

CITY OF NEWTON, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2013



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, 2013, 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. We also want to make you aware of a recently issued accounting standard that will significantly impact your financial statements in future years. The memorandum that accompanies this letter summarizes our comments and recommendations regarding those matters. This letter does not affect our report dated November 25, 2013, 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

November 25, 2013

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Prior Year Comments - Resolved

Water and Sewer Billings

Last year's management letter communicated that some water and sewer bills continued to be based on estimates and false reads resulting from a faltering metering system that was in the process of being replaced. Accordingly, we recommended the new metering system be implemented as soon as possible.

The new metering system has been installed, although many of the transponders associated with the initial installation had to be replaced. As a result, we consider this comment resolved.

City-Wide Grants Administrator

Last year's management letter communicated that, except for the City's School and Planning and Development Departments, we believed the City's grants administration structure placed the City at risk in the administration and adherence to compliance requirements of state and federal grants. Accordingly, we recommended the City consider employing a City-wide Grants Administrator.

The City, given the fact that funding for all federal stimulus (ARRA) programs has expired and likely further reductions in federal spending, does not believe there will be sufficient federal grant activity outside the Newton Public Schools and Planning and Community Development Department to support a full time position devoted to federal grants administration. However, the City indicated it would evaluate other options for enhancing the level of control and oversight over federal grant programs in departments other than the Newton Public Schools and Planning and Community Development Department.

Parks and Recreation

Last year's management letter communicated the following deficiencies regarding the cash receipt activities of the Parks and Recreation Department:

1. No log was maintained at Gath Pool and Crystal Lake that identified the starting and ending bracelet number sold for each day. In addition, no documentation was maintained that reconciled the number of daily bracelets sold to the actual cash receipts collected.
2. The Schedule of Payments to City Treasurer (Schedule) submitted by the Department did not contain the signature of the preparer or reviewer of the document.
3. There was no documentation supporting the review/reconciliation of the deposit made to the bank to the summary report of receipts entered into the Department's internal database (SportsMan).

During fiscal year 2013 controls were implemented to resolve the deficiencies identified above.

Service Organization Controls

Last year's management letter communicated that the City, like many local governments in Massachusetts, engage third-party service providers (service organizations) to process certain financial transactions (i.e., Deputy Tax Collector). Accordingly, we recommended the City identify each service organization utilized and request the applicable *Service Organization Control* report (annually). We also recommended that all service organization contracts include a requirement to obtain the appropriate SOC report (annually).

During fiscal year 2013, requests were made to obtain the applicable SOC reports and consideration has been given to including a contractual requirement (where applicable) to obtain a SOC report annually.

Old Outstanding Checks

Last year's management letter communicated that the vendor and payroll outstanding checklists maintained by the Treasurer include many checks greater than three (3) months old totaling approximately \$214,000. Accordingly, we recommended the Treasurer/Collector's office implement monthly procedures to investigate and resolve outstanding checks greater than three (3) months old.

During fiscal year 2013, procedures were implemented to effectively manage checks greater than 3 months old. At June 30, 2013, vendor and payroll outstanding checks greater than 3 months old totaled approximately \$21,000.

Unclaimed Checks

Last year's management letter communicated that the unclaimed check amount (@ \$500,000) reported on the general ledger was not supported by a current list of check numbers, check dates, payee names, address and related amounts. Accordingly, we recommended the Treasurer/Collector's office investigate and identify the applicable information that reconciled to the general ledger. We also recommended that procedures be implemented to investigate and resolve the unclaimed check amounts in accordance with Massachusetts Abandoned Property Laws.

During fiscal year 2013, procedures were implemented to accumulate the supporting documentation and the City adopted Massachusetts General Law Chapter 200, Section 9A, allowing the City to retain unclaimed property after following the required process.

Prior Year Comments – Partially Resolved

Student Activity Funds

Comment

The City maintains student activity funds at many 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.”

