

CITY OF NEWTON, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2009



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 financial statements of the City of Newton, Massachusetts (City) as of and for the year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the condition identified in our *Report on Internal Control Over Financial Reporting and on Compliance and Other Matters*, dated January 12, 2010, represents a material weakness.

During our audit we also became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. Our comments and recommendations concerning those matters are summarized in the memorandum that accompanies this letter. This letter does not affect our report dated January 12, 2010, on the financial statements of the City.

The City's written responses to the matters identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, the Audit Committee, Board of Aldermen, Mayor, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Sullivan, Rogers & Company, LLC".

January 12, 2010

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Comments and Recommendations

Water and Sewer Billings

Comment

We identified the following deficiencies related to the City's water and sewer billing system:

1. Many water and sewer bills are based on estimates. We identified that some accounts had as many as 25 consecutive estimates.
2. Many water and sewer bills were based on "false reads", resulting from a faltering metering system.

During fiscal year 2009, the Water and Sewer Department made a concerted effort to obtain actual readings on accounts that were based on estimates (beginning with accounts with the largest number of consecutive estimates) and accounts where readings appeared abnormal. As a result, the Water and Sewer Department issued approximately \$8,600,000 in abatements during fiscal year 2009. The cause of a substantial amount of these abatements is as follows:

1. Overestimates (approximately \$4,200,000)
2. False readings (approximately \$4,100,000)

It is important to note that the majority of these abatements were made prior to the taxpayer physically paying the bill. Actual cash outflows (i.e., refunds) totaled approximately \$540,000 during the fiscal year.

At June 30, 2009, the Water and Sewer Department had obtained actual readings of a significant portion (81%) of the accounts that had between 10 and 25 consecutive estimates. In addition and as part of our subsequent audit work, we identified that abatements totaling approximately \$860,000 had been granted for July, August and September 2009 billings, which is significantly less than the abated amount for the same period of the previous fiscal year (approximately \$4,200,000). It is imperative that accurate actual readings occur on all accounts at all times to properly bill customers for water and sewer use, which, under the current system, will require Water and Sewer personnel to manually obtain. The current billing system is ineffective and inefficient.

Recommendation

The City is currently in the process of replacing all of the City's meters and implementing a new metering process that will allow the City to remotely obtain a reading from City Hall at any point in time. The implementation of this new system should significantly reduce the need for substantial abatements (once the system is fully operational) since estimates will no longer be required and the ability to identify false readings will be enhanced. We recommend that the new metering system be implemented as soon as possible.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Accounts Receivable Reconciliations

Comment

Consistent with prior years, procedures are not in place to reconcile the Collector's detailed accounts receivable balances to the general ledger timely. Effective internal controls require the timely reconciliation of detailed accounts receivable balances to the general ledger. Failure to perform these tasks timely inhibits the safeguarding of assets and does not provide for accurate and timely financial reporting.

Although the City performed procedures to resolve some of the variances between the accounts receivables records of the Comptroller and the Treasurer/Collector that were identified in the prior year; the following variances still remain at June 30, 2009:

<u>Receivable Type</u>	<u>Comptroller</u>	<u>Treasurer</u>	<u>Variance</u>
Real Estate Taxes - 2009..... \$	2,860,685 \$	2,842,558 \$	18,127
Sewer Liens Added to Taxes - 2007.....	37,633	37,650	(17)
Sewer Liens Added to Taxes - 2008.....	47,052	60,736	(13,684)
Sewer Liens Added to Taxes - 2009.....	200,374	206,595	(6,221)
Water Liens Added to Taxes - 2007.....	25,685	26,205	(520)
Water Liens Added to Taxes - 2008.....	36,897	44,328	(7,431)
Water Liens Added to Taxes - 2009.....	143,886	144,413	(527)
Stormwater Management Fees.....	164,498	122,363	42,135
Sewer User Charges.....	3,927,673	3,756,198	171,475
Sewer Renewal.....	36,984	6,175	30,809
Water User Charges.....	2,089,453	2,212,652	(123,199)
Water Maintenance Charges.....	29,939	12,183	17,756
Water Renewal.....	24,748	494	24,254

In addition, the City hired a consultant to assist with the reconciliation, which, among many things, identified that current personnel did not have a full understanding of how the system operates. The current condition has a negative impact on the reconciliation process and accurate and timely financial reporting.

