

**CITY OF NEWTON, MASSACHUSETTS**

**MANAGEMENT LETTER**

**JUNE 30, 2006**





*Certified Public Accountants*

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To the Honorable Board of Aldermen and Mayor  
City of Newton, Massachusetts

In planning and performing our audit of the basic financial statements of the City of Newton, Massachusetts (City) for the fiscal year ended June 30, 2006, we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on internal control.

During our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and recommendations concerning those matters. This letter does not affect our report dated October 18, 2006, on the basic financial statements of the City.

The accompanying comments and recommendations are intended solely for the information and use of management and should not be used by anyone other than these specified parties.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with City personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

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October 18, 2006

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## Informational Comment and Recommendation

### New Accounting and Financial Reporting Requirements for Post-Employment Benefits Other Than Pensions

#### Comment

The City provides post-employment benefits (i.e., health insurance) to its qualified retirees. Consistent with other Massachusetts municipalities, the City's OPEB expenditures are financed on a pay-as-you-go-basis from annual appropriations and the City's current financial statements do not report the financial impact of OPEB until the benefits are paid. During fiscal year 2006, the City had 2,411 retirees and/or survivors that received such benefits. For the year ended June 30, 2006, the cost of these benefits totaled approximately \$12,561,000.

The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. This Statement establishes the standards for the measurement, recognition, and display of other postemployment benefits (OPEB) expense/expenditures and related assets, liabilities, note disclosures and required supplementary information in the audited financial statements of state and local governments. As part of determining OPEB amounts and disclosures, the Statement requires, at a minimum, a biannual OPEB actuarial valuation.

Implementation of this statement will improve financial reporting by:

- Recognizing the cost of benefits in periods when the related services are received by the employer
- Providing information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Providing information useful in assessing potential demands on the employer's future cash flows.

Given the significant dollars spent on the City's OPEB plans, the measurement of OPEB under the new standard will have a significant impact on the City's financial statements. The City's required implementation date of GASB Statement No. 45 is fiscal year 2008.

For the past several years the City has had an annual actuarial valuation performed for its OPEB liability. At June 30, 2006, the actuarially determined present value of earned OPEB totals approximately \$560,860,000. In addition, if the City was amortizing this liability over a 30-year period (which it will begin to for financial statement purposes in fiscal year 2008), the fiscal year 2006 annual required contribution would have totaled \$48,820,000. The difference between this amount and the actual amount paid by the City during fiscal year 2006 totals \$36,259,000.

#### Management's Response

The City has arranged for an actuarial valuation of its OPEB liability since 2001 and will comply fully with the accounting and financial reporting requirements of GASB statement 45 in our June 30, 2008 CAFR. Any change in OPEB funding requires approval of the mayor and board of aldermen.

## **Other Matters**

### **Parking Meters**

#### Comment

We evaluated the system of internal control surrounding the City's parking meter collection process and identified the following deficiencies:

1. Collections (coins) are unsecured from the time the meter is opened until the time the collections are delivered to the Treasurer/Collector's office.
2. A set of keys (used to open the parking meters) are maintained at an employee's home.

#### Recommendation

We recommend that the City evaluate the cost/benefit of purchasing parking meters that provide increased collection security (e.g., locked coin canister).

We recommend that all parking meter keys be secured and maintained in a City facility.

#### Management's Response

1. We agree with the recommendation and while this process has been in place for many years, the technology of parking meter revenue has improved and it would be in the City's interest to review costs and associated risks if lock boxes were implemented. It is management's expectation that in the next sixty (60) days a review of the process and evaluation of current products on the market will allow for a cost-benefit analysis and a recommendation made to the Mayor. Maintaining security of parking proceeds is of the highest importance, and with 1711 parking meters in use which take coins, any change in protocols will have a potentially large impact on the program. Based on some general information gathered recently, an estimated cost of a generic lock box City-wide may cost in the vicinity of \$30,000. After discussions with the Treasurer, another protocol we are investigating is the direct delivery of coinage to the bank, instead of to the Treasurer and ultimately to the bank. Review of the parking meter program generated points which fall into two areas for consideration:

#### **Operational Protocols:**

- a. Two men at all times are dispatched to collect coins from the parking meters.
- b. The employees assigned this duty must be consistent and must pass background checks prior to beginning work.
- c. A locked van was purchased in 2002 to provide additional security of cash while in transit or during collections.
- d. A key accountability policy was adopted (see below)

