

CITY OF WALTHAM, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2006



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To the Honorable Mayor Jeannette A. McCarthy
and Members of the City Council
City of Waltham, Massachusetts

We have audited the financial statements of the City of Waltham, Massachusetts, (the "City") as of and for the fiscal year ended June 30, 2006, and have issued our report dated October 13, 2006. In planning and performing our audit of the financial statements of the City we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the City's financial statements and not to provide assurance on internal control.

During our audit we noted certain matters involving internal controls and other operational matters. The memorandum that accompanies this letter summarizes our comments and recommendations concerning those matters. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal controls or result in other operating efficiencies.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the City's organization gained during our work to communicate comments and suggestions that we hope will be useful to you.

We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by the personnel of the City during the course of our audit.

This report is intended solely for the information and use of management and is not intended to be and should not be used by anyone other than these specified parties.

October 13, 2006

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Prior Period Comments and Recommendations

STATEMENT NO. 45 OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD

Prior Comment

In July of 2004, the Governmental Accounting Standards Board (the GASB) issued Statement No. 45 *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. This Statement improves the relevance and usefulness of financial reporting by (a) requiring a systematic, accrual-basis measurement and recognition of other postemployment benefits (OPEB) cost over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. The projection of benefits should include all benefits covered by the current substantive plan (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the healthcare cost trend rate for postemployment healthcare plans, be guided by applicable actuarial standards. Failure to obtain an actuarial valuation will result in a qualification to the independent auditors' opinion on the basic financial statements.

Net OPEB obligations, if any, including amounts associated with under- or overcontributions from governmental funds, should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

An employer's net OPEB obligation is defined as the cumulative difference between annual OPEB cost and the employer's contributions to a plan, including the OPEB liability or asset at transition, if any. (Because retroactive application of the measurement requirements of this Statement is not required, for most employers the OPEB liability at the beginning of the transition year will be zero.) An employer with a net OPEB obligation is required to measure annual OPEB cost equal to (a) the annual required contribution (ARC), (b) one year's interest on the net OPEB obligation, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under- or overcontributions.

This Statement generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. The City is required to implement this statement in fiscal 2008 although earlier implementation is encouraged.

Recommendation

We recommend that management take a proactive approach to the planning and implementation of GASB Statement No.45. The most important consideration in the planning process is obtaining an actuarial valuation.

Current Status – *Pending implementation*. The City has contracted with an actuary to calculate the City's OPEB obligation.

STUDENT ACTIVITY FUNDS

Prior Comment

In past management letters, we noted that the City is required to maintain its student activity funds in a manner that is mandated by Massachusetts General Law (MGL), Chapter 71 of the Acts of 1996. In reviewing the City's policies and procedures, we made the following recommendations:

1. That reimbursement to the principal's account be funded through the warrant process.
2. That a monthly reconciliation be performed between the internal records of the school principals and the bank accounts.
3. That each school principal, responsible for a student activity checking account, be bonded in an amount equal to the maximum cash balance approved by the school committee
4. That an assessment of current procedures be performed to determine if they are in compliance with MGL, Chapter 71 and consider best practices as recommended by the Massachusetts Association of School Business Officials.

Current Status – *Resolved*. The City has implemented all of the recommendations noted above.

CIRCUIT BREAKER PROGRAM

Prior Comment

In fiscal year 2005, Chapter 71B §5A of Massachusetts General Laws (MGL) established a program to reimburse schools for certain costs related to special education students. This program is referred to as the "Circuit Breaker" program. Under this program, the school will be reimbursed up to 75% of those costs associated with special education students based on a prescribed formula. The underlying nature of this program is to supplement the schools funding of special education costs and, as such, the preparation of the School Committee's budget recommendations should exclude any costs expected to be reimbursed. In March 2004, the Department of Revenue issued a bulletin that provided guidance on how to account for this grant. Based MGL and the Department of Revenue directive, this program is designed for communities to pay for current special education costs, not create a special revenue fund surplus.

Each community must establish a Circuit Breaker special revenue fund to account for the grant reimbursements and allowable expenditures that match the payments received. Payments are made on a quarterly basis based on the prior years per pupil costs as outlined in subsection (c) of MGL Chapter 71B §5A. As the reimbursements are received, costs earmarked as qualifying for reimbursement are to be transferred to the special revenue fund in an amount equal to the reimbursement received thus offsetting the monies received and bringing the fund to a zero balance.

We made management aware that there had been confusion in many communities, between accounting departments and school departments, regarding how to account for this grant.

Current Status – *Resolved*. The Department of Revenue issued additional regulations that clarified how to account for circuit breaker money.

Current Period Comments and Recommendations

SCHOOL GRANTS – TIMELINESS OF RECONCILIATION PROCEDURES

Comment

School grants are recorded and identified on the general ledger by grant name and fiscal year (i.e. SPED FY06, SPED FY05, etc.). We noted that while the aggregate balances were correct, the individual grants balances were, in most case, not accurate.

These errors resulted from the School Department coding revenue and expenditure activity to the wrong fiscal year. They were not detected and corrected on a timely basis because monthly reconciliations between the general ledger and the School Department's grant records were not performed. Since the City's grant reporting and compliance is based on the general ledger balances, it very important that these balances and the related activity are correct.

Recommendation

The City should adopt a policy requiring monthly reconciliation of all general ledger grant balances and activity to the School grant records. Reconciliations quickly identify errors and ensure the accuracy of the monthly financial statements and underlying documentation. When reconciliations are performed infrequently errors can occur and remain uncorrected for a significant period of time.

EVALUATE THE EXISTING ACCOUNTING SYSTEM

Comment

The computer software used to capture the general ledger accounting activity was acquired several years ago. Since that time, the growth of the City has significantly affected its accounting and reporting requirements. Industry trends have produced and keep introducing new applications that enhance reporting capabilities and increase productivity. At present, the City is very dependent on Excel spreadsheets for financial reporting. We believe that the City can reduce the use of Excel spreadsheets by migrating toward system generated reports.

Recommendation

We recommend that the City consider evaluating the capability of its existing accounting system in meeting its short and long-term reporting requirements. Both the City and School should collaborate in a search to find a more comprehensive financial software application.

This evaluation should focus on ensuring that both the City and School's financial reporting requirements and the information needs of management are met.

FRAUD RISK ASSESSMENT

Comment

The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the City perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the City's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

The fraud risk assessment can be informal and performed by a management-level individual who has extensive knowledge of the City that might be used in the assessment. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the City, its environment, and its processes. The fraud risk assessment process should consider the City's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

- What individuals have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- Are there any known pressures that would motivate employees with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.
- What assets of the City are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use.
- How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running through an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.

Recommendation

We recommend that management develop and implement a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation.