

# **FINANCIAL AUDIT ADVISORY COMMITTEE**

## **REPORT**

**Friday, September 21, 2012**

Present: Alderman Ruthanne Fuller (Chairman), Alderman Vicky Danberg, Robert Fox Alderman Lenny Gentile, School Committee Member Matt Hills, Tony Logalbo and Howard Merkowitz,

Also present: Robert Barrett (Chief Information Officer), David Wilkinson (Comptroller), Maureen Lemieux (Chief Financial Officer), and Sue Dzikowski (Director of Finance; School Department)

### **Sub-committee Updates**

The Committee reviewed the work of each of the sub-committees.

A status report on the work of the Accounting and Audit Sub-Committee related to the issues contained in the City's June 30, 2011 Management Letter was provided by Alderman Ruthanne Fuller. The sub-committee has heard from each department with a management issue and it appears that each department either has taken steps or is in the process of taking steps to address the issues, as outlined in the sub-committee reports. Some of the management issues will reoccur in the next management letter due to the nature of the issues, such as the water and sewer abatements. The abatements will remain an issue until the new water meter system is entirely in place and operational. Portions of the system are installed and the abatements have come down to 1.4% this year from 8.5% in the past and the department has hit its targets on billings. The Newton Community Development Authority loan accounting and reporting issues are fully resolved and are unlikely to occur in the next management letter. The Police Department and Law Department are in the process of addressing collection of police detail invoices. Attached is information from the School Department outlining agreed upon procedures and guidelines to address the issue related to student activity funds contained in the management letter. In addition, the Chief Information Officer provided the attached summary on the short and long-term disaster recovery and business continuity plans for all critical systems as recommended in the management letter.

The Internal Controls & Financial Policies and Procedures Sub-Committee has begun working on cash management and will present a policy on internal cash controls at the next meeting. Dave Wilkinson has asked the auditor to provide assistance in developing this policy. The Committee discussed the advantages and disadvantages of not accepting cash for services at any of the City's satellite offices. The City cannot accept credit card payments due to the fees to the City for transactions that cannot be charged back to the customer. If the City limits other types of transactions (cash and/or checks), it would not be customer friendly. The city needs to balance customer service

with security. Cash transactions need to be controlled, which could be done through improved collection methods.

The Investment Policy Ad Hoc Committee continues to review the need for an updated investment policy. There have been two meetings of the sub-committee, where the sub-committee discussed the bank account inventory, the 15% limit to the amount of funds that can be invested in an individual bank, the current investment policy and whether the policy required updates. The sub-committee would like an opportunity to review investment policies developed by other communities before making any determinations. The Treasurer has put together the attached memo to the sub-committee detailing how the City's position is best served by changes in the current investment policy. The sub-committee will hold further discussions on the points provided in the memo, particularly the collateralization of funds. Committee member Tony Logalbo explained that any bank that is willing to provide third-party collateralization for deposit should be eligible for investment. Third-party collateral agreements help to mitigate or offset risk to the city by ensuring that all pledged collateral is held at an independent third-party bank or institution.

**Chair's Note:** *The Financial Audit Advisory Committee had an extensive discussion about collateralizing public deposits during the meeting. I thought the committee would find the attached Government Finance Officers Association (GFAO) "Best Practices for Collateralizing Public Deposits" helpful. The GFAO specifically recommends that governmental entities should have all pledged collateral held at an independent third-party institution outside the holding company of their bank.*

The Risk Assessment, Monitoring and Compliance Sub-Committee is focusing on developing an internal whistleblower policy. The sub-committee has met with the City Solicitor and Human Resources Director regarding this type of policy. It was determined that the City does need a separate, distinct policy. The draft policy is underway and the sub-committee is meeting on October 26, 2012 to review the draft policy.

### **Process for Selecting Auditor**

The current external auditor's contract ends at the conclusion of the June 30, 2013 audit; therefore, the Committee began an initial discussion about the process for selecting an auditor. The procurement process generally takes three to four months to complete. The City could use either of two processes to contract with an external auditor. The City has traditionally used a Request for Qualifications and gone out to bid to procure an auditor. The Committee would like to consult with the City's new Chief Procurement Officer regarding the procurement process.

