

CITY OF LOCKPORT, NEW YORK

**Communication of Matters Related to Internal Control
Over Financial Reporting and Other Matters
August 9, 2018**

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To the Honorable Members of City Council of the
City of Lockport, New York:

In planning and performing our audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the City of Lockport, New York (the City) as of and for the year ended December 31, 2017, 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore material weaknesses or significant deficiencies may exist that were not identified. However, as discussed on the following pages, we identified deficiencies in internal control that we consider to be significant deficiencies.

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

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

This communication is intended solely for the information and use of management, the City Council, and others within the City, and is not intended to be and should not be used by anyone other than these specified parties.

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The following communications represent findings which were previously reported in connection with our December 31, 2016 and prior audits. While the City has made progress on certain of these findings, they have been unable to fully address all matters presented. As such, they still warrant reporting to the Council at this time. As applicable, information has been updated to reflect the current conditions as of December 31, 2017.

CITY OF LOCKPORT, NEW YORK

COMMUNICATION OF MATTERS RELATED TO INTERNAL CONTROL OVER FINANCIAL REPORTING AND OTHER MATTERS AUGUST 9, 2018

INTERNAL CONTROL RELATED MATTERS

We consider the following to be *significant deficiencies in internal control*:

1. SEGREGATION OF DUTIES

Observation

In our discussion with management and various departments, we noted that there is one person who records and processes payroll, and is responsible for inputting new employee information and editing existing employee information. While the City has begun to cross-train the Staff Accountant to perform these duties, there is still no employee fully or effectively cross-trained in these duties and; therefore, a vacancy for any reason would pose a risk. Furthermore, since there is no one formally reviewing the payroll once it is processed, errors could go undetected or unidentified by the individual with sole control over the activity.

Recommendation

We recommend that the City determine what the best mechanism will be to enable the proper segregation of duties and reduce the risk. While we understand that certain collective bargaining agreement limitations exist, payroll represents the single largest cost to the City. As such, it is imperative that appropriate controls exist for this area. We understand that the City is in the process of implementing a new payroll system that integrates with the general ledger system. We are hopeful that the system will help to improve segregation and controls.

Management's Response

The City has hired a Director of Finance, which oversees the payroll function for the City. In addition, the Staff Accountant has been cross-trained to process payroll. The City is conducting a payroll certification audit comparing records in the Civil Service Office with that of Payroll to ensure accuracy and integrity. This audit is in conjunction with the implementation of a new, fully integrated payroll system. This system has been constructed to provide a segregation of duties through entry permissions and approvals. It is anticipated that this system will be fully operational for fiscal year 2019.

2. COMMUNITY DEVELOPMENT FUND LOANS RECEIVABLE/DEFERRED LOANS

Observation

During the current and prior two years' audits of the loans receivable for the Community Development department we noted that significant write-offs and adjustments were needed to adjust the amounts to reflect the net realizable value to the City.

During the 2017 audit, the Office of Finance and Accounting had maintained spreadsheets to track the loan balances and payments made during the year; however, significant adjustments were still required. The City had significant adjustments to the loans to properly reflect the amounts within the trial balances for payments and loans that had met the year's requirements as required by the HOME loan program. Adjustments to the loans were also needed for the amounts received on payments for outstanding loans. In addition, we noted that for at least six grants/loans, mortgage liens had never been recorded by the City. Two of these loans are still within the time period in which the City could receive payment, however, as the mortgage liens were not recorded, this may impact the City's ability to collect.

2. COMMUNITY DEVELOPMENT FUND LOANS RECEIVABLE/DEFERRED LOANS (Continued)

Recommendation

We recommend that the Office of Finance and Accounting continue in their efforts to track and record all known loans and pursue cash collections on those loans with no activity in recent years. We understand the City is currently going through the process to implement procedures for the recordkeeping of the community development monies. If amounts are not recorded properly this could have an effect on compliance with both single audit requirements and those requirements of the deferred loan amounts.

Management's Response

The Finance and Accounting Office has completed the process of reconciling the Community Development loan receivables. Adjustments and write-offs of loan receivables are a normal activity based upon the nature of the loans i.e. they are forgiven after 5-7 years of ownership and occupancy in the home depending on the program and program year. That notwithstanding, the City continues to improve its accounting of these loans to the auditor. New procedures have been instituted to ensure that the loans, loan balances and loan repayments and forgiveness information is posted accurately and timely. In addition, the City has changed the procedures regarding the receipts of payments of these loans shifting the responsibility of the receipt of these payments from the Community Development Department to the City Treasurer's Office. Finally, loan, loan balances and loan repayment information is currently being kept on Excel spreadsheets. The City is in the process of replacing its current Financial Management Software with a system that will better record the activities of the loan program.

The following are considered *deficiencies in internal control*:

3. CASH ACCOUNTS

Observation

While performing an audit of the City's cash accounts during the 2016 audit, the collateral statement received from the bank contained information related to accounts that were not recorded within the accounting system of the City, nor were they reconciled or reviewed under the control procedures of the City. The accounts were those related to activities within the City police department. These accounts were recorded within the books of the City for the year ended December 31, 2016. During the 2017 audit, the City Treasurer's office had recently taken over the review and reconciliation of these police department accounts; however, adjusting journal entries were needed to record the cash accounts on the City's books at December 31, 2017.

