

CITY OF NORTH ADAMS, MASSACHUSETTS

MANAGEMENT LETTER

FOR THE YEAR ENDED JUNE 30, 2010

CITY OF NORTH ADAMS, MASSACHUSETTS

Management Letter

Year Ended June 30, 2010

	<u>Page</u>
TABLE OF CONTENTS	2
INTRODUCTORY LETTER	3
CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Items	
1. Reliance on Reserves and Establish a Plan to Build up Reserves.....	4
2. Develop Multi-Year Revenue and Expenditure Forecasts – Operating and Capital.....	4
3. Review Special Revenue and Trust Fund Accounts.....	5
4. Monitor Health Insurance Fund.....	5
5. Maintaining Budget Revenue and Expenditure Subsidiary Ledgers	6
6. Component Units	6
7. Long Term Debt	7
8. Financial Reporting – Full Purchase Order System & Requisition System.....	7
9. Overpayment of Vendor	8
10. Review of Investments	8
11. Procurement – Chapter 30B.....	9
12. Accounts Receivable.....	9
13. Review of Tax Title and Tax Foreclosure Accounts.....	10
14. Review Older Motor Vehicle Excise Levies	10
15. GASB Statement No. 45 - OPEB	10
16. New Accounting and Financial Reporting Requirement for Fund Balances GASB No. 54	11
17. Accounting/Financial Policies and Procedures Manual.....	12
18. Establish Internal Audit Function	13
19. Risk Assessment and Monitoring	13

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, 2010, 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
January 31, 2011

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

OTHER ITEMS:

1. Reliance on Reserves and Establish a Plan to Build up Reserves

Comment:

We noted during our audit that the City used reserves (i.e. Sale of Land, Overlay surplus) to fund the City's 2010 operating budget. These reserves are considered a non-reoccurring available fund and should not be used on a consistent basis to fund reoccurring expenses. Also, we noted that the City also used receipts reserved (i.e. landfill receipts, sale of cemetery lots, parking meters and municipal access) as an available fund to fund the 2010 operating budget. The amounts voted appear to be in excess of the average annual amounts collected for these activities by the City. The practice of using non-reoccurring reserves to fund reoccurring expenditures and utilizing receipts reserved in excess of amounts collected will have a financial impact on the City.

The City should formulate and adopt a policy to establish financial healthy reserves and the use of those reserves.

Management Response:

The administration acknowledges the over use of city reserve accounts over the past several fiscal years and subsequent depletion of reserves and free cash. These past practices were done to offset deep cuts in state aid however might have been less impactful on reserves had budget cuts and tax increases been more prominently utilized. While this administration fully concurs with the auditors comment, utilization of the remaining Sale of Land account was factored into the FY 2011 budget and will be depleted as a revenue source. Additionally, this administration did raise taxes, water rates, and a sewer fee to close the budget shortfalls. The use and depletion of reserves has had and will have a very adverse effect on the FY 2012 budget. The Administration with the Finance Team and The City Council Finance Committee will draft and adopt a policy during the FY 2012 budget preparation process that will address the re-establishment of healthy reserves.

2. Develop a Multi-Year Revenue and Expenditure Forecast – Operating and Capital

Comment:

During our audit we noted that the City does not have a formal budget practice of forecasting multi-year revenue and expenditures for both operating and capital. The forecasting to multi-years should be between three to five years. In recent years municipalities have had significant financial constraints and have had difficulties in adopting budgets. By adopting this practice the City would establish sound financial practices.

During our audit we noted that the certain estimated receipt amounts were in excess of the actual collections. This was a direct result of having a practice of using prior years actual revenues as a budget for the up coming year. In fiscal year 2009, there were several one-time revenues and these amounts were used as budgeted revenues for 2010. If this practices continues to occur the City will be financially impacted. The City should review all the estimated receipts in order to forecast a more accurate estimate of the revenues used to set the tax rate.