**Long-term Strategy:**

- a. With newly developed technology, cashless meters (those allowing debit or credit cards) are envisioned to play a more central part in parking collections. Since 2005, over 250 meters have been installed which provide the option of card debits or charges. Additionally, this year an appropriation was approved for a centralized "Muni-Meter" was approved, in an effort to allow for the use of debit or credit cards while reducing the number of meter heads from 58 down to 1. As the number of cashless meters reach saturation in particular areas and central multi-space meters that produce time slips increase, the options available in the management of the receipts as well as improved service to the community widen.
- b. While dependence on a "cash only" meter is expected to quickly drop quickly across the City, meters will continue to allow for cash payment for the foreseeable future. It will be the preference of the users however, that will dictate the frequency of cash collections from the meters.
- c. The purchase of new multiple-space meters, will also allow for a more practical accounting and auditing system. Cash collections could be kept separate by lot or street, thus improving revenue projections and impacts of rate changes.

In summary, many of the City's parking meters are technologically obsolete and as they are replaced, newer multi-space meters with cashless options will reduce the coinage requirements and increase efficiencies in collection and accounting. With newer meters, other auditing procedures will be available than the current system can offer. If this can be implemented at a reasonable cost, it would important for the City to do so. In the next few months, management will investigate options which offer more security and better accounting practices.

2. The practice of an employee bringing a set of parking meter keys home, has ceased as of the time of this writing. Our employees had adopted this procedure out of convenience, not malicious intent. However, management recognizes the importance for policy and procedures which protect the meter keys from misuse and keep positive control of the keys at all times. Effective immediately, **Policy #06-02 Parking Meter Key Accountability** (Encl A) has been instituted by the Department. Through this policy, protocols are set in place which will provide safeguards and create the necessary checks and balances to avert situations which undermines the transparency and trust in the meter collection program.



## **Student Activity Funds - Newton South High School**

### Comment

We evaluated the Newton South High School's (NSHS) system of internal control surrounding the student activity funds and identified the following deficiencies:

1. There is no process in place to reconcile the total individual student activity fund balances (maintained by the NSHS in Quickbooks) to the book balances of the student activity fund checking and agency bank accounts. Lack of this procedure does not provide assurance that all student activity fund activity has been recorded properly.
2. A reconciliation of deposits posted to Quickbooks and deposits made to the agency account is not performed. Lack of this procedure does not provide assurance that all student activity fund deposits have been recorded properly.
3. Individual student activity fund detailed transaction reports are not forwarded to the student activity fund advisors on a monthly basis. Currently, these reports are only forwarded to the advisors when requested.
4. Several instances where the descriptions of disbursements (as recorded in Quickbooks) did not correlate with the actual disbursement. Transactions should be described appropriately in all accounting records.
5. Five individual fund deficits, totaling approximately \$3,281, exist at June 30, 2006.

### Recommendation

We recommend that procedures be implemented to reconcile the total individual student activity fund balances to the total book balances of the checking and agency bank accounts.

We recommend that procedures be implemented to reconcile deposits posted to Quickbooks to the deposits made to the agency bank account.

We recommend that procedures be implemented to reconcile the individual detailed student activity funds reports with the appropriate student activity fund advisors monthly.

We recommend that all transactions recorded in Quickbooks include the appropriate description.

We recommend that the individual fund deficits be investigated and appropriately resolved. We also recommend that procedures be implemented to prevent deficit spending in individual student activity funds.

### Management's Response

1. A regular procedure is currently being developed to regularly reconcile the school ledger of individual student activity accounts in total to the combined balances of the school checking account and the agency account included in the City's financial records and in the City bank account. This will include a regular monthly reconciliation of Quickbooks account deposits and agency bank account deposits.

2. The high school administrative office staff will receive training on reviewing the Agency account balance in the Finance Plus ledgers. The balances will be monitored both by the Business Office and the high school office to allow tracking of deposits to the account.
3. The high school administration will distribute monthly Quickbooks reports to individual fund advisors.
4. The business office will review the Quickbooks records in order to assist with accurate descriptions of transactions within the Student Activity Account.
5. The individual club balances with deficits as of June 20, 2006 have been queried and the club advisors indicate that revenues will be/have been received to offset these deficits. The reconciliation procedure will highlight any internal deficits and the school administration will work with club advisors to avoid spending funds in advance of deposits whenever possible.

