

FINANCIAL AUDIT ADVISORY COMMITTEE

REPORT

Thursday, December 6, 2012

Present: Alderman Fuller (Chairman), Alderman Danberg, Alderman Gentile, Alderman Lennon, Gail Deegan, and Tony Logalbo

Also present: Chris Rogers, CPA (Sullivan, Rogers & Company, LLC), Marisa Batista CPA (Sullivan, Rogers & Company, LLC), David Wilkinson (Comptroller), Maureen Lemieux (Chief Financial Officer), and Sue Dzikowski (Director of Finance; School Department), Anne Marie Belrose (Community Development Manager), and Stephen Curly (Comptroller's Office)

The Committee met with Chris Rogers and Marissa Batista of Sullivan, Rogers & Company, LLC, the City's external auditing firm, to review the draft Reports on Internal Control and Federal Awards and the Management Letter related to the Fiscal Year 2012 Audit. The attached handout provides an overview of the audit, which includes the Comprehensive Annual Financial Report, Reports on Internal Control and Federal Awards and the Management Letter. The Committee also received a copy of the audited Comprehensive Annual Financial Report (CAFR), which can be found on the City web site under the following link: <http://newtonma.gov/gov/comptroller/new.asp>.

Reports on Internal Control and Federal Awards

The discussion began with the Reports on Internal Control over Federal Awards. The auditor issued an unqualified opinion on all nine federal award programs, as the auditor did not find any material weaknesses in internal control or material costs that exceed the stated expenses. However, there are fourteen findings, seven related to internal controls and seven related to program non-compliance. Six of the findings related to the ARRA Energy Efficiency and Conservation Block Grant Program, the HOME Investment Partnerships Program and Child Nutrition Cluster are repeat findings from the previous audit. Mr. Rogers pointed out that the ARRA Energy Efficiency and Conservation Block Grant Program was completed in Fiscal Year 2012; therefore, the finding will not continue to Fiscal Year 2013. The report also notes that four findings from last year have been resolved (three related to the Child Nutrition Cluster and one related to the HOME investment Partnerships Program.) Mr. Rogers reviewed each of the findings with the Committee.

Many of the auditor's findings relate to a lack of documentation per grant requirements. Mr. Rogers recommended that the City consider creating a position for a Chief Compliance Officer or establish an Internal Audit Department to ensure that each City department complies with requirements of grants and the policies of the City. Although most cities and towns do not have internal audit departments due to the expense, Mr. Rogers believes that in the end it would generate savings.

The City's new Purchasing Agent Nick Read will now handle all documentation that relates to verifying that no vendors that the City contracts with for contracts greater than \$25,000 have been suspended or debarred, which should eliminate one of the findings. In order to address other documentation issues, the Finance Committee of the Board of Aldermen is asking that departments identify a point person to manage a grant whenever an appropriation for a grant is approved. The School Department volunteered to provide grant administration training to all city departments that receive grants. Mr. Rogers stated that regular top-level training session might help curtail the number of findings and material weaknesses cited in the annual audit.

There was some sentiment among the Committee that there should be one person within the City tracking grants. The concern is that as the grant pot grows smaller, federal and state reporting requirements will become more stringent. There is a possibility that if the City cannot meet the reporting requirements, it will be less likely to receive grants. There was suggestion that the Administration may want to investigate the possibility of sharing a grants manager with a neighboring city or town. In addition, it may be helpful for the Administration to establish an internal group to review grant requirements and provide oversight on grant management.

Management Letter

The Management Letter contains twelve comments, which Mr. Rogers reviewed with the Committee. There are three new comments this year, eight repeat comments from the prior year and an informational comment. Mr. Rogers reminded the Committee that the Management Letter does not identify the strengths of the City's financial systems.

Mr. Rogers reviewed each of the comments with the Committee. Issues remain in the water and sewer bills. Although the number of estimated reads have dropped significantly from the previous year, approximately 5% of the property owners have been billed based on multiple estimated reads, which has resulted in \$4,000,000 in abatements this past fiscal year. The abatements are an issue, as the state abatement average is between 0 and .5% and Newton is issuing abatements on 1 to 2% of its bills. The new metering system has already helped to reduce the number of abatements. However, although the new metering system is almost fully installed, there are approximately 300 new meters that have not been installed due to significant plumbing or construction costs to property owners. The Department of Public Works is working with those property owners in order to get the new meters installed. The auditor anticipates that the finding will be gone next year.

The Management Letter also contains an informational comment regarding hiring a citywide grants administrator. The above section related to the Report on Internal Control over Federal Awards contains information on this comment.