Management Response:

The administration concurs with the auditor's comments and is currently working on a multi-year capital plan. This will be a 5-year plan that will compile capital needs to include equipment, fixed assets, and building improvements. The plan will also outline the revenue sources anticipated to fund the capital needs. Additionally, the administration is working with the Auditor and Treasurer to develop an annual (month by month) cash flow analysis to aid in cash management. Finally, the administration is working with the Department of Revenue as they finalize software that will allow the city to do 3-5 year budget forecasting for revenues and expenses. It is anticipated that this will all be completed by the end of the fiscal year.

3. Review Special Revenue and Trust Fund Accounts

Comment:

During our audit we noted several special revenue accounts and trust fund accounts that appear to be not utilized correctly, either by not being legally established by authorization or not meeting the definition of special revenue or trust. We recommend that the City Auditor review all the special revenue and trust accounts and verify each has been properly established by legal authorization and being accounted for under the correct fund. Also, the City should account for separately between expendable and non-expendable trust funds.

Management Response:

The City Auditor will contact Scanlon and Associates in order to discuss in detail their findings regarding Special Revenue and Trust Funds.

4. Monitor Health Insurance Trust Fund

Comment:

The City has adopted special legislation involving its contribution to the medical insurance trust fund. It allows the City to amortize no more than \$880,000 for a term of not more than seven years. The City beginning fiscal year 2011 (July 1, 2010) moved to a premium based insurance program. As of June 30, 2010 the medical insurance trust fund had a balance of approximately \$688,000. As of June 30, 2010 the City has a funding deficit for its share of contribution based on the working rates and participants of approximately \$680,000. The City should constantly monitor the balance of the trust and its impact on the deficit of \$680,000 that needs to be provided for.

Management Response:

As of December 31, 2010 we have \$586,041.12 in the MIT account. In addition to that at the end of November we have \$134,347.56 left in the Run Out account with Blue Cross Blue Shield.

5. Maintaining Budget Revenue and Expenditure Subsidiary Ledgers

Comment:

During our audit we noted variances between the revenue and expenditure subsidiary ledgers and adopted budgets for revenues and expenditures. For instance, the debt line item budget and the state assessments in the subsidiary ledger did not agree to the budget line item adopted by City Council and amount raised on tax recapitulation sheet. Also, the estimated receipts (local and state) utilized on the tax recapitulation sheet did not agree to the revenue budget subsidiary ledger. We recommend that the City Auditor implement a procedure to reconcile the revenue and expenditure subsidiary ledger to the Council Votes and tax recapitulation sheet.

Also, we noted that expenditures for school debt project and Hoosac Water Quality District assessment were not incorporated as part of the budget voted by City Council. Instead, they were included on the tax recapitulation sheet as other amounts to be raised. In order to keep the integrity and true amount of the budget, these amounts should be part of the City's budget voted by City Council. We recommend that the City not include these amounts on the tax recapitulation sheet as other amounts raised and include them in the budget.

Management Response:

The City Auditor concurs and will implement this suggestion and realizes that it has been overlooked in the past and will maintain Budget Revenue & Expenditure Subsidiary Ledgers. The HWQD assessment was brought into the budget in FY 2011 and we will look at the rationale and regarding the school debt and discuss best practices with the Scanlon & Associates.

6. Component Units - North Adams Redevelopment Authority and MASS MoCA Cultural Development Commission

Comment:

During our audit we found a bank account that was in the custody of the City's community development department and not accounted for on the City's general ledger. This bank account is for activity involving Gateway Urban Heritage Park, which is controlled by the North Adams Redevelopment Authority Western. The City's community development department also maintains departmental accounting ledgers for this activity. We recommend that the City research this matter and determine if the North Adams Redevelopment Authority is a separate legally establish entity from the City and should maintain a separate complete set of financial statements.

