Police and Fire Departments.
- An Accounting Procedure manual is not maintained.

Information Technology

- A disaster recovery plan does not exist.
- Overall data center environment is not up to standards.
- The off site data backup routine requires improvement.
- Implementation of a VoIP phone system would be provide a major cost savings.

Purchasing and Expenditures

- Claimants certifications are not always obtained.
- Re-imburements should not be made to political fund raising committees.

Payroll and Human resources

- A number of personnel files were not available for inspection.
- Documentation for child support garnishments were not available.

STATUTORY AND REGULATORY FINDINGS

Internal and External Report Reviews:

In conjunction with our overall review of the City's system of internal control, we reviewed the following documents:

- SFY 2008 Annual Financial Statement (AFS)
- Audit Report for the Year ended June 30, 2007
- SFY 2009 Municipal Budget
- Organizational Chart
- Administrative Code
- Internal procedural manuals or policies, including but not limited to: Personal, Purchasing, and Risk Management

The following observations do not address any general fiscal operations as they are included in its respective section:

SFY 2008 Annual Financial Statement (AFS)

The Annual Financial Statement for the year ended June 30, 2008 was prepared by the Acting Director of Finance and dated July 28, 2008.

Audit Report for the Year ended June 30, 2007

The year ended June 30, 2007 annual audit was performed by the Certified Public Accounting firm of Donohue, Gironde & Doria who issued a qualified opinion as the City prepares its financial statements in accordance with a regulatory basis of accounting which differs from accounting principals generally accepted in the United States of America. This qualification is consistent with all other annual audits of local governmental units in New Jersey.

It is our understanding, based upon discussions with the Independent Auditors and the Acting Director of Finance, that there have not been any material adjustments recommended by the Auditors for the past several years.

The June 30, 2007 annual report of audit was issued subsequent to the statutory filing date of December 31, 2007. The SFY 2007 Independent Auditors' Report was dated February 20, 2008. The SFY 2008 annual audit will also be issued subsequent to the statutory filing date as field work was being performed by the independent auditors during our review process.

The SFY 2007 annual audit included three (3) comments and recommendations all addressing issues within the Municipal Court. There were also three (3) comments and recommendations in the SFY 2006 annual audit addressing the Municipal Court. One comment was a repeat between the two (2) fiscal years. None of the comments were considered a major noncompliance. A Corrective Action Plan was prepared and approved at the City Council's meeting of May 14, 2008.

SFY 2009 Municipal Budget

The SFY 2009 Budget was introduced January 13, 2009 at approximately \$3 million dollars under the State mandated 4% Levy CAP and approximately \$3.5 million under the State mandated 3.5% appropriation CAP (after passage of CAP Rate Ordinance). However, the budget was introduced anticipating \$30 million in Special Municipal Aid (the full amount received in 2008) and the State's **planned** deferral of 50% of the employer's pension costs for both the Public Employees Pension System and the Police and Fireman's Retirement System. The deferred pension costs amounts to \$822,127 and \$5,600,000 for the Public Employees Pension System and the Police and Fireman's Retirement System, respectively. As of this writing, neither item has any basis as the funds for the Special Municipal Aid has not been appropriated and the legislation required for the pension deferral has not passed the Senate and signed into law by the Governor.

In addition to the above, the City introduced the budget without moving the Police and Fireman's Retirement System appropriation to within CAPs and make the required CAP base adjustment. This mandate became effective for SFY 2009 while the Public Employees Pension System reclassification to within CAPs is effective for SFY 2010. This mandate may be addressed as part of the pension deferral legislation.

The Budget is prepared and monitored by the Budget Officer, Division of Budgeting, within the City's Department of Administration.

General Fiscal Operations

Organizational Chart

The City has developed a basic organizational chart reflecting the following six (6) Departments who report directly to The Mayor:

- Department of Administration (includes 8 Divisions)
- Department of Human Services (includes 11 Divisions)
- Department of Community Development (includes 10 Divisions)
- Department of Public Works (includes 11 Divisions)
- Legal Department
- Department of Finance (includes 7 Divisions)

The organization chart failed to include the Departments of Police and Fire; these charts do exist and stand alone.

The Division of Internal Audit should be re-aligned from the Department of Finance. The internal audit function should not report to the Director of Finance but rather directly to the governing body via an audit and finance committee.

Presently there are two (2) individuals within the internal audit division. This division primarily performs special projects as requested by the administration and the Acting Director of Finance rather than any attest function normally performed by internal auditors.

Administrative Code

A review of the *Code of the City of Paterson New Jersey* (“Code”) appears to be complete and properly maintained. A complete codification is performed on an annual basis. The 2008 codification has not occurred prior to our review.

Internal Procedural Manuals or Policies

The City developed a Personnel Policies and Procedures Manual in 2005. This manual includes all policies and procedures which govern and affect personnel administration for all departments. The manual appears to be complete and concise with all polices and procedures.

The only other internally produced manual is a purchasing manual. This manual has been drafted and forwarded to the Division of Local Government Service for their review and comment. The manual appears to be complete with the exception of fixed assets and inventory control which was not addressed and reserved for future inclusion.

The City does not have an accounting procedural manual.

During our review of numerous financial reports, we noted the following that have an impact on the City's operation:

Sewer Operations

The City's sewer operation is accounted within the Current Fund and any excess or deficiencies in sewer revenues are a component part of the City's tax structure.

The City's sanitary and storm sewer is combined in a single collection system. Combined sewer systems are sewers that are designed to collect rainwater runoff, domestic sewage, and industrial wastewater in the same pipe. Most of the time, combined sewer systems transport all of their wastewater to Passaic Valley Sewerage Commission's (PVSC) treatment plant, where it is treated and then discharged to a water body. During periods of heavy rainfall or snowmelt, however, the wastewater volume in a combined sewer system can exceed the capacity of the sewer system. Therefore, combined sewer systems are designed to overflow occasionally and discharge excess wastewater directly to streams, rivers, or other bodies of water. These overflows, called combined sewer overflows (CSOs), contain not only stormwater but also untreated human and industrial waste.

These CSOs have created mandates from the federal government to correct the overflows. The City has approximately \$12.8million of outstanding loans from the New Jersey Environmental Infrastructure Trust Loans (NJEIT) and \$6.9 in Bond Anticipation Notes outstanding at June

30, 2008 to finance these projects associated with said corrections and projects associated with the wastewater system, respectively. In addition, the City has \$18.3 million additional unfunded authorization to finance phase III of this project of which \$8 million of NJEIT bonds were issued in late 2008. The City estimates an additional \$15 million in authorizations to fully comply with the Federal mandates

The City realized \$7,349,000 from municipal sewer charges for the year ended June 30, 2008 which is based upon a rate structure that became effective mid 2006. This rate structure is based upon a flat dwelling unit charge that decreases from a single unit charge of \$112 per annum to \$84 per annum for a user who has 300 or more units. Non domestic accounts are billed a per load charge as determined by reads developed by the PVSC.

The 2006 rate was the first rate change since 1981 which represented a 40% rate increase. The operating expenses (salaries & wages, other expenses, and treatment costs to PVSC) amounted to \$10.7 million, which resulted in a deficit of approximately \$3.3 million for the year ended June 30, 2008 and a projected deficit of \$4.2 million based upon the SFY 2009 budget. These deficits do not include any debt service mentioned above as any distinction between wastewater and stormwater projects was not readily determinable.

Observations

- The City should consider establishing a sewer enterprise fund in order to account for the financial activities as a stand alone entity rather than a component of the tax structure.
- A cost of service study should be performed to determine the most equitable rate methodology that is based upon usage with the larger users absorbing a larger per unit charge. This will prevent the tax base in subsidizing sewer operations when there is no direct correlation between usage and the assessed value of real property. The prior cost of service study was performed in the early 1980s.

