

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

CITY OF NORTH ADAMS, MASSACHUSETTS

Management Letter

Year Ended June 30, 2013

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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, 2013, 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
South Deerfield, Massachusetts

February 5, 2014

CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Free Cash/Financial Condition

Comment:

The City was unable to obtain a positive Free Cash Certification by the Commonwealth of Massachusetts, Department of Revenue for the last two fiscal years (2012 and 2013).

Free cash is a community’s unrestricted available fund that may be used as a funding source for budgetary appropriations. Free cash is generated when the actual operating results compare favorably with the budget. Specifically, free cash is generated when actual revenue collections are more than budget estimates, and actual expenditures and encumbrances are less than budget appropriations, or both.

The lack of free cash or other available reserves is often indicative of a community’s financial instability in difficult economic times. The following is a summary of the contributing factors precluding the certification of positive free cash:

	FY 2012	FY 2013
Return of unexpended/unencumbered departmental appropriations	\$ 40,700	\$ (42,711)
Variance with budget vs actual - state receipts	(177,700)	43,364
Variance with budget vs actual - Local receipts	53,200	14,987
Variance with budget vs actual - State Assessments	215,900	(25,702)
Deficit accounts	(348,000)	(183,006)

The results summarized above would not be considered financially healthy by municipal financial standards. 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 \$40,000,000 (i.e. \$1,200,000 would be 3%)

The City has several reserves whose approximate balances for last two fiscal years ended are summarized as follows:

	June 30, 2012	June 30, 2013
Stabilization Fund	\$ 236,000	\$ 80
Receipts Reserved:		
Parking meter reserve	132,000	79,000
Transfer station reserve	236,000	16,300
Sale of town property	33,000	33,000

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. State aid and property taxes are the two major revenues for the City’s general fund budget and are approximately 48% and 34% of the City’s budget, respectively. Any significant changes (increases or decreases) to the City’s budget would have a direct impact on these two revenue sources.

We further noted that the City made significant council votes to fund various line items in the budget at the end of fiscal year 2013 for approximately \$749,364. The funding source for these budgets items were from stabilization (\$252,241), unspent budget line items (\$325,602), transfer station reserve (\$153,543) and parking meter reserve (\$17,979). The City also did similar transfers the previous two fiscal years (2011 and 2012). The trend of these year-end transfers is indicative that original adopted budgets are not reflective of the departments intended spending.

We recommend that the City review and consider making significant structural changes to the City's budget (i.e. increase revenue or decrease expenditures).

We further 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 balance in the stabilization fund. 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.

We have communicated our view of the above matter to the City's management. The City Administration is very cognizant of the importance of strong reserves and the role they play in the overall fiscal health of the entity.

As part of our recommendation mentioned above to review and making structural changes to the City's budget we recommend that the City review and consider the effects of having an override or exclusion on the tax rate. A municipality can raise tax revenue beyond annual statutory limits imposed by proposition 2 ½ through approval of an override or an exclusion. An override or exclusion can help a municipality alleviate its financial burden and achieve its intended objectives to provide adequate services to City residents. However, a municipality must have a properly documented and responsible plan that utilizes the override or exclusion to be effective.

Management Response:

The Administration fully concurs with the comment of the auditor and as indicated fully understands the relevance and importance of a healthy reserve. The Administration has worked diligently over past cycles to reduce expenses however year over year losses in State funding since FY2009 have far outpaced the city's ability to raise revenue to cover rising costs in recurring expenses. As stated, free cash is gained by formula based in part on operating results compare favorably with the budget. This has not been the case as overruns in accounts indicated have forced transfers from reserves to cover said overruns.

The Administration is committed to continued fiscal discipline, and will strive to derive free cash in future cycles through further downsizing of expenses combined with the analysis of prudent ways to increase revenue, including exploration of a Prop 2½ override.

2. Deficit Accounts

Comment:

During our audit we noted several accounts that were in deficit at June 30, 2013. Our testing on these accounts revealed that these accounts were the result of timing issues of receipts and expenditures, lack of timely request for reimbursement from granting agencies, accrual of receipts that were not earned and measurable and from misposting of expenditures and receipts.

During our fieldwork we had communications with the City Auditor and other City Personnel with regards to these accounts. We had a similar comment in the prior year management letter and the City did implement procedures to review all deficit accounts. However, there are several accounts that still need to be reviewed and provided for. These accounts are identified as reductions in the City's free cash calculation as noted in comment 1.

Management Response:

The Administration concurs with this comment and is disappointed to see a recurring comment. That said, it is recognized that procedures are in place to mitigate this issue. Procedures to review deficit accounts will be reviewed and adjusted as necessary to prevent this from happening again. Additionally, General Fund deficits amounting to \$31,274.84 were the result of accrual of expenses that surfaced after the close of the fiscal year. Other deficit accounts were in Special Revenue accounts such as Tropical Storm Sandy \$7,431.66 that was never reimbursed by FEMA and \$13,132.10 for the City's portion of a prior year Fire Grant. All of the aforementioned deficit accounts have been provided for on the FY14 Tax Recap. Other FY 13 Special Revenue Grants such as the Verizon 911 Grant were submitted in a timely fashion and as of eight months later have not yet been fully reimbursed.

3. Payroll

Comment:

The City in fiscal year 2013 implemented new payroll procedures in an effort to improve efficiency with the process. During our audit we reviewed the procedures and noted that not all department heads were signing the payroll sheets indicating that they have reviewed and approved their department's payroll. One of the key controls in the payroll process is having the department head review and approve the payroll of their department. An indicator that this control is being performed is with a signature of the department head on City payroll forms. We recommend that the City review this matter and implement the necessary procedures to insure that this control is being done.

We further recommend that the City review payroll deductions codes in the software system to insure that they are properly being deducted in accordance with tax regulations and laws.

Management Response:

The Administration concurs with this comment and will be certain that department heads adhere to the controls in place by reviewing and approving their departmental payroll at each pay cycle. Additionally, payroll codes will be reviewed and adjusted as necessary.

4. Review Tax Title and Tax Foreclosure Accounts

Comment:

As of June 30, 2013 the principal balances in the tax title and tax foreclosure accounts are approximately \$2,136,480 and \$250,680, 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. The City did adopt a plan to enter into payment plan agreements with City residents.

Management Response:

The Administration concurs with the comment and our Finance TEAM has been reviewing options to collect and dispose of tax title and foreclosure accounts. As the comment states, the City has re-defined and solidified a uniform payment plan that can be entered into by delinquent tax-payers that aligns itself with Department of Revenue regulations. This program has been quite successful. Other solutions such as more assertive collections procedures and selling off our tax title to the private sector are also being discussed.

5. 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.

Management Response:

The Administration assures that appropriate staff will become fully cognizant of the GASB regulations noted.

6. 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)
- Accounts Payable Preparation
- Payroll preparation
- Compliance with procurement laws and regulations
- 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?

We have noted this matter in prior management letters and have had communications with City's administration. The City is in the process researching and gathering templates to use for a policies and procedures manual.

Management Response:

The Administration concurs with the auditors comment and as stated, we are researching, comparing and assessing solutions. Additionally, we have gathered templates and have begun the process of developing a policy and procedures manual.