

CITY OF NORTH ADAMS, MASSACHUSETTS

MANAGEMENT LETTER

FOR THE YEAR ENDED JUNE 30, 2012

CITY OF NORTH ADAMS, MASSACHUSETTS

Management Letter

Year Ended June 30, 2012

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To the Honorable Mayor and City Council
City of North Adams
North Adams, Massachusetts

In planning and performing our audit of the basic financial statements of the City of North Adams 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 North Adams'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 charged 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

January 24, 2013

CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Matters:

1. Free Cash/Financial Condition

Comment:

The City was unable to obtain a positive Free Cash Certification by the Commonwealth of Massachusetts, Department of Revenue for the Fiscal Year ended June 30, 2012.

Free cash is a community’s unrestricted available fund that may be used as a funding source for budgetary appropriations. Free cash is generated when the actual operating results compare favorably with the budget. Specifically, free cash is generated when actual revenue collections are more than budget estimates, and actual expenditures and encumbrances are less than budget appropriations, or both.

The lack of free cash or other available reserves is often indicative of a community’s financial instability in difficult economic times. In fiscal 2012, the following were contributing factors precluding the certification of positive free cash:

- Return of unexpended/unencumbered departmental appropriations \$ 40,700
- Variance with budget vs. actual – state receipts (\$ 177,700)
- Variance with budget vs. actual – local receipts \$ 53,200
- Variance with budget vs. actual – state assessments \$ 215,900
- Deficit accounts (\$ 348,000)

The results summarized above would not be considered financially healthy by municipal financial standards. Under sound financial policies, a municipality should strive to generate free cash in the amount equal to 3 to 5 percent of its annual budget. The City’s budget is approximately \$39,000,000.

The City has a stabilization fund that has a balance at June 30, 2012 of approximately \$236,000. Also, the City has several reserves maintained as receipts reserved fund balances in the special revenues funds which are parking meter reserve, transfer station reserve and sale of town property, of which have balances at June 30, 2012 of approximately \$132,000, \$236,000 and \$33,000, respectively.

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. State aid and property taxes are the two major revenues for the City’s general fund budget and are approximately 48% and 34% of the City’s budget, respectively. Any significant changes (increases or decreases) to the City’s budget would have a direct impact on these two revenue sources. We recommend that the City review and consider making significant structural changes to the City’s budget (i.e. increase revenue or decrease expenditures).

We recommend the City strive to maintain an Unreserved Fund Balance (free cash) in the General Fund of 3 to 5 percent. We also recommend that the City add to the balance in the stabilization fund. 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.

Management Response:

The City Administration is very cognizant of the importance of strong reserves and the role they play in the overall fiscal health of the entity. Administration also shoulders responsibility for certain overruns (most specifically in Public Safety and Veterans Services) that have been a draw on reserves and negatively impacted free cash. Grant accounts in the deficit in FY2012 most specifically airport related as well as some lingering Chapter 90 reimbursements had the most significant negative impact on the free cash situation. As the City moves forward and the budget becomes even more finely tuned, the opportunity for significant free cash will be reduced. Procedures have been reviewed and reinforced to see that all year end transactions that effect free cash calculation such as grant reimbursements and Chapter 90 project reimbursements are collected in a timely fashion to maximize any dollars that might flow to free cash. – (COMPLETED)

2. Compensated Absences

Comment:

The City did not have at the time of our fieldwork a listing of compensated absences for the City employees (non-school). We recommend that a detailed listing of the compensated absences be generated and computed at June 30 each year for inclusion in the City's financial statements. Furthermore this list should be reviewed by management once a year to insure its accuracy and future impact on the financial matters of the City.

Management Response:

City Administration has kept and continues to keep a record of compensated absences for the City employees however the report was not available at the time of the audit. The report was completed and has been reviewed and will be done in a timely manner going forward. – (COMPLETED)

3. Deficit Accounts

Comment:

During our audit we noted several accounts that were in deficit at June 30, 2012. Our testing on these accounts revealed that these accounts were the result of timing issues of receipts and expenditures, lack of timely request for reimbursement from granting agencies, accrual of receipts that were not earned and measurable and from misposting of expenditures and receipts.

During our fieldwork we had communications with the City Auditor and other City Personnel with regards to these accounts. The City should implement procedures to review all deficit accounts to determine why they are in deficit and how the deficit will be provided for or eliminated.

Management Response:

Procedures are now in place to review all deficit accounts in order to make timely adjustments before closing the books at the end of the FY. – (COMPLETED)

4. Airport Grants

Comment:

The City of North Adams receives various grants from the Federal Aviation Administration and from the Commonwealth of Massachusetts Department of Transportation for improvements at the Harriman and West Municipal Airport. Currently there is no centralized location for the records of the grants. The City's consulting project engineer prepares various Outlay Reports and Requests for Reimbursement (SF-271) and monitors for compliance with Davis-Bacon prevailing wage requirements and procurement. The Secretary to the Airport Commission files copies of the SF-271 Forms and other documents for the grants and submits invoices to the City Auditor's office for payment. The City Auditor has original copies of all the invoices charged to the projects and posts payments to the City's general ledger based on account code numbers submitted by the airport department. There is no one person or department that monitors the activity in the airport projects to determine that costs are properly charged to the projects, and there is no reconciliation of the projects from the airport department to the City Auditor's general ledger. During our audit we found some expenditures and grant receipts were posted to the incorrect accounts on the City's general ledger and were not be detected by the City's employees. We have proposed several adjustments to these grants. Furthermore we found that the several airport grants were in deficit at June 30, which resulted in the City being penalized on free cash calculation.