Miscellaneous Fees

A review of numerous fee ordinances revealed that they were not updated since the period 2003 through 2005. These ordinances should be reviewed on periodic bases and adjusted accordingly to insure associated cost recovery.

Grant Management

The City's grants management function operates in a decentralized fashion. There is no individual grant manager but rather all administration is performed at the department/division level that utilizes the grant. All accounting functions are performed within the Finance Department's Division of Accounts and Controls.

The June 30, 2007 annual audit report contained nineteen (19) significant deficiencies, material weaknesses, and instances of noncompliance in the single audit report section. Eleven of these comments were repeated from the June 30, 2006 audit. The majority of these comments were addressing issues in the Section 8 Housing program. We were informed by a representative of the independent auditor that all comments relating to the grants have been addressed and rectified by the City.

There were approximately \$2 million in grant receivables and \$.7 million in grants appropriated as of June 30, 2008 that had no activity during the fiscal year. All efforts should be made to collect these grants or a determination made as to the collectability and proper disposition made.

Payment in Lieu of Taxes (PILOT):

The City has twenty (23) separate PILOT programs in place for the years ended June 30 2008 and 2007. There have not been any new programs executed for a few years. The City realized \$3.5 million in anticipated revenues for the SFY 2008 and anticipated \$3.2 million for SFY 2009. The decrease resulted in the largest program being terminated due to change in ownership which resulted in the property being reinstated back onto the tax rolls.

The PILOT programs are administered by the Internal Audit Division. The internal auditor is responsible for the compliance of each of the agreements. The procedures performed and the documentation maintained by the Internal Auditor appears to be in excellent condition. A review of the files reflect that the internal auditor has been successful in identifying additional revenues from numerous payers and are being anticipated as revenues in the SFY 2009 budget under the headings of audit adjustments.

Cash Management Plan

The City has a formal cash management plan that was adopted February 17, 1998 by the City Council in accordance with N.J.S.A.40A:5-14. Subsequent updates and modifications are made by resolution with the latest being July 1, 2006. This modification identified institutions that are designated legal depositories for the City.

The plan appears to be all inclusive whereby the flow of funds, both receipts and disbursements, are outlined as to the method of depositing and disbursing, including the report methodology between the divisions of revenue collection, treasury, and accounts and controls. In addition, the plan identifies specific investment instruments that are permitted as follows:

- Savings Accounts
- Certificates of Deposit
- Securities of the United States Government or its agencies
- Repurchase Agreements
- New Jersey Cash Management Fund

During the SFY 2008, the investments of the City were limited to the New Jersey Cash Management Fund and money market funds. These instruments, including those authorized by the cash management plan, are in accordance with those authorized by State statutes.

The cash management plan should include a statement that all financial institutions designated as official depositories be insured and in compliance with the Governmental Unit Deposit Protection Act (GUDPA). The plan should also indicate that the City should be in receipt of each financial institutions GUDPA statement semi-annually. In addition, the City should consider modifying and updating the plan on a more frequent basis.

Accelerated Tax Sale

The City has followed the practice of conducting accelerated tax sales pursuant to Chapter 99, P.L. 1997. The accelerated tax sale at June 30, 2008 resulted in approximately \$4.1 million of additional tax collections, coupled with a lower reserve for uncollected taxes, accounts for the majority of the City's \$7.3 million fund balance. The tax sale appears complete with only \$7,564 of taxes receivable outstanding at June 30, 2008.

Tax Title Liens

Tax title liens amounted to approximately \$2.6 million dollars at June 30, 2008. This amount has increased approximately \$1 million dollars since June 30, 2007. These amounts should be reviewed and all efforts employed to reestablish these properties to active accounts.

Miscellaneous Revenues Not Anticipated (MRNA)

MRNA amounted to approximately \$1.5 million and \$3.2 million for the years ended June 30, 2008 and 2007, respectively. There appears to be revenues that can be easily identified and anticipated as reoccurring. As of June 30 2008, \$.4 million appears to be reoccurring and available to be anticipated. The SFY 2008 Annual Financial Statement included \$151,139 from premium on a note sale as MRNA incorrectly as premiums remain with the Capital Fund.

Capital Projects

During SFY 2008 the City authorized five (5) capital projects in the aggregate amount of \$12.1million which were financed by \$9.1 million in authorized debt, \$.3 down payment, and \$2.7 million in anticipated grants. The City has taken advantage of the benefits afforded by the Municipal Qualified Bond Act, Title 40A of the New Jersey Statutes, Section 40A:3-1, *et. seq.*, as amended. Therefore, the City made an application to the Local Finance Board, Department of Community Affairs, State of New Jersey and obtained approval to have this debt qualified under the Municipal Qualified Bond Act. The application, including the ordinances and Supplemental Debt Statements, appear to be in good order.

The City is anticipating permanently financing various projects during the late Spring. The City prepares all Official Statements internally in connection with the issuance of debt

Elected Officials

The City is governed under the Mayor-Council form of Government. The Mayor is elected for a four year term without limitation as to the number of terms he may serve. The Council consists of nine members, one from each of the six wards and three elected at large. All elections are held in May.

The Mayor is chief executive and administrative officer of the City and, as such, is responsible for administering local laws and policy development. The Council exercises all legislative powers, including final adoption of the spending legislation such as budgets and bond authorizations and zoning ordinances.

The Mayor's office incurred \$320,000 and \$20,600 in expenses for SFY 2008 for salaries and wages and other expenses, respectively. The Mayor's salary was approximately \$115,000 with the balance allocated to the support staff. Office related expenses, including cell phones, accounted for approximately 70% of all other expenses. Travels and Conferences amounted to approximately \$1,000.

The City Council office incurred \$590,800 and \$228,890 in expenses for SFY 2008 for salaries and wages and other expenses, respectively. The nine (9) Council members' annual salaries amounted to approximately \$38,000 each, with the Council President earning an additional \$1,000. The remaining salaries are for five (5) clerks. In addition, all Council Members are eligible for City provided health care.

Each Council Member is budgeted \$3,000 for an expense account. Eight (8) members incurred \$21, 225 in expenses and one member with none. The remaining expenses were as follows:

- Stenographic Services \$77,901
- Outside Services 36,442
- Cell Phones 22,349
- Office Expenses 44,190
- Public Luncheons 4,714
- Miscellaneous 22,069

Included in the cell phone amount are the costs, not only of cell phones, but the cost of actual hardware, PDA's (Personal Digital Assistant), wireless internet cards and actual service connection service. State contracts were used for much of these items.

Trust Funds

A review of the trust accounts recorded in the SFY 2007 Annual Audit, SFY 2008 Annual Financial Statements, and the 2009 SFY Budget revealed that a few trust accounts were established that do not appear on the Division of Local Government Services, Bureau of Financial Regulation and Assistance's Budget Rider Report for 2009. The City should review all their trust funds to insure compliance with N.S.J.A. 40A:4-38.

Parking Enforcement

During field work we have made observations as to the lack of parking enforcement. We observed, on numerous occasions, parking offenses that consist of both illegal parking and overtime meters. This appears to be the practice for a couple block areas surrounding City Hall.

Parking enforcement will not only create a positive revenue stream, it can be accomplished without incurring any additional costs.

Parking Authority

The City has established a Parking Authority that is a component unit of the City. The City has, in the past, unconditionally guaranteed the bonds issued by the Paterson Parking Authority. In addition, the City anticipated \$500,000 as revenue from the Authority in the SFY 2008 Budget which was never received and anticipated in the SFY 2009 Budget.