Also, during our audit we noted that an organization was created as a municipal agency named the MASS MoCA Cultural Development Commission. This organization was created to hold title to the property and building for which the MASS MoCA Foundation operates and programming of the museum. The Mayor is the chairman of the commission and appoints six other members, with approval of City Council. The commission holds no cash instruments and its only assets appear to be the buildings. The City should research to determine if the commission has any fiduciary reporting responsibility to the City.

Management Response:

The North Adams Redevelopment Authority is a separate legal entity with a separate tax ID number. The bank account in question is in the name of the Authority and not the City and the Authority does keep a completely separate set of financials. An employee of the Community Development Department does this work. The City does not have any reporting responsibility as the property is in the name of the Commission to eliminate the City from incurring building liability.

7. Long Term Debt

Comment:

During our review of the Treasurer's debt records we noted that the Treasurer's statement of Indebtedness did not agree to the loan supporting documents (i.e. amortization schedule) for three loans. We noted that all three loans were issued thru MWPAT, in which loan subsidies are involved. Also, the HUD section 108 loan for MASS MoCA was not included in the statement of indebtedness. Consequently, the City Auditor's general ledger was also incorrect as the Treasurer's statement of indebtedness was in agreement with the general ledger. We have proposed adjustments to the Treasurer's debt records and City Auditor's general ledger to reflect the accurate loan balances as of June 30, 2010. We recommend that the Treasurer insure that the statement of indebtedness is accurately completed and agree to loan supporting documents and also reconciled to the City Auditor's general ledger.

Management Response:

The administration concurs with the above findings and the adjustments have been made.

Also, we noted that the City has loan authorization project balances that date back several years. These projects appear to be inactive, obsolete or complete, thus leaving balances in the loan authorized that could be rescinded. We recommend that the City review all the loans authorized projects and determine if City Council should rescind the authorizations to borrow.

Management Response:

This is an active issue that the Treasurer will research and correct.

8. Financial Reporting – Full Purchase Order System and Requisition System

Comment:

The City currently does not use the practice of having a full purchase order system. A full purchase order system and requisition system should be implemented in order for encumbrance accounting to be implemented to assure effective budgetary control. By adopting the system, accountability at the departmental level can be controlled to facilitate effective planning for the City management. However, we feel that to properly implement a purchase order system the City would need to reorganize current financial personnel's duties and positions. Also, the City would need to educate departments on the purchase order system.

We recommend that the management of the City study to determine if it's feasible for the City to implement a full purchase order system. In determining whether it beneficial to implement a purchase order system certain factors should be assessed. For instance, does the current financial software have the capabilities of a purchase order system, the reorganization of personnel and overall cost.

Management Response:

The administration is so advised and will make this a point of discussion at Finance Team meetings during the first quarter of 2011. Discussion will center on cost/benefit as well as prioritization as we move into the budget cycle.

9. Overpayment to Vendor

Comment:

During our testing of expenditures we found that a vendor was overpaid approximately \$26,955 for contracted services associated with a building demolition project. We communicated this situation to City personnel to which they concurred. City personnel contacted the vendor and the vendor returned the monies. The City should review the above situation and implement new procedures for approval and processing of purchases. When designing and implementing new procedures several other management letter points should be taken under advisement as well

Management Response:

The administration concurs with the auditors finding and has made the necessary adjustments with no loss to the city. Management also recognizes the need to review procedures for such expenditures and will do and create solutions as part of the Fiscal Team meeting process.

10. Review of Investments

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.

Management Response:

The administration concurs with the audit findings however after contacting other local municipalities, we find that most have no written policy. Management will ask Scanlon and Associates to provide a list of municipal clients that have a policy for the City to use as a template. Upon receipt, the City will draft and adopt an investment policy before the end of the fiscal year.

11. Procurement - Chapter 30 B

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.

We noted that the City has Purchasing Director position. However, we found during our testing that not all purchases are processing thru this department. We recommend that the City review the current procurement procedures and the job duties of the Purchasing Director position. Once this is completed the City should adopt procedures and policies to insure that all purchases are in accordance with the State's procurement laws.