Internally performed audits and/or agreed upon procedures are considered acceptable in complying with the related requirements of MGL Chapter 71, Section 47. However, the Massachusetts Association of School Business Officials' (MASBO) *Student Activity Accounts Guidelines for Massachusetts School Districts* recommends an independent audit firm conduct the audits and/or agreed upon procedures at least once every three (3) years.

Based on our discussions with School Department personnel, agreed upon procedures have been internally performed on the Newton North and Newton South High Schools' and Day and Brown Middle Schools' student activity funds. However, there is no formal documentation of the procedures performed and the results of such procedures.

Recommendation

We recommend the School Department formally document the procedures and related results of the annual internal student activity funds' agreed upon procedures.

We recommend the City consider the MASBO recommendation to have an independent audit firm conduct the student activity fund audits and/or agreed upon procedures at least once every three (3) years.

Management's Response

Regarding the first of the two recommendations above, the district plans to continue annual internal audits based on the above-mentioned agreed upon procedures according to an annual schedule as follows: both of the high schools, two of the four middle schools, and one third of the nine elementary schools (nine of fifteen elementary schools maintain student activity accounts while the balance are through the PTO). The district will produce and maintain on file documentation for all site visits similar to what is done for the high schools.

Regarding the second of the two recommendations above, the use of an independent audit firm at least once every three (3) years would require operating budget funding by the School Committee during the annual budget process.

Disaster Recovery Plan

Comment

Our prior year management letter identified that the City did not have the hardware required to access the detailed accounts receivable data (MUNIS) in the event of a disaster. During fiscal year 2013, the hardware was purchased but is not currently offsite. In addition, the City is currently transitioning to a new disaster recovery plan.

Recommendation

We recommend the City complete the transition to the new disaster recovery plan during fiscal year 2014.

Management's Response

Over this past year the Information Technology Department purchased a Storage Area Network. Of its primary goals is to house our financial systems.

Our SAN is ready for the new version of Finance Plus and installation services by Sungard Pentamation have begun. After trials and testing, we expect to cut over in the weeks after January 1, 2014.

Once Finance Plus is up and running we will move Munis into the fold as well.

In September we purchased a disk deduplication system. This system is our backup system for the virtual servers running on our SAN. Infinitely scalable, this system will reduce backup time, enable us to retain more snapshots of the system and its data, and greatly enhance data restoration opportunities.

In October we awarded an Invitation to Bid for a Disaster Recovery or Business Continuity system. This system will be connected by city owned fiber from City Hall to the Education Center (100 Walnut St.). It will be a mirror version of our Finance Plus and Munis data.

We are also configuring our disk deduplication system. This is our nightly backup system for the financials once they are brought onto the SAN. This system will be located in City Hall but not in the data center. We are considering a secure wiring closet with proper ventilation in our attic.

Prior Year Comments - Unresolved

Police Details

Comment

Consistent with the prior year, the City has approximately \$28,000 of police detail accounts receivables that are greater than one-year old. The receivables greater than one-year old date as far back as May 2008. 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.

In addition, the Police Department utilizes an internally developed access database to account for its police detail billings and collections. We believe the use of software specifically designed for billing and collection would provide clearer audit trails and the ability to produce billing and collection reports effectively and efficiently.

Recommendation

We recommend the City develop and implement a formal policy regarding uncollectible police detail accounts receivable and the "write-off" of such receivable balances.

We recommend the City consider purchasing "off the shelf" software to maintain its police detail billing and collection activities.

Management's Response

The Newton Police Department routinely refers delinquent police detail bills to the City Law Department for collection. These bills are either collected through the district court or recommended for write-off by the City Solicitor. Unpaid police detail bills are only legally written off when in the opinion of the Solicitor, the bill is uncollectible or the cost of legal action to enforce collection exceeds the value of the outstanding bill.

The City will continue to evaluate the cost/benefit of replacing the existing police detail assignment/billing/collection system with a replacement system.