The City should review the possibility of dissolving the Authority and including the operation as an enterprise fund within the City. Savings can be obtained through the elimination of various professionals where duplication exists. In addition capital costs may be reduced through the issuance of general obligation bonds rather than revenue bonds.

Information Technology

Overview and Background

The Division of Technology, referred to as data processing (DP) of the City is responsible for implementation, maintenance and support of the day-to-day information processes of the City. The staff consists of six individuals (the acting director and five (5) technicians and operators) under the supervision of Department of Administration. The DP group supports all, with the exception of the Police Department, divisions of the City relating to hardware, software, network infrastructure and phone systems.

The network consists of ten (10) servers and approximately four hundred sixty (460) end users operating on two platforms – UNIX and Server 2003. Twenty (20) locations are connected by fiber and eight (8) other locations by VPN and dial-up. The major applications are found on the UNIX server and include KVS . The Windows servers are application, file, domain, e-mail and print servers.

KVS is a software solution provided based in Buffalo, New York, that specializes only in public sector software. The modules in use include:

General Ledger Payroll	Human Resources	Permits and Inspections
Requisitions	Purchasing	Accounts Receivable
General Receipts	Tax & Sewer Billing	Tax Assessments

TimeTrak software provides the time and attendance application with Tempo Systems BioScan Terminals communicating over the City's fiber optic network; the application is running under the Window 2003 Applications Server.

As part of our procedures, we obtained a high level of understanding of DP function. The following are key areas that were investigated in addition to lesser processes.

- Security
- Hardware
- Software (operating and application systems)
- Disaster Recovery Plan
- Data Center

The acting DP director was furnished with an IT center review questionnaire and a site walk through was performed with the director and the head technician.

The DP Center for the City of Paterson is housed in the basement of City Hall.

Observations

The overall security of the site is good with locking mechanisms and camera surveillance.

Only certain members of the DP staff have rights on the servers and access to sensitive information. End users have limited rights and their hardware configurations are limited. All computers are password protected and all pass words must be changed every one hundred twenty (120) days. Antivirus software is from Symantec and is kept up to date system-wide. There is content monitoring software preventing access to certain web sites as well as monitoring e-mails. There is a main firewall and a secondary firewall at the police computer center. Connection to the outside is via two T1 lines.

The hardware in place is virtually all Dell equipment purchased through State contracting. The KVS and other systems operate in a UNIX environment on an Aviion server. Aviion was developed by Data General in the early 1990's; before Y2K the line was purchased by EMC and maintained for two years. Post warranty support is now provided by Park Place International, a major provider of this service. Hardware inventory control is maintained by the DP department and device tagging is used.

The major network operating systems are UNIX and Microsoft Server 2003; the desktop operating system is XP. The Microsoft Office suite is in general use. All licensing is up to date and adequate. There is no source code available for application; no custom programming is performed. Any special reports are usually generated by report writers.

The present staff provides most training and all support to end users.

There is limited use of VoIP on the network.

There is no disaster recovery plan. Back-ups are made daily and off site storage is done weekly.

The size of the actual data center is adequate; there are two rooms with one being for the UNIX server and related peripherals and the other for the rack mounted Windows servers, switches and telephone equipment. This is a basement of a very old City Hall; the environment could be improved. This is a very busy department and the staff is short a few people. There is little time or dollars available for this endeavor. The UPS systems and temperature control appear adequate.

Recommendations

A disaster recovery plan should be designed and tested. The City has become reliant on information technology and any interruption of data flow could have a major impact on the operations of the City. A good disaster recovery plan not only includes hardware and software, but includes plans for the lost of key employees. Once the plan is written; it should be tested for adequacy and to familiarize with DP staff and all City employees.

The overall environment and house keeping of the data center needs to improve.

The Aviiion server is an older piece of equipment and the present support is from an after warranty third party provider. Consideration should be given to replacement of this server before a catastrophic event takes place.

The off site backup routine needs to be improved. With the fiber optic network, this should be an achievable task.

The City could receive a substantial cost saving if a VoIP phone system was installed. This system would greatly improve operations and pay for itself in a very short period.

Risk Management

Administration of all insurance is performed within the Department of Treasury. There is only employee who administers all insurance matters between the City, employees, brokers and underwriters.

The City contracts with an outside risk manager who reviews all insurance proposals and policies. The risk manager is responsible for the type and adequacy of all coverage.

The City, through an a Request for Proposal Process (RFP) every three (3) years, utilizes two (2) insurance brokers who are responsible for locating insurance companies to insure that the City obtains the requested coverage and at the least cost.

In addition, the City contracts the services of three (3) third party administrators to administer the claims of all the self-insurance funds. Cannon Cochran Management Services, Inc (“CCMSI”) administers the self insurance funds for general liability, auto liability, and workers’ compensation insurance; Horizon BCBSNJ administers the health and dental insurance; and Benecard RX administers the prescription drug plan.

The City has excess insurance coverage for all self insurance funds with workers’ compensation insurance at the statutory limit while general liability and auto with excess coverage at \$10,000,000 and \$5,000,000, respectively.

The only employee participation towards health insurance is \$4.59 per payroll for dental insurance which is a fully insured plan.

The City currently provides lifetime medical benefits to employees who retire on a paid pension under the following conditions:

- After twenty-five (25) years of service with the City; or
- After fifteen (15) years of service with the City at age 62 or older; or
- On an accidental disability pension with not less than five (5) years of continuous service with the City in the case of firemen and policemen, or ten (10) years in the case of employees in the Public Employees Retirement System.

Coverage is also provided for family members per the employees union contracts and paid by the City for the life of the retiree.

Upon the death of the retiree, the surviving spouse and dependent children under the age of twenty-three shall be entitled to remain enrolled in the City's medical-hospital insurance plan. This coverage ceases when any of the following occurs:

- Spouse dies; or
- Spouse remarries; or
- Spouse reaches the age of 65

Prescription drug benefits are provided and paid by the City under the same circumstances except upon retiree's death. Coverage would be provided for the surviving spouse only, and would be discontinued upon:

- Surviving spouse's remarriage; or
- Surviving spouse's obtaining coverage from another source

The City accounts for these post retirement benefits on a pay-as-you-go basis. Expenditures during the years ended June 30, 2008, 2007, and 2006 amounted to \$9,197,538, \$9,036,295, and \$7,075,872, respectively. The number of employees eligible to receive benefits for the same period was 872, 852, and 814.

Effective June 30, 2008, the City will be required to follow The Government Accounting Standards Board (GASB) statement number 45 "Accounting and Financial Reporting by Employers for Post-Employment Benefits Other than Pensions." GASB 45 will require the City to disclose the actuarially determined liability for all Other Post-Employment Benefits (OPEB). OPEB are non-pension benefits that a government has contractually or otherwise agreed to provide employees once they have retired.

Observations:

- The City maintains a reserve for insurance liability in the Current Fund with a balance of \$957,000 at June 30, 2008. Our review of the June 30, 2007 audited financials and the SFY 2008 Annual Financial Statements did not reflect any recording of case reserves or reserves for claims incurred but not

reported (IBNR). Actuarial computations should be performed and recorded to determine the adequacy of the reserves.

- Consideration should be given to establishing the practice of employee contributions to assist in subsidizing the increase in health care costs.
- The City should obtain a service organization report from the third party administrators (TPA) in order to provide assurance that internal controls within the TPA are achieving specified control objectives.
- The City should consider establishing an insurance committee which should review all or selection of workers' compensation and general liability claims to determine legal liability. In addition the committee should establish guideline to review and approve reserves for losses.
- Other Post–Employment Benefits are escalating at a very significant rate. The City should consider addressing these benefits in order to reduce the burden on future budgets.