The auditor did a site visit to the Parks and Recreation Department to review their cash management processes at the request of the Committee. The auditor reviewed each of the Parks and Recreation Department's programs and discovered that there are internal control issues related to the swimming facilities. The Parks and Recreation Department sells daily bracelets to swimmers but there is no log kept that identifies the starting and ending number of the daily bracelets sold. As a result, it is not possible to do a reconciliation of bracelets sold to cash receipts. In addition, the Schedule of Payments to the Treasurer does not include signoffs of the preparer or reviewer resulting in no documentation supporting the reconciliation of bank deposits to receipts. The auditor recommends that the Parks and Recreation Department maintain a daily log and reconcile it to the daily cash collections and that all schedules and reconciliations be documented by both the preparer and reviewer. Control is ultimately the Treasurer/Collectors responsibility and he should be informed about any change that requires signoffs by individuals. The Committee's Internal Controls Sub-committee will be meeting to review the cash management practices in satellite departments and develop cash management policies. Mr. Rogers added that risk assessment and monitoring is easier with an internal audit division or an experienced auditor. The City should look at and understand the costs of going in the direction of establishing an auditing position or department.

The auditor continued to the next comment with the recommendation that the City identify each third-party service provider organization it utilizes and request a service organization controls report annually for each organization. The auditor strongly recommends that the City only do business with companies that can provide a service organization control report.

The next recommendation is that the City implements formal risk assessment and monitoring programs. It would be easier to develop programs if the City were to establish an internal audit division. The Committee commented that the Investment Policy Ad Hoc Sub-Committee should discuss this recommendation.

The next recommendation is a suggestion that the City develop a Financial Policies and Procedures manual. The City is in agreement with the recommendation and plans to work to implement the manual.

There were several more recommendations from the auditor that are repeats of the previous year's recommendations, which were addressed as part of a review of the prior year's audit by the Accounting and Audit Sub-committee. The recommendations relate to the creation of a disaster recovery plan, pension accounting and financial reporting, police detail billing and collection, the School Department's student activity funds, and unclaimed and old outstanding checks.

Mr. Rogers also included an informational comment noting that in fiscal year 2015, there will be financial reporting changes for pension plans. The City will be required to recognize its long-term obligation for pension benefits as a liability in its

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government-wide financial statements. Conditions will also be placed on the use of the discount rate used to measure the projected benefit payments to their actuarial present value.

Mr. Rogers completed the presentation of the draft Reports on Internal Control and Federal Awards and the Management Letter related to the Fiscal Year 2012. The Committee will meet again on January 10, 2013 to continue discussion on the Fiscal Year 2012 external audit including the CAFR.

Respectfully submitted,

Ruthanne Fuller, Chair

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City of Newton, Massachusetts

Fiscal Year 2012 Audit Exit Conference

December 6, 2012

Presented by: Chris Rogers, CPA, Shareholder

Agenda

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- Engagement summary
- CAFR/Financial Statement summary
 - ▣ CAFR Structure
 - ▣ Opinion
 - ▣ Financial highlights
 - ▣ Significant footnotes
 - ▣ Required Supplementary Information
- Reports on Internal Control and Federal Awards
- Management Letter

Report on IC over FR, Compliance and Federal Award Programs

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- Document structure
 - ▣ Report on internal control (IC) over financial reporting (FR), compliance and other matters (p 1-2)
 - Required by Government Auditing Standards
 - No opinion provided
 - Must report the following:
 - Any significant deficiencies or material weaknesses in internal control over financial reporting
 - Material noncompliance related to laws, regulations, contracts and grant agreements

Report on IC over FR, Compliance and Federal Award Programs

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- Document structure (continued)
 - ▣ Report on Compliance with Major Federal Award Programs (p 3-5)
 - Provides an opinion on compliance related to major federal award programs
 - Reports on any significant deficiencies or material weaknesses in internal control over major federal award program compliance
 - ▣ Schedule of Expenditures of Federal Awards (p 6-8)
 - ▣ Notes to Schedule (p 9)
 - ▣ Schedule of Findings and Questioned Costs (p 10-21)

Report on IC over FR, Compliance and Federal Award Programs

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□ Results

- No findings cited in Report on IC over FR, Compliance and Other Matters
- Material weaknesses in internal control over compliance is reported in several federal award programs
- Unqualified opinion (best available) on all major federal award programs, which were:
 - Child Nutrition/School Lunch; CDBG; HOME; Public Safety Partnership and Community Policing; Energy Efficiency (ARRA); Special Education; Safe Schools; Education Jobs (ARRA); and Public Assistance
 - Total federal expenditures - \$11.9M
- 14 findings reported (7 related to internal control; 7 related to program noncompliance)

