

**CITY OF NEWTON, MASSACHUSETTS**

**MANAGEMENT LETTER**

**JUNE 30, 2011**





*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, 2011, 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.

However, 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 regarding those matters. This letter does not affect our report dated December 20, 2011, 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, the Board of Aldermen, Mayor, and others within the organization and should not be used by anyone other than these specified parties.

*Sullivan, Rogers & Company, LLC*

December 20, 2011

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## Comments and Recommendations

### Water and Sewer Billings

#### Comment

Consistent with the prior years, we identified the following deficiencies related to the City's water and sewer billing system:

1. Many water and sewer bills continue to be based on estimates. We identified that some accounts had as many as 12 consecutive estimates and overall approximately 19% of users have multiple estimated bills.
2. Many (although a decrease from the prior year) water and sewer bills were based on "false reads", resulting from a faltering metering system.

Beginning in fiscal year 2010 and continuing in fiscal year 2011, the Water and Sewer Department continued to make 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 \$4,800,000 in abatements during fiscal year 2011, an increase of approximately \$1,500,000 from fiscal year 2010. The cause of a substantial amount of these abatements is as follows:

1. Overestimates (approximately \$4,080,000)
2. False readings (approximately \$369,000)

The installation of new meters and reading devices began in February 2010 and is expected to be completed by April 2012. As of June 30, 2011 approximately 50% of these new meters had been installed, but not necessarily functional. As part of our subsequent audit work, we identified that abatements totaling approximately \$473,000 had been granted for July and August 2011 billings, which is slightly more than the abated amount for the same period of the previous fiscal year by approximately \$41,000. 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 meter reading 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 City concurs that accurate and timely actual readings are needed for all water and sewer accounts. As relayed in the "Recommendation" section, the City is in the process of replacing all water meters and reading system to achieve this objective. The current schedule, as of late December, indicates that approximately 98% of the meters will be installed by mid-January, 2012. The remaining meters will be delayed due to coordination requirements with the residents, including the need to replace existing water service lines and other plumbing related issues. The meter contract requires that all meters be tested for accuracy prior to shipping. In addition,

the City conducted independent flow tests in December 2011 on selected new water meters. Thirty meters were tested, including meters that had been installed previously, some that were awaiting installation, and meters of various sizes. All meters met American Water Works Association standards for accuracy.

A recent review of the reading system indicated approximately 80% of the installed meters have been synchronized to the fixed network and are reporting actual consumption. The consumption for the remaining 20% is currently being obtained manually using a hand-held device until they can be synchronized to recently installed collectors. Full synchronization of all meters to the fixed network system is anticipated to be completed in fiscal year 2012.

The fixed network system will allow the City to transform the City's meter reading methods from reactive to proactive, with the new system regularly recording water use data to flag unusual water use patterns. The new reading technology will provide our water and sewer billing clerks with the prompt to reach out to high usage accounts and recommend issues be investigated. The City anticipates abatements will continue to be issued throughout the remainder of fiscal year 2012 with the final bills being issued on the old meters. Beginning in fiscal year 2013, the city anticipates all meters will be read remotely and bills will reflect actual water use.

## 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 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 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 City's Chief Financial Officer and Comptroller will work with the City's new Financial Audit Committee in developing a process for identifying risk exposures and monitoring the effectiveness of existing internal controls.



## Newton Community Development Authority

### Comment

The Newton Community Development Authority (NCDA) was established to develop housing programs for low and moderate income families and elderly and handicapped persons. The NCDA is a legally separate entity that is governed by the City's Director of Planning and Development and is reported as a discretely presented component unit in the City's financial statements. Prior to fiscal year 2011, the NCDA's day-to-day financial activities were accounted for separately from the City's accounting information system.

During fiscal year 2011, the NCDA's financial activities were transitioned to the City's accounting information system. We identified the following deficiencies regarding the transition:

1. There is currently no process in place to authorize, record and reconcile loan activity between the Department of Planning and Development and the Comptroller's Office
2. Loans receivable were not reconciled to detailed amortization schedules (by loan recipient) during the year
3. Outstanding loans receivable balances are currently maintained in Excel

### Recommendation

We recommend that the City and the NCDA implement appropriate controls surrounding the authorization, recording and reconciliation of NCDA loan activity.

We recommend the City implement controls to reconcile loans receivable to detailed amortization schedules.

We recommend the City utilize loan amortization software to maintain the NCDA loans.

### Management's Response

The Comptroller is working with the City's new Community Development Director to improve on-going communications between Community Development program staff and the Comptroller's Office so that loan activity will be recorded on a timely basis and detailed loan receivable records, maintained by Community Development staff, are reconciled to the City's general ledger on a regular basis. Loan receivable activity is currently only reconciled mid-year and at the end of the each fiscal year. The City is considering contracting with an outside party to review existing recordkeeping procedures; to recommend improvements; and to train program staff.

## **Police Details**

### Comment

The City currently has approximately \$125,000 of police detail accounts receivables that are greater than one-year old. The receivables greater than one-year old date as far back as March 2005. For financial reporting purposes, the City considers these amounts uncollectible.

A formal policy that addresses the actual "write-off" of uncollectible police detail accounts receivable would assist the City in maintaining a fair and accurate accounts receivable balance and, in turn, identify amounts that must be funded from the General Fund timely.

### Recommendation

We recommend that the City develop and implement a formal policy regarding uncollectible police detail accounts receivable.

We also recommend the City evaluate the current billing and collection practices surrounding its police detail activities.

