

INTERNAL AUDIT REPORT

CITY OF MANCHESTER

NEW HAMPSHIRE



*MCTV Contract Compliance Audit
23 Months Ended November 30, 2009*

Prepared by
City of Manchester, NH
Office of the Independent City Auditor

**INTERNAL AUDIT REPORT
CITY OF MANCHESTER, NEW HAMPSHIRE
MCTV CONTRACT COMPLIANCE AUDIT
23 MONTHS ENDED NOVEMBER 30, 2009**

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City of Manchester
Office of the Independent City Auditor

One City Hall Plaza
Manchester, New Hampshire 03101
Phone: (603) 624-6460
Fax: (603) 624-6549

*Committee on Accounts, Enrollment and Revenue Administration
City of Manchester, New Hampshire
Honorable Aldermen: Sullivan, Lopez, Devries, M.Roy, Ouellette*

Dear Honorable Committee Members:

In September of 2009 the Superintendent of Schools was performing his monitoring and approval function over the expenditures of MCTV. He received an invoice dated September 14, 2009 for renovations at MCTV totaling \$19,000. The invoice was based on a purchase order dated August 21, 2009 also for \$19,000. He then received an invoice for \$19,500 for renovations on a separate purchase order dated October 21, 2009 from the same contractor. Both of these invoices were processed for payment and the first was paid. In early November he then received two more invoices from the same contractor dated September 24, 2009, one invoice dated October 21, 2009 and one invoice dated October 28, 2009. The additional four invoices were attached to requisitions all dated October 28, 2009. The superintendent questioned counsel to determine if these transactions would be considered an expenditure over \$20,000 that would require approval by the City under section 6 of the MCTV contract with the City of Manchester.

MSD's counsel determined the expenditures did not fall under section 6 of the contract. However due to other issues between the City and the School District concerning the MCTV contract the Superintendent notified the Mayor on 11/24/09 by letter of the expenditures.

On Monday November 30, 2009 a letter was received by my office from the Mayor requesting that I perform an audit of the Manchester School District's financial records as they pertain to Manchester Community Television. He further requested that my audit focus upon any and all expenditures involved with the renovation or improvement of the MCTV studios. He requested that I look at expenditures as far back as January 2008.

The audit procedures began with a documentation and evaluation of the internal control structure in place over capital expenditures and contract compliance. The current contract between the School and the City was reviewed to determine the allowable treatment of capital expenditures. A review of the general ledger for the 23 months ended November 30, 2009 was conducted. All expenditures that appeared to be greater than \$20,000 by themselves or combined with other invoices from the same vendor were selected for testing.

Conclusion

My testing revealed that the expenditures for renovations were part of a project totaling over \$131,000 and most likely should have been pre-approved by the Board of Mayor and Aldermen. My testing also noted two other minor issues.

The draft audit report was sent to the Manchester School District for review and comment. The observations generated and the auditee written responses are included on pages five through ten. The auditee responses indicate general agreement with the report recommendations and states that corrective action will or have been taken. I appreciate the courtesy and cooperation of the staff and administration of the Manchester School District on this assignment. At all times they acted in the highest professional manner throughout the course of the audit.

Kevin M. Buckley
Independent City Auditor

December 18, 2009

INTRODUCTION

AUDIT BACKGROUND

On October 20, 2000 the City of Manchester entered into a 10 year cable television franchise agreement renewal MediaOne (the predecessor to Comcast of NH). The agreement was amended on the 9th of June 2003 and extended for 5 years to October 20, 2015. The original agreement provided a one-time grant of \$900,000 to be used for the purchase and/or lease of public, educational and government (PEG) access equipment. The amendment provided an additional \$300,000 for this purpose. The agreement also provides for a franchise fee to be paid to the City equal to 5% of the franchisee's gross annual revenues.

PEG in the City is split into two entities. MCAM is a non-profit company whose responsibility is to provide the City's Public access channels only. MCTV is a department of the School District and is responsible for providing educational and government access programming.