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 Risk Assessment Sub Committee of the Financial Audit Advisory Committee expects to work with management of the City and Newton Public Schools in the study of what steps can be taken to begin development of a more formalized risk assessment and monitoring process.

Financial Policies and Procedures Manual

Comment

Although the City has adopted top level financial policies and has certain limited processes documented, we believe that preparation of a formal policies 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
- Cash disbursements
 - Payroll
 - Vendor
- Procurement
- 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 Comptroller has distributed and posted the following policies on his page of the City web site:

- Fiscal year-end closing guide
- Departmental cash receipt collection and custody policy
- Payroll certification guide
- Payable submission guide
- Petty cash policy
- Credit card procurement policy

During the next fiscal year is expected that a grants administration guide for programs other than education and community development grants, will be prepared, distributed, and posted on the Comptroller's page of the City web site. The month end closing check list will also be formalized and posted on the City web site.

The Chief Procurement Officer has distributed and posted on his page of the City intranet a comprehensive procurement policy guide.

The Human Resources Department has posted the following policies on their page of the City web site:

- Domestic Violence policy
- Sexual Harassment policy
- Telecommunications policy
- City vehicle use policy
- Whistleblower policy

Current Year Comments

Departmental and Other Accounts Receivable

Comment

Procedures are not in place to reconcile departmental and other detailed accounts receivable balances (maintained at the individual department level) to the general ledger monthly. Effective internal controls require monthly reconciliations 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.

Recommendation

We recommend formal procedures be implemented to reconcile departmental and other detailed accounts receivable balances to the general ledger no later than 30 days after the end of the previous month. We also recommend the applicable department head and Comptroller approve (e.g., sign off) each accounts receivable reconciliation.

Management's Response

The Comptroller and Treasurer's Offices have a formal process for regular monthly reconciliation of all real estate and personal property taxes; auto and boat excise taxes; community preservation surcharges; and water, sewer, and storm-water management use charges. The Comptroller also maintains detailed receivable records on major state grants such as the Chapter 90 Highway program; the Mass Works Highway improvement program; the Veterans Benefit reimbursement program; and the Massachusetts School Building Authority school construction grant program, and for all major rental agreements involving City owed real and personal property.

Detailed receivable records for infrastructure betterments; police private duty detail assignments; water and sewer payment plans and certain charges such as school lunch fees and rental of school buildings are maintained by individual department and transactional activity is generally only recorded on the general ledger for reported purposes at fiscal year-end only.

The Comptroller is in agreement that it would be beneficial to enhance the level of regular general ledger oversight over major receivables that are not under the oversight of the Treasurer. Priority will be directed to infrastructure betterments; water and sewer payment plans; and police detail accounts during fiscal year 2014.

F.A. Day Middle School and Angier Elementary School

Comment

We evaluated the systems of internal control surrounding the student activity funds cash receipts processes at the F.A. Day Middle School and Angier Elementary School and identified the following deficiencies:

F.A. Day Middle School

- Cash receipts collected by teachers and activity advisors are submitted to the Bursars Office in an envelope and not accompanied by a standard turnover form. The use of a standard turnover form would strengthen internal controls by identifying, among other things, the purpose of the receipt, the amount and the person turning the money over.
- Reconciliations of the total student activity funds to the general ledger and bank account are not signed by the preparer or reviewer. The lack of signed reconciliations creates an inadequate audit trail. In addition, the lack of a reviewer signature does not provide evidence that the reconciliations were reviewed for appropriateness, which is a deficiency in internal controls over cash receipts.

Angier Elementary School

- Cash receipts collected for field trips are not typically submitted to the Executive Assistant for deposit until every student has provided payment. As a result, cash receipts collected are not consistently deposited timely.
- There is no formal reconciliation of the total student activity fund balances to the general ledger. The lack of a formal reconciliation does not provide assurance that activities are posted correctly and balances are appropriate.