Inventory Control

System Description

The fixed asset and inventory control system is maintained by the Acting Chief Financial Officer. There are no formal procedures in place to insure the recording of the acquisition, disposition or impairment for tangible personal property.

The last full documentation of all fixed assets was performed in 1985 to conform to the State's Technical Accounting Directive Number 85-2 "Accounting for Governmental Fixed Assets." The fixed asset subsidiary ledger is maintained on an excel spread sheet without a dynamic link to the accounting system.

The City does not maintain an inventory of materials and supplies of any larger dollar items required for the normal operation of the Department of Public Works, including the Sewer Division.

The City's Capitalization Policy is that of the States. In 1996, the City increased the capitalization threshold from \$1,000 to \$5,000 based upon Local Finance Notice # CFO-96-13.

The inventory associated with any technology and electronic equipment is addressed in the information technology section of this report.

Recording

Additions to fixed assets are recorded on a fixed asset addition spread sheet with each entry supported by a copy of a voucher and invoice. The accumulation of these entries is solely based upon the CFO's, and the accounts payable clerk, "eyeballing" each transaction to determine which ones are to be capitalized.

There have been only been five (5) entries made to the Land and Building asset ledger since 1985 which amounted to \$1,497,698 of the total \$42,292,103 at June 30, 2008. The inventory control consists of Location, Block/Lot, Description, Cost, and Replacement Costs for assets dated prior to December 31, 1985. All assets dated 1985 and prior are recorded at replacement cost.

The detail inventory of equipment is maintained by recording the following for each item: Department, Division, Commodity Code, Description, Manufacturer, Serial #, Cost, and Replacement Costs for assets dated prior to December 31, 1985. There is very little evidence that any assets have been disposed of. There are numerous assets carried at replacement cost dated December 31, 1985 and prior with their existence being highly doubtful. The CFO indicated that the Fire and Police Departments had an inventory of their assets taken and adjustments made accordingly.

The fixed asset spread sheets are updated annual in conjunction with the annual audit.

Observation

- A complete physical inventory should be taken to determine whether the fixed assets recorded still physically exist.

- Assets should indicate the funding source to assure compliance with the terms and conditions of any grants, restricted contributions, etc.
- The fixed asset system should be integrated into the City's purchasing/expenditure system to insure the proper recording of assets.
- Procedures should be established to insure the recording of any assets disposed of is supported by disposition documents.
- Policies and procedures should be implemented to insure correct treatment for calculating asset impairment, including those requiring management's estimates and judgments.

Purchasing and Expenditures

A statistically valid sample of cash disbursements was drawn from a population of approximately 14,500 transactions that occurred during the period July 1, 2007 through June 30, 2008. Voided checks selected were examined to see if they were properly voided and no exceptions were noted relating to voided checks.

Observation

During our detailed testing some exceptions items were noted. With a large scope employed, these findings are not considered to be material weaknesses. The overall purchasing and expenditures cycle appears to be functioning adequately. The City should improve on the requirements for claimant certifications.

Professional Services, Competitive Contracting and Extraordinary Unspecifiable Service Contracts

For the State fiscal year ended June 30, 2008, the Purchasing Department of the City of Paterson distributed twenty-six (26) Requests for Proposals for Professional Services and one competitive contract was used for specialized services. There was one (1)

extraordinary unspecifiable service contract used by the City. The Purchasing Department made the entire twenty-seven (27) bid packages available to us and a 100% scope was used. Of the scope of twenty-seven (27), the City Council rejected four bids and in one (1) case no bids were received. Each file was neatly arranged and contained all necessary documentation.

Observation

Some files did not contain a resolution approving the contract, while others had resolutions that were not finalized. The City Clerk provided us with all necessary finalized resolutions and they were filed in the appropriate folders.

Vendor Data Base

A vendor data base was obtained as of June 30, 2008. Vendors are to remain on this data base for three years. It contains vendor name and addresses or multiple addresses and post office boxes. The report was 748 pages in length and an average of twenty (20) items on a page; in total this is approximately twelve thousand items. The obvious post office box addresses (Verizon, AT&T, etc.) were not included in our scope. Two hundred and thirteen (213) vendors were selected who had post office box addresses or the vendor appeared to require further investigation. One hundred and twenty six (126) selections were verified as to the post office box and being an appropriate vendor through internet investigation. City finance personnel were requested to pull supporting documentation for the remaining eighty-seven (87) vendors.

Observation

In most cases, the vendors were valid and the related purchases appeared reasonable.

Two checks were made out to the "Friends of Councilperson _____" for reimbursement of the purchase of three tickets totaling \$225 for the NJ Elected Official's Hall of Fame. This re-imbursement should not have been made out to the political fund raising arm of the Councilperson.

It was also noted the vendor listing was much older than three (3) years and had not been purged recently.

Analysis of Purchase Orders where amounts paid exceeded the original purchase order amount by 20%.

During the detailed disbursement testing, a review was made for total disbursements in excess of 20% over the original purchase order. The purchasing agent also maintains a file of purchase orders where total disbursements were greater than 120% of the original purchase order; this is for disclosure in the Annual Budget and to adhere to the controls in place.

Observation

All purchase orders that increased by 20% were properly handled and documented.

Payroll and Human Resources

Overall Payroll Testing

A statistically valid sample was made of employees and detailed testing was performed.

All personnel files were requested and supporting documentation was agreed to the payroll data base with emphasis placed on missing hire and birth dates, status, address, and other basic information.

Observation

In two (2) cases support for child care deductions could not be located.

Twenty (20) personnel files could not be located.

It appears that employees were paid in accordance with appropriate contracts, time sheets support hours compensated, and only active employees were paid. Information in the data base appears complete. The position control reconciles to the payroll and budget

Recommendation

Control over personnel records should be improved.

Employees receiving a greater than normal number of payroll checks

Observation

Seventeen (17) employees in our sample received more than twenty six payroll checks.

The reasons for the additional checks were for clothing allowances and retroactive pays, which were in accordance with existing contracts. It appears employees are not receiving additional compensation that is not authorized.

Examination of Employees whose base salary increased greater than \$7,500 in a year

The Data Processing department generated a report comparing 2007 and 2008 base salaries for all employees. Forty-four (44) employees had their base salaries increase over \$7,500 in a full year to year comparison.

Observation

Explanation for salary increases over \$7,500 were valid, explanations included:

- Promotion
- Contractual increases
- Step increases
- Retro active pays
- Transfer from part time to full time status

Labor and Employee Contracts

A review was made of labor contracts, which were signed toward the end of 2008 for the period July 1, 2007 through June 30, 2011. Seven (7) contracts were with AFSCME and the remainder were with United Service workers Union and Amalgamated Industrial Union. All contracts included annual raises of between 3 and 4 percent, longevity was consistent and, where applicable, there was tuition reimbursement, clothing allowance and auto allowance.

Observation

There did not appear to be any questionable areas of these contracts. Individual employee contracts are not used.

Terminated Employees

A sample of terminated employees was selected and detailed testing was performed to determine proper final pay calculation and cut-off.

Observation

Terminated employees appear to have their final compensation correctly determined and were removed from the payroll data base.

Manual Payroll Checks

Manual payroll checks can be required when a department, by error, does not include an employee's timesheet for compensation or the payroll clerk in charge of that department makes an error.

Employees who do not get their checks or have an error on their checks, immediately notify their department head, who in turn notify the Payroll Department of the error or omission. The department head will fax in the employee's timesheet with approval for

payment. If the error is made in payroll by one of the clerks, the payroll supervisor reviews the error and determines the correction. A manual check is typed, the signature stamped and the payroll supervisor initials by the stamp. The stamp is maintained in a safe in a Treasury supervisor's office; she is the only one who has access to this stamp.