Recommendation

We recommend that formal procedures be implemented to reconcile the Collector's detailed accounts receivable balances to the general ledger no later than 30 days after the end of the previous month. We also recommend that the Treasurer/Collector and Comptroller approve (e.g., sign off) each accounts receivable reconciliation.

We recommend that the Comptroller and Treasurer/Collector investigate and resolve the variances identified above.

We recommend that the appropriate personnel obtain the necessary training on the MUNIS detailed accounts receivable module. We also recommend that the City evaluate the need for additional training as new versions of the software become available and are implemented.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

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 City's operations. Ordinarily, the management-level employees would conduct interviews or lead group discussions with personnel who have knowledge of the City's operations, its environment, and its processes. The risk assessment process should consider the City'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 City's systems, procedures, and existing controls related to these areas should be conducted. The City 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 City'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

The Comptroller's Office and Audit Committee will review this recommendation in greater detail and attempt to begin work on an implementation plan over the next two fiscal years.

Treasurer's Office - Retirement System Disbursement Bank Account

Comment

The Treasurer (as custodian of the Retirement System's funds) is responsible for preparing the monthly bank reconciliation of the Retirement System's disbursement bank account. We identified that these reconciliations are not being prepared on a timely basis. Proper internal controls require the timely reconciliation of all bank accounts.

Recommendation

We recommend that monthly bank reconciliations be prepared no later than 30 days after month-end.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department head and make a determination about an appropriate course of action after the review.

Student Activity Funds

Comment

The City maintains student activity funds for several of its schools. Massachusetts General Laws (MGL) Chapter 71, Section 47, which establishes various guidelines related to student activity funds, states the following:

“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.”

An annual audit or agreed upon procedures is not being performed on the City’s student activity funds. Based upon the MGL requirement and the inherent risks associated with student activity funds, we believe that the performance of an audit or agreed-upon procedures on the City’s student activity funds would be prudent.

Recommendation

We recommend the City comply with the requirements of MGL Chapter 71, Section 47 by having an audit or agreed-upon procedures performed on their student activity funds.

Management’s Response

The new City administration will review this recommendation in detail with the appropriate department head and make a determination about an appropriate course of action after the review.

Inspectional Services - Permitting Database

Comment

The Inspectional Services Department maintains a database that, among other things, identifies the type of permit issued, the permit number and related amount. We identified that the total dollar amount of permits issued (as reported by the database) are not reconciled to the general ledger. As a result, we identified variances between amounts recorded on the general ledger and the amounts reported in the database. Lack of performing this procedure does not provide assurance that all permits have been entered into the permitting database or turned over and reported to the Treasurer/Collector and Comptroller.

In addition, since the permitting database is used to identify properties that may require a supplemental tax bill, the City could be at risk of not billing all properties that are subject to such a bill if all permits have not been entered into the database.

Recommendation

We recommend that procedures be implemented to reconcile the dollar amount of permits issued per the permitting database to the general ledger monthly. Implementation of this procedure will provide assurance that all permits have been properly entered into the database and reported to the Treasurer/Collector and Comptroller.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Parking Meters

Comment

Our prior years' management letters identified that parking meter collections (coins) were unsecured from the time the meter was opened until the time the collections were delivered to the Treasurer/Collector's office.

During fiscal year 2009, the City purchased closed system collection containers and new collection carts that are intended to secure collections from the time the meter is opened to delivery to the Treasurer/Collector's office. However, this new process has not been fully implemented.

In addition, due to the weight of the containers, we identified that the Treasurer/Collector is responsible for processing the coins for deposit. This is not an effective or efficient use of the Treasurer/Collector's time.

