

FINANCIAL AUDIT ADVISORY COMMITTEE

Report

Tuesday, October 14, 2014

Present: Ald. Fuller (Chairman), Ald. Danberg, Margaret Albright (School Committee Member), Gail Deegan, and Tony Logalbo

Also present: David Wilkinson (Comptroller), Sue Dzikowski (Director of Finance; School Department), and Matthew Hunt (CPA; Clifton, Larson, & Allen, LLC)

Update on External Audit

The Committee received an update from Matthew Hunt of Clifton, Larson & Allen, LLC on this year's ongoing external audit. He informed the Committee that Audit Supervisor Marisa Batista has left Clifton, Larson & Allen, LLC (CLA). Ms. Batista has worked on the Newton audit for a number of years and this year could have provided some continuity in the audit, as there was a change in managing partners. Mr. Hunt was able to bring Audit Supervisor Sean Goldrick, who has worked on the Newton audit in previous years onto the audit team. Mr. Hunt reported that all of the City departments he has worked with were helpful, especially the departments that are closely involved in the audit.

The majority of the audit fieldwork was complete last week and the audit is on track to meet all deadlines. At this point, the auditors have not found any significant deficiencies or material weaknesses in internal controls as it relates to the financial statements. However, there are two material weakness findings in the schools associated with the federal award program audits related to the child nutrition program and the SPED Cluster Grant. The City did not have internal controls in place to comply with the federal requirement that documentation be provided that verifies that there has not been a suspension or debarment of a vendor associated with the child nutrition program.¹ In the case of the SPED Cluster Grant, the City lacked documentation that the city's employees involved in the SPED program are deemed highly qualified. The auditors found no reason to believe that those employees were not highly qualified but there was no evidence of transcripts or copies of degrees related to the federal requirements to deem them highly qualified. The City should have all transcripts and degrees for all of the para-professionals and professionals that work in that program in the personnel files. The School Department's Director of Finance Sue Dzikowski will provide documentation for these employees to the Financial Audit Advisory Committee.

Mr. Hunt reviewed the requirements of the newly implemented Governmental Accounting Standards Board (GASB) Statement No. 65 (summary attached), which requires that some of the City's assets and liabilities be broken out into deferred inflows and outflows of resources. Deferred inflow and outflow refers to monies that are not recognized as revenue or liabilities until a future period. The implementation has minimal impact on the City's financial statements, as it is a small change to the financial statements and only requires the creation as a separate section for deferred inflow and outflow.

The auditors are in the Manager Work Paper Review Phase of the audit. This will be followed by Partner Work Paper Review Phase, which is the auditor firm's internal check to make sure that nothing has been missed. Mr. Hunt does not anticipate that anything will arise because of these reviews. As CLA is now part of a national firm, there will be an additional second review process done by someone independent outside of the Boston office that has not been directly involved with the Newton audit.

In terms of open items, the auditors are still awaiting information that has not been received due to timing, such as the reports related to the accrued health claims incurred but not reported liability. Those reports are usually available sometime in late October or early November. The SPED Medicaid Reimbursement Program is one of the federal grants that are being tested this year. The auditors sent out a request to the SPED Medicaid Reimbursement Program last week for information needed for additional testing. The auditors are also still awaiting a few third-party audit confirmations, which are expected in the next few weeks. The financial statements are in good shape.

CLA did an in depth review of cash management policies for the student activity funds at Bigelow Middle School and the Inspectional Services Department with a focus on building permits. Mr. Hunt is meeting with the School Department's Director of Finance Sue Dzikowski, and Comptroller David Wilkinson to review the findings at Bigelow Middle School and after that meeting, he will be meeting with the Inspectional Services Department to review the findings in that department. The auditors did not come across any significant deficiencies or material weaknesses but Mr. Hunt would like to hold off any discussion regarding what the auditors did find until after meeting with the School Department and Inspectional Services Department to be sure that the auditors have all necessary information and clear up any factual misunderstandings. The Committee members asked Mr. Hunt to let them know if there are any issues.

CLA expects to provide the first draft of the Comprehensive Annual Financial Report (CAFR) to Comptroller David Wilkinson sometime between mid and late November with the expectation that the final report is issued in early to mid-December prior to the Financial Audit Advisory Committee exit conference with CLA (scheduled for December 16). The draft management letter and draft single audit report will also be provided before the exit conference. The final management letter and final single audit report will be issued in late December or early January before CLA meets with the Finance Committee for its exit conference (usually scheduled in late January).