The State will be recommending that cities and towns rotate auditors every seven years. It was pointed out that it did not necessarily mean that the City had to change firms, as a different team from the current auditor could manage the audit.

One issue that the Committee should begin to contemplate is whether to extend the scope of the audit to include Angino Farm and the Commonwealth Golf Course. Both of these audits need to be completed before the City can complete its audit.

The Committee will continue to discuss the selection of an external auditor and in the scope of the next audit.

**Schedule for 2013**

The last two meetings of the Committee will focus on the Fiscal Year 2012 audit and the auditor will be at both meetings.

The Chair would like to begin to schedule the Committee meetings for the first six months of next year. The Chair expects that the Committee will need to meet quarterly next year and would like to schedule two meetings: one in March and one in June. The March meeting will involve the external auditor and the June meeting will be an update from all of the sub-committees.

Respectfully submitted,

Ruthanne Fuller, Chair

## **NEWTON PUBLIC SCHOOLS STUDENT ACTIVITY FUND AUDITS FY12**

As a follow up to the June 12, 2012 Accounting and Audit Subcommittee meeting, the following set of agreed upon procedures was obtained from Sullivan, Rogers & Company to serve as a work plan for conducting in-house student activity fund audits. Based on the following four procedural points, audits were performed this summer for the student activity accounts at Newton North and Newton South High Schools. Audits will be performed this fiscal year for the student activity accounts at Brown and Oak Hill Middle Schools, and next fiscal year for Day and Bigelow Middle Schools. Within the elementary schools, the relatively small volume of transactions allows for accounts to be reviewed on an on-going basis during the school year with the school secretaries.

The four procedural points/responses are as follows:

#1) Verify that the banking and accounting systems related to student activity funds have been established in accordance with the Massachusetts Student Activity Law (Massachusetts General Law [MGL] Chapter 71, Section 47).

**Response to #1:** Banking and accounting systems related to student activity funds have been established in accordance with MGL for all twenty-one schools. The text of MGL Chapter 71, Section 47 is included at the end of procedural point #4. Secondary school student activity accounts have been in existence for well over a decade. However, the School Committee voted to establish student activity accounts for the elementary schools in FY10. All schools except Cabot, Horace Mann and Lincoln-Eliot have made deposits into student activity accounts which are set up for all 15 elementary schools. Of the 12 schools which have made deposits, all but Burr, Franklin and Williams are actively using the accounts for deposits and expenses. The six elementary schools mentioned above use PTO accounts for student activities; however, the district maintains accounts for these six elementary schools should they need to switch processes. The remaining nine of the fifteen elementary schools including Angier, Bowen, Countryside, Mason-Rice, Memorial-Spaulding, Peirce, Underwood, Ward and Zervas use the student activity account mainly for deposits of field trip monies and for the payment of field trip venue expenses and field trip bus transportation.

#2) Obtain and review a list of each of the student activity funds maintained at the Schools for the purpose of identifying any individual funds that fall outside the definition of student activity funds in accordance with the Massachusetts Student Activity Law and the Student Activity Accounts Guidelines for Massachusetts School Districts issued by the Massachusetts Association of School Business Officials.

**Response to #2:** Within the twenty-one schools, there are no individual funds that fall outside the definition of student activity funds in accordance with MGL.

#3) Obtain and review a sample of the student activity bank account reconciliation(s) for each school during the engagement periods to verify that the reconciliation(s) are complete

and accurate and agree to the detailed balances of the individual student activity funds and the general ledger.

**Response to #3:** Student activity Citizens Bank account reconciliations as of June 30, 2012 are on file at the Education Center for the six secondary schools and the four elementary schools which have a student activity checking account. In addition, as part of the audit of each of the high schools, an analysis was done to confirm the reconciled total of funds in the agency account (general ledger) plus the Citizens checking account was equal to the total of student "club" funds as recorded in QuickBooks by the bursar. The reconciliation analyses for North and South High Schools are attached.

