

CITY OF WALTHAM, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2012



Certified Public Accountants

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

In planning and performing our audit of the financial statements of the City of Waltham, Massachusetts (City) as of and for the year ended June 30, 2012, 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. A separate report dated January 18, 2013, contains our communication of material weaknesses in the City's internal control over financial reporting. This letter does not affect our report dated January 18, 2013, on the financial statements of the City.

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

Sullivan, Rogers & Company, LLC

January 18, 2013

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Comments and Recommendations

Police Detail

Comment

At June 30, 2012, the police detail fund had a deficit of approximately \$86,000 (after applying accounts receivable totaling approximately \$257,000). When a police detail fund is in deficit, it is typically an indication that one or more of the following events has occurred and gone undetected and/or unresolved:

1. Billing error
2. Accounts receivable were written off without a funding source (i.e., the general fund)
3. Revenue or expenditure posting errors

Recommendation

We recommend the City determine the cause of the current deficit and take corrective action, which may only require an adjusting entry to reclassify incorrect postings of activity. However, corrective action may also require the deficit to be funded by available funds.

We recommend procedures be implemented to reconcile the police detail fund balance deficit to the detailed accounts receivable balances monthly.

Water and Sewer Abatements

Comment

We evaluated the systems of internal control related to water and sewer user charge abatements and identified the following deficiencies:

1. A standard abatement application or request form is not utilized. Abatement requests are currently made through letters, phone calls and other informal communications. The lack of a formal abatement application does not provide for a consistent process or audit trail.
2. A water and sewer abatement log is not maintained that identifies and tracks abatement requests and the related outcome (e.g., approved or denied).
3. Water and sewer abatements do not require written approval of the Business Manager. As a result, unauthorized and/or erroneous abatements could be processed and go undetected.

Recommendation

We recommend the following:

1. Development and implementation of a formal abatement application form.
2. Maintenance of a water and sewer abatement log, which incorporates, among other things, the date of the request, the name of the applicant, the outcome and specific reasons supporting the outcome.
3. All abatements are approved/authorized by supervisory personnel (i.e., Business Manager).

Continuing Appropriations

Comment

General fund continuing appropriations represent amounts that were budgeted (during the current fiscal year or prior fiscal years), unspent at fiscal year-end and carried over to the subsequent fiscal year. These appropriations remain available until exhausted or until the completion of the purpose of the appropriation. We identified the following regarding the City's continuing appropriations at June 30, 2012:

1. An accounting of certain continuing appropriations identifying the original appropriation amount, date and council order number is not maintained
2. The expenditure ledger does not specifically identify or segregate individual continuing appropriations through the use of individual account numbers and line items
3. There are no year-end procedures in place to determine what projects have been completed and if the appropriation should be closed out to undesignated general fund balance or carried over to the ensuing fiscal year

The current condition creates difficulties when determining the appropriate amounts to carry forward to the subsequent fiscal year and turn back to the general fund.

Recommendation

We recommend procedures be implemented to account for individual continuing appropriation balances in the expenditure ledger.

We recommend procedures be implemented to verify the continuing appropriation carry forward and/or turn back to the general fund at the end of each fiscal year.

Parking Tickets Accounts Receivable

Comment

The City engages a third-party service provider (service organization) to maintain a detailed (i.e., by violator) accounts receivable ledger for unpaid parking tickets. However, the City has not developed and implemented policies and procedures to record commitments in the general ledger for parking tickets issued and unpaid.

The lack of such policies and procedures creates the following deficiencies:

- There is no assurance that all amounts owed for parking tickets are being collected
 - In order to maintain proper control over amounts owed for parking tickets, an accounts receivable balance must be maintained in the general ledger and reconciled monthly to the detailed accounts receivable ledger managed and maintained by the service organization
- There is a risk of misstatement in the City's financial statements related to the inability to reconcile a general ledger balance to the balance maintained by the service organization

Recommendation

We recommend the City develop and implement policies and procedures to:

- Record commitments in the general ledger for parking tickets issued and unpaid
- Update the general ledger accounts receivable balance for parking tickets paid, as well as authorized abatements and adjustments
- Reconcile (monthly) the general ledger accounts receivable balance to the detailed accounts receivable balance maintained by the service organization

Revenue Postings

Comment

Our audit identified the following significant revenue posting errors in the general ledger:

1. Medicare Part D and FEMA/Flood Relief receipts of approximately \$1,062,000 were recorded to a miscellaneous revenue account in the general ledger, which overstated miscellaneous receipts and understated intergovernmental revenue in the general ledger.
2. Approximately \$198,000 of Massachusetts Water Pollution Abatement Trust (MWPAT) loan proceeds were recorded as state revenue in the general ledger, which overstated intergovernmental revenue and understated proceeds of bonds and notes in the general ledger.

Revenue posting errors creates a lack of transparency and does not present accurate data when evaluating budget to actual results, financial statements and other financial reports.

The financial statements have been properly adjusted to reflect the revenue posting errors identified above.

Recommendation

It is critical that all activity be posted to the appropriate line items to promote accuracy and ultimately fiscal transparency. We recommend additional procedures be implemented to validate the account coding of revenue postings to the general ledger.