Report on IC over FR, Compliance and Federal Award Programs

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□ Findings

□ Child Nutrition Cluster (p 12-13)

- Material weakness in IC (finding 12-1)
 - Eligibility and Special Tests and Provisions - Procedures are not in place to ensure that lunch applications and income documentation obtained are maintained on file
- Noncompliance (finding 12-2)
 - The October 2011 claim for reimbursement to DESE did not agree to the detailed breakdown of school nutrition activity
 - Questioned costs - \$21
- Noncompliance (finding 12-3)
 - 4 of the 60 student files tested were either missing the original applications filed or did not contain sufficient documentation to support eligibility
 - Questioned costs - \$2,658

Report on IC over FR, Compliance and Federal Award Programs

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□ Findings

□ HOME Program (p 13-14)

■ Noncompliance (finding 12-4)

- Program management did not enter program income enter federal IDIS system timely. As a result, there were instances where program income was not applied against grant expenses prior to federal grant drawdowns
- Questioned costs – None

□ Public Safety Partnership and Community Policing (p 14-15)

■ Material weakness in IC (finding 12-5)

- Internal controls are not in place to verify contracts entered into > \$25k are not suspended, debarred or otherwise excluded from doing business

Report on IC over FR, Compliance and Federal Award Programs

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- ▣ Public Safety Partnership and Community Policing (cont)
 - Noncompliance (finding 12-6)
 - Salaries charged to the grant for several employees were not supported by timesheets
 - Questioned costs - \$1,920
- ▣ Public Assistance Grants (p 15)
 - Material weakness in IC (finding 12-7)
 - Internal controls are not in place to verify contracts entered into > \$25k are not suspended, debarred or otherwise excluded from doing business

Report on IC over FR, Compliance and Federal Award Programs

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- ▣ ARRA Energy Efficiency (p 16–19)
 - Material weakness in IC (finding 12-8)
 - Internal controls are not in place to maintain payment requests and the accounting records supporting them
 - Material weakness in IC (finding 12-9)
 - Internal controls are not in place to prepare financial reports submitted to the Department of Energy based on activity recorded in the general ledger
 - Material weakness in IC (finding 12-10)
 - Internal controls are not in place to label equipment as federally funded and perform an annual physical inventory
 - Material weakness in IC (finding 12-11)
 - Internal controls are not in place to verify contracts entered into > \$25k are not suspended, debarred or otherwise excluded from doing business

Report on IC over FR, Compliance and Federal Award Programs

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- ▣ ARRA Energy Efficiency (cont)
 - Noncompliance (finding 12-12)
 - Program management did not maintain copies of the payment requests and supporting documentation
 - Questioned costs – none
 - Noncompliance (finding 12-13)
 - Financial reports submitted to the Department of Energy were not completed based upon expenditures recorded in the general ledger, which does not reflect an accurate and complete disclosure of results
 - Questioned costs – none
 - Noncompliance (finding 12-14)
 - Equipment purchased with federal funds was not labeled as such. In addition, the City did not perform a physical inventory.
 - Questioned costs - none

Management Letter

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- Does not identify the strengths of the financial systems
- 3 comments removed from prior year
 - ▣ NCDA, Bank Reconciliations and Test Database
- Summary
 - ▣ 12 comments
 - 3 new
 - 8 repeat
 - 1 informational

Management Letter

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- Water and Sewer Billings (Page 1)
 - Consistent with prior years, some water and sewer bills are based on estimates and false reads from a faltering reading system
 - Approximately 5% have multiple estimated reads (up to 12)
 - Abatements totaling approximately \$4M were issued during the year
 - \$800k less than the prior year
 - Our subsequent audit work identified abatements totaling \$130k for July & August 2012, a \$343k decrease from same period in prior year
 - Approximately 99% of the new meters were installed at June 30, 2012; however, the reading system was not entirely functional
 - We recommend the new metering system be fully implemented as soon as possible

Management Letter

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- City-Wide Grants Administrator (Page 2)
 - ▣ Current structure places responsibility of administering grants at the Department level
 - Grant administration positions only exist in the School and Planning and Development Departments
 - ▣ We believe the City is at risk in the administration and adherence to state and federal grant compliance requirements
 - Failure to comply with grant requirements potentially results in repayments to the granting agency or reduction in future awards
 - ▣ We recommend consideration of a City-Wide Grants Administrator

