

CITY OF SALEM, MASSACHUSETTS

REPORTS ON FEDERAL AWARD PROGRAMS

FISCAL YEAR ENDED JUNE 30, 2006

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Honorable Mayor
and Members of the City Council
City of Salem, Massachusetts

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Salem, Massachusetts, as of and for the fiscal year ended June 30, 2006, which collectively comprise the City of Salem, Massachusetts' basic financial statements and have issued our report thereon dated September 29, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Salem, Massachusetts' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have communicated to the management of the City of Salem, Massachusetts, in a separate letter dated September 29, 2006.

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

A handwritten signature in cursive script that reads "Bowers + Sullivan". The signature is written in black ink and is positioned above the date.

September 29, 2006



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

To the Honorable Mayor
and Members of the City Council
City of Salem, Massachusetts

Compliance

We have audited the compliance of the City of Salem, Massachusetts, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006. The City of Salem's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Salem's management. Our responsibility is to express an opinion on the City of Salem's compliance based on our audit.

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

In our opinion, the City of Salem, Massachusetts, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 06-1 and 06-2.

Internal Control Over Compliance

The management of the City of Salem, Massachusetts, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Salem's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

A handwritten signature in cursive script that reads "Bowers + Sullivan".

September 29, 2006



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INDEPENDENT AUDITORS' REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

To the Honorable Mayor
and Members of the City Council
City of Salem, Massachusetts

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Salem, Massachusetts, as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated September 29, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City of Salem, Massachusetts' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

September 29, 2006

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE:		
<u>Passed through State Department of Education:</u>		
Food Donation	10.550	\$ 80,715
School Breakfast Program	10.553	202,226
National School Lunch Program	10.555	<u>681,868</u>
TOTAL AGRICULTURE		<u>964,809</u>
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:		
<u>Direct Program:</u>		
Community Development Block Grant/Entitlement Grants	14.218	1,649,807
Community Development Block Grants/Browning Economic Development Initiative	14.246	54,851
<u>Passed through North Shore Home Consortium:</u>		
HOME Investment Partnerships Program	14.239	<u>252,711</u>
TOTAL HOUSING		<u>1,957,369</u>
U.S. DEPARTMENT OF JUSTICE:		
<u>Direct Program:</u>		
Grants to Encourage Arrest Policies and Enforcement of Protection Orders	16.590	94,445
Local Law Enforcement Trust Funds Program	16.592	<u>10,362</u>
TOTAL JUSTICE		<u>104,807</u>
U.S. DEPARTMENT OF LABOR:		
<u>Passed through State Commonwealth Corporation:</u>		
Unemployment Insurance	17.225	15,719
<u>Passed through State Division of Career Services:</u>		
Employment Service	17.207	28,285
Unemployment Insurance	17.225	12,990
Workforce Investment Act - Adult Program	17.258	705,421
Workforce Investment Act - Youth Activities	17.259	659,555
Workforce Investment Act - Dislocated Worker	17.260	947,777
Work Incentive Grant	17.266	55,145
<u>Passed through Community Transportation Association of America:</u>		
Employment and Training Administration Pilots, Demonstrations, and Research Projects	17.261	<u>23,975</u>
TOTAL LABOR		<u>2,448,867</u>
U.S. ENVIRONMENTAL PROTECTION AGENCY:		
<u>Direct Program:</u>		
Brownfield Job Training Cooperative Agreements	66.815	<u>16,747</u>

(continued)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION:		
<u>Direct Program:</u>		
Fund For the Improvement of Education	84.215	501,319
Foreign Language Assistance	84.293	28,427
<u>Passed through State Department of Education:</u>		
Adult Education State Grant Program	84.002	31,549
Title I Grants to Local Educational Agencies	84.010	1,217,922
Special Education Grants to States	84.027	1,523,762
Vocational Education Basic Grants to States	84.048	54,218
Special Education Preschool Grants	84.173	63,218
Safe and Drug Free Schools and Communities State Grants	84.186	128
State School Improvement Grants	84.218	125
Eisenhower Professional Development State Grants	84.281	97
Twenty-First Century Community Learning Centers	84.287	342,793
State Grants for Innovative Programs	84.298	18,187
Education Technology State Grants	84.318	60,260
Reading First State Grants	84.357	257,616
English Language Acquisition Grants	84.365	66,888
Improving Teacher Quality State Grants	84.367	282,001
<u>Passed through Town of Rockport, Massachusetts:</u>		
Education Technology State Grants	84.318	542
 TOTAL EDUCATION		 4,449,052
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:		
<u>Passed through North Shore Elder Services, Inc.:</u>		
Special Programs for the Aging Title III, Part B Grants for		
Supportive Services and Senior Centers	93.044	16,655
Special Programs for the Aging Title III, Part C Nutrition Services	93.045	58,154
Job Opportunities for Low-Income Individuals	93.593	2,733
 TOTAL HEALTH & HUMAN SERVICES		 77,542
U.S. DEPARTMENT OF HOMELAND SECURITY:		
<u>Direct Program:</u>		
State Domestic Preparedness Equipment Support Program	97.004	191,304
Assistance to Firefighters	97.044	6,300
<u>Passed through Mass Emergency Management Agency:</u>		
Public Assistance Grants	97.036	186,513
State and Local All Hazards Emergency Operations Planning	97.051	30,495
 TOTAL HOMELAND SECURITY		 414,612
 TOTAL		 \$ 10,433,805

(concluded)

See notes to schedule of expenditures of federal awards.

NOTE 1 - Definition of Reporting Entity

The accompanying Schedule of Expenditures of Federal Awards presents the activity of all federal financial assistance programs of the City of Salem, Massachusetts. All federal financial assistance received directly from federal agencies as well as federal financial assistance passed through other governmental agencies is included on the schedule.