Recommendation

We recommend that the new parking meter system be fully implemented during fiscal year 2010.

We recommend that management redesign the process of preparing parking meter collection deposits in a manner that requires limited (if any) time from the Treasurer/Collector.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Accounting for the Newton Community Development Authority

Comment

The Newton Community Development Authority (NCDA) was established to develop housing programs for low and moderate income families, the elderly and handicapped residents of the City. The NCDA is governed solely by the City's Director of Planning and Development and is funded primarily by federal grants passed through the City and is subject to the same laws and regulations the City is.

The NCDA's financial activity is currently accounted for independently from the City's accounting system. Annually, the Comptroller records a journal entry to include the summary activity of the NCDA in the City's accounting system so the NCDA's activity can be included in the City's annual financial reports.

We believe the maintenance of an independent accounting system places an unnecessary burden on the Office of Housing and Community Development's staff. In addition, because of the separate accounting system, activity of the NCDA is not subject to the automated internal controls inherent in the City's accounting information system.

Recommendation

We recommend that the NCDA's activity be accounted for through the City's accounting system and recommend that the current independent accounting system be discontinued.

Management's Response

The Community Development Department and Comptroller's Office staffs are in the process of developing an implementation plan to bring the NCDA fund on to the general ledger effective July 1, 2010.

Documentation of Department Control Activities

Comment

City Departments have read only access to the accounting information system (Finance Plus) to view/print reports (i.e., appropriation status reports) of their respective department's activities. City Departments have the responsibility to monitor the activities that are posted to the general ledger and report any discrepancies in posted transactions to the Comptroller.

Although the current system appears to be adequately functioning, there is no evidence of the control procedures performed by the City Departments. For example, appropriation reports are not printed and signed to indicate that the activity posted to the general ledger is appropriate and consistent with the respective Department's expectations and remaining budgets are sufficient to cover future operating costs.

Recommendation

We recommend that procedures be implemented to document the control procedures performed at the Department level regarding the appropriateness of posted transactions and the sufficiency of remaining budgets to cover future operating costs. For example, Departments could print monthly appropriation reports and be required to submit a signed copy of the report to the Comptroller indicating that the activity posted is correct and the remaining budget is sufficient to cover future operating costs. If the Department Head does not agree with the activity, they would be required to submit documentation of the errors and request journal entries to correct such amounts.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Capital Asset Accounting

Comment

The City maintains its capital asset activity and balances using spreadsheet software (Microsoft Excel). While Excel is an automated software program, it is not the most effective and efficient program for capital asset accounting. A relational database program is more effective and efficient to manage and account for capital asset inventory. The benefits of a relational database are as follows:

- Databases are designed to link tables of related data together, such as classes, additions, disposals, functions, departments. Storing related data together in a single table or spreadsheet can be unwieldy and invite error.
- Databases are safer. Excel, for example, does everything in memory, so unsaved data may be lost if your system crashes. Databases write data to the hard drive immediately.
- Databases can handle more data.

Because the City segregates capital assets by activity and function for governmental activities and each individual enterprise activity, many spreadsheets are maintained to accomplish financial reporting objectives and requirements. As a result, the complexity of the spreadsheets increases annually and is very susceptible to human error. The current process is inefficient and limits reporting capabilities.

Recommendation

We recommend the City use relational database software to maintain and account for its capital asset inventory. There are several inexpensive (under \$200) capital asset programs available that would satisfy the City's financial reporting requirements.

Implementation of this recommendation will strengthen internal controls over capital asset accounting and provide efficiencies in the perpetual maintenance of capital assets.

We would be pleased to assist the City with this process.

Management's Response

The Comptroller's office expects to implement this recommendation no later than the fiscal year ending June 30, 2011.

Treasurer's Office -Unauthorized Bank Accounts and Authorized Signatory

Comment

Unauthorized Bank Accounts

We identified six (6) 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 potentially at risk if fraudulent activities were to occur in any of these accounts. The City is also potentially at risk if the bank account is unknowingly controlled by a City department, whereby activity would occur outside the City's internal controls and circumvent municipal finance laws.