## Cash Receipts – School Lunch Program

### Comment

We evaluated the system of internal control surrounding the school lunch program’s cash receipts process and identified the following deficiencies:

#### *High Schools and Bigelow Middle School*

1. There are no procedures in place to ensure that students who are eligible to receive free or reduced lunch only receive one lunch per day. Currently, the cashiers at these schools use manual lists that include the students’ names and applicable lunch statuses (i.e., free, reduced, or full price) when cashing the students out at the registers. Since there are several lunch lines at each of these schools, students who receive free or reduced lunch have the ability to go to different lines in the same day. As a result, these students could potentially receive more than one free or reduced lunch on any given day.

#### *Elementary Schools*

2. School lunch cash receipts are not consistently maintained in a secure location. The following are instances where the cash receipts are vulnerable and susceptible to theft or loss:
  - a. Although some parents mail in school lunch payments to the food service office, students often bring lunch money to school with them, which they place in envelopes that are taped on the classroom doors. All of the students and teachers have access to these envelopes and know that they contain the cash payments.
  - b. All of the elementary school lunch receipts are sent to the School Lunch Manager’s central office. However, not all of the money maintained in the central office is kept in a safe. There is an open and unlocked file cabinet for all of the elementary schools where the most recent payments are placed.
3. Bank deposits are made approximately twice a month. The lack of timely deposits not only increases the risk of theft, misplacement, or misappropriation, but has a negative impact on cash flows and investment income and potentially delays the cash reconciliation process, which negatively impacts the financial reporting process.

#### *All Schools*

4. The Food Service office reconciles the bank deposit slips with the bank statements. However, there are no procedures in place to reconcile the deposits posted to the bank statements with the cash receipts recorded in the City’s general ledger.
5. The Food Services Director is responsible for making the daily (except for the elementary schools as identified above) deposits for all school lunch programs. At times, these deposits can be as large as \$85,000.

## Recommendation

### *High Schools and Bigelow Middle School*

We recommend the implementation of an automated process whereby the lunches served to students receiving free and reduced lunch can be simultaneously tracked by each employee working a cash register.

### *Elementary Schools*

We recommend that school lunch money brought in by students be given directly to the applicable homeroom teacher. We also recommend a process whereby an employee picks up the school lunch money from each homeroom teacher at the start of every school day.

We recommend that all cash receipts maintained in the School Lunch Manager's central office be kept in the safe until they are deposited in the bank.

We recommend that the Food Services Director deposit the elementary school lunch receipts daily (similar to the secondary schools' process).

### *All Schools*

We recommend that procedures be implemented to reconcile bank deposits between the bank statements and the City's general ledger monthly.

We recommend that management consider the cost/benefit of having a courier or police escort assist in making the daily deposit.

## Management's Response

1. The Food Service Program is implementing the lunchbox point of sale (POS) system. All secondary schools will be on-line by the middle of January. This electronic system will eliminate manual recordkeeping of free and reduced lunches at those schools.
2.
  - a. A secure location in each elementary classroom will be designated. The current practice now includes the senior lunch attendant picking up cash and menus on a daily basis.
  - b. The Elementary office will begin a process to secure all monies in a safe until it is deposited.
3. The Elementary office will implement weekly deposits of money to improve cash management and cash flow.
4. All bank deposit slips are reconciled in the Operations office on a weekly basis. The bank deposit slips are reconciled with the activity cash receipts schedule that is retrieved from Bank of America on a daily basis. This document is also used to create the revenue sheet which is provided to the Treasurer for recording in the City's general ledger. A monthly reconciliation process for all schools' deposits will be developed.
5. The school administration will review options for reducing the risk of large deposits being made by the Food Service Director including use of a courier or police escort or making more frequent deposits.

## **Reconciliation of Accounts Receivable**

### Comment

An employee of the Treasurer/Collector's office reconciles accounts receivable (i.e., real estate, personal property, motor vehicle excise, etc.) balances monthly between the Comptroller's general ledger and the Treasurer/Collector's detailed records. However, we identified that the reconciliation does not include sign-offs for either Department Head. Requiring Department Head sign-offs would formalize the process and strengthen the controls related to the reconciliation.

### Recommendation

We recommend that the monthly accounts receivable reconciliation include sign-offs for the Comptroller and Treasurer/Collector identifying that the balances as presented in the reconciliation in fact agree to the respective Departments' records.

