

FINANCIAL AUDIT ADVISORY COMMITTEE

REPORT

Tuesday, December 16, 2014

Present: Ald. Fuller (Chair), Gentile, Danberg, School Committee Member Margaret Albright, Gail Deegan, Robert Fox, and Tony Logalbo

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

06/30/2014 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 drafts of the Reports on Internal Control and Federal Awards and the Management Letter related to the Fiscal Year 2014 Audit. The Committee members received copies of all documents related to the audit. The CAFR can be found on the City website under the following link: <http://www.newtonma.gov/civicax/filebank/documents/63147>.

Mr. Hunt began the discussion by reviewing the City's Comprehensive Annual Financial Report (CAFR), particularly the Management's Discussion and Analysis (MD & A) and the Budget to Actual Statement portions of the CAFR. Comptroller David Wilkinson prepares the MD & A. Mr. Hunt noted that he does a great job summarizing the data and information contained in the CAFR. The budget to actual statements provides a good window into how the City's general fund performed. The CAFR also includes the Pension Trust Fund and the Other Post-Employment Trust Fund Statements.

Planning for the fieldwork for the audit started in April 2014 and the primary fieldwork began in September 2014. All information that was needed was provided by the City in a timely, 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.

Comprehensive Annual Financial Report

The discussion continued with a review of the Fiscal Year 2014 CAFR. There is a statistical section in the rear of the CAFR that goes beyond the financial statement numbers and includes assessed values, collection rates on receipt on taxes and items of that nature. There are no major GASB pronouncements this year. The only GASB Statement of any impact whatsoever is GASB 65, which is a presentation change. Previously the offsets to the tax receivables were classified as deferred revenue and listed as liabilities. In this year's CAFR, the deferred revenue has been reclassified as deferred

inflows of resources and reported in a separate section in the balance statements. There are no new auditing standards for the Fiscal Year 2014 audit. The auditor's opinion on Fiscal Year 2014 Comprehensive Annual Financial Report is unmodified, which is in keeping with prior years. It was pointed out that part of the opinion includes reliance on the auditors that provide the audit of the City's component unit, the Newton Commonwealth Foundation.

The Statement of Net Position reported on Pages 18 and 19 of the CAFR provides the City's assets, liabilities, and net position. Currently, there is an unrestricted *deficit* of a little more than \$138.5 million, which is mostly due to the recognition of the approximately \$198 million in net Other Post-Employment Benefit obligations. The City's total net position is \$139,901,149. The net OPEB obligation is the difference between what the actual required contribution is to fund OPEB liabilities and what the City actually contributes to OPEB. The actuarial accrued liability is \$554 million, which is the overall liability accrued over a multi-year valuation.

The schedule of OPEB Benefits on Page 74 of the CAFR shows a decrease of approximately \$50 million dollars in OPEB liabilities because in previous years some retirees who had both life insurance and health insurance were counted twice in the City's retiree census. The incorrect data was provided to the City's actuary resulting in an inflated actuarial approved OPEB liability. The City realized that there was an error this past year and corrected it, which resulted in a decrease of approximately \$50 million in the actuarial approved liability. The error and subsequent correction are not noted in either the actuarial report or the CAFR. The Chair felt that it would be helpful to include the explanation for the decrease in the CAFR, as a footnote. Mr. Hunt explained that changes in assumptions or methodologies would result in footnotes but a change in census numbers would not be disclosed in the CAFR. It may be more appropriate to include a reference in the Management's Discussion and Analysis (MD & A) Section of the CAFR.

It was noted that Page 61 of the CAFR states, "The [OPEB] Plan does not issue a stand-alone financial report since there are no assets legally segregated for the sole purpose of paying benefits under Plan." In Fiscal Year 2014, the City established a trust fund to begin providing some funding towards the City's OPEB liability. Although there is no need for a stand-alone report for the trust, the statement should be corrected to reflect that there are assets that have been segregated.

Mr. Hunt reviewed the financial highlights for Fiscal Year 2014. The key information is the fund balance information, particularly for the General Fund. The City had approximately \$36.7 million in total in the General Fund that is comprised of a restricted fund balance of \$2.8 million, a committed fund balance of \$4.88 million, an assigned fund balance of \$2.67 million, and an unassigned fund balance of \$26.26 million that includes \$14 million in the Rainy Day Stabilization Fund. At the end of fiscal year 2014, the percentage ratio of how much the unassigned fund balance is as it relates to the total revenues and other financing sources was 7.1%, which is an increase from the ratio

of the previous year of 1.1%. The City has done a good job of increasing its reserves over the past few years.