In addition, 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.

Authorized Signatory

We identified six (6) bank accounts where the previous Treasurer/Collector is an authorized signer. This is a weakness in internal control.

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.

We have provided a list of the bank accounts where the previous Treasurer/Collector is still an authorized signor to the current Treasurer/Collector. We recommend that the Treasurer/Collector remove the former Treasurer/Collector as an authorized signor on the identified bank accounts. We also recommend the Treasurer/Collector become the authorized signor on the identified bank accounts.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department head and make a determination about an appropriate course of action after the review.

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 \$698,000. 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

The new City administration will review this recommendation in detail with the appropriate department head and make a determination about an appropriate course of action after the review.

Position Control

Comment

Our prior year management letter identified that the City has purchased, but does not utilize, the position control module of the Finance Plus accounting information system. The position control module is designed to define, track, and control available employee positions and, when utilized appropriately, can be an invaluable budget tool.

Recommendation

We recommend that management evaluate and consider the use of the position control module.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Financial Policies and Procedures Manual

Comment

Although the City adopted top level financial policies during fiscal year 2008, 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 the City develop and implement a financial policies and procedures manual.

Management's Response

The Comptroller's office expects to implement this recommendation for priority items during the fiscal year ending June 30, 2010.

New Accounting and Financial Reporting Requirements for Fund Balances

Comment

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and to clarify the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that will be made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with loans receivable. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

Governments will also be required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements will be required.

This Statement also provides guidance for classifying stabilization funds on the face of the balance sheet and requires disclosure of certain information about stabilization funds in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

Implementation of this statement will improve financial reporting by:

- Providing fund balance categories and classifications that will be more easily understood
- Eliminating the *reserved* component of fund balance in favor of a *restricted* classification to enhance the consistency between information reported in the government-wide statements and information reported in the governmental funds financial statements
- Requiring governments to classify amounts consistently, regardless of the fund type or column in which they are reported
- Providing disclosures to give users information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified or eliminated
- Reducing uncertainty about which resources can or should be reported in the respective governmental fund types

Given the significance of fund balance amounts (both quantitatively and qualitatively), the fund balance reporting 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. 54 is fiscal year 2011.

Recommendation

We recommend that management familiarize itself with GASB Statement No. 54 to prepare for its implementation. We would be pleased to assist the City with its preparation for implementing the new standards.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Disaster Recovery Plan

Comment

In prior years' management letters, we identified that the City's disaster recovery plan did not address the hardware required to access financial data or the location to operate the hardware. To address this issue, the City has purchased an additional server and selected a separate location to maintain financial operations in case a disaster occurs.

The additional server will have the capability of operating Finance Plus, which includes the City's general ledger, payroll and human resource functions. However, the server will not have the capability of operating the MUNIS accounting information system, which maintains all of the detailed activity (i.e., commitments, payments, refunds, etc.) of the City's accounts receivable (i.e., real estate, personal property, water, sewer, etc.).

Recommendation

We recommend that management include the hardware required to access financial data from the MUNIS accounting information system in the current disaster recovery plan.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.

Collective Bargaining Agreements

Comment

In prior years' management letters, we reported that when the City renegotiates a collective bargaining agreement (CBA), a fully updated and complete CBA is not executed. Instead, Memorandums of Agreement are written that details the changes from the original CBA.

Over the past several years, improvements have been made in this area as several CBA's were updated/re-written to reflect the current CBA. However, this process has not occurred for all existing CBA's. It should also be noted that completed CBA's have been posted on the Human Resources web page of the City's website since 2006.

Recommendation

We recommend that the City continue its progress towards executing a full and complete CBA each time a negotiated contract is settled. The CBA's should be maintained in electronic format (word) so when a re-negotiation occurs, the electronic file can simply be updated for any changes. As a result, a full and complete CBA will be maintained in one document at all times.

Management's Response

The new City administration will review this recommendation in detail with the appropriate department heads and make a determination about an appropriate course of action after the review.