#4) Obtain and review the detailed activity of the student activity funds at the schools during the engagement periods and:

Select a sample of 10 receipts at each school to verify that they were:

Credited to the appropriate student activity account

Deposited to the appropriate agency bank account

Recorded to the appropriate account in the City's general ledger

Select a sample of 10 disbursements at each school to verify that they were:

Appropriately supported by an approved invoice or other documentation

Charged to the appropriate student activity account

For an appropriate purpose related to a legitimate student activity fund

**Response to #4:** As part of the audit for North and South High Schools, a sample of 10 receipts and 10 disbursements for each high school was selected and verified as properly recorded or disbursed on the general ledger. The selected transactions are on file at the Education Center; an additional level of detail is on file at the high school bursar's office, including, for example, the individual checks which were combined into one deposit slip into the agency fund, or a copy of the original invoice paid from the checking account for which reimbursement is requested from the agency fund. Three transactions for each high school are attached as a sample of the backup.

**Massachusetts General Law, C.71, S.47**

- **PART I** ADMINISTRATION OF THE GOVERNMENT  
(Chapters 1 through 182)
- **TITLE XII** EDUCATION
- **CHAPTER 71** PUBLIC SCHOOLS
- **Section 47** Athletic programs; school organizations; student activity accounts

Section 47. The committee may supervise and control all athletic and other organizations composed of public school pupils and bearing the school name or organized in connection therewith. It may directly or through an authorized representative determine under what conditions the same may compete with similar organizations in other schools. Expenditures by the committee for the organization and conduct of physical education, athletics, sports, games and play, for providing proper apparatus, equipment, supplies, athletic wearing apparel, including appropriate souvenir garments and trophies, and facilities for the same in the buildings, yards and playgrounds under the control of the committee, or upon any other land which it may have the right or privilege to use for this purpose, and for the employment of experienced athletic directors to supervise said physical education, athletics, sports, games and play, shall be deemed to be for a school purpose. Expenditures by the committee for making special awards to pupils who have performed meritoriously in the fields of art, debating, distributive education, music, science, social studies or languages shall also be deemed to be for a school purpose. Cities and towns may appropriate for the employment of coaches to supervise in public schools physical education, athletics, sports, games and play, and for the transportation and expenses of public school athletic teams, coaches, cheerleaders, bands and any other groups composed of public school pupils which bear the school name and are under the control of the school committee, within and without the commonwealth, to places where athletic contests or physical education, sports, games, play, musical festivals, competition or other events are held, and for the purchase of band and cheerleaders' uniforms and musical instruments for the members of bands composed of public school pupils and bearing the school name and under the control of the school committee. All receipts by the committee in connection with the conduct of activities provided for under this section or any other activity not expressly provided for in this chapter but sponsored by the school committee in which participation is contingent upon the payment of a fee by the participant, shall be deposited with the treasurer of such town or, in cases where the town is a member of a regional school district, with the treasurer of such district and held as a separate account and expended by said school committee without further appropriation, notwithstanding the provisions of section fifty-three of chapter forty-four. No moneys may be expended from an appropriation or from the separate fund authorized by this section except upon the approval of the school committee, or of the selectmen in towns and of mayors in cities, for travel to other states.

Notwithstanding the provisions of the preceding paragraph or section fifty-three of chapter forty-four, the school committee of a city, town or district may authorize a school principal to receive money in connection with the conduct of certain student activities and to deposit such money, with the municipal or regional school district treasurer, into an interest bearing bank account,

hereinafter referred to as the Student Activity Agency Account, duly established by vote of the school committee to be used for the express purpose of conducting student activities. Interest earned by such Student Activity Agency Account shall be retained by the fund and the school committee shall determine for what purpose such earnings may be used. In addition to such Student Activity Agency Account, the school committee may authorize the municipal or regional school district treasurer to establish a checking account, hereinafter referred to as the Student Activity Checking Account, to be operated and controlled by a school principal and from which funds may be expended exclusively for student activity purposes for the student activities authorized by the school committee. Such account shall be used for expenditures only and funds received for student activities may not be deposited directly into such account.

The school committee shall vote to set the maximum balance that may be on deposit in such Student Activity Checking Account. The principal designated to operate and control such Student Activity Checking Account shall give bond to the municipality or district in such amount as the treasurer shall determine to secure the principal's faithful performance of his duties in connection with such account. To the extent that the funds are available in such Student Activity Agency Account, funds up to the maximum balance set by the school committee shall be transferred from the Student Activity Agency Account through the warrant process to initially fund such Student Activity Checking Account.