Manual checks are usually prepared on Friday or Monday, the latest. At the end of the day a spreadsheet is drafted stating the additional payroll amounts, then a voucher is drawn by a Treasury supervisor and approved by the Treasurer. This is then sent across the hall to Finance, so the payroll account can be increased.

The manual checks are put into the system the following pay period by a payroll department clerk. When Treasury reconciles the payroll account they incorporate the manual check spreadsheets.

Observation

No exceptions were noted.

Payroll Payout

A payroll payout was performed. The City has approximately 2,100 employees with the largest departments being police (500), fire (400), and DPW (300); the remaining employees are in City Hall and other outside locations. A sample of employees was taken from the entire population; all employees received a notice stating the payout would occur on Friday February 6, 2009. The notice was signed by administration and stated that proper identification was needed before the actual pay checks were distributed. Employees with direct deposit would be given their deposit advice.

Due to stipulations in the police contract, uniformed officers are to receive their checks by three o'clock of the preceding day. The payout started on Thursday afternoon, went into the evening and resumed all day on Friday and also included non uniform personnel. Two police shifts were included in our scope. One fire shift payout was performed. A minor number of DPW night shift employees also receive their checks on Thursday night; these individual were not included in the payout.

The payouts were physically performed at four locations on Friday: Police Headquarters, Fire Headquarters, DPW yard, and City Hall. The Library, Municipal Court, Museum and Health Lab were excluded from our scope.

At each location a City representative distributed the checks in the presence of an MBC representative who checked the employee's identification and had them sign a departmental roster that was generated by the City's Data Processing department.

The week following all employees who had not picked up their checks came to City Hall to receive their checks. The payout was closed on Wednesday February 18th; at this point alternate procedures were instituted for any unclaimed checks or advices. For police and fire, the daily shift log was obtained which was signed by the employee and commanding officer. The crossing guards represent the next largest group of people who had not signed for checks. As an alternate procedure, the roster sheets prepared by a supervisor, and approved by the police department were used to see if the employees were valid. The remaining employees had their personnel file reviewed, biometric attendance reports and time sheets were reviewed.

The statistics for this step are as follows:

Total employees	2,100
Number not selected	400
Number of employees included in scope	1,700
Number that signed for check	1,560
Number of alternate procedures	140
Exceptions	None

Observation

All employees receiving compensation were valid employees.

INTERNAL CONTROLS

OVERALL INTERNAL CONTROLS (as it relates to the attached matrix and narrative)

Management of the City of Paterson has the responsibility to design and implement a system of internal control to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial accounting and reporting
- Effectiveness and efficiency of operations
- Compliance with applicable State and Federal laws and regulations

Internal Control consists of five interrelated parts:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring

Control Environment

The control environment is established on the basis of the attitude of City management toward internal control. It is the basis for all other elements of the system of internal control. It is the foundation for all other parts of internal control, and provides discipline and structure.

The collective effort of various factors affects the control environment, including the following:

- Integrity and ethical values
- Commitment to competence
- City Council participation
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

The substance of internal controls is more important than the form because of the risk that controls may not be effectively implemented or maintained.

Risk Assessment

Risk assessment is the City's identification and determination of risks relevant to the achievement of their objectives and is the basis for determining how risks are managed. Risks can arise or change as a result of many factors, including:

- Changes in operating environment
- New personnel
- New or updated IT systems
- Rapid growth
- New technology
- New grant programs, building projects, or City improvement tasks
- Organizational change
- Accounting pronouncements (State, GASB, etc.)
- Federal and State regulations

Control Activities

Control activities are the policies and procedures that assist in ensuring that management principles are carried out. Control activities are usually divided into four categories:

- Performance reviews
- Information processing
- Physical controls
- Segregation of duties

The application of controls is affected to some degree by the size of the governmental entity. Paterson being a larger city has more sophisticated controls.

Information and Communication

Information and communication relate to the identification, summary, and exchange of information in a form with a time frame that enable City employees to carry out their duties. Information systems include procedures and documents that do the following:

- Identify and record all valid transactions
- Describe, on a timely basis, transactions in sufficient detail to permit proper classification for financial reporting
- Measure the value of transactions in a manner that permits their correct recording in the financial statements
- Permit the recording of transactions in the proper year
- Present properly the transactions and related disclosures in the financial statements

Monitoring

Monitoring is a process that reviews the quality of internal control performance over a period of time. Ongoing monitoring activities include regular management and supervisory activities and other actions taken during the normal performance of management's responsibilities.

City management should clearly assign responsibility and delegate authority with enough care to ensure that:

- Persons who perform control procedures are held accountable for their performance by those who monitor these activities, and
- Persons who monitor the performance of control procedures are held accountable by the City Council.

Common Types of Control Procedures

Numerous control procedures and monitoring activities are performed by individuals in governmental entities to accomplish particular objectives. All these controls, however, can be classified within one of the basic categories of controls described below.

Access Controls

Certain controls prevent access to assets by unauthorized persons. Often these controls are physical in nature. For example, an organization might store check stocks or receipts in a vault or a locked drawer, and use alarm systems to restrict access by unauthorized individuals. If controls to prevent unauthorized access are not effective, assets may be lost or stolen.

Reconciliation and Comparison of Assets with Records

Reconciling and comparing assets with accounting records establish a system of independent verification, either through preparing an independent control document used to reconcile accounting records and assets or by directly comparing accounting records with related assets. An example of this would be the preparation of a bank reconciliations.

Analytical Reviews

The purpose of analytical reviews is to evaluate summarized information by comparing it with expected results. City management perform these reviews to determine whether the City is performing as planned. For example, a common analytical review procedure is the comparison of budgeted to actual performance for anticipated revenues and appropriations.

Authorization and Approval

Authorization and approval procedures prevent invalid transactions from taking place. Thus, this type of control typically involves authorization or approval of transactions at specific dollar amounts.

Reviews of Output

Reviews of output data should be performed by City personnel who have the knowledge and experience to identify errors. These reviews check the validity and accuracy of output by comparing it in detail with expected results. For example, a purchasing manager may compare recorded amounts or quantities purchased with separate records of purchase orders.

Transactional Reviews

Transactional reviews check the validity and accuracy of transaction processing by comparing it in detail with expected results. Reviews often use exception reports, which list items that failed to be processed because they did not meet specified criteria.

General Computer Controls (while not covered by the attached matrix and narrative, are an important part of Internal Control)

Computer systems frequently have common areas of control and related control procedures referred to as general computer controls. These controls directly or indirectly affect all systems that operate within the data processing area.

- **Computer operations.** The computer operations staff is responsible for the day- to-day processing activities of the entity's system. It ensures that jobs are scheduled and processed as planned, data are properly stored on the system or tapes, and reports are distributed in a timely and accurate fashion.
- **Systems acquisition, development, and maintenance.** The systems acquisition, development, and maintenance staff is responsible for planning, acquiring or developing, testing, and implementing new application systems and changes to existing application systems.
- **Information security.** The information security function is responsible for administering and maintaining a city's information security program, including both physical and logical security. The primary goal of such a program is to insure that access to program data, online transactions, and other computing resources is restricted to authorized users.
- **Information systems support.** Information systems support includes such functions as system software maintenance, database administration, communications and network management, end-user computing, and other groups with technical and administrative support responsibilities.

In the final analysis, maintaining the internal control environment and related control procedures is an integral part of the City of Paterson management's responsibilities. In the context of governmental accounting and reporting, the control environment has a direct impact on an entity's ability to collect and present accurate financial information.

The following matrix delineates the controls that should be in place in municipalities. It has been tailored to fit the control environment in the City of Paterson. The matrix states where risk may possibly be and the severity of that risk. Also stated, is timing or immediate impact of those risks.