### Management's Response

The Law Department is actively engaged in a multi-step process towards the collection of delinquent police detail accounts receivables. The City has been successful in recouping a large number of account receivables, as well as the costs associated with the collections process. Additionally, the Law Department is assisting the Police Department in the development of improved collection procedures. Such measures include a four-hour minimum deposit to be paid at the time of the detail request, a comprehensive application procedure, and improved record keeping.

## **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.

It should be noted that the City’s general fund does not necessarily have to bear the cost of the audit or agreed-upon procedures engagement, as these activities can be funded from student activity fund resources.

### 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 the student activity funds.

### Management’s Response

There are agreed-upon written procedures in place for Student Activity Funds of the Newton Public Schools. A representative of the School Business Office annually reviews certain Student Activity accounts for compliance with the agreed-upon procedures and targets one of the two high schools, two of the four middle schools; or three of the elementary schools. These procedures, developed by the Deputy Superintendent/Chief Administrative Officer, in conjunction with the Director of Business Services and the Director of Finance, insure reconciliation of each school’s checking account and fund balance records to the City’s Agency Fund general ledger control account and that revenues and expenditures flowing thru the Student Activity accounts are solely for purposes of student related goods and services

At present, fifteen of the City’s twenty-one schools have Student Activity Funds. The remaining six schools provide for student activities in conjunction with PTO’s.

## Unclaimed Checks

### Comment

At June 30, 2011, the City's general ledger reports a liability for unclaimed checks totaling approximately \$505,000. However, a current list of check numbers, check dates, payee names, address and related amounts that support the amount reported on the general ledger was not provided to us. This information (identified above) is critical when following up and resolving unclaimed check amounts.

### Recommendation

We recommend that the Treasurer/Collector's office investigate and identify the check numbers, check dates, payee names and related amounts that reconcile to the balance reported on the general ledger.

We recommend that the Treasurer/Collector's office implement procedures to investigate and resolve the unclaimed check amounts.

### Management's Response

Supporting information for unclaimed checks was available but not centralized at the time of the audit. A file containing supporting information is now available and will be maintained in the future. Additionally, unclaimed checks will be posted to the City's website together with the instructions and the form needed to claim the funds.

## 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 \$259,000. Typically, checks greater than three (3) months old reflect checks that have been void, lost, misplaced or stolen.

### 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

Treasury continues its efforts to address this issue. The process has been hampered largely due to procedural issues. It is the policy of the bank that provides the City's vendor and payroll processing to include stop payments on its outstanding list for a period of not less than six (6) months. After this time, the check is again presented to the City as a "positive pay" item. Treasury deems this system to be unacceptable, and has been working with the bank to develop new procedures involving alteration of their system as it applies to Newton. Successful efforts to date include the regular issuance of a "Stale Dated Check Report" by the bank. Additional internal actions taken by Treasury include working with the IT Department to match the check information to names and addresses in the City's records. Treasury will review the "Stale Dated Check Report" monthly to identify and to clear items as they appear. Also, outstanding checks will be posted on the City's website.

## Bank Account Reconciliations

### Comment

We identified several instances where reconciling items identified on *individual bank account reconciliations* were not clearly described and the documentation supporting the reconciling items was not readily available. Bank reconciliations should clearly describe reconciling items and provide a clear audit trail to documentation supporting such items.

### Recommendation

We recommend that all bank reconciliations clearly describe the reconciling items that provide a clear audit trail to the documentation supporting the amounts.

### Management's Response

While effort is made to identify every reconciling item at least generally, some items may have appeared to be unidentified or inadequately identified. The reason the individual accounts appear this way involves a combination of factors including timeliness in completing the reconciliation; the nature of a particular account; the nature of a particular item; whether or not supporting information is readily available elsewhere; and whether the item was a known or recurring item. For example, a 457 Plan wire for a recurring amount that will be matched to a warrant or statement within a short period is listed in a particular section of the reconciliation, but may not have the specific vendor name listed. Effort will be made to insure that future reconciliations clearly describe each item and its source.

## 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 the City develop and implement a financial policies and procedures manual.

### Management's Response

The City's Chief Financial Officer and Comptroller will work with the City's new Financial Audit Committee to develop a plan for better documentation of the City's policies and procedures. It is expected that this will be done in conjunction with the development of a risk assessment and monitoring plan.

## Disaster Recovery Plan

### Comment

The City has a documented disaster recovery plan that addresses its financial data and related software. However, the plan does not address the hardware required to access the data or the location(s) to operate the hardware. Therefore, in the event of a disaster, the City's financial data and software could be recovered, but the City may not have the ability to physically run the software and access the financial data to maintain financial operations.

### Recommendation

We recommend management update the current disaster recovery plan by addressing the hardware requirements to access the financial data and the location(s) to operate the hardware.

### Management's Response

The City has acquired a back-up server that will be located at a secure, primary remote site that is attached to the City's network. This server will be powered off and used only for quarterly testing and for actual emergencies. Documentation, tape drives, spare checks and cabling will be stored with the unit at the secure off-site location.



## **Test Database**

### Comment

The City currently utilizes one test database related to its accounting information system. We identified that the test database was utilized for a significant portion of fiscal year 2011 for an ongoing project whereby the test database could not be used for any other purpose. As a result, new processes and/or applications could not be tested, which potentially could have resulted in increased efficiencies and/or effectiveness of the City's financial processes and reporting.

### Recommendation

We recommend that the City have access to multiple test databases associated with its accounting information system.

### Management's Response

The fact that the City's test data base was essentially locked for an extended project is an anomaly that we do not anticipate happening again. With this hindsight, the City's IT Department will not commit to any exclusionary use that prevents proper use of the test data base by all users.