Management Response:

The administration concurs with the audit findings and will strengthen existing procedures to insure compliance with 30B. Additionally, as part of the Commonwealth's Financial Management Review, we will be writing job descriptions for all staff. The job description for purchasing and procurement will provide for compliance at all levels. This process is ongoing and should be completed by the end of the calendar year.

12. Accounts Receivable – Veterans, Mass MoCA and Community Development Loans

Comment:

The City currently has several accounts receivable that are not accounted for on the City's general ledger. The significant receivables noted during our audit were veterans, community development loans and Mass MoCA HUD Loan. To insure sound internal controls these receivables should be accounted for on the general ledger and reconciled periodically to departmental records. Also, the City should establish a procedure to review and monitor it's various revenue streams to determine if receivables should be established as an internal control.

Management Response:

The City Auditor will obtain amortization schedules as well as contracts regarding the loans in question. Furthermore, he will see that the Veteran's Agent commits (books a receivable) on a monthly basis those amounts expected from the State of Massachusetts' (75% of expense). It is imperative that the City book these amounts as the expenses have increased to over \$250,000.00 per fiscal year.

13. Review Tax Title and Tax Foreclosure Accounts

Comment:

As of June 30, 2010 the balances in the tax title and tax foreclosure accounts are approximately \$1,131,638 and \$656,303, respectively. In today's economic climate we have seen tax title and tax foreclosure accounts receivable increasing due to taxpayers inability to pay their bills. Having a large or increasing amount of tax title receivables can have a significant impact on a municipality to operate efficiently. We have been recommending that Cities and Towns implement procedures to monitor and review the tax title and tax foreclosure accounts receivable on a periodic basis.

Management Response:

The City will monitor as suggested and will take measures to take properties as appropriate.

14. Review Older Motor Vehicle Excise Levies

Comment:

During our audit we noted that there is motor vehicle excise levies that go back to 1995. These levies should be researched and reconciled to the deputy collector's outstanding detailed lists. Once these levies are researched and reconciled to the deputy collector to insure accounts are marked at the Registry these amounts should be given to the assessors office to be abated. Abating these older motor vehicle excise levies will reduce the City's receivables on the balance sheet. If any abated amount is collected, than these amounts can be recommitted at that time of collection.

Management Response:

Abatements for 1995-1999 have been completed and the Treasurer's office is currently working on tax years 2000-2005.

15. GASB Statement No. 45 – Other Post Employment Benefits (OPEB)

Comment:

The city has met the requirements for implementation of GASB Statement No. 45, Accounting and Financial Reporting for Post Employment Benefits Other than Pensions. Now it is necessary for the City to understand the requirement necessary to stay in compliance with the statements. For financial reporting purposes an actuarial valuation is required at least biennially for OPEB plans with a total membership (active, retired, employees terminated who earned accumulated benefits but are not receiving them) of 200 or more.

The City last actuarial evaluation was dated June 30, 2008 used for June 30, 2009 financial statements. The City will need to have the information updated for the financial statement disclosures for fiscal year 2010 using the information and calculations from this actuarial report. The City will need a full actuarial study completed for fiscal year 2011 (July 1, 2010). The City should also perform a reconciliation of financial transactions of the City's health and life insurance costs for post employment benefits to the amounts used in the actuarial report.

Although there is no mandate that requires funding of the City's annual OPEB obligation, the City should be aware of its OPEB liability and the possible impact it could have on the City's finances.

Management Response:

The City concurs with the auditor's recommendation to have an updated actuarial report done for FY 2010 as well as a full actuarial study completed for FY 2011. Due to the City's dire financial condition, the city will recognize the future liability but will not be able to fund until mandated.

**16. New Accounting and Financial Reporting Requirement for Fund Balances –
GASB No. 54**

Comment:

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. The objective of this Statement is to enhance the usefulness of the fund balance information by providing clearer fund balance classifications that can be more consistently applied and to clarify the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that will be made in reporting fund balance information is identifying amounts that are considered nonexpendable, such as fund balances associated with inventories. This statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

Governments will also be required to classify and report amounts in the appropriate fund balances classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements will be required.