This is not stating that there is a break down in internal control within the City of Paterson; at the end of each transaction cycle it states that the systems are functioning adequately.

CITY OF PATERSON – INTERNAL CONTROL MATRIX

Section	Area	Timing		Potential Risk		
		Long Term	Short Term	High	Med.	Low
Revenue/ Cash Receipts	Segregation of Duties		X		X	
	Standard Operating Procedures		X		X	
	Cash Receipting Process - General		X		X	
	Taxes		X	X		
	Grant Receipts		X			X
	Outside Offices		X	X		
	Treasury Functions		X		X	
	Investing		X			X
	Reconciliation of Cash Accounts		X	X		
Purchasing/ Accounts Payable	Segregation of Duties		X		X	
	Standard Operating Procedures		X		X	
	PO Requisition Process		X	X		
	Completeness of Purchase Order Packets		X	X		
	Centralized Purchasing Department		X	X	X	
	PO's (100% or normal)		X	X		
	PO's Blanket/Partial Payment		X	X		
	PO's Cash Vouchers		X	X		
	PO's Expense Reimbursement		X	X		
	Bid Thresholds		X	X		
	Quotation Process		X	X		
	EUS/Competitive Contracting		X	X		
	Vendor List Maintenance		X			X
	Professional Services		X	X		
	Safeguarding of Check Stock		X	X		
Approval Process for Processed Checks		X	X			

Section	Area	Timing		Potential Risk		
		Long Term	Short Term	High	Med.	Low
Human Resources/Payroll	Segregation of Duties		X		X	
	Standard Operating Procedures		X	X		
	Approval of Standard Payroll Forms		X		X	
	System Completeness and Accuracy (Hire Dates, Birth Dates, SS#'s, Termination Dates)		X		X	
	Salary Ordinance					
	Sign off on Check Distribution		X		X	
	Segregation of Types of Pay Types of Computer Reports		X		X	
	Existence of Personnel (Pay out)		X			X
	Supporting Documentation for Payments to Terminated Employees		X		X	
	Securing Payroll Information (Physical Security)		X		X	
	Safeguarding Check Stock (Manual Checks)		X	X		
	Management Reviews of Overtime, Longevity, etc.		X	X		
	Historical Payroll Information		X			X
	Union Contracts		X			X
	Compensated Absences	X				X
	Reconciliation of Net Payroll Accounts		X	X		
	Reconciliation of Payroll Deductions Accounts		X	X		
General Operations/Accounting	Segregation of Duties		X	X		
	Written Procedures					
	Reconciliation of Bank Accounts		X	X		
	Grants Management		X		X	
	Approval of Budget Transfers		X	X		
	Manual Journal Entries Posted to General Ledger		X	X		
	Authorization of Wire Transfers		X	X		
	Monitoring Open Purchase Orders		X		X	
	Internal Auditor		X			X
	Controls Over Data Entry	X		X		

REVENUE AND CASH COLLECTION

Revenue and Cash Collections

System Summary

The Revenue Office is comprised of twelve (12) employees six (6) account clerks, three (3) cashiers, one (1) license Inspector, one (1) customer service, and one (1) secretary under the supervision of the Director of Revenue, who is also the Certified Tax Collector. The City Revenue Office is responsible for the collection all revenue with the exception of grants, which are electronically transferred directly into the City's account and interest earnings which are directly credited to the applicable accounts.

The Revenue Office has proper segregation of duties. Cashiers, who are assigned their own cash draw, collect, counts and validate all cash collections. The validation process includes:

- Date paid
- Amount
- Cash or check
- Cashiers ID #
- Terminal #

A daily report is printed (per terminal) which totals the amount collected and is reconciled to the funds on hand. Any discrepancies noted are reviewed by the Head Cashier. Upon full reconciliation, a daily report is prepared by each cashier, signed and placed in individual marked bags that are placed in the safe overnight.

The next morning each bag is recounted by a different individual and prepares a laundry sheet (summarization of deposits) that reflects each bag's monies by revenue source. The sheet is the foundation for the preparation of the deposit slip. A Police Officer escorts the deposit to the bank. The City rotates on a monthly basis the four accounts utilized for deposits. The validated deposit slip along with the copy of the laundry sheet is forward to treasury.

The Treasury's Office records directly off the deposit slip and creates a manual cash journal that includes the Revenue Office collections coupled with the grants and interest

earnings that are received directly by treasury. Monthly cash reconciliations are prepared by an account clerk in treasury and reviewed, approved and signed by the Administrative Clerk. Any discrepancies are investigated and resolved in conjunction with the Revenue Office.

The Accounts and Controls Office also works from the laundry sheet, cash journal, and reconciliation prepared by Treasury and creates their own cash receipt spread sheet for recording into the City's manual general ledger.

Observations

The system as documented is functioning as prescribed. The controls that are in place are highlighted by a proper segregation of duties, interaction between offices, and the numerous counts and reconciliations that are performed

PURCHASING AND EXPENDITURES

Purchasing and Expenditure

Purchasing and Expenditure Cycle

Overview and Background

This section covers the entire cycle of purchasing from requisition to payment and through to bank reconciliations. The City has a separate Purchasing Department which is headed by a Qualified Purchasing Agent. The predominant amount of transaction flows occur in Accounts and Controls that is under direction of Certified Municipal Finance Officer. A separate Treasury Department performs all bank reconciliations and investments.

During our work we developed a high level of understanding of this cycle. The following are the key areas we have documented:

- Requisitions
- Purchase Orders:
 - 100% Expenditures
 - Blanket and Partial Payment
 - Cash Vouchers
 - Expense Reimbursement
- Flow of Transactions
- Reconciliations
- Bidding

Requisitions

The City has nine departments that purchase goods and services:

- Administration
- Finance
- Personnel
- Law
- Community Development

Human Services
Public Works
Police
Fire

Any department that needs a good or service will prepare a coded, pre-numbered purchase requisition containing the date, the budget line item to be charged, supplier's address, quantity, description of the good or service, amount and the department or division head will sign or initial the requisition and forward the requisition to the purchasing division.

Purchase Orders

100% Expenditures (Normal Expenditures)

The purchasing agent reviews all purchase requisitions for vendor, quantity, type of good/service, date, and proper coding. The purchase requisition is inputted into the City's KVS accounting system by a purchasing assistant. The purchase requisition is input into the KVS system by name, vendor, description of items, number of items, and cost. A review is performed to determine if there are sufficient funds available in the particular budget line to spend the requested amount. If funds are available, the request is encumbered. If there are insufficient funds available, the requisition is stamped "insufficient funds available" and sent back to the requesting department. If there are sufficient funds available in the particular budget line item, a four (4) part purchase order is prepared containing date, purchase requisition number, delivery address for the goods or service, and description of the goods or service to be furnished by the vendor.

This purchase order consists of four (4) parts:

- (1) white copy, which is signed by the vendor attesting that the description and amount of the goods or services is correct and returned to the Accounts and Control department
- (2) blue copy, which is kept by the vendor
- (3) yellow copy, which is returned to the Accounts and Control department

(4) gold copy, which is the receiving copy that the department head sign after acknowledging receipt of the goods or services and returned to the Accounts and Control department

The purchasing division mails the white copy of the purchase order to the vendor for certification who then sends the purchase order back to Accounts and Control along with the invoice for the goods or services supplied. The vendor keeps the blue copy of the purchase order and delivers the goods to the designated receiving address. The department director signs the receiving report (gold copy) on the purchase order, tears off the bottom portion of the receiving certification and forwards this to Accounts and Control for payment.

