



## FINANCIAL AUDIT ADVISORY COMMITTEE

### Report

**Tuesday December 18, 2018**

Present: Councilor Gentile (Chair), Councilor Markiewicz, Councilor Grossman, School Committee Member Kathy Shields, Citizen Representative Tony Logalbo, Citizen Representative Terry Finn, and Citizen Representative David Spector

Also present: Comptroller Sue Dzikowski, Public Schools Assistant Superintendent Liam Hurley, Schools Long Range Planning Manager Department Julie Kirrane, and Matthew Hunt of Clifton Larson Allen LLP

#### **06/30/2018 Audit**

The Committee met with Matt Hunt of Clifton, Larson, Allen, LLP (CLA), the City's external auditing firm, to discuss CLA's review of the City's Comprehensive Annual Financial Report (CAFR) and to review the auditor's draft of the Reports on Internal Control Federal Awards and Management Letter related to the Fiscal Year 2018 Audit. The Committee members received copies of all draft documents related to the audit. Once finalized, the CAFR, Reports on Internal Control and Federal Awards, and the Management Letter will be available on the City's website on the Comptroller's page.

#### **Comprehensive Annual Financial Report**

Mr. Hunt reviewed the audit of the City's Comprehensive Annual Financial Report (CAFR), including the Management's Discussion and Analysis (MD & A) and the Budget to Actual Statement portions of the CAFR. The primary fieldwork by the auditor began in September 2018 and the City provided all information that the auditors requested in a well-organized manner. The City management and staff involved in the audit were responsive to all inquiries. There were no disagreements with management during the audit process and everything went smoothly.

The CAFR has an introductory section that includes a letter of transmittal, a financial section that includes the auditors' opinion and the management's discussion and analysis, and a statistical section. The auditor's opinion on Fiscal Year 2018 Comprehensive Annual Financial Report is unqualified and unmodified (i.e., the financial statements present fairly, in all material respects, the City's financial situation), which is in keeping with prior years. The opinion includes reliance on the auditors that provide the audit of one of the City's small component units, the Newton Commonwealth Foundation.

Mr. Hunt reviewed the financial highlights of the audit of the CAFR. The Government Wide Financial Statements are reported on Pages 18-21 of the CAFR, which shows the City's assets, liabilities, and net position. The City's revenue and expenses are comparable to last fiscal year. The key information is the fund balance information, particularly for the General Fund. The City's assets are currently valued at approximately \$775 million of which \$207.5 million is from cash and investments and \$567 million is from capital assets. The City's current liabilities are approximately \$1.3 billion of which \$295.6 million are bond payable obligations, \$624 million are net OPEB obligations, and \$295 million are net pension liabilities. The pension liability decreased by approximately \$22 million in Fiscal Year 2018.

The City's has a negative net position of \$562.5 million, which is an increase of \$382.5 million from last year, which is largely attributable to the recognition of the full Other Post-Employment Benefit (OPEB)

in the government wide financial statements as required by GASB Statement 75. Almost every municipality is seeing the impact of GASB 75 and the City's negative net position is like that of other municipalities. The City is in the process of funding the pension liabilities and has a plan for funding the OPEB liabilities.

The City's general fund balance at the end of the fiscal year was \$66.6 million. It is a .6% decrease over the last fiscal year. Debt service is not absorbing a large piece of the City's operating budget. The general fund balance at the end of FY 2018 was \$67 million, which includes \$2.53 million in restricted funds, \$14.38 million in committed funds, and \$5.66 million of assigned funds. The City continues to build its unassigned fund balance primarily through increasing the City's Rainy Day Stabilization Fund. The FY 2018 unassigned balance is \$44 million, which includes \$20.5 million in the Rainy Day Stabilization Fund and \$11.9 million in certified Free Cash. The MDMA on Page 12 of the CAFR show trends on how balances in the unassigned funds have changed over the past five years. The 9.9% of unassigned fund balance is a good number and a health ration. The unassigned balance has declined over the past three years. In addition, Pages 24-26 provides a reconciliation of the governmental fund balance totals to the statement of net position that pinpoints how the General Fund compares to the budget.