### Management's Response

**Treasurer:** We agree that this should be done. We are projecting that with improved computer technology and improved Munis integration to the Munis general ledger system that we can speed up this accounts receivable reconciliation process.

**Comptroller:** A monthly analysis of general ledger receivable activity and beginning and ending receivable balances is prepared each month and forwarded to the Treasurer's Office for review and verification against detail receivable records. Effective immediately, signature lines have been added to the bottom of this document for both the Comptroller's Office and Treasurer's Office.

## Community Development Block Grant and HOME Drawdowns

### Comment

The City's Community Development office prepares drawdown requests weekly for the Community Development Block Grant (CDBG) and HOME vendor disbursements. However, the payroll drawdown requests are prepared monthly or every other month. As a result, the Community Development office frequently uses the City's funds for the grant related payroll expenditures, which has a negative impact on the City's cash flows and investment income.

### Recommendation

We recommend that the Community Development office prepare CDBG and HOME payroll drawdown requests weekly.

### Management's Response

**Planning and Community Development:** The CDBG and HOME draw-downs for payroll have periodically been held for specific purposes, such as accumulating large enough balances to off-set credit draw-downs. However, based on the recommendation of the auditors, the Community Development office now prepares CDBG and HOME drawdown requests weekly.

**Comptroller:** A monthly analysis of cash receipt and disbursement activity, along with beginning and ending cash balances is prepared for both the CDBG and the HOME grant by the Comptroller's Office. This monthly report identifies any disbursements for which a federal funds draw-down is outstanding at month end. A copy of this report is forwarded to the Planning and Community Development Department for review and reconciliation against detailed program records. Effective immediately, signature blocks have been added to the bottom of this report for both the Comptroller's Office and the Planning and Community Development Department.

## **Student Activity Funds – Elementary Schools**

### Comment

The City's elementary schools have not adopted the student activity fund law as defined in Chapter 66 of the Acts of 1996 (Act). In summary, the Act requires the following:

- The School Committee to authorize School Principals to receive funds in connection with the administration of student activities.
- Student activity funds to be deposited with the Treasurer into a separate interest bearing account (Student Activity Agency Account).
- Interest earned on the Student Activity Agency Account to be retained by the fund and disbursed at the discretion of the School Committee.
- In addition to the Student Activity Agency Account, the School Committee may authorize School Principals to establish a separate checking account (Student Activity Checking Account), which may only be used to disburse funds for the exclusive benefit of student activities.
- The School Committee to establish a maximum amount to be maintained in the Student Activity Checking Account.
- Funds, up to the maximum amount authorized by the School Committee, to be transferred from the Student Activity Agency Account to the Student Activity Checking Account (via the City's warrant process) to initially fund the Student Activity Checking Account.
- Periodically and to the extent funds are available in the Student Activity Agency Account, the City to reimburse the Student Activity Checking Account through the City's warrant process.

### Recommendation

We recommend that all student activity funds be maintained in accordance with the Act.

### Management's Response

A review of all elementary school student activity funds will be conducted to determine which of the schools maintain funds separate from the Parent Teacher Organizations. For those schools with funds maintained by the principals, a process will begin to determine the implementation steps for achievement of compliance with Chapter 66 of the Acts of 1996.

## **Old Outstanding Checks**

### Comment

The vendor and payroll outstanding checklists maintained by the Treasurer include many checks greater than three (3) months old totaling approximately \$499,000. Typically, checks greater than three (3) months old reflect checks that have been void, lost, misplaced or stolen. There is currently no process/procedure in place to investigate and resolve the status of these checks.

### Recommendation

We recommend that the Treasurer/Collector's office implement monthly procedures to investigate and resolve outstanding checks greater than three (3) months old. Implementation of this recommendation will strengthen internal controls over cash disbursements.

### Management's Response

We agree with the recommendation and we will work on this item. We feel that the account receivable reconciliation process is of a higher priority than this item.



## **Unauthorized Bank Accounts Using the City's Tax Identification Number**

### Comment

We identified nine bank accounts that are using the City's tax identification number that are not authorized by the Treasurer. Usually these accounts represent quasi-governmental organizations, such as parent teacher organizations, booster clubs, etc. However, since these accounts are maintained under the City's tax identification number, the City is at risk if fraudulent activities were to occur in any of these accounts. Additionally, the Treasurer should have signature authority on all bank accounts maintained under City's tax identification number and the activity related to the bank accounts should be recorded on the general ledger.