Recommendation

It is recommended that these accounts be properly reviewed and reconciled by the Director of Finance and recorded on the general ledger on a timely basis to ensure all revenue and expenditures are properly recorded within the City's general ledger based on the nature of the activities.

Management's Response

These accounts and all activities occurring within these accounts will be incorporated into the general ledger within the City's accounting system. The City Treasurer has incorporated these accounts into their oversight and control and all check stock for these accounts has been destroyed. The Director of Finance had previously audited and reconciled the activity of these accounts at the end of year 2015. Reconciliation responsibilities have been incorporated into the monthly reconciliation processes performed by the Finance and Accounting Office. The Director of Finance has developed processes and procedures to incorporate the receipt and expenses of the funds contained within these accounts into the City's budget through budget amendment.

4. FINANCIAL STATEMENT CLOSING PROCESS

Observation

The City's Community Development and Capital funds historically have required year-end adjustments based on analysis prepared by management or with the assistance of the auditors. In addition, throughout the year management identifies transactions for which clarification with the external auditors is required. Procedurally, the City has waited until the commencement of the audit to discuss and resolve some of these complex questions to ensure the appropriateness of the accounting treatment. As a result, the audited trial balance has not been complete at the start of the audit process.

Recommendation

We recommend that the City review items on a regular basis throughout the year as questions arise. Additionally, at year-end we suggest that any open matters necessary for the closing process be discussed during the February/March timeframe and prior to the filing of the Annual Update Document. In this way, the City can be sure that these funds are fully reconciled prior to the start of the external audit.

Management's Response

The City will make it a point to meet with the external auditors in the spring to bring all open items needing clarification and guidance to the attention of the audit team for resolution.

5. TREASURER'S OFFICE CASH BOX

Observation

The City's Treasurer's Office collects cash for various fees. There are four individuals within the office that all have access to the cash box where the daily collections are kept. Those four individuals can all collect cash from residents.

Recommendation

Cash collections by any department should be segregated so that one person collects the cash and one person verifies the cash collected. These duties could be restated on a regular basis so that effective cross-training and oversight exists. The Treasurer's office should create procedures for cash collections that allow only two of the individuals to collect the cash while the other two record a log of receipts and reconcile the receipts at days end. The office could also give each individual their own cash box and at day's end, each individual would be responsible for the reconciliation of that cash box to the receipts taken in. The assistant treasurer would oversee the daily cash collections and review the daily reconciliation process, and finally create the deposit ticket for the bank.

Management's Response

The City continues to review internal control structure within the City and the Treasurer's Office and has implemented a cash handling policy which details the process and procedures for departments that collect cash to follow and outlines the reconciliation and internal audit processes. In addition, employees within the Treasurer's Office are recording their initials on transactions they have recorded. However, given limited staffing and inadequacies of the City's financial management system, a separation of cash collections within the Treasurer's Office is operationally impractical at this time. The City is in the process of replacing its current Financial Management Software with a system that will better allow for a separation of cash collections and handling within the Treasurer's Office on a daily basis.

6. CAPITAL ASSET LISTINGS

Observation

Currently, the City does not maintain a listing of capital assets and related depreciation. The City's external auditor has always assisted in maintaining a spreadsheet and adding any current assets with the approval of City management. Management has not maintained or tracked its own fixed asset records and the related depreciation as required under generally accepted accounting principles.

Recommendation

While it is acceptable to obtain assistance from the external audit firm to maintain the capital asset records, the City needs to be more proactively involved in the process of identifying those assets for capitalization throughout the year. We recommend that the City develop a way to track its fixed assets along with any related depreciation. The tracking should be done on a computerized system that would calculate depreciation for assets as well key information such as physical location, internal ID number, etc. Ideally, the tracking system should integrate either directly, or through an interface, to the general ledger system. We understand that the City is currently investigating a new general ledger accounting system and is looking to integrate the tracking of this information.

Management's Response

The City has created a rudimentary spreadsheet listing of fixed assets that allows for minimal tracking and related depreciation. The City has a new financial management system in operation which will allow for better reporting of capital assets.

OTHER MATTERS FOR CONSIDERATION OF MANAGEMENT

7. ACCOUNTING FOR SCHOOL TAXES RECEIVABLE

Observation

During our testing of taxes receivable we noted that the City adjusts all prior years' tax receivables into a tax certificate account after the initial year of collection. The City is not actually selling them as tax certificates, but merely putting them in those accounts by year. The school taxes that are collected for the most recent two years were also moved into those accounts as well so that the amounts still remaining to be collected was not easily identifiable.

Recommendation

The City should separately identify the two years of school taxes receivable on the trial balance in order to better track the amounts they have collected for those two years. The initial amounts turned over to the City should also be properly recorded in a due to other governments for the entire amount due to the school district. This will enable better tracking for amounts due to schools. The City's property tax receivables should be left in taxes receivable at the end of the year and not put into a tax certificate unless they are to be converted to certificates.