Mr. Hunt reviewed the financial highlights related to the enterprise funds and internal service funds. The sewer enterprise fund ended the fiscal year with an unrestricted balance of \$16 million. There was an increase of \$4.5 million in net position over the past year. The water enterprise fund ended the fiscal year with an unrestricted balance of \$7 million. There was an increase of \$3.2 million in net position over the past year. The internal service funds total assets is approximately \$32 million at the end of fiscal year 2014 and liabilities totaled \$14.7 million, consisting mainly of incurred but not reported health claims liabilities of \$3.3 million and workers compensation liabilities of \$8.3 million. The net position of the internal service funds was slightly over \$17 million. Overall, the internal service funds increased about \$3.5 million, which is primarily related to activity in the workers' compensation fund. In addition, Mr. Hunt provided a quick review of the footnotes included in the CAFR, which can be found on the City's website.

GAO and OMB A-133 Reports

The independent auditor provides reports on the internal control over financial reporting and on compliance. The reports include any significant deficiencies and/or material weaknesses in internal controls. There were no material weaknesses identified in either the financial statements or federal awards; however, the auditors found one significant deficiency in the internal control over federal awards related to the Special Education Cluster Grant. The City lacked sufficient educational documentation for the paraprofessionals and teachers working in the program in its personnel files, as required by the grant. Subsequent to the finding, the School Department obtained the correct documentation and included it in the personnel files. The Committee asked Mr. Hunt to change the language in the footnote that refers to the finding to state that the correct documentation was provided after the fact. The current language only states that further documentation was provided. The GAO and OMB A-133 Reports can be found by following this link: <http://www.newtonma.gov/civicax/filebank/documents/63439>

Management Letter

Mr. Hunt stated that three of the seven comments from the previous year's management letter were resolved. The resolved comments relate to the City's disaster recovery plan, departmental and other accounts receivable, and the student activity funds at the Day Middle School and Angier elementary School. A summary of the resolved comments are included in this year's management letter.

This year's management letter contains four prior year comments that have been partially resolved and four new comments. Mr. Hunt reviewed each of the comments and the Auditor's recommendation. Issues are partially resolved in four areas. First, issues remain in the student activity funds; however, the School Department has

documented and performed agreed upon procedures. The auditor's continue to recommend that the city have an independent audit firm audit the student activity funds and/or agreed upon procedures every three years, as recommended by MASBO. The City does not agree with the recommendation and the Committee asked if the comment could be removed. Mr. Hunt responded that he would remove the comment from the management letter. The Committee agreed that the School Department should provide an annual report to the Financial Audit Advisory Committee on the school activity funds to provide oversight. The second partially resolved issue is related to the Police Department detail accounts receivables, which continues to be an issue in this audit. 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 did not provide a new software program designed for billing and collection for the police detail billings. Mr. Hunt understands that the City has developed software but still needs to integrate it with the general ledger software. Third, the auditor also recommends the development, and implementation of a documented risk assessment program to identify, evaluate, and manage the risk of asset misappropriation, formally document the program and become part of the City's financial policies and procedures. The City has made progress in the area but needs to document all financial policies and procedures and monitor the controls and risks. Fourth, the auditor's comment relates to the continued development of financial policies and procedures. Bob Fox felt that it may be helpful to look at how other communities have addressed the development of financial policies and procedures and suggested that the Accounting and Audit Sub-committee look into it. Although the City has provided several written policies and procedures, the auditors recommend that the City continue to work on a written formal policies and procedures manual to improve and standardize the City's financial policies and procedures. Mr. Hunt and Comptroller David Wilkinson will work together to develop a more specific comment on what policies and procedures are needed.

There are four new comments this year. The first is related to the Inspectional Services Department's cash receipts collection and reconciliation. The auditor recommends developing and implementing written financial policies and procedures, as well as the development of procedures for accurate cash receipt turnover forms. The second comment is related to the Bigelow Middle School activity funds and standardization of procedures. The auditor's recommendation includes utilization of a standard turnover form and implementation of procedures for the deposit of cash receipts. The third new comment is related to information technology and potential risks associated with information technology. The auditor recommends the city consider utilizing an independent third party to conduct tests of the information technology environment that includes an internal vulnerability assessment and a general controls review. The last new comment relates to the development of an investment policy for certain trust funds. The auditor recommends the City develop and adopt written investment policies for trust funds that are not governed by existing policies or laws.

The Accounting and Audit Sub-committee will meet with each of the departments regarding their individual management letter comments. For further detail on the

Management Letter, comments and the City's responses please refer to the following link <http://www.newtonma.gov/civicax/filebank/documents/63438>.

Draft Annual Report

The Committee reviewed the draft annual report provided by the Chair and supported its submittal to the Finance Committee.

Upcoming Committee and Sub-committee Dates

The Chair provided the Committee with a draft 2015 meeting calendar and work plan. The Committee changed the December 15, 2015 proposed date to December 14, 2015. The Chair asked that Committee members further review the calendar and work plan for conflicts. The Chair will try to accommodate members, if they have conflicts with the dates.

Respectfully submitted,

Ruthanne Fuller, Chairman