Recommendation

We recommend the following:

F.A. Day Middle School

- The use of a standard cash receipts turnover form is used by student activity fund advisors and teachers when submitting collections to the Bursars Office. Such a form should include, at a minimum, name, date, amount, trip and trip date.
- Procedures be implemented requiring the supervisory review of all reconciliations and that the preparer and reviewer sign all reconciliations.

Angier Elementary School

- That cash receipts collected be submitted to the Executive Assistant daily and that deposits be made no later than 48 hours after receipt.
- Procedures are implemented to perform monthly reconciliations of the total student activity fund balances to the general ledger. In addition, such reconciliations must include the signature of the preparer and reviewer.

Management's Response

F.A. Day Middle School

Regarding the first recommendation, the school bursar in conjunction with the school principal is currently in the process of implementing a standard receipts turnover form which includes the name of the person handing in the deposit, deposit date, breakdown of dollar amount of the deposit including cash, coin and/or checks, and the purpose of the deposit. The standard receipts turnover form will be available on the school's website. The goal is to have the form in full use before September 2014.

Regarding the second recommendation, the Deputy Superintendent/Chief Administrative Officer conducts a supervisory review of student activity reconciliations which are prepared by the Director of Finance in conjunction with the school bursar. After the review is complete, electronic copies of the final documents are kept on file at the Education Center. As per the auditor's recommendation, the signature of the preparer and the reviewer will be added in FY14 and beyond.

Angier Elementary School

Regarding the first recommendation, the principal of Angier School requested in November 2013 that all field trip monies be paid via check only; the school no longer accepts cash, although only 5% of receipts have typically been in cash. Payments for any given field trip are received over the course of one school week. During this week, checks (and formerly cash) are kept in a locked cabinet in the Executive Secretary's Office until they are deposited within one week. The office is also locked after school hours. This system is considered reasonable by the school principal and by the Deputy Superintendent/Chief Administrative Officer.

Regarding the second recommendation, due to the relatively low volume of transactions over the course of the school year as compared to the secondary schools, quarterly reconciliations are performed by the Director of Finance between the general ledger, deposits, invoices and the Angier Field Trip Cost Sheets; nearly 100% of revenues and expenses are for field trips. Reconciliations may also be done at the request of the school's Executive Secretary. Reconciliations are subject to review by the Deputy Superintendent/Chief Administrative Officer. Electronic copies of general ledger reconciliations are kept on file at the Education Center. As per the auditor's recommendation, the signature of the preparer and the reviewer will be added in FY14 and beyond.

Informational Comment

Pension Accounting and Financial Reporting

Comment

In June of 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, which revises and establishes new financial reporting requirements for governments that provide pension benefits to its employees and retirees.

The implementation of this Statement will represent a significant change in the accounting and reporting of pension expense and the related liability. For the first time, the City will be required to recognize its long-term obligation for pension benefits as a liability in its government-wide financial statements. The implementation of this Statement will also:

- More comprehensively measure the annual costs of pension benefits
- Place conditions on the use of the discount rate used to measure the projected benefit payments to their actuarial present value
- Require the use of the “entry age” actuarial cost allocation method, with each period’s service cost determined by a level percentage of pay (referred to as attribution method)
- Expand pension related note disclosures
- Expand pension related required supplementary information disclosures

The requirements of this Statement will improve the decision-usefulness of pension information in governmental financial statements and will enhance the comparability of pension information between governmental entities.

Given the significance of the pension fund liability, the financial reporting impact under the new standard will significantly affect the City’s financial statements.

It should be noted that the implementation of GASB Statement No. 68 is strictly a financial reporting standard and does not constitute a state or federal mandate regarding the funding of the net pension obligation.

The City’s required implementation date of GASB Statement No. 68 is fiscal year 2015.

Recommendation

We recommend management familiarize itself with GASB Statement No. 68 to prepare for its implementation.