Periodically, to the extent that funds are available in such Student Activity Agency Account, the municipal or regional school district treasurer shall reimburse such Student Activity Checking Account, through the warrant process, to restore the limit set by the school committee. The principal shall adhere to such administrative procedures as the municipal or regional school district treasurer or accountant may prescribe. There shall be an annual audit of the student activity funds which shall be conducted in accordance with procedures as agreed upon between the school committee and the auditor based upon guidelines issued by the department of education.

**NEWTON NORTH HIGH SCHOOL RECONCILIATION**

8.7.2012

Checking Account Balance (Citizens)	\$79,948.58	
Minus outstanding checks	(\$10,114.82)	
Citizen's cancelled check fee #	\$0.00	
SA reimb deposit from agency fund not yet in Citizen's (vendor payment history)	7,371.17	
<b>Available Citizens Bank</b>	<b>\$77,204.93</b>	<b>C</b>
49S931 Balance	\$166,804.24	
Pending notice of rejected checks from City (noted in FP)	\$0.00	
Deposits on Revenue Ledger, not yet on Expense Ledger	\$0.00	
Minus Reduced from Revenue Ledger, not yet reduced on Expense Ledger	\$0.00	
Plus Deposits Not Input into Agency Fund yet	\$0.00	
Minus Employee Reimb withdrawals-not yet taken out of agency fund	(\$25.00)	
<b>Available Agency Fund (General Ledger)</b>	<b>\$166,779.24</b>	<b>B</b>
Outstanding SA reimbursements	\$0.00	
<b>Total Available Balance Reconciled (B+C)</b>	<b>\$243,984.17</b>	<b>B + C</b>
Club Balances	\$244,052.06	<b>A</b>
Minus pending Quickbooks adjustment	(\$67.90)	
<b>Final Club Balances</b>	<b>\$243,984.16</b>	
<hr/>		
<b>Surplus/Deficit (B+C-A)</b>	<b>\$0.00</b>	



**NEWTON SOUTH HIGH SCHOOL RECONCILIATION**

6/30/2012

Citizen's Balance #1135659122	\$43,411.28	
Minus outstanding checks	(\$13,069.37)	
Citizen's cancelled check fee #	\$0.00	
SA reimb deposit from agency fund not yet in Citizen's (vendor payment history)	0.00	
<b>Available Citizens Bank</b>	<b>\$30,341.91</b>	<b>C</b>
49S935 Balance	\$103,513.82	
Pending notice of rejected checks from City (noted in FP)	\$0.00	
Deposits on Revenue Ledger, not yet on Expense Ledger	\$14.00	
Plus Pending Correction of vendor paid twice	\$2,625.00	
Plus Deposits Not Input into Agency Fund yet	\$7,220.57	
Minus Employee Reimb withdrawals-not yet taken out of agency fund	\$0.00	
<b>Available Agency Fund (General Ledger)</b>	<b>\$113,373.39</b>	<b>B</b>
Outstanding SA reimbursements	\$55,116.22	
Total Available Balance Reconciled (B+C)	\$143,715.30	<b>B + C</b>
<b>Club Balances</b>	<b>\$143,715.30</b>	<b>A</b>
<b>Surplus/Deficit (B+C-A)</b>	<b>\$0.00</b>	

CITY OF NEWTON  
SCHOOL DEPARTMENT

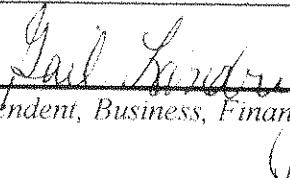
SCHEDULE OF PAYMENTS TO CITY TREASURER

<u>FROM WHOM</u>	<u>SOURCE</u>	<u>AMOUNT</u>
SOUTH <u>Student Activity Account</u> Main Office #316	date 3/12/2012	\$16,886.73
CITY/SCHOOL ACCOUNT# 49S935-429038		
Newton South Student Activity Account		
TOTAL		\$16,886.73

TO THE CITY COMPTROLLER AND TREASURER:

The above is a detailed list of receipts collected by the School Department. Date 3/12/2012  
Amounting in the aggregate of:

