

CITY OF NORTHAMPTON, MASSACHUSETTS

MANAGEMENT LETTER

FOR THE YEAR ENDED JUNE 30, 2012

CITY OF NORTHAMPTON, MASSACHUSETTS

Management Letter

Year-Ended June 30, 2012

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To the Honorable Mayor and City Council
City of Northampton
Northampton, Massachusetts

In planning and performing our audit of the basic financial statements of the City of Northampton as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Northampton's internal accounting control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic 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 deficiency in internal control 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 and correct misstatements on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charges with governance.

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

However, during our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. We have already discussed these comments and suggestions with City personnel. We will be pleased to discuss them in further detail and to assist you in implementing the recommendations.

The City's written response to our comments and suggestions has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the management, the Mayor and City Council, others within the entity and the Commonwealth of Massachusetts Department of Revenue and is not intended to be and should not be used by anyone other than these specified parties.

Scanlon & Associates LLC

Scanlon & Associates, LLC
South Deerfield, Massachusetts

March 22, 2013

CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Matters:

1. Utilization of Free Cash

Comment:

The City's general fund free cash for June 30, 2012 was certified by the Department of Revenue for \$2,834,914. The key elements that contributed to this amount were approximately as follows:

- Return of unexpended/unencumbered appropriations \$1,049,000
- Excess over budget of state and local receipts \$ 365,000
- Closeout of Ambulance Reserve \$ 850,000
- Closeout of non-excludable portion of bond premium \$ 375,000
- Prior year unused free cash \$ 267,000

Free cash is considered a non-reoccurring available fund and should not be used on a consistent basis to fund reoccurring expenses. As outlined above a significant portion of these free cash amount was from one-time events (close out of ambulance and bond premium) and closeout of appropriations. We feel it is important for the elected governing boards of a City and Town to understand how free cash is generated in their City or Town and how the use of it impacts future budgets.

We recommend the City strive to maintain an Unreserved Fund Balance (free cash) in the General Fund of 3 to 5 percent of the City's budget. We further recommend that the City add to their stabilization funds. Maintaining healthy reserves can impact a municipality's credit rating and can be used to finance unforeseen or emergency needs, fund future projects or serve as a revenue source for operating budgets in limited instances.

Like most municipalities in recent years, the City has had to operate with reduced levels of revenue from State aid and local receipts and rising costs of services and products, while continuing to provide a quality of services. We have discussed free cash and reserve practices with financial personnel of the City during our fieldwork. With the state of the economy and the current financial environment we would like to remind the City of discouraging the practice of using significant amount of free cash (non-recurring available fund) for reoccurring expenditures.

2. Review Indirect Costs for Enterprise Funds

Comment:

The City maintains three enterprise funds (water, sewer and landfill). As part of maintaining enterprise the City charges the enterprise funds for indirect costs of the City (i.e. insurance, interdepartmental support). As part of the audit we review the indirect costs and have found them to be proper. However, it has been several years since the City has reviewed the policy and framework of the indirect costs. We recommend that City finance director review the indirect cost framework and to establish a written internal policy.

City Response:

The City Finance Director recently updated the formulas used in calculating the indirect costs for the Enterprise Funds for the indirect charges for FY14. She is in the process of writing the internal policy that will accompany the indirect cost worksheet.

3. Improve Bank Account Reconciliations

Comment:

The City has procedures in place to reconcile the City Auditor's general ledger to the Treasurer's records for cash and investments on a monthly basis. The Treasurer is maintaining a cashbook and performing monthly individual bank reconciliations. However, we noted that improvements could be made on the monthly individual bank account reconciliations. During our audit we noted a reconciling item on one of the bank account reconciliations that had been used as a reconciling item for several months. Upon review the item generated an adjustment to the general ledger. We recommend that all reconciling items be properly reviewed and researched to insure they are properly recorded. We would point out that this item was identified by City's monthly bank account reconciliation procedures.

City Response:

The City Finance Director and City Auditor will work with the Treasurer to address and improve reconciliations with the General Ledger.

4. Implement Procedures to Review Compliance Requirements with Grant and Bond Agreements

Comment:

The City over the past two years has had capital projects that involved various sources of funding from QCEB and CREB bonds, Massachusetts Water Pollution Abatement Trust (MWPAT), and federal and state grants. Furthermore various City departments have received increase funding from federal, state and local grants to fund their departmental operations. The use of these funding sources can require compliance requirements to be met in accordance with their respective agreements. Currently the City relies on the various department heads in charge of the projects and operations to insure compliance is met. Some of these funding sources can have complex compliance and accounting requirements.

We recommend that the City consider centralizing the process of reviewing compliance with various grants, bonds and other sources of funding.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – Other Matters:

5. Parking

Prior Year Comment:

The City currently collects approximately \$1.3 million in parking revenue and approximately \$630,000 in parking fines. The City has on street parking, several parking lots and a garage with several "pay to park" options utilized throughout the City. There are approximately 700 meters and 24 kiosks used to collect monies from individuals. During our audit we reviewed the parking internal controls and procedures. We noted the following:

- There is no separate surety bond for parking personnel.
- There was a lack of documentation supporting a reconciliation of parking records revenue collected to City's general ledger and amounts deposited into City treasury.
- There was a lack of documentation of a reconciliation of daily Kiosk machine reports to bank deposits.
- Due to the number of personnel assigned to parking department there is a lack of segregation duties. The same employee is responsible for collecting, counting and processing receipts for deposit.
- A list/log of monthly parking passes was not maintained and reconciled to revenue turned over to City treasury.

We recommend that City management review the current internal controls and implement additional procedures to insure there are adequate controls over parking revenue and fines in place to safeguard City's assets. A procedure that should be implemented is the revenue categories on the City's subsidiary ledger should be segregated into the significant revenue streams of the parking department.