The City of Manchester entered into an agreement with the Manchester School District dated June 26, 2007 that provides a formula for funding MCTV as well as conditions for the expenditure of funds. The agreement is for 8 years and ends on June 30, 2015. Per section 4 of the agreement the City will pay the School District 40% of the 5% franchise fee collected under the Comcast agreement for the sole benefit and use of MCTV. The City will also pay to the School District a one-time lump sum payment of \$432,304.67 from the facilities and equipment grant. The funds are to be maintained in a separate interest bearing account and all principle and interest is to be used for "the purchase, lease, improvement or maintenance or equipment, equipment, facilities or services as provided for in, and in compliance with the Cable Contract".

Section 6 of the agreement provides that all Long-Term Obligations and Expenditures over \$20,000 be approved by the City. It defines long-term obligations as over one year. It goes on to say "To the extent that MCTV **operations** (*emphasis added*) require the expenditure of amounts over twenty thousand dollars (\$20,000), all such expenditures shall also be approved by the City."

In September of 2009 the Superintendent of Schools was performing his monitoring and approval function over the expenditures of MCTV. He received an invoice dated September 14, 2009 for renovations at MCTV totaling \$19,000. The invoice was based on a purchase order dated August 21, 2009 also for \$19,000. He then received an invoice for \$19,500 for renovations on a separate purchase order dated October 21, 2009 from the same contractor. Both of these invoices were processed for payment and the first was paid. In early November he then received two more invoices from the same contractor dated September 24, 2009, one invoice dated October 21, 2009 and one invoice dated October 28, 2009. The additional four invoices were attached to requisitions all dated October 28, 2009. The superintendent questioned counsel to determine if these transactions would be considered an expenditure over \$20,000 that would require approval by the City under section 6 of the MCTV contract with the City of Manchester.

I was asked to perform an audit to determine if the contractor payments were allowable and proper under the contract and to determine if there were any other payments in excess of \$20,000 that could fall under this section of the contract.

Government Auditing Standards require that a peer review be conducted every three years for an audit organization reporting under the standards. The Office of the Independent City Auditor has not had a peer review in accordance with the standards.

Except for the matter noted above my audit was conducted in accordance with standards applicable to compliance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

AUDIT SCOPE AND OBJECTIVES

This audit was a contract compliance audit designed to test the Manchester School Districts Compliance with certain provisions of the contract with the City of Manchester's funding of the MCTV program.

I tested expenditures posted to the program's operating and capital grant accounts from January of 2008 through November of 2009 for compliance with the two sections of the contract (section 4 and 6) as noted on the preceding page.

Audit Objectives:

The objective of my audit was to

- Determine if MCTV expenditures greater than \$20,000 are being approved and paid by the Manchester School District in violation of the agreement

The results of my testing and the related observations and recommendations are included in the report that follows.

BACKGROUND OF MCTV

Organization and Personnel

MCTV is a unit of the Manchester School District funded mainly from a portion of franchise fees collected from the City's cable television provider. The City of Manchester and the Manchester School District have a written agreement that details the funding and the use of funds.

MCTV currently has four employees. The Director oversees the entire operation of the facility and produces various programs for the City. In addition MCTV employs an Operations Manager, Education Access Coordinator and Operations Assistant.

History

In July of 2005 Manchester Community Television was separated into Manchester Community Access Media (MCAM) a non-profit corporation oversees the public access channel 23 and MCTV which oversees the educational access and government access channels 16 and 22. At that time MCTV was housed in the Manchester School of Technology and was funded by an appropriation from the Board of Mayor and Aldermen based on an approved budget. The City maintained the account containing the facilities and equipment grant as well as the account containing the operating funds. The City would reimburse MCTV for actual expenses based in approved invoices.

MCTV's Strategic Plan submitted in October of 2005 called for the creation of a new stand-alone facility as well as a change in the funding mechanism in order to better serve the needs of MCTV. The School District signed a lease on February 20th 2008 for studio and office space at 1037 Elm Street.

Funding

In June of 2007 the Manchester School District entered into an agreement with the City of Manchester outlining the funding and operation of MCTV. Per the agreement the City would transfer to the School District the balance of the Facilities and Equipment Grant of \$432,305 to be held in a separate interest bearing account to be used for "the purchase, lease, improvement, or maintenance or equipment, facilities or service as provided for in, and in compliance with, the Cable Contract." The City also agreed to pay to the School District 40% of the 5% cable franchise fee that the City receives from the cable contract. Payments are to be kept in a separate interest bearing account for the sole use by and benefit of MCTV.