The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010 (FY 2011). Given the significance of the City's fund balance amounts, the new reporting requirement will have an impact on the City's financial statements. We recommend that the City become familiar with the new financial reporting requirement to insure that the City will be in compliance with requirements of GASB No. 54.

Management Response:

The City Auditor is reviewing GASB 54 and will make the necessary adjustments.

17. Accounting/Financial Policies and Procedures Manual

Comment:

The City does not have a current and comprehensive accounting policies and procedures manual. All governments should document their accounting policies and procedures. Although other methods might suffice, this document is traditionally in the form of an accounting policies and procedures manual. This manual should document the accounting policies and procedures which make up the City's internal control system.

An accounting policies and procedures manual will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies. It can also help to prevent deterioration of key elements in the City's internal control system and can help to avoid the circumvention of City policies.

We recommend the City finance team develop and document the accounting policies and procedures manual. The accounting policies and procedures manual should be prepared by appropriate levels of management and be approved by the Mayor and City Council to emphasize its importance and authority. The documentation should describe procedures as they are intended to be performed, indicate which employees are to perform which procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support controls.

Management Response:

The administration concurs with the audit recommendation and will work with the Finance Team to create an Accounting Policies and Procedures Manual. The Commonwealth's Financial Management Review also indicated that the City incorporate the most recent budget preparation process into ordinance. It would be wise to incorporate budget preparation and practices into the Accounting manual. The City Auditor realizes that there currently is not an accounting manual in place and that it is an involved process of which considerable time must be devoted: The City Auditor learned at his last training session with the Massachusetts Municipal Auditor's Association that the process could take up to six months or longer. The accounting policies and procedures manual should cover: policy and procedure for our budget process, our accounts payable process, our payroll process and cash receipts process. Each category should flowchart the system from start to finish. Furthermore, controls over assets and accounting controls that ensure each transaction is properly posted to the GL. Also, it should have a section on accounting policies as to the recording of receivables, accruals and deferrals and other estimates. There should be a section covering thresholds for recording fixed assets for GASB 34 as well as depreciation methods, useful lives, etc. Controls over expenses (payroll – adding employees, pay-codes and who can access as well as who reviews the following: final pay-offs, compensated balances, sick, vacation, personal, and comp time. Written procedures to approve write-offs and uncollectible loans should be documented. Furthermore, accounts payable: purchase order required, if an electronic purchase order gets created and encumbers funds as well as any payments that require extra review and appropriate signatures. Also, the Warrant process should be described as well as flow-charted.

The City Auditor's constituents have conveyed that there are templates available and that the biggest grey area is administrative policies as they are seldom in writing and are subject to change.

18. Establish Internal Audit Function

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.

Management Response:

The City Auditor duly notes the recommendation and will establish an internal audit plan.

19. Risk Assessment and Monitoring

Comment:

When internal controls are initially implemented, they are usually designed to adequately safeguard assets. However, over time, these controls can become ineffective due to changes in technology, operations, etc. In addition, changes in personnel and structure, as well as the addition of new programs and service, can add risks that previously did not exist. As a result, all municipalities should periodically perform a risk assessment to anticipate, identify, analyze and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. The City, like most Massachusetts municipal organizations, does not adequately perform this assessment.

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

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- What operations are the 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?

Once the areas vulnerable to fraud have been identified, a review of the City's systems, procedures, and existing controls related to these areas should be conducted. The City should consider what additional controls (if any) need to be implemented to reduce the risk.

After the risk has been assessed and controls implemented the City should periodically monitor these controls to evaluate the operational effectiveness.

Management Response:

The administration concurs with the audit findings and will discuss risk assessment as part of our monthly Finance Team meetings. This can be done via both the Auditors findings from internal audits as well as discussions regarding "at risk" departments or entities...most specifically where cash is received with few, if any controls in place.