Status:

The Mayor in fiscal year 2012 has reorganized the parking department. One of the key changes as part of this reorganization was increased management oversight. City management understands the need for proper segregation of duties and where possible had made efforts to implement compensating controls.

The City in fiscal year 2013 has segregated the significant revenue streams in the City Auditor's general ledger. This implementation will improve the effectiveness of analytical procedures used by the City to evaluate the parking department

The City has reviewed its insurance policy and has determined there is adequate insurance over parking personnel collecting the monies.

6. Risk Assessment Procedures and Financial Policies and Procedures Manual

Prior Year Comment:

The City does not have a current comprehensive Policies and Procedures Manual to assist in documenting the policies, procedures and controls over key financial transactions, which have been in place and relied upon over the years.

A key component of the comprehensive Policies and Procedures Manual is the Risk Assessment Process. The financial management team within the City should document the policies, procedures and controls over key financial transactions, which by nature are deemed more susceptible to fraud, waste or abuse. The knowledge gained through the risk assessment process will help establish relevant and effective control procedures designed to assess the risks of material misstatement at the financial statement and relevant assertion level.

Specific areas which should be assessed are documented as follows:

- Cash collected at a decentralized location (outside City Hall)
- Parking Collection of Monies and Reporting
- Accounts Payable
- Payroll
- Inventory of City assets, such as computer technology

The following questions should also be considered when conducting the assessment:

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

Status:

The Finance Director and the City Auditor are in the process of reviewing Policies and Procedures over key financial transactions that would be susceptible to fraud, waste and abuse.

As part of this process we recommend that the Finance Director and City Auditor determine the City's significant financial transactions. Once these are determined they should review the current policies and procedures of internal control over these transactions and determine if they are adequate. For instance, departmental permits maybe classified as a significant transaction. The City would review this area to determine if the source documentation maintained by the department supports the revenue collected for the use/participation of that that particular activity.

7. Proration of Retiree Health Insurance Premiums Between Employers

Prior Year Comment:

The State Legislature amended chapter 32B when it enacted the fiscal year 2011 State budget. It inserted section 9 A1/2 which allows governmental units to prorate costs for retirees (after January 1, 2011) health insurance premiums to other governmental units. During our fieldwork we inquired to management on this matter and they were aware of the new amendment to chapter 32B. Because of the complexities and financial impact of the new law we recommend to all our governmental clients to review and monitor the controls and procedures in place to insure compliance.

Status:

The City has implemented procedures and has begun to bill other governmental units for prorated costs for health insurance premiums for retirees.

8. Water and Sewer Accounts Receivable

Prior Year Comment:

During our current audit and prior audits we noted that the accounts receivable subsidiary records for water and sewer were not periodically reconciled to the general ledger. Effective internal controls require timely and proper reconciliation of the accounts receivable subsidiary records to the general ledger. Failure to perform these tasks timely and properly increases the risk of misstatement due to error or fraud, prohibits the safeguarding of assets and does not provide for accurate a timely financial reporting.

We recommend that procedures be implemented to reconcile the water and sewer accounts receivable subsidiary records to the general ledger on a monthly basis. All variances should be investigated and resolved in a timely manner. When the variance has remained at a consistent at the same amount and adjustment can be made to the general ledger.

Status:

The City Auditor and DPW financial manager implemented procedures to reconcile on a monthly basis. The variance changed by an immaterial amount during fiscal year 2011 and 2012. We recommend that reconciliation continue to take place and that an adjustment be made to the general ledger if the variance remains the same at the end of fiscal year 2013.

9. Review Old Outstanding Receivable Balances

Prior Year Comment:

During our audit we noted there are older accounts receivable that exists in the motor vehicle, personal property, boat excise and departmental receivables. We recommend that the City research the older accounts receivables to determine if the accounts should be abated or make an effort to collect them. Also, the City Collector should reconcile the motor vehicle outstanding amounts to the deputy collector on a periodic basis.

Status:

The condition remains the same as of June 30, 2012. However, management is in the process of reviewing the older accounts receivable.

City Response:

The Finance Director has instructed the Collector and Assessor to begin address this finding by reviewing outstanding receivables in five year increments. The Collector and Assessor have been given a deadline to address the five oldest years before the end of FY13.

10. Smith Vocational School – Net School Spending

Prior Year Comment:

During our audit we reviewed the end of year report that was prepared by the Smith Vocational School business manager and submitted to the Department of Elementary and Secondary Education. We found that the report indicated that the City did not meet net school spending for the Smith Vocational School as required by the State. We recommend that the City review this matter and determine if the City met net school spending as required. If the City did not meet net school spending then City needs to take corrective action.

Status:

City management has met with the Department of Elementary and Secondary Education and Smith Vocational School management to discuss this matter. The City has taken our comment under advisement and is in the process of trying to resolving this matter.

11. Establish Internal Audit Function

Prior Year Comment:

Currently, the City does not perform regular departmental internal audits. Massachusetts General Laws provide powers and duties to the City Auditor to perform internal audit functions, including examining records of all departments responsible for receiving and expending funds. Internal audits compliment the independent audit and will provide important oversight over departmental accounting records throughout the year.

We recommend the City Auditor perform periodic internal audits of the Cities departmental records. This will result in improved oversight and should reduce the risk of errors and irregularities from occurring and going undetected.

Status:

The condition remains the same. However, it is the intent of the City to start an internal audit process. We encourage the City to adopt this practice.

City Response:

The Finance Director and Auditor have determined they will begin with departments that handle cash on a regular basis. The Finance Director and Auditor will meet with the Independent Auditor to review the process for internal auditing.