### Recommendation

We have provided a list of the unauthorized bank accounts to the Treasurer/Collector. We recommend that the Treasurer/Collector contact the related banks to begin the process of closing all of the unauthorized bank accounts.

### Management's Response

We agree and will work with the auditor provided list, the city departments and banks to try to eliminate these accounts and also monitor these banks periodically going forward.

## **Financial Policies and Procedures Manual**

### Comment

We believe that preparation of a formal policy and procedures manual would improve and standardize the City's financial policies and procedures. Without formalized written policies and procedures, the City is inherently subject to everyday inconsistencies in its operations. It is also difficult to measure performance and efficiencies without a baseline. The number of such inconsistencies can be minimized by the written codification of policies and procedures and insistence on adherence to them.

Such a manual should include policies and procedures relative to all financial functions and processes, including, but not limited to, the following:

- Cash receipts
- Purchase orders
- Cash disbursements
  - Payroll
  - Vendor
- Administration of grants
- Administration of student activity funds
- Personnel (i.e., hiring, payroll and related changes, etc.)
- Month-end and year-end closing procedures

The manual should also clearly define the objectives, responsibilities and authorizations for all employees/job positions.

The use of written policies, procedures, and job descriptions in conjunction with specific assignment of responsibilities would increase supervisory personnel's effectiveness. Such written documents would decrease the time spent on supervision of clerical personnel and in attempts to define job responsibilities on each occasion of employee turnover.

### Recommendation

We recommend that management develop and implement a formal financial policies and procedures manual.

The Comptroller has undertaken the project to develop and implement a formal financial policies and procedures manual. The project was started in fiscal year 2006. We recommend the City continue its progress in developing and implementing a formal financial policies and procedures manual.

### Management's Response

During the fiscal year ended June 30, 2006 and inventory was prepared of all financial activities for which detailed policies and procedures must be prepared. A copy of this inventory, along with a sample policy and procedure document was forwarded to the City's Audit Committee for review.

Given the staffing and workload of the Comptroller's Office, policy and procedures documentation can only take place during the January – March quarter of the year. During the January – March 2007 time frame, documentation will be undertaken for the most unique financial activities. Each policy and procedures document will then be submitted to the Audit Committee for review. It is expected that a period of two to three years will be necessary in order to finalize the necessary documentation of the City's financial policies and procedures.

## **Risk Assessment and Monitoring**

### Comment

When internal controls are *initially* implemented, they are usually designed to adequately safeguard assets. However, over time, these controls can become ineffective due to changes in technology, operations, etc. In addition, changes in personnel and structure, as well as the addition of new programs and services, can add risks that previously did not exist. As a result, all municipalities must periodically perform a risk assessment to anticipate, identify, analyze and manage the risk of asset misappropriation. Risk assessment (which includes fraud risk assessment), is one element of internal control.

The risk assessment should be performed by management-level employees who have extensive knowledge of the Town's operations. Ordinarily, the management-level employees would conduct interviews or lead group discussions with personnel who have knowledge of the Town's operations, its environment, and its processes. The risk assessment process should consider the Town's vulnerability to misappropriation of assets. It should also address operations that involve heightened levels of risk. When conducting the assessment, the following questions should be considered:

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- What operations are the most complex?
- How could assets be stolen?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could potential misappropriation of assets be concealed?
- What prior internal control issues could still continue to be problematic?

Once the areas vulnerable to risks have been identified, a review of the Town's systems, procedures, and existing controls related to these areas should be conducted. The Town should consider what additional controls (if any) need to be implemented to reduce risk.

After risk has been assessed, periodic monitoring of the identified risk areas must be performed in order to evaluate the controls that have been implemented to mitigate the risks. Since control-related policies and procedures tend to deteriorate over time, the monitoring process ensures that controls are fully operational and effective.

### Recommendation

We recommend that management develop and implement a risk assessment program to periodically anticipate, identify, analyze, and manage the risk of asset misappropriation. The risk assessment program should be formally documented and become part of the Town's financial policies and procedures manual.

We recommend that management develop and implement a monitoring program to periodically evaluate the operational effectiveness of internal controls. The monitoring process should be documented in order to facilitate the evaluation of controls and to identify improvements that need to be made.

### Management's Response

During the fiscal year that ended June 30, 2006, the City established a formal Audit Committee of the Board of Aldermen. It is expected that over time, the Audit Committee, in conjunction with senior financial management of the City will develop a formal process for on-going financial risk assessment and monitoring.