At the Accounts Payable Department, a Division of Accounts and Control, the purchase order package at this point consists of four (4) parts: the white copy (the claimant's certification), the yellow copy (the Division of Accounts and Control copy), the bottom portion of the gold copy (receiving certification), and the vendor invoice. A clerk reviews the invoice to determine: (1) if the invoices clerically accurate and agrees to the purchase order amount; (2) the vendor certification on the white copy; and (3) the receiving certification of the goods. If the purchase order amount agrees to the invoice, and the vendor's certification and the receipt certification are filled in, the clerk initials the white copy of the purchase order and then date stamps the purchase order "Audited for Payment City of Paterson." The clerk then enters the purchase order into the accounting system when to pay the purchase order, hand dates and stamps the purchase order "Terminal Posted by Division of Accounts and Control" indicating the purchase order has been input into the accounting system. The hand dating of the purchase order indicates the date of the City Council meeting that the purchase order is to be paid. At this point the purchase order becomes a voucher.

The Treasury department will prepare a check register from the accounting system for bills to be paid at the City Council meeting. The check register is then sent back to the Accounts and Control and reviewed against the vouchers to be paid. The voucher is assigned a check number from the check register prepared and the check number is manually written on the voucher.

The paid vouchers are filed by fund type and check number in the Accounts and Control department.

Blanket and Partial Payment

This type of purchase order is used by a department that has a contract for goods or services; the department will prepare a coded, pre-numbered purchase requisition containing the date, the budget line item to be charged, supplier's address, quantity, description of good or service, and amount. Blanket and partial payment purchase orders are typically used by the City to encumber and pay large installment expenditures on City contracts that, for example, are put out to bid.

An original purchase order is prepared and held for the entire contract along with a copy of the resolution authorizing the award of a bid for the goods or services.

This purchase order consists of four (4) parts:

- (1) brown copy, which is signed by the department or division stating they have received the goods or service
- (2) pink copy, which gets mailed with the check to the vendor
- (3) blue copy, this copy gets filed with Accounts and Control
- (4) gold copy, this copy goes to the department who requested the goods and is kept by the department

At the Accounts Payable Department, the purchase order now consists of two parts: the brown copy ,the department's certification, and the vendor invoice. The blue copy of the partial payment purchase order is filed in a separate file in Accounts and Control.

A clerk, reviews the invoice to determine: (1) if the invoices are clerically accurate and agrees to the purchase order amount; and (2) the receiving certification of the goods. If the purchase order amount agrees to the invoice, and the receipt certification are filled in, the clerk then enters the purchase order into the accounting system when to pay the purchase order, hand dates and stamps the purchase order “Terminal Posted by Division of Accounts and Control” indicating the purchase order has been input into the accounting system. The hand dating of the purchase order indicates the date of the City Council meeting that the purchase order is to be approved to be paid. At this point the partial payment purchase order is ready to be paid and becomes a voucher. The remainder of the cycle is as described above.

Cash Vouchers

Cash vouchers originate from the various departments requesting funds to pay for special types of goods and services. Examples of these types of vouchers include:

- Tax overpayment refunds
- Tax appeal refunds
- Medicare tax reimbursement for former City employees
- Attendance fees for Board of Adjustment, Planning Board meetings
- School and County tax levy
- Meeting reimbursements
- Small item reimbursements

Cash vouchers originate from the various individual departments where it is prepared containing the vendor, address, account number to be charged to, and description of good or service to be purchased. The department head signs the cash voucher as being a valid expense.

The cash voucher requires, where applicable, the claimant’s certification and an invoice attached before actual input into the accounting system.

At the Accounts Payable, a clerk reviews the cash voucher for department head signature, vendor signature and supporting invoice; then the cash voucher is inputted into the accounting system; this is the point that the expenditure is encumbered.

The cash voucher is then stamped “Terminal Posted by Division of Accounts and Control” indicating that the cash voucher has been input into the accounting system, and the clerk manually writes the future meeting date the City Council is to pay the expenditure. The remainder of the cycle is as described above.

Expense Reimbursement

The City uses expense reimbursement vouchers for various trip expense and mileage reimbursements.

Any department that requests an expense reimbursement prepares a pre-numbered expense reimbursement voucher with all the necessary information including name, address, date, account number to be charged, business purpose, mileage expense, tolls, and explanation of expense incurred. The expense reimbursement voucher must be signed by the department head or division head and must be signed by the person who incurred the expenditure, claimant’s certification, before being sent to Accounts and Control.

The expense reimbursement voucher must have an invoice attached if expenses were incurred. The expense reimbursement voucher may not have an invoice attached if there was mileage reimbursement only.

A clerk reviews the reimbursement voucher for the department head signature, proper vendor certification, and supporting invoice attached and recalculates the reimbursement amount. All expense reimbursement vouchers are approved by the CFO.

The expense reimbursement is then stamped “Terminal Posted by Division of Accounts and Control” indicating that it has been input into the accounting system, and the clerk manually writes the future meeting date the City Council is to pay the expenditure. The remainder of the cycle is as described above.

Flow of Transactions

The Data Processing department prints the check register and the vendor checks from the accounting system where the purchase orders were entered. DP brings the vendor checks to the Treasury department and the check register to Accounts and Control for review.

After Accounts and Control review, copies of the vouchers are brought over to the Treasury department for agreement with the actual checks. The checks and a copy of the voucher is inserted into an envelope and mailed to the vendor.

The mail room is called and the vendor checks are tendered over to an individual in the mail room, vendor checks are run through the postage machine and mailed by individuals from the mail room.

Vendor checks require two signatures, the mayor and CFO, before mailing. Checks are signed using a facsimile check stamp signature, which stays locked inside the Treasurer's Office when not in use.

Reconciliations

The Treasury Department performs all bank reconciliations. Individuals in that department are responsible for the reconciliation of certain accounts; all reconciliations are reviewed by a supervisor in the Treasury Department. The manual general ledger is posted from cash disbursement reports and cash balances are agreed to the reconciliations.

Bidding

All possible biddable items first originate in the department that needs the goods or services. The requesting department contacts the Purchasing Department who draws up a City Council resolution authorizing a bid proposal to be solicited through an advertisement in a city designated newspaper.

A newspaper advertisement is prepared and advertised in a City designated newspaper by the purchasing department requesting prospective bidders to submit written proposals on the specific bid item requested by a specific date. The purchasing department sends out

prospective bid packages including all specifications, to the respective bidders who desire to submit a bid. Bidders fill out the bid package and submit their written bid proposals to the City purchasing department by the specific date. Bids are opened at a designated time and date in the purchasing department and the prices submitted are publicly announced in the purchasing department. Bids prices are tallied by price from lowest to highest and a written tally sheet called a “canvas sheet” is prepared by the Purchasing Department on all bids received for that particular item or service.

The bid information is sent to the particular department requesting the item, who recommends a vendor. Purchasing then prepares a resolution for the City Council to accept or reject.

The Purchasing Department uses State contract and Cooperative pricing where applicable; these items are approved by resolution. The use of competitive contracting and extraordinary unspecifiable services are rarely used.

See a separate section of this report for comments on Professional Service contracts.

The system as documented is functioning as prescribed. The controls that are in place are highlighted by a proper segregation of duties, interaction between offices, and the numerous counts and reconciliations that are performed.

PAYROLL AND HUMAN RESOPURCES

Payroll and Human Services

Payroll and Personnel

Overview and Background

The Payroll Department consists of three full-time employees under the Division of Treasury. The Personnel Department is separate and apart from the Payroll Department. The Personnel Department has five (5) full-time employees. Each bi-weekly payroll period, the Payroll Department with the assistance of Data Processing prepare the payroll. The base information obtained for the payroll preparation are the manual daily departmental time sheets and a biometric attendance program. The payroll software is an in-house module of the KVS UNIX based system and all checks and reports are prepared in-house by the Data Processing Department. These checks and reports are reviewed by the Payroll Department for accuracy and then distributed to the proper departments.