Administration

By the agreement the School District would continue to provide general administrative support for MCTV including maintaining financial records, receiving revenue and making payments on behalf of MCTV, processing payroll and other benefits, and assistance with requisitions, procurements and grants.

The City maintained approval authority of any long-term obligations (over one year) and expenditures over \$20,000.

RENOVATIONS OF THE LEASED STUDIO SPACE

In January of 2009 MCTV entered into an agreement with an architect firm to design the renovations to the leased Elm Street space. According to the proposal, the landlord's facilities services provider would serve as the construction manager for the project. The final cost for the architectural services amounted to \$8,500 dollars and was paid out of the Facilities and Equipment account.

On August 17, 2009 a contract draft was presented by the landlord's facilities provider to the MCTV Director but was never considered as the Director informed the contractor that it was not needed. On August 26, 2009 a budget with a breakdown of the total cost of the project was presented to the Director showing that the total cost of the project would be \$131,579. The contract called for payment to be made by purchase orders issued by phases. The contract requires that each phase be in increments of less than \$19,000.

On September 14, 2009 invoice #1 in the amount of \$19,000 was issued and processed for payment by the School District on September 25, 2009.

On September 24, 2009 invoice #2 for \$19,500 was presented to the Director and processed for payment by the School District on November 25, 2009 but payment was void until the issues surrounding the transaction were resolved.

On September 24, 2009 Invoices #3 (\$19,210) and #4 (\$19,404) were presented to the Director for payment.

In October of 2009 Invoices #5 (\$19,247) and #6 (\$19,196) were presented to the Director for payment.

Invoices #3 through #6 were not sent to the School District office for payment until early November. At this point the School District presented a request to the City for approval of payment which was granted by the BMA on December 15, 2009.

OBSERVATION 1: SPLIT PURCHASE ORDERS

Manchester School District Policy Fiscal 119 states "All contracts from, and purchases of supplies, materials, and equipment in the amount of \$25,000 or more, and contractual services of \$20,000 or more, shall be based, when feasible, on at least three competitive bids." The policy also states that "The bidder to whom the award is made shall be required to enter into a written contract with the District."

The City of Manchester entered into an agreement with the Manchester School District dated June 26, 2007 that provides a formula for funding MCTV as well as conditions for the expenditure of funds. The agreement is for 8 years and ends on June 30, 2015. Per section 4 of the agreement the City will pay the School District 40% of the 5% franchise fee collected under the Comcast agreement for the sole benefit and use of MCTV. The City will also pay to the School District a one-time lump sum payment of \$432,304.67 from the facilities and equipment grant. The funds are to be maintained in a separate interest bearing account and all principle and interest is to be used for “the purchase, lease, improvement or maintenance or equipment, equipment, facilities or services as provided for in, and in compliance with the Cable Contract”.

Section 6 of the agreement provides that all Long-Term Obligations and Expenditures over \$20,000 be approved by the City. It defines long-term obligations as over one year. It goes on to say “To the extent that MCTV **operations** (*emphasis added*) require the expenditure of amounts over twenty thousand dollars (\$20,000), all such expenditures shall also be approved by the City.”

Testing revealed one instance where a renovation project with an estimated final cost of \$136,954 was split into six invoices of less than \$20,000 in what appears to be an attempt by the MCTV Director to circumvent either School District policy and/or the contractual obligations as noted in the agreement with the City of Manchester. The expenditure was paid out of the Facilities and Equipment account and not the Operating account.

The MCTV Director picked a contractor to complete the renovations to the MCTV studio and office space without putting it out to bid or executing a contract with the contractor. A contract was written up and presented to the Director but was never signed or approved. According to the contractor the MCTV Director stated that a contract was not needed. She also was reported to have agreed that the payment terms of the contract would be used. Section 4.1.2 of the contract (unexecuted) calls for “Payments shall be made by phases with phase values not to exceed \$19,000.”

An October 22, 2008 purchase of camera equipment paid out of the Facilities and Equipment account exceeding \$20,000 was presented by the MCTV Director to the BMA at the September 16, 2008 meeting for approval.