\$16,886.73 dollars



*Sandra Guryan, Assistant Superintendent, Business, Finance and Planning*

4. RECEIPT COPY

Laura Gaspari  
South

3/13/2012

### CITY OF NEWTON SCHOOL DEPARTMENT

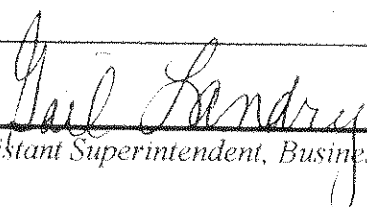
#### SCHEDULE OF PAYMENTS TO CITY TREASURER

<u>FROM WHOM</u>	<u>SOURCE</u>	<u>AMOUNT</u>
SOUTH <u>Student Activity Account</u> Main Office #316	date 3/28/2012	\$11,552.00
CITY/SCHOOL ACCOUNT# 49S935-429038 Newton South Student Activity Account		
<b>TOTAL</b>		<b>\$11,552.00</b>

**TO THE CITY COMPTROLLER AND TREASURER:**

The above is a detailed list of receipts collected by the School Department. Date 3/28/2012  
Amounting in the aggregate of:

\$11,552.00 dollars



*Sandra Guryan, Assistant Superintendent, Business, Finance and Planning*

**4. RECEIPT COPY**

Laura Gaspari  
South

3/30/2012

### CITY OF NEWTON SCHOOL DEPARTMENT

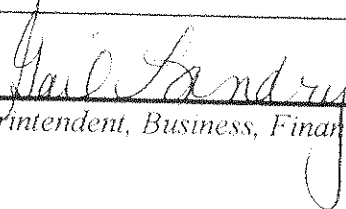
#### SCHEDULE OF PAYMENTS TO CITY TREASURER

<u>FROM WHOM</u>	<u>SOURCE</u>	<u>AMOUNT</u>
SOUTH <u>Student Activity Account</u> Main Office #316	date 4/9/2012	\$19,970.65
CITY/SCHOOL ACCOUNT# 49S935-429038		
Newton South Student Activity Account		
TOTAL		\$19,970.65

**TO THE CITY COMPTROLLER AND TREASURER:**

The above is a detailed list of receipts collected by the School Department. Date 4/9/2012  
Amounting in the aggregate of:

\$19,970.65 dollars



*Sandra Guryan, Assistant Superintendent, Business, Finance and Planning*

**4. RECEIPT COPY**

Laura Gaspari  
South

4/10/2012



Mail Check to: Vendor #13208  
 NNHS Associates  
 360 Lowell Ave.  
 Newton, MA 02460

Newton Public Schools  
 Student Activity Reimbursement Account

DATE: 4/19/2012

**Newton North Reimbursement: 4.19.2012 49S931**

03/27/2012 3941	Nespa	5314-Fees/Registrations	102.50	
03/28/2012 3944	Nespa	5314-Fees/Registrations	59.00	
04/02/2012 3947	Nespa	5314-Fees/Registrations	51.50	
04/09/2012 3952	USA Ultimate	5314-Fees/Registrations	1,920.00	
04/09/2012 3955	Mass FBLA	5314-Fees/Registrations	45.00	
04/11/2012 3959	The College Board	5314-Fees/Registrations	325.00	
04/12/2012 3960	Community Newspaper Co.	5314-Fees/Registrations	102.06	2,605.06
04/05/2012 3951	First Student	538302-Transportation	377.18	
04/11/2012 3957	First Student	538302-Transportation	362.00	739.18
02/09/2012 3869	Paul Fox	5716-special events	14.00	
04/04/2012 3949	The Shirt Guys	5716-special events	618.75	
04/04/2012 3950	Chillybears	5716-special events	497.90	
04/09/2012 3954	Home Depot Commercial Credit	5716-special events	529.71	
04/10/2012 3956	Backstage Hardware & Theatre Supply	5716-special events	749.03	
04/11/2012 3958	Annunciation Mission	5716-special events	875.00	
04/12/2012 3962	Apperson Print Management	5716-special events	155.79	3,440.18
			<b>6,784.42</b>	<b>6,784.42</b>

**Citizens Bank** Customer Receipt

Please be sure to enter this transaction in your records.

Transaction Description	Date	Amount
0101 674E291391 5177 05/07/12 CK CK 0101 XXXXX9130	05/07/12	12:33 \$6,784.72

**DEPOSIT TICKET**

TOTAL ITEMS

DEPOSITS MAY NOT BE AVAILABLE FOR IMMEDIATE WITHDRAWAL.

5-7017/2110  
641

RE-ENTER GRAND TOTAL IN SCREENED BOXES

6,784.72

Funds from your deposit may not be available for immediate withdrawal. All transactions are subject to verification as outlined in the rules and regulations of the Bank.

Member FDIC

⑆5110⑆ 1155⑆ 1135659130⑆

CHECKS AND OTHER ITEMS ARE RECEIVED FOR DEPOSIT SUBJECT TO THE UNIFORM COMMERCIAL CODE AND ANY APPLICABLE COLLECTION AGREEMENT.

Local Motion of Boston  
 66B Roccam Park Rd  
 Braintree, MA 02184  
 Phone : 781-535-6344 Fax : 781-535-6028

REGINA MOODY  
 NEWTON PUBLIC SCHOOLS  
 100 WALNUT ST  
 NEWTONVILLE, MA 02460

Account# : 2627  
 Invoice# : 46504  
 Inv Date : 06/13/2012  
 Net Terms : 15 days  
 Page# : Page 1 of 1

Date Time	Res# Voucher#	Passenger Caller	Pickup	Vehicle Type Dropoff	Total
06/04/12 05:00 pm	375395-1	SENIOR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERS PORT YACHT CLUB	789.91
06/04/12 05:00 pm	375395-10	SENOIR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERS PORT YACHT CLUB	789.91
06/04/12 05:00 pm	375395-11	SENIOR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERS PORT YACHT CLUB	789.91
06/04/12 05:00 pm	375395-2	SENIOR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERS PORT YACHT CLUB	789.91
06/04/12 05:00 pm	375395-3	SENIOR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERSPORT YACHT CLUB	789.91
06/04/12 05:00 pm	375395-4	SENIOR PROM NICOLE FRANCHI	WALNUT ST NEWTON NORTH HIGH SCHOOL	CB55 DANVERSPORT YACHT CLUB	789.91

Invoice Total ( 6 Rides ) 4739.46

**Original Invoice Amount: \$4,739.46      Balance Due: \$4,739.46**

*Please Voucher  
 pay  
 6/14/12  
 \$ 4,739.<sup>46</sup>/<sub>100</sub>  
 495931-5716  
 (Class of 2012)*

**From:** Bob Barrett [mailto:bbarrett@newtonma.gov]  
**Sent:** Wednesday, September 19, 2012 11:17 AM  
**To:** 'Ruthanne Fuller'  
**Cc:** 'fuller ruthanne'; 'Gail Deegan'; Joe Mulvey; Maureen Lemieux; David Wilkinson  
**Subject:** RE: Fin Audit Adv Comm: Follow up on Disaster Recovery Plan  
Alderman Fuller:

In response to the question about having a **Disaster Recovery Plan for the Munis system**, here is a brief summary:

We are starting to look at long term Disaster Recovery and Business Continuity plans for all critical systems. The long term approach will take advantage of our planned fiber network, redundant data centers, and modern technology such as SANs, Virtual Machines (VMs), and backup-by-wire. It may be 1-2 years before much of this is funded and installed, so we are also implementing a short term solution for the FinancePlus and Munis systems as needed for financial systems processing in the event of a disaster. The short term plan is:

1. Use a spare CPU processor that will become available as we start to move applications onto our new EMC virtual machine (VM) server. This server is a few years old, but will be adequate as a backup server in the event of a crisis.
2. Relocate this server at the Ed Center, as we have done for the Finance Plus backup server. (Target completion: October 30.)
3. Create an image of the Munis software, including all customizations, upgrades, and patches.
4. Write a procedure for the startup of this backup server, as well as how to redirect client PCs and the UniPay interface to the backup server.
5. Load the software image, as well as a copy of a nightly (10 PM) data backup on the server.
6. Test the startup and cutover procedure, as well as the major functions and reports. (Target Completion: November 30)
7. Retest both the Finance Plus and Munis backup systems and procedures on a quarterly basis.

I have also drafted a longer explanation and rationale for this plan (attached), if you want to discuss more of the details.

Let me know if you have any questions. I can be available at your Thursday meeting as well, if needed.

Regards,

Bob Barrett

Robert Barrett | Chief Information Officer

City of Newton | 1000 Commonwealth Avenue | Newton Centre, MA 02459

[bbarrett@newtonma.gov](mailto:bbarrett@newtonma.gov) | 617-796-1181



## INVESTMENT POLICY ITEMS

The following are items pertaining to the city's investment policy that may be considered for review or updating:

1) Applicable Veribanc rating for certain types of city investments.

Discussion: The current policy calls for a minimum Veribanc rating of "green" based upon a scale utilizing green, yellow, and red as to a bank's overall condition. However, some city operational accounts are established to provide specific vital services requiring a relationship with the bank that is not immediately severable. Examples of such services are payroll withholding tax payments, health care payments, and payroll and vendor payments.

Consideration: Banks providing critical services where discontinuation of a banking relationship would result in immediate operational difficulties could be allowed to continue with the city under a "yellow" designation given certain restrictions. Recommended restrictions would include a lowering of the limit to funds deposited from 15%; a time limit on how long a bank would be allowed to remain in "yellow" status or restriction based on "prudent person" monitoring.

2) In conjunction with #1, collateralization of funds.

Discussion: Consideration may be given to the relationship between collateralization of deposits and their Veribanc status.

Consideration: Whether or not a bank with a "yellow" designation would be acceptable with a collateralized account. Also what type of collateral would be acceptable?

3) Official incorporation of Acts of 2007, Chapter 75 into Investment Policy.

Discussion: Acts of 2007, Ch. 75 exempts Newton from Section 54 of Chapter 44 of the General Laws with regard to the investment of trust funds.

Consideration: Specific mention of this authority should be included in the Investment Policy document

4) Review of limits to risk limits for investment of funds.

Discussion: The City's current investment policy limits the amount of funds placed with a single banking institution to 15% of the bank's capital and surplus and to no more than 25% of the Treasurer's cash balance.

Consideration: MGL Ch. 44 Sec. 55 specifies a limit of 60% of capital and surplus. Is Newton's level appropriate?

## GFOA Best Practice

### Collateralizing Public Deposits (1984, 1987, 1993, 2000, 2007, 2010) (TIM)

**Background.** The safety of public funds should be the foremost objective in public fund management. Collateralization of public deposits through the pledging of appropriate securities or other instruments (i.e. surety bonds or letters of credit) by depositories is an important safeguard for such deposits. The amount of pledged collateral is determined by a governmental entity's deposit level and the policy or legal required collateral margin. Some states have established programs for the pooling of collateral for deposit of public funds.

Federal law imposes certain limitations on collateral agreements between financial institutions and public entities in order to secure governmental entity deposits. Under certain circumstances, as are discussed in recommendations below, the Federal Deposit Insurance Corporation (FDIC) may void an otherwise perfected security interest and leave the governmental depositor with only the right to share with other creditors in the pro rata distribution of the assets of a failed institution for the amount of deposits that exceed the FDIC coverage. Separate governmental "corporations" such as economic development corporations or water supply corporations, etc., do not fulfill the FDIC's definition of "public unit"<sup>1</sup> and therefore even accurately completed collateral definition may not be honored by the FDIC on a bankruptcy.

**Recommendation.** The Government Finance Officers Association (GFOA) recommends the use of a written agreement with pledging requirements as protection for state or local government's deposits. GFOA encourages governmental entities to establish adequate and efficient administrative systems to monitor such pledged collateral, including state or locally administered collateral pledging or collateral pools. To accomplish these goals, GFOA recommends the following:

1. Governmental entities should implement programs of prudent risk control. Such programs could include a formal depository risk policy, credit analysis, and use of fully secured investments. In the absence of a state program for pooling collateral, public entities should establish and implement collateralization procedures, including procedures to monitor their collateral positions. Monitoring informs a public entity of undercollateralization, which may threaten the safety of an entity's deposits, and overcollateralization, which may increase the cost of banking services. Governmental entities however can not and should not accept the liability for maintaining collateral levels which liability must fall to the financial institution.

<sup>1</sup>For deposit insurance purposes, the term "public unit" includes a state, county, municipality, or "political subdivision" thereof. Governments should review Section 330.15 of the FDIC's regulations (12 C.F.R. 330.15) to identify if they fall within the FDIC's definition of 'public unit' and to determine whether they are public entity qualifying for collateral protection under the definition. This information can be found at <http://www.fdic.gov/deposit/deposits/FactSheet.html>

2. Governmental entities/depositors should take all possible actions to comply with state and federal requirements in order to ensure that their security interests in collateral pledged to secure deposits are enforceable against the receiver of a failed financial institution. Federal law provides that a depositor's security agreement, which tends to diminish or defeat the interest of the FDIC in an asset acquired by it as receiver of an insured depository, shall not be valid against the FDIC unless the agreement:

- is in writing;
- was approved by the board of directors of the depository or its loan committee and<sup>2</sup>
- has been, continuously, from the time of its execution, an official record of the depository institution.<sup>3</sup>

3. Governmental entities should have all pledged collateral held at an independent third-party institution outside the holding company of their bank, and evidenced by a written agreement in an effort to satisfy the Uniform Commercial Code (UCC) requirement for control. The UCC states that the depositor does not have a perfected interest in a security unless the depositor controls it. Control means that swaps, sales, and transfers cannot occur without the depositor's written approval.

- The value of the pledged collateral should be marked to market monthly, or more frequently depending on the volatility of the collateral pledged. Some state statutes do dictate a minimum margin level for collateral based on deposit levels (e.g., Georgia and Minnesota statutes require 110 percent). If not, the margin levels should be at least 102 percent, depending on the liquidity and volatility of the collateral pledged. State statutes also govern whether minimum margin levels apply to principal only or to accrued interest as well. On a sale, accrued interest would be received. Governmental entities should review applicable state statutes and confirm compliance.

- Substitutions of collateral should meet the requirements of the collateral agreement, be approved, by the entity in writing prior to release, and the collateral should not be released until the replacement collateral has been received.

- The public entity should require reporting directly from the custodian. The custodian should warrant and be signatory to the agreement

- Reporting by the third party institution should at a minimum be monthly.

4. The pledge of collateral should comply with the investment policy or state statute, whichever is more restrictive. Governmental entities should know and understand securities pledged as collateral.

<sup>2</sup> The FDIC does not require every transaction to be reviewed by the board of directors. The board may fulfill this function by setting parameters and authorizing a particular officer to carry out its wishes. The officer would be performing ministerial acts on behalf of the board. (FDIC Interpretive Letters)

<sup>3</sup> Corporate resolutions that list specific officers who are authorized by the board of directors to execute agreements securing public deposits will meet this requirement.

5. Governmental entities that use surety bonds in lieu of collateral should limit the insurers to those of the highest credit quality as determined by a nationally recognized insurance rating agency. A thorough review of the terms of the bond is required.

6. The governmental entity should thoroughly review the terms and conditions of any letters of credit, including those issued by a federal agency or government sponsored enterprise.

7. The governmental entity should establish and follow procedures for on-going review of collateral.

**Note:** As a result of the court case North Arkansas Medical Center v. Barrett, 963 F.2d 780 (8th Cir. 1992), the FDIC issued a policy statement in March 1993 indicating that it would not seek to void a security interest of a federal, state, or local public unit solely because the security agreement did not comply with the contemporaneous execution requirement set forth in Section 13(e) of the Federal Deposit Insurance Act 12 U.S.C.1823(e). The policy statement was officially enacted by Section 317 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Public Law 103-325).

**References:**

- GFOA Sample Security Agreement (long and short versions), [www.gfoa.org](http://www.gfoa.org), 2009.
- GFOA Sample Custodial Trust Agreement, [www.gfoa.org](http://www.gfoa.org), 2006.
- *An Introduction to Collateralizing Public Deposits for State and Local Governments*, Second Edition, M. Corinne Larson, GFOA, 2006.
- *Investing Public Funds*, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- FDIC Act (12 U.S.C. 1811 et seq. and 12 C.F.R. Part 330.330.15 Public Unit Accounts ([www.FDIC.gov](http://www.FDIC.gov)))

Approved by the GFOA's Executive Board, October 23, 2007.

<http://www.gfoa.org/downloads/collaterization.pdf>