

CITY OF NORTHAMPTON, MASSACHUSETTS
MANAGEMENT LETTER
FOR THE YEAR ENDED JUNE 30, 2013

CITY OF NORTHAMPTON, MASSACHUSETTS

Management Letter

Year Ended June 30, 2013

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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, 2013, 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
South Deerfield, Massachusetts

January 10, 2014

CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Adopt a Reserve Fund for Compensated Absences

Comment:

The State Legislature voted Chapter 66 of the acts of 2012, which is now Chapter 40 section 13D, and provides a City, Town or School District that adopts the above section to establish a reserve fund for the future payment of accrued liabilities for compensated absences due any employee or fulltime officer upon termination of employment. As of June 30, 2013 the City's Liability for compensated absences (sick, vacation, etc.) is approximately \$3,500,000.

We recommend that the City review Chapter 40, section 13D and consider accepting the provisions of this new law.

City's Response:

Reserve Fund for Compensated Absences created in July 2013.

2. Health Insurance Withholding Account

Comment:

During our audit we noted that health insurance withholding account balance was not being properly reconciled. Because this account has significant annual activity and carries with it statutory responsibilities, we recommend that this account be accounted for accurately and consistently. A proper and timely reconciliation of the health insurance withholdings would minimize and control potential discrepancies from occurring. During our fieldwork we proposed adjustments to the health insurance withholding account and reviewed what procedures needed to be implemented to personnel.

We recommend that the health insurance withholding account be reconciled monthly to the applicable governmental regulations and source documents to insure that proper employee contributions are being properly accounted for.

City's Response:

This had not been an issue in prior years. With the implementation of the new payroll system and the IRS mandatory reporting of the employer's share of health insurance on the W-2, the system needed to be corrected on the withholding account. Proper reconciliation is currently being conducted.

3. Encumbrance Reporting

Comment:

Encumbrances (the portion of the current year budget carried forward for expenditure in the subsequent year) should be based on actual contracted obligations. Generally, these obligations take the form of purchase orders, contracts, salary commitments and binding commitments that is chargeable to a specific appropriation in the current year's budget. These amounts are reserved on the year-end financial statements and paid out in the subsequent year. Our testing of the City's fund balance reserved for encumbrances noted certain departmental encumbrances were not adequately supported by known obligations.

We recommend that the City and School review its' procedures for year-end encumbrance reporting and implement procedures to ensure the accuracy of known obligations for encumbrances.

City's Response:

The City and the School will review its' procedures for year-end encumbrance reporting and implement procedures to ensure the accuracy of known obligations for encumbrances.

4. Future Government Accounting Standards Board (GASB) Statements – GASB no. 65 and 68

Comment:

The GASB has issued new pronouncements that will significantly affect financial accounting and reporting requirements. Two of the pronouncements that will affect the City are summarized as follows:

- GASB Statement No. 65 "*Items previously reported as Assets and Liabilities*" is required to be implemented in fiscal year 2014. This statement established accounting and financial reporting standards that reclassify and recognizes, as deferred outflows and deferred inflows of resources, certain items that were previously reported as assets and liabilities.
- GASB Statement No. 68 "*Accounting and financial reporting for pensions*" is required to be implemented in fiscal year 2015. This statement will significantly change the reporting and accounting of the pension liability and expense. The primary objective of the statement is to improve accounting and financial reporting by state and local governments for pensions. Changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes will be required. Current actuarial methods and assumptions may continue to be used to determine funding amounts. Governments will be required to recognize in their financial statements a net pension liability (asset) determined annually as of the end of the fiscal year. GASB statement no. 68 is a financial reporting standard and does not require funding of any net pension obligation.

Given the significant impact of these two GASB statements on the City's financial accounting and reporting we recommend that the City familiarize and educate themselves with the statements.

City's Response:

The City will work with the Independent Auditor and the Northampton Retirement Board's Actuary to familiarize and educate ourselves with the statements.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Utilization of Free Cash

Prior Year 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.

Status:

The City's general fund free cash for June 30, 2013 was certified by the Department of Revenue for \$3,200,159. The key elements that contributed to this amount were approximately as follows:

- Return of unexpended/unencumbered appropriations \$1,740,000
- Excess over budget of state and local receipts \$ 835,000
- Prior year unused free cash \$ 278,000

The City has taken our recommendation under advisement and understands the need for strong reserves and the utilization of free cash.

2. Review Indirect Costs for Enterprise Funds

Prior Year 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.

Status:

The City Finance Director updated the formulas used in calculating the indirect costs for the Enterprise Funds for the indirect charges for Fiscal year 2014. Also, the City Finance Director is in the process of writing the internal policy that will accompany the indirect cost worksheet.

3. Improve Bank Account Reconciliations

Prior Year 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.

Status:

The City Treasurer's office has made improvements to the individual bank accounts reconciliations in fiscal year 2013. However, in fiscal year 2014 there was a change in key personnel in the City Treasurer's office. We reviewed certain subsequent to year-end transactions and noted that the individual bank statement reconciliations were not being completed in a timely manner (excess of a month). We believe that this situation has not risen to a material weakness or significant deficiency in internal control, but if attention to this matter is not given it could lead to a one of those categories. We recommend the City monitor this situation to insure the individual bank reconciliations are performed in a timely manner.

City's Response:

The Finance Director has made timely reconciliation of the cash book a priority for the Treasurer's Office and is working to improve internal controls and processes in that office.

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

Prior Year 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.

Status:

The City has taken our recommendation under advisement.

5. Review Old Outstanding Receivable Balances

Prior Year Comment:

During our prior 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 City Tax Collector has started the process of reviewing the older tax receivables and as a result six years of the older motor vehicle has been abated in fiscal year 2013. We encourage the City to continue the process of researching and reviewing the older tax receivables.