

CITY OF NORTH ADAMS, MASSACHUSETTS

MANAGEMENT LETTER

FOR THE YEAR ENDED JUNE 30, 2014

CITY OF NORTH ADAMS, MASSACHUSETTS

Management Letter

Year Ended June 30, 2014

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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, 2014, 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

December 22, 2014

CURRENT YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Financial Condition

Comment:

The City was able to obtain a positive Free Cash Certification by the Commonwealth of Massachusetts Department of Revenue for fiscal year 2014 in the amount of \$140,822. The last two fiscal years (2012 and 2013) the City was unable to obtain a positive free cash certification.

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 exceed budget estimates and actual expenditures along with encumbrances are less than the budget appropriations, or when both scenarios occur.

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 for the City's free cash calculation for the last three years:

	FY 2012	FY 2013	FY 2014
Return of unexpended/unencumbered departmental appropriations	\$ 40,700	\$ (42,711)	\$ 21,925
Variance with budget vs actual - state receipts	(177,700)	43,364	(66,756)
Variance with budget vs actual - Local receipts	53,200	14,987	37,082
Variance with budget vs actual - State Assessments	215,900	(25,702)	288,673
Deficit accounts	(348,000)	(183,006)	(240,250)

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%). One of the main contributing factors to the City's 2014 positive free cash certification is the positive variance with state assessments of \$288,673. This positive turn back from state assessments line item is something that cannot be depended on from occurring each year. We caution the City on the use of free cash as a funding source for future budget line items.

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

	June 30, 2012	June 30, 2013	June 30, 2014
Stabilization Fund	\$ 236,000	\$ 80	\$ 244
Receipts Reserved:			
Parking meter reserve	132,000	79,000	37,000
Transfer station reserve	236,000	16,300	46,300
Sale of town property	33,000	33,000	-

Furthermore, the City has been awarded, as part of the 2015 State budget, a grant from the Commonwealth in the amount of \$750,000. The purpose of the grant was to fund City projects and capital needs including purchase of equipment and facility upgrades. There are several conditions and requirement associated with the acceptance of this grant. We recommend that the City review and implement procedures to ensure all requirements associated with the grant are met.

We have communicated our view of the above matter (financial condition) to the City's management during this year's audit as well as in prior year audits. 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.

Management response:

As pointed out by the auditor, "free cash is generated when the actual operating results compare favorably with the budget. Specifically, free cash is generated when actual revenue collections exceed budget estimates and actual expenditures." Budgets over the past 5 cycles have reflected as accurately as possible actual anticipated expenditures and revenues, neither being over or under-stated. While the City Administration is very cognizant of the importance of strong reserves and the role they play in our overall fiscal health, it is highly unlikely based on the incredibly tight budgets that we will see significant free cash in the near term.

2. GASB 68 – Accounting and Financial Reporting for Pensions

Comment:

The GASB has issued new pronouncements that will significantly affect financial accounting and reporting requirements for Pensions. One of the pronouncements that will affect the City is summarized as follows:

- 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 this GASB statement on the City's financial accounting and reporting we recommend that the City familiarize and educate themselves with the statement.

Management response:

The City acknowledges and will comply with the auditor's recommendation.

3. New OMB Circular

Comment:

In December 2013 the Office of Management and Budget (OMB) released new guidance on administrative requirements, cost principles and audit requirements for federal awards, which has been so called the "Super Circular" or "Omni Circular". This new guidance supersedes and streamlines requirements contained in OMB Circulars A-21, A-50, A-87, A-89, A-102, A-110, A-122 and A-133 by consolidating the requirements of those eight documents into one. The new guidance affects entities receiving and administering federal awards as well as auditors responsible for auditing federal award programs. The goal of this reform is to provide guidance that ease the administrative burden of federal awards, strengthen oversight over federal funds to reduce risks of waste, fraud and abuse and eliminate duplicate and conflicting guidance between circulars. The new guidance will be in effect for all federal awards or funding to non-federal entities on or after December 26, 2014 and will apply to non-federal entity audits for fiscal years beginning on or after that date (fiscal year 2016).

We recommend City personnel that administer and account for federal awards familiarize themselves with this new guidance.

Management response:

The City acknowledges and will comply with the auditor's recommendation.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – Other Matters

1. Deficit Accounts

Prior Year 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 financial condition comment.

Status- 2014 Audit:

The City, subsequent to the fiscal year-end, implemented procedures to review deficit accounts. The City's free cash for fiscal year 2014 was reduced by \$240,250 as noted in financial condition comment above. We noted that some of the deficit accounts have been re-occurring from prior years. We recommend that City provide for these re-occurring deficits. In addition to the City