Mr. Hunt reviewed the financial highlights related to the enterprise funds and internal service funds. The sewer enterprise fund ended the fiscal year with assets totaling \$91 million and liabilities of just over \$21 million, which includes both pension and OPEB liabilities. The Sewer Fund net position at the end of Fiscal Year 2018 was \$69,257,636. The water enterprise fund ended the fiscal year with assets of \$83 million and liabilities of \$35.6 million. The water Fund ended the year with a net position of \$47.5 million. The Storm Water Enterprise assets total \$8.2 million, the liabilities total \$5 million and ended the year with a net position of \$3.11 million. The internal service assets were \$34 million at the end of the fiscal year and liabilities totaled \$15.2 million, consisting mainly of incurred but not reported health claims liabilities and workers compensation liabilities. The net position of the internal service funds is \$18.6 million. Further information on the City's enterprise funds, insurance funds can be found on Pages 28-30 of the CAFR. Page 103 of the CAFR provides a further breakdown of the Internal Services Fund.

Mr. Hunt continued with a review of the fiduciary funds financial statements found on Pages 31-32 of the CAFR. The City's Pension Trust Fund total is \$351 million increasing by \$45 million over last year and the OPEB Trust Fund total is \$8.7 million, which is an increase of \$2.7 million over last fiscal year, which is partially due to a \$605,000 return on investment.

In addition, Mr. Hunt provided a quick review of the footnotes included in the CAFR, which can be found on the City's website on the Comptroller's webpage. Note 10 of the CAFR footnotes relate to long-term debt. Total outstanding long-term debt is \$295.2 million (Note 10). The City has issued \$36.4 million of general obligation bonds in FY 18 and retired \$26 million in debt from general fund bonds. The OPEB unfunded actuarial accrued liability is \$643.5 million (Note 12). The OPEB liability is 1.35% funded with assets of \$8.7 million. The City recognized \$39.2 million of OPEB expenses and reported deferred outflows of \$22.2 million related to OPEB. The deferred inflow reported was \$68.3 million. The discount rate used for FY 18 was 3.87%, compared to a discount rate of 3.58% used in 2017 to measure total OPEB liability. The net pension liability is \$308.1 million. This year the liability is 53.26% funded, which is an increase of 5% from the prior year funding percentage. There was a positive return on interest in Fiscal Year 2018. It was pointed out that to begin funding the City's OPEB liability in 2031, it is necessary for the City to stick to the pension funding schedule. It may require increasing the City's contribution to the pension fund. It may make sense to ask the pension actuary for an analysis based on a one-time payment to the pension fund from Free Cash. For further information on the pension liabilities, refer to Pages 74 – 76 of the CAFR. There are related statistical tables for both pension and OPEB, which present the net liabilities if there is a 1% decrease or a 1% increase in the discount rate. The statistical tables are a GASB requirement.

## **Government Accountability Office (GAO) and Office of Management and Budget (OMB) A-133 Reports**

The independent auditor provides reports on the internal control over federal and state financial reporting and on compliance. The report does not provide an opinion on internal controls but includes any significant deficiencies and/or material weaknesses in internal controls and material noncompliance to laws and regulations. The City received an unmodified opinion on federal grant award programs; and there are no findings on the federal grants for Fiscal Year 2018.

There was a reduction in the number of major grants reviewed as the threshold for the dollar value of grant review was increased from \$300,000 to \$750,000. The auditor's reviewed the Community Development Block Grant this year and did not identify any financial or compliance findings. The auditor also followed up on finding from the previous year's grants. The auditor reviewed Child Nutrition and the SPED Programs in 2017.

As part of last year's audit of the Child Nutrition Program, the auditor identified insufficient information to support eligibility for free or reduced lunch benefits in four of 40 applicants tested. The auditor recommended implementation of procedures to ensure that all applications and supporting records are preserved for all participants in the program. In addition, the verification for qualification for free and reduced price was not done in accordance with the federal guidelines. The auditor recommended implementing a process to ensure the verifications are done in accordance with the uniform guidelines. The finding is resolved based on the audit for compliance for FY 2018.

The second finding was related to the SPED Program's special reporting requirements. One of the student files tested did not contain evidence of a signature review and approval. The auditor recommended putting procedures in place to make sure that all student files have the appropriate review and signatures.

### **Management Letter**

Mr. Hunt explained that the auditor does not express an opinion on the effectiveness of the City's internal controls but does suggest opportunities to strengthen the internal controls and operating efficiency. This year's Management letter contains information on three resolved comments, one partially resolved comment, one unresolved comment, and three new comments.