Budgeted Transfers

Comment

The fiscal year 2012 certified tax recapitulation included a \$75,000 subsidy from the general fund to the Veterans Memorial Rink (Rink) enterprise fund. However, both the appropriation and transfer were never recorded in the general ledger. As a result, the general fund appropriations and transfers out were understated, while ending fund balance was overstated; and the Rink enterprise fund's transfers in and ending fund balance were understated.

Recommendation

We recommend procedures be implemented to record all authorized appropriations to the expenditure ledger.

We recommend procedures be implemented to record all budgeted transfers between funds during the fiscal year the transfer applies to.

Capital Asset Accounting

Comment

The City maintains its capital asset activity and balances using spreadsheet software (Microsoft Excel). While Excel is an acceptable automated software program, a relational database program is more effective and efficient to manage and account for capital asset inventory. The benefits of a relational database are as follows:

- Databases are designed to link tables of related data together, such as asset classes, additions, disposals, functions, departments, etc. Storing related data together in a single table or spreadsheet can be unwieldy and invite error.
- Databases are safer. Excel, for example, does everything in memory, so unsaved data may be lost if the computer crashes. Databases write data to the hard drive immediately.
- Databases can handle more data.

Because the City must add data and formulas each year to capture asset additions, disposals and depreciation, the complexity of the spreadsheets increases annually and is very susceptible to human error. The current process is inefficient and limits reporting capabilities.

Recommendation

We recommend the City use relational database software to maintain and account for its capital asset inventory.

Grants Administration – Requests for Funds

Comment

The City participates in a number of reimbursable state and federal grant programs where the City is required to disburse funds first and subsequently file reimbursement requests with the applicable granting agency.

We identified that reimbursement requests are not being filed timely (by City grant administrators) for several of the City's reimbursable grant programs. Untimely requests for funds have a negative impact on the Department of Revenue's certification of the City's "Free Cash" and negatively impacts cash flows and investment income.

Recommendation

We recommend management implement procedures to request funds in a manner that minimizes the elapsing of time between the disbursement and receipt of reimbursable grant program funds.

Student Activity Funds

Comment

The School Department 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.”

The School Department communicated to us that internally performed agreed upon procedures were conducted on their student activity funds during fiscal year 2012. However, the Massachusetts Association of School Business Officials' (MASBO) *Student Activity Accounts Guidelines for Massachusetts School Districts* recommends an independent audit firm conduct an audit or agreed upon procedures at least once every three (3) years.

Recommendation

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

Utilization of Payroll Module

Comment

The City reports on its financial statements the future liability for accrued sick and vacation time earned by employees. Currently, individual departments manually track and maintain accrued sick and vacation balances that are periodically reported to the Personnel Department.

The City's payroll module has the ability to electronically track these balances. As of the date of this report, this functionality of the payroll module is not being utilized.

Recommendation

We recommend the City utilize the payroll module to track sick and vacation balances earned and used by its employees.

Service Organization Controls

Comment

The City, like many local governments in Massachusetts, engages third-party service providers (service organizations) to process certain financial transactions (such as parking tickets). In such instances, the related financial transactions are affected by the City's internal controls and the controls employed by the service organization. Therefore, as part of its monitoring efforts to ensure that internal controls over financial reporting are effective and functioning as intended, City management must evaluate whether service organization controls are suitably designed and effective.

Furthermore, service organizations often have information regarding employees and customers that must be protected (e.g., social security numbers). Such controls generally relate to the security, availability, processing integrity, confidentiality or privacy of information. Therefore, as part of its monitoring efforts to ensure the privacy and protection of its employees and customers' information, management must evaluate whether service organization controls are suitably designed and effective.

The most effective and efficient way for the City to accomplish its monitoring efforts is to obtain the appropriate *Service Organization Control (SOC)* reports from its third-party service providers.

There are two types of SOC reports that service auditors provide to service organizations for the benefit of their users, which are as follows:

- SOC 1 (previously SAS 70) reports – provide an opinion on controls at a service organization that are likely to be relevant to a user entity's internal control over financial reporting
- SOC 2 reports – provide an opinion on controls at a service organization that are related to the American Institute of Certified Public Accountants (AICPA) Trust Service Principles, which are (1) security; (2) availability; (3) processing integrity; (4) confidentiality; and (5) privacy.

Service organizations should be engaging a service auditor to provide the appropriate SOC report(s) and should make the resulting report available to their customers (e.g., the City).

Recommendation

We recommend the City identify each service organization utilized and request the applicable SOC report (annually).

Because all service organizations are an extension of the City's internal control, we recommend all service organization contracts include a requirement to obtain the appropriate SOC report (annually).

Financial Policies and Procedures Manual

Comment

We believe that preparation of a formal policy and procedures manual would improve and standardize the City's financial policies and procedures. Inherent in any organization that operates without formalized written procedures are inconsistencies in everyday policies and procedures. 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
- Budget
- Grants administration
- Capital assets
- Month-end and year-end closing
- Month-end and year-end reporting

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 management design and implement a formal financial policies and procedures manual.

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.