

CITY OF NORTHAMPTON, MASSACHUSETTS

MANAGEMENT LETTER

FOR THE YEAR ENDED JUNE 30, 2011

CITY OF NORTHAMPTON, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

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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, 2011, 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

January 10, 2012

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

OTHER ITEMS:

1. Parking

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.

City Response: The Mayor is in the process of reorganizing the Parking Department and will address internal controls and procedures in the upcoming restructuring.

2. Risk Assessment Procedures and Financial Policies and Procedures Manual

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?

City Response: The Finance Director and the City Auditor would like to begin development of a Policies and Procedures Manual focusing first on key financial transactions that would be susceptible to fraud, waste and abuse. It is our hope to meet with our Independent Auditors at the start of FY13 to obtain guidance on implementing this project.

3. 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.

City Response: The Human Resource Department is aware of this change and has begun billing other governmental units for pro-rated costs for health insurance premiums for retirees who have worked for multiple governmental units.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS

OTHER ITEMS:

4. 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. We recommend that reconciliation continue to take place and that an adjustment be made to the general ledger at the end of fiscal year 2012 for the prior year variance.

City Response: The City will continue to reconcile on a monthly basis.

5. 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 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, 2011. However, management is in the process of reviewing the situation.

6. Build Up Reserves

Prior Year Comment:

The City's free cash was certified by the State Department of Revenue at June 30, 2010 for approximately \$1,050,000. 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 \$68,000,000. The City has two stabilization funds that have balances at June 30, 2010 of approximately \$64,400 and \$646,000. Also, the City has several reserves maintained as receipts reserved fund balances in the special revenues funds which are parking meter reserve, ambulance reserve and sale of land, of which have balances at June 30, 2010 of approximately \$930,500, \$707,000 and \$436,500, respectively. The City does have a policy for guidelines and maintaining its reserves.

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 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 balances in the two 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.

City Response: The City is in agreement with the recommendation and has taken it under advisement. The City has sustained significant cuts to state local aid accounts. Since FY2008 the city has lost \$3.5 million in state local aid and has used its reserves to help fund the gap created by this revenue loss. It is the City's intention to rebuild reserve accounts and the FY12 budget appropriated \$150,000 into the stabilization fund. We intend to maintain that amount in the FY13 budget.

7. 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:

This has been an on-going issue for many years, recognized by the City and the Department of Elementary and Secondary Education. This is a direct result of the uniqueness of the City having two separate school districts, the Northampton Public Schools and the Smith Vocational and Agricultural High School. Both the City and DoESE are in agreement over the cause and effect of the problem, however, no corrective action has been requested or agreed to as yet.

City Response: This has been an on-going issue for many years, recognized by the City and Department of Elementary and Secondary Education. This is a direct result of the uniqueness of the City having two separate school districts; the Northampton Public Schools and the Smith Vocational and Agricultural High Schools. We are the only municipality in the state with this configuration and the state-wide standard net school spending formula does not accommodate this special situation. The City is in excess of net school spending for Northampton Public Schools. If the two districts were combined the City would still be in excess of net school spending. Both the City and DESE are in agreement over the cause and effect of the problem, and no changes have been requested or agreed to as yet.

8. 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. We encourage the City to adopt this practice.

City Response: The City Auditor and Finance Director will work to begin this practice in FY12 by identifying the departments that should be audited and in what priority they should be audited.