NOTE 2 - Significant Accounting Policies

The accounting and reporting policies of the City of Salem, Massachusetts are set forth below:

- (a) Basis of Presentation - The accompanying Schedule of Expenditures of Federal Awards is presented on the modified accrual basis of accounting.
- (b) School Lunch Program - Program expenditures represent federal reimbursement for meals provided during the year.

NOTE 3 – PROGRAM CLUSTERS

In accordance with Subpart A §.105 of OMB Circular No. A-133, *Audits of States, Local Governments and Non Profit Organizations*, certain programs have been clustered in determining major programs. The following represents the clustered programs:

<u>Name of Cluster/Program</u>	<u>CFDA Number</u>
Child Nutrition Cluster	
School Breakfast Program	10.553
National School Lunch Program	10.555
Summer Food Serve Program for Children	10.559
Special Education Cluster	
Special Education Grants to States	84.027
Special Education Preschool Grants	84.173

A. Summary of Auditors' Results

1. The auditors' report expresses an unqualified opinion on the basic financial statements of the City of Salem, Massachusetts.
2. No reportable conditions relating to the audit of the financial statements are reported in the Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.
3. No instances of noncompliance material to the financial statements of the City of Salem, Massachusetts, were disclosed during the audit.
4. No reportable conditions relating to the audit of the major federal award programs is reported in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133.
5. The auditors' report on compliance for the major federal award programs for the City of Salem, Massachusetts, expresses an unqualified opinion.
6. There were two audit findings related to federal award programs.
7. The programs tested as major grants include:

<u>Program Title</u>	<u>CFDA Number</u>
School Breakfast Program	10.553
National School Lunch Program	10.555
Title I Grants to Local Educational Agencies	84.010
Special Education Grants to States	84.027
Special Education Preschool Grants	84.173
Fund for the Improvement of Education	84.215

8. The threshold for distinguishing Types A and B programs was \$300,000.
9. The City of Salem, Massachusetts, was determined to be a low-risk auditee.

B. Findings-Financial Statements Audit

None.

C. Findings and Questioned Costs-Major Federal Award Programs Audit**Finding 06-1**

Teaching American History Grant – CFDA No. 84.215X
Smaller Learning Communities Grant – CFDA No. 84.215L

Condition and Criteria: The City was not in compliance with Federal Regulations for Cash Management, which requires grantees to follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement of the funds. Additionally, the City was not in compliance with Federal Regulations requiring interest earned on advances by local government grantees to be submitted at least quarterly to the federal agency.

Effect: On the Teaching American History Grant, the City requested and received the entire grant of \$877,472 in the first year of a three year grant program. The cash was pooled with other City funds in interest-bearing bank accounts. Expenditures on the program totaled \$148,853 in year 1 (fiscal year 2004), \$196,701 in year 2 (fiscal year 2005) and \$260,608 in year 3 (fiscal year 2006). Consequently, the City accumulated approximately \$31,000 in interest revenue which it did not report or remit to the federal awarding agency as required.

On the Smaller Learning Communities Grant, the City requested and received \$85,000 in year 1 (fiscal year 2004), \$175,000 in year 2 (fiscal year 2005) and \$240,000 in year 3 (fiscal year 2006). The cash was pooled with other City funds in interest-bearing bank accounts. Expenditures on the program totaled \$44,233 in year 1, \$158,087 in year 2 and \$240,711 in year 3. Consequently, the City accumulated approximately \$3,100 in interest revenue which it did not report or remit to the federal awarding agency as required.

Cause: The City does not have procedures in place to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement of the funds. Specifically, when requesting a draw of funds from the U.S. Treasury, the City is required to certify that the funds will be expended within 3 days of receipt. This certification was required for the transfer to take place. The funds were then not expended within 3 days and were not returned to the grantor.

Questioned Costs: Approximately \$34,100

Auditor's Recommendation: We recommend the City return the unreported interest earnings to the awarding federal agencies. We also recommend the City adopt procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the use of the funds for program purposes.

Management Response: The City has identified funds, equal to the amount of unreported interest income, to be sent to the U.S. Department of Education. The City will return unreported interest earnings to the awarding agencies as soon as possible. The City has developed a policy to place federal grant funds in separate accounts. All funds from these grants have either been spent or placed in a non-interest bearing account. The City is developing procedures to ensure that minimal time elapses between the receipt of funds from the U.S. Treasury and the use of those funds for program purposes. The School Department has hired a Grants Manager to oversee the drawing down and expenditure of all grant funds including federal funds. The Grants Manager is supervising the completion of the cited grants and will ensure the timely return of any federal funds drawn down and not utilized for program purposes. The School Department will codify these processes as part of the Grants Manual it is developing.

Finding 06-2

Title I Grants to Local Educational Agencies
CFDA No. 84.010

Condition and Criteria: Form FR-1 (Final Financial Report) for the Title I Program was due on October 31, 2006 and was not filed until December 6, 2006

Cause: Lack of procedures in place to file final reports timely

Effect: The City is not in compliance with the grant requirements.

Auditors' Recommendation: We recommend the City implement procedures to comply with all grant reporting guidelines.

Management Response: The City of Salem is developing procedures to ensure that it complies with all grant reporting guidelines. The School Department is preparing a Grants Manual that will codify these processes. The Grants Manager will ensure the timely implementation of these processes.

D. Prior Year Audit Findings and Questioned Costs**Finding 05-1**

Teaching American History Grant – CFDA No. 84.215X
Smaller Learning Communities Grant – CFDA No. 84.215L

These findings are detailed in finding 06-1.