The payroll distribution reports automatically interface to the budget system, while the general ledger is posted manually.

Each bi-weekly payroll is for the prior two weeks work performed. Each departmental supervisor must approve the daily timesheets of both the hourly and salaried personnel. Additional payrolls can be processed for retro-active pays and miscellaneous contractual reimbursements.

There are approximately 2,100 employees. There are also additional seasonal employees.

As part of our work, we gained a high level understanding of both the payroll and personnel cycles. The following were key areas reviewed during our work:

- Payroll Preparation
- Check stock
- Attendance
- Payroll Deductions
- Personnel Files
- Contract Review

- Termination
- Manual Checks
- Payroll Pay-out
- Compensated Absences

We performed a system walk through and interviewed key personnel functioning within the cycle; from this we created a system narrative determining controls and weaknesses.

Observations

The payroll preparation starts with employees on a daily basis entering their employee numbers and two fingers into the Tempo Systems biometric time clock machine which are located at 22 locations around the City and tie back into the Data Processing Department via the City's fiber optic network. Also, each employee fills out and signs a manual daily timesheet which is reviewed and signed by the division director. Computer generated time sheets are produced bi-weekly and adjusted manually for changes, like personnel days, that the time keeping does not handle well. These timesheets play a secondary role in payroll preparation, while the daily manual time sheets provide the primary input into the payroll preparation.

At the beginning of each payroll week, Data Processing prepares a departmental report from the Tempo system; this is sent for review by the Mayor's Office and the appropriate sections are distributed to the proper department. These are reviewed and updated at the departmental level and then approved on a division level. When the payroll department receives these corrected and approved reports, a "Biweekly Time Sheet Report" is prepared. This report is reviewed and approved by the director of the Treasury Department before the payroll can be generated. One of three (3) clerks who are responsible police, fire, and other departments, enter the necessary changes to payroll into the system. Only required changes are made; the system rolls forward all other information. An edit function is performed agreeing the entered payroll with the Biweekly Time Sheet Reports by the payroll supervisor and, after approval, the payroll checks are generated by Data Processing.

Pre-numbered blank payroll checks are maintained in a locked closet in the payroll department. When the checks are to be prepared, a clerk signs out the required number of

checks and signs a Check Control Book that is maintained by another clerk. Unused checks are signed back in and locked in the closet. The keys to this closet are limited and not available to the person preparing the checks.

The checks are signed by the mayor and CFO on a dedicated laser printer in Data Processing. The checks are sorted by department by the payroll department staff and are available for pick up at 9:00 A.M. on each payroll Friday; by contract the police department payroll is available after 3:00 P.M. on Thursday. All checks picked up by departmental representatives must be signed for.

Data Processing creates a Payroll Distribution Report which is given to Payroll so a voucher can be drawn up and Finance can transfer the funds to the payroll and deductions accounts. This voucher is approved by the CFO. Finance uses this report to post the manual general ledger.

The two bank accounts are reconciled monthly by individuals of the Treasury Department who are independent of the payroll function. These reconciliations are then reviewed and approved by supervisors with Treasury. The payroll account from time to time has uncashed checks and other miscellaneous items. Once a year before year end, these amounts are reviewed, employees are notified, and a resolution is adopted transferring funds and bringing the account back to zero.

The system as documented is functioning as prescribed. Control over personnel files could be improved.

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RESPONSES

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Response to Audit Engagement Summary

The City will explore the items outlined in the audit as cost savings and possible revenue enhancements.

However, certain items as listed below are already reviewed annually to maximize the potential revenue stream. These items are:

- 1) Tax Title Liens are reviewed by the Tax Collector and offered through assignment sale to investors, further, there is currently a foreclosure list in process and a second list being prepared.

- 2) Certain large value MRNA (*Miscellaneous Revenues Not Anticipated*) items that were realized in the Fiscal Year 2008 were as follows:
 - \$390,000 from FEMA for April 07 Flood Expense reimbursement
 - \$92,000 for a 1994 Insurance Settlement
 - \$69,000 for a Restitution matter
 - \$140,000 for DMV fees
 - \$151,000 of BAN Sale premiums which were reclassified to Capital Surplus by the City Auditor.

These items made up the majority of MRNA revenue received during that year. The remaining MRNA's which some may be reoccurring are small value amounts and are closed-out to operations/surplus and are used to support the following year budget. However the large value items that can be anticipated up front in the Municipal Budget will be anticipated as was done during the Fiscal Year 2009 budget cycle.

- 3) Each year the Comptroller/Chief Financial Officer reviews with the department directors all outstanding capital project improvements authorizations along with any grant receivable and grant reserves. This is evident for each year a City Council resolution is prepared and approved by the governing body to cancel the grant receivables/reserves no longer valid. The same is done for any improvement authorizations. The grants and improvement authorizations outstanding as of year-end were valid.

Other items being responded to are as follows:

- In the matter of benefits for employees the City reviews this item on an ongoing basis. This is done during labor negotiations and at the time of insurance contract renewal. In regards to employee contributions for their health benefits the city takes into consideration the total compensation package which is salary and benefits. The City pays lower wages up front and compensates this through its benefit package.
- In reference to the unallocated receipt account of approximately \$223,000 as of June 30, 2008. The City will research this item before its current fiscal year end and refund or apply these funds accordingly.
- The city's Cash Management Plan will be updated at the July 1, 2009 Reorganization Meeting and will include the Government Unit Deposit Protection Act (GUPA) language as required. The current adopted resolution approving the plan has the reference to the GUPA requirement in it. The City already receives the required GUPA certificates from the financial institutions on a semi-annual basis.
- The City will conduct a physical inventory review of its fixed assets to determine what assets should be removed from inventory. The city's Internal Auditor will be put in charge of this task and will be worked on over the next year.
- The City will review its trust funds and obtain the necessary Dedication by Rider approvals from the Department of Community Affairs for those items where we have not already received riders.
- The Internal Auditor is located in the proper department according to the city's code book. Details of the job duties and who he reports to are outlined in the city's code book.
- Although the main organizational chart does not include the Police and Fire Departments there are separate organizational charts for both the Police and Fire Departments.

- The City will explore the preparation of an accounting procedure manual. The City has never had a manual in place for this function. It should be noted that proper accounting controls and procedures are in place as evident by our annual audit reports over the past thirty years.
- In reference to the Information and Technology Division during 2008 the city engaged the services of a Consultant ATI Tele-management to perform a comprehensive analysis of the city's technology division also known as Data Processing. The city is currently awaiting the consultant's final draft of recommendations with respect to the city technology division. After the plan is finalized the city will then prepare a necessary funding bond ordinance to offset the cost associated with the issues outlined in the audit report.
- There are few instances when the claimant's certification is not obtained. The City is aware that the vendor's signature is a requirement and every effort is made to obtain it. If a vendor fails to return a white copy of a purchase order as is required they are contacted and in most cases the vendor claims that it must have gotten lost in the mail. In lieu of the vendor signature the city has controls in place to process the purchase order even though the white copy including the vendor signature is not returned. The entire voucher package is reviewed by the city comptroller to insure that all other required documents including the vendors original invoice is attached. The Comptroller then signs-off on the voucher package and authorizes that it be processed for payment.
- The City's Division of Personnel was in the process of relocating from the City Hall to another city building at 125 Ellison Street. The missing files may have been in moving boxes being transferred to the new location. Further the new personnel director is instituting a tracking system for any personnel file removed from the central holding location. This will strengthen existing control over personnel files.