We recommend that the City establish someone that is responsible for monitoring the activity in each of the airport projects and for reviewing the City Auditor's general ledger to see that all receipts and expenditures are posted to the correct grant accounts.

Management Response:

City Administration has had very intense conversations with the Airport Commission, project engineers, managers, DOT Aeronautics and the FAA to come up with better internal controls over airport projects and grants. The City's Administrative Office and the Auditor have been working with the Airport Commission and project managers to be certain that procedures are in place that will assure proper reconciliation and reimbursements going forward – (COMPLETED)

5. School Lunch Accounts Receivable

Comment:

During our audit we reviewed the school lunch charge policy and unpaid balances. We noted as of September 25, 2012 there was 251 students with school lunch unpaid charges for an amount of \$9,164. Of this balance there was 30 accounts that had unpaid balances of greater than \$100 for an amount of \$4,596.

During our fieldwork we inquired to School management on this matter and they were aware of the situation and were in the process of working on a charge policy.

We recommend that the School Department management continue to review this matter and adopt a strong policy to insure that all accounts are paid in a reasonable amount of time.

Management Response:

Administration and School Committee are aware of the issues raised in the audit. In November 2012, this issue was vetted at School Committee and the Superintendent was charged with establishing collection procedures for unpaid school lunch balances. Since, a new Director of Food Services has been hired and is working on identifying situations whereby some of the overdue accounts may be eligible for the free or reduced lunch program. Others who would not qualify will become subject to a collection process that will be developed soon.
– (IN PROCESS)

6. Proration of Retiree Health Insurance Premiums Between Employers

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.

Management Response:

Administration agrees with the finding and will review and monitor as required –
(COMPLETED)

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Payroll Charged to Grants and Year-End Salary Appropriations

Prior Year Comment:

During our audit we noted that payroll related expenditures charged to the 911 support grant and SAFER grant for fiscal year 2011 were approximately \$136,212 and \$152,716, respectively. We further noted that majority of these payroll costs were associated with regular pay and not overtime or other unordinary pay. The City should review and monitor regular payroll charged to grants and its impact on future City's budgets.

We further noted that the City made significant appropriation transfers at year-end of fiscal year 2011 to fund various salary line items in the City's Budget. Upon inquiry to management and review of documentation we noted majority of the amounts were for overtime and retroactive pay. We recommend that the City review this situation to determine its impact on future budgets and the integrity of the City's original budget submitted to council for adoption.

Status:

The City has taken our comment under advisement and has considered its impact when formulating future budgets. – (COMPLETED)

2. 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)
- Accounts Payable Preparation
- Payroll preparation
- Compliance with procurement laws and regulations
- 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 City is researching and gathering templates to use for a Policies and Procedures Manual.
- (IN PROCESS)

3. Review Computer Financial Software for Update to Newer Version

Prior Year Comment:

The City utilizes KVS Information System (KVS) software to account for the City's financial transactions. KVS has two versions of the software, Standard (older version) and Enterprise (newer version). The City currently utilizes the older Standard version. We recommend the City review the current software version of KVS to determine if it would be beneficial to upgrade to the newer Enterprise version.

Status:

The City has taken our recommendation under advisement and has researched and reviewed the financial software.

Management Response:

City Administration through the MIS Department completed an extensive review of financial software in 2012. It has been determined that due to the cost of new systems or upgrades, it was not in the City's best interest to upgrade at this time – (COMPLETED)

4. Review of Investments

Prior Year Comment:

During our audit we noted that there was no formal procedure to review the investments of the City periodically. The financial personnel of the City should review the investments periodically to see if they are in compliance with their investment policy, in compliance with legal investments for Massachusetts's municipalities and meeting the needs of the City. In today's market climate the importance of this procedure becomes essential.

Also, we noted that the City does not have a formal adopted investment policy. The City should adopt an investment policy. In this way, the responsibility of investing funds can be shared with other City officials to alleviate any interest rate pressures on the City treasurer.

Status:

The City has not formally adopted an investment policy as of the date of the audit. However, the City does review and reconcile their investments on a monthly basis.

Management Response:

City Administration will continue to assess the need for a formal investment policy. Cash assets and reserve accounts will be reviewed to determine best options for return on investment – (COMPLETED)

5. - Chapter 30 B

Prior Year Comment:

Massachusetts General Laws Chapter 30B requires that purchases of \$5,000 to \$25,000 be supported by documentation that quotes were obtained by at least three vendors and that expenditures of \$25,000 or more be subjected to a formal bidding process. During our audit we tested the City's compliance of Chapter 30B. We noted several instances in which the procurement laws were not met. We communicate these instances with City personnel during our fieldwork.

Status:

During our current audit we tested the City's compliance with procurement laws. We found two instances where we could not find the necessary supporting documents to determine if compliance with procurement laws were met. Both instances were for purchases between \$5,000 and \$10,000.

The City has communicated to departments the need to comply with procurement laws. – (COMPLETED)

6. 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 City's departmental records. This will result in improved oversight and should reduce the risk of errors and irregularities from occurring and going undetected.

Status:

The City has taken our recommendation under advisement and in fiscal year 2011 began to perform departmental reviews. In fiscal year 2012 no internal departmental reviews were performed due to time constraints with other areas of the City Auditor's job responsibilities. It is the intention of the City Auditor's office to perform periodic departmental reviews in the future. – (COMPLETED)