A summary of the resolved comments is included in this year's management letter. Mr. Hunt stated that three comments from the previous year's management letter were resolved during Fiscal Year 2018. The first resolved comment a recommendation that the City strengthen procedures for collecting document approvals for termination before the termination. During the FY 18 review of the comment, the auditor did not identify any deficiencies. The second comment relates to the development and adoption of a written investment policy for trust funds that do not have policies associated with them. The City adopted an investment policy for the Rainy Day Stabilization fund in FY 2018 and the auditor no longer deems it necessary to carry the comment forward but would encourage the City to consider adopting additional policies for trust funds. The third comment recommended that the City strengthen its procedures to reduce late adjustments to payroll during

check processing. The Auditor identified improvements over the course of 2018 and consider the comment resolved.

In addition, this year's management letter contains a prior year comment that has been partially resolved. The one partially resolved comment relates to testing done on the internal controls for athletic fees and football gate receipts for Newton North and Newton South High Schools last year. The auditors identified areas for improvement including implementing formal policies and procedures, formal reconciliations, full utilization of the athletic fees software, using pre-numbered tickets, and developing better refund policies. The school department has developed draft policies and procedures that need to be finalized. The School Department is planning on implementing formal reconciliations of participant fees in FY 2019, when a new online payment management system is available. The new software will also track refunds for tickets for athletic events. The auditor recommended using a pre-numbered ticket system for games. The School Department does not want to use pre-numbered tickets for games but now has two individuals responsible for counting, documenting, and signing off on gate receipts for games. The new policies and procedures implemented by the School Department addresses comments related to timeliness of deposits, segregation of duties, and documentation of gate collections.

The police detail comment continues to remain unresolved. The City developed and implemented a policy regarding the uncollectible police detail funds and the write-off of those funds in fiscal year 2014 but the City still has not provided a new software program designed for police detail billing, and collection that is integrated with the general ledger software. The auditor recommends that the City consider developing processes and procedures to fully integrate police detail transactions within the anticipated new MUNIS financial software.

There are three new comments this year. The first comment is a result of the auditor's evaluation of the City's policies and procedures for the year-end close process. The auditors took the conversion to MUNIS software program in the upcoming fiscal year to attempt to identify possible improvements to the year-end close on the City has fully implemented the software. The auditors identified several areas for improvement, which are included on Page 8 of the Management Letter. The Auditor is recommending that once the MUNIS conversion is complete, the City should take advantage of the multi-year functionality when designing the chart of accounts. With proper setup of the chart there will be no need to manually rollover budgets. With MUNIS, the City can backdate warrants process from July to July 15 to close out the fiscal year. The cash disbursements would still post in July, but the expense would record in June. The auditors comments include a recommendation that departments deliver cash receipts to the Treasurer's Office for deposit by the Treasurer's Office. The City may improve the timelines of posting cash receipts to the general ledger benefiting the year-end close. The auditor's recommendations on the comment include a suggestion to evaluate the cost/benefit of utilizing the MUNIS module for capital assets. The auditor would encourage the City to look at its current and future reporting needs to see how MUNIS could be used to automate the generation of required reports.

The second comment results from the auditor's review of the internal controls for the student activity funds at Oak Hill Middle School. The Management Letter provides details on the auditor's recommendations for improvements including periodically revisiting and reapproving the maximum account balance for student activity funds. MUNIS software has a student activity module for

student activity accounts, which the City should consider using for all student activity funds. In addition, there were standard suggestions related to monthly reconciliations like implementing best practices for sign-offs and reviews by a school official.

The third new comment result from the auditor's evaluation of the City's computer processing environments and general controls over information technology related to business and financial systems. The evaluation was not a full scope network security review; it was limited to internal controls related to transactions and data that could affect financial reporting. The auditor raised concerns around the City's password complexity settings, as they do not comply with best practice leaving possible openings for unauthorized access to networks. The auditor would like to see the password settings follow best practice recommendations as outlined in the Management Letter. The auditor also feels that the City should be doing credentialed internal and external vulnerability screening on a monthly and quarterly basis, respectively. The USB drives on computers have not been disabled to restrict use of external storage devices on workstations, which creates risk of the transfer of confidential information to unencrypted USB drives. The auditor recommends the City run vulnerability scans every 30 days on all internal hosts and every 90 days on external hosts to ensure that systems are patched and securely configured. The City should consider technically restricting the use of USB storage devices on workstations.

The City's management team has not had an opportunity to respond to the Management Letter comments but will be responding soon. Once the City's management has responded to the auditors' comments and recommendations, the Management Letter with the responses from the City will be available on the City website.

### **Next Meeting**

The next meeting of the Financial Audit Advisory Committee is scheduled for February 19, 2019 at 8:15 PM.

The Committee adjourned at 9:30 a.m.

Respectfully submitted,

Leonard J. Gentile, Chair