Management Letter

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- Parks and Recreation (Page 3)
 - ▣ Cash receipt activities
 - Swimming facilities daily bracelets
 - No log is maintained that identifies the starting and ending number of daily bracelets sold. As a result, a reconciliation of bracelets sold to cash receipts cannot be performed.
 - Schedule of Payments to City Treasurer does not include signoffs of the preparer or reviewer. As a result, control activities are not being documented.
 - No documentation (signature or initials) supporting the reconciliation of bank deposit to receipts entered to SportsMan
 - ▣ We recommend (1) a daily log be maintained and reconciled to daily cash collections; and (2) that all Schedules and reconciliations performed be documented by the preparer and/or reviewer's signature or initials

Management Letter

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- Service Organization Controls (Page 4)
 - ▣ City engages third-party service providers to process certain financial transactions (i.e., deputy tax collector)
 - The use of service organization's is an extension of the City's internal control over financial reporting, compliance, privacy, etc.
 - When third-party service providers are utilized, the City can monitor the third party's controls through the requirement of them obtaining a SOC 1 or SOC 2 report
 - ▣ We recommend:
 - The City identify each service organization utilized and request the applicable SOC report (annually)
 - The City include a requirement for each service organization to obtain an annual SOC report

Management Letter

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- Risk Assessment and Monitoring (Page 5)
 - ▣ The City, like many municipalities, has not implemented a formal risk assessment and monitoring program
 - Important element of internal control
 - Purpose is to identify, anticipate, analyze and manage risk of asset misappropriation (i.e., cash, movable inventory, etc.)
 - ▣ Should be led by employees who have extensive knowledge of the City's operations
 - However, all departments must be involved
 - ▣ We recommend the City implement a formal risk assessment and monitoring programs

Management Letter

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- Police Details (Page 6)
 - ▣ For financial reporting purposes, the City considers police detail accounts receivable uncollectible if greater than 1 year old (approximately \$33k)
 - However, a formal policy does not exist for the actual “write-off” of uncollectible amounts
 - ▣ In addition, the Police Department utilizes an internally developed database for billings and collections that doesn’t facilitate a clear audit trail and effective reporting
 - ▣ We recommend the development of a formal uncollectible policy and the consideration of purchasing software specifically designed for billing and collection

Management Letter

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- Student Activity Funds (Page 7)
 - ▣ MGL Chapter 71, Section 47 requires annual audit of student activity funds
 - MASBO recommends that every 3 years an independent audit firm perform agreed-upon procedures or an audit
 - ▣ Consistent with prior years, an annual audit or agreed upon procedures were not performed
 - Subsequent to year-end the City performed agreed-upon procedures related to the NNHS and NSHS student activity funds
 - ▣ We recommend the City have an annual audit or agreed-upon procedures of its student activity funds annually

Management Letter

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- Unclaimed Checks (Page 8)
 - A current list of check numbers, check dates, payees, address and related amounts was not provided to support the \$500,000 liability reported on the general ledger
 - This information is critical when following up and resolving unclaimed check amounts
 - We recommend:
 - T/C investigate and identify the pertinent unclaimed check information and reconcile to the general ledger
 - T/C implement procedures to investigate and resolve the unclaimed check amounts in accordance with MGL

Management Letter

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- Old Outstanding Checks (Page 9)
 - Vendor and payroll outstanding checklists identify approximately \$214k in checks > 3 months old
 - Typically means checks are lost, void or misplaced
 - We recommend procedures be implemented to investigate and resolve checks > 3 months old monthly

Management Letter

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- Financial Policies and Procedures (Page 10)
 - A formal financial policies and procedures manual does not exist
 - A formal manual would improve and standardize the City's financial policies and procedures, which enhances supervisory personnel effectiveness and transition effectiveness and efficiencies upon employee turnover
 - Should address major financial processes, such as cash receipts and disbursements, purchase orders, personnel, etc.
 - We recommend the development of a formal manual

Management Letter

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- Disaster Recovery Plan (Page 11)
 - ▣ In the prior year, we identified that although the City's financial data and software could be recovered, the City may not have the ability to physically run the software and access the data
 - During FY 12, the City addressed the hardware required to access the data and location to operate the g/l software; however, the hardware required to access the detailed accounts receivable data (MUNIS) has not been addressed
 - ▣ We recommend the detailed accounts receivable data be addressed in the City's disaster recovery plan

Management Letter

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- Pension Accounting and Financial Reporting (Pg 12)
 - ▣ GASBS 68 revises/establishes new financial reporting requirements related to pension benefits
 - Required to recognize long-term obligation for pension benefits in government-wide financial statements
 - Also requires:
 - More comprehensive measure of annual pension costs
 - Conditions on the use of discount rate
 - Requirement to use entry age method and each service period's cost is determined by level % of pay (attribution method)
 - Expanded note disclosures
 - ▣ We recommend management familiarize itself with GASBS 68 and prepare for its implementation