Mr. Hunt explained that Newton is a very well run City; therefore, from an audit perspective Newton does not have any more complexities than other cities of a similar size. Mr. Hunt has not come across and does not believe that there is any major area of concern related to the City's finances. If there are no issues that have a direct material impact on the financial statements then the management letter comments focus on recommendations for improvements.

Comptroller David Wilkinson explained that a separate schedule of the override funds cannot be done, therefore; he approached it narratively in the CAFR. Unfortunately, the override funds for the additional police officers in the Police Department and the supplemental funds for

building maintenance in the Public Building Department were not specifically identified and tracked in those budgets. Both of the departments turned back a greater amount of money in Fiscal Year 2014 than what was allocated from the override funds.

The Government Accounting Standards Board (GASB) Statement 68 implementation is the next emerging issue for the Fiscal Year 2015 external audit. GASB Statement 68 requires the City to include all of its unfunded pension liabilities in the CAFR in Fiscal Year 2015, which is similar to the GASB requirement that the City's Other Post-Employment Benefits (OPEB) are part of the CAFR. The City's unfunded OPEB liabilities are already part of the CAFR, as required by GASB Statement 45. GASB is expected to issue another statement requiring additional note disclosures for OPEB. The Financial Audit Advisory Committee, Mr. Hunt, Mr. Wilkinson and Kathleen Riley of Segal Advisors (the actuary for the City's pension fund) met with Thomas Hanna and Paul Todisco of the Pension Reserves Investment Management (PRIM) Board to begin discussing the information required for the implementation of GASB 68. Since that meeting, PRIM has provided some of the information that the City requires for implementation. The City is in good shape for the implementation of Statement 68.

The Committee asked how GASB 68 affects Newton compared to other municipalities in the State. Mr. Hunt responded that the impact really depends on where a community is at in terms of its pension liabilities funding schedule. Municipalities are required to fund their pension liabilities by 2040. The City expects its pension liabilities to be fully funded in 2029. It would be helpful to have a fuller discussion on the OPEB and pension liabilities in the spring, as the City prepares for the new information on the financial statements. The discussion should include how to develop public understanding of the OPEB and pension liabilities. CLA can incorporate benchmarking comparatives for future conferences.

There will be a new note disclosure in the financial statements for the I-Cubed commitment the City made in conjunction with the Chestnut Hill Square Project. The developer received approximately \$10 million in loans from the Commonwealth of Massachusetts to subsidize public infrastructure improvements that were made in the area of the projects. In essence, the City co-signed the loan to fund the improvements. The City has two years of debt service from the developer as surety. The Committee will have a further discussion at its next meeting on the I-Cubed note disclosure.

Comptroller David Wilkinson is very happy with Clifton, Larson & Allen, LLC. The team that was provided for the audit was an excellent and talented team. From the City's perspective, it was great to have a fresh set of eyes for the audit. The Committee members asked Mr. Hunt to let them know if there are any areas that the City can improve upon in terms of the external audit.

Data Privacy and Information Technology Security

CLA has Information Technology (IT) Specialists and Mr. Hunt will contact them to see if there are any IT audits that they do or any kind of engagement that they can do as it relates to doing a full review of the IT systems. The Chair pointed out that there will be a future

discussion in the Committee regarding developing a policy related to data privacy with the Administration. The City also has an Information Technology Cluster that will be working on IT security and data privacy.

Respectfully submitted,

Ruthanne Fuller, Chairman

ⁱ In response to the audit finding described by Matthew Hunt of Clifton Larson & Allen, LLC (CLA) at the October 10, 2014 Financial Audit Advisory Committee, the School Department's Director of Finance Susan Dzikowski provided documentation from the City's Purchasing Agent to CLA. The Purchasing Agent found the signed statement dated March 13, 2013 from Whitsons, the City's child nutrition program vendor, indicating they have not been suspended or disbarred. Mr. Hunt has stated that the documentation satisfies the verification requirement.

Summaries / Status

SUMMARY OF STATEMENT NO. 65 ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES (ISSUED 03/12)

This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4.

This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.