Recommendation:

The Manchester School District Administration Business Office caught this problem in the normal course of business and the Superintendent reported it to the Mayor in a timely manner. The internal controls in place to detect and prevent such expenditures from going through appeared to have caught the irregularity after the third invoice was presented for payment and prior to the second invoice being paid. A further strengthening of controls should be instituted to prevent a person from negotiating a no bid contract and then allowing the work to commence with out a signed contract. Contracts for work should not be negotiated solely by the person requesting the work.

Auditee Response:

The Manchester School District Administration agrees with the findings of the audit. District policy and/or regulations will be updated to include the recommendations of the auditor. The updates will be reviewed with appropriate staff to ensure compliance in the future.

In addition to the audit work performed on the invoices mentioned in Observation 1 the general ledgers of both the Operating account and the Facilities and Equipment account were scanned to look for items that appeared unusual or seemed to exceed \$20,000 by themselves or in total with other invoices from the same vendor. Eight addition items were selected for testing and the following errors were noted.

OBSERVATION 2: RECORDS RETENTION

General State Rules

RSA 33-A:4-a established a municipal records board in order to establish (by rule) standards procedures and regulations for the effective and efficient management of municipal records. The Municipal Records Board has established such rules for record management and an accompanying retention schedule.

Records may be retained in their original form or the record may be microfiched. (MUR 302.02 a)

If the original was created in electronic format, a paper or microfilm copy of such record shall be obtained and retained. (MUR 302.02 b)

In addition:

RSA 33-A:3-a XVIII requires capital projects and fixed assets that require accountability after completion should be kept for the life of project or purchase.

RSA 33-A:3-a LIX requires that invoices and bills be retained until audited plus one year.

General Federal Requirements

IRS regulations require most records supporting payroll and tax matters to be kept for a minimum of seven years or until audited. Employee personnel records are to be kept at a minimum of seven years after termination.

Documentation for expenditures funded by federal assistance follow the “Common Rule” that has been incorporated into all of the assistance programs. The Common Rule applies to all financial and programmatic records, supporting documents, statistical records and other related records.

Except as otherwise provided, records must be retained for three years from the date the last expenditure report is submitted.

When real property and equipment is purchased with federal funds the records involved must be kept for three years from the date of disposition, transfer or replacement.

Retention of records relating to the earning of income on federally supported programs start from the end of the fiscal year in which the income was earned.

Copies made by microfiching may be substituted for the originals.

The grant agreements may involve other record retention requirements and should be consulted when deciding when to dispose of the records.

Manchester School District

The Manchester School District follows a retention policy issued by the Department of Education dated January 1998. When asked for invoices related to capital expenditures paid for by the cable television franchise fees I was informed that all invoices, other than federal funds, are destroyed one year after the audit is complete. This appears to violate RSA 33-A.

Recommendation:

The Manchester School District should establish a written records retention policy that complies with all federal, state, city and grant regulations.

Auditee Response:

The Manchester School District will work to update its retention procedures to comply with all federal, state, city and grant regulations.

OBSERVATION 3: OPERATING EXPENSES CHARGED TO FACILITIES AND EQUIPMENT ACCOUNT

The City of Manchester entered into an agreement with the Manchester School District dated June 26, 2007 that provides a formula for funding MCTV as well as conditions for the expenditure of funds. The agreement is for 8 years and ends on June 30, 2015. Per section 4 of the agreement the City will pay the School a one-time lump sum payment of \$432,304.67 from the facilities and equipment grant. The funds are to be maintained in a separate interest bearing account and all principal and interest is to be used for “the purchase, lease, improvement or maintenance or equipment, equipment, facilities or services as provided for in, and in compliance with the Cable Contract”.

The cable agreement provides the money to be used for the purchase and/or lease of PEG equipment and facilities.

A scan of the general ledger of the facilities and equipment account revealed a few small purchases of banners, books, pamphlets and personal services to MCTV totaling about \$500 that could be considered operating expenses that would more appropriately be charged to the operating account. It was also noted that \$1,379 of WB Mason supplies were originally charged to the facilities and equipment account and later transferred to the operating account.

Recommendation:

Greater care should be taken to ensure that only allowable expenditures are charged to the equipment and facilities account.

Auditee Response:

The Manchester School District Finance department will implement procedures to ensure only allowable expenditures are charged to the equipment and facilities grant. Appropriate staff will be advised to review all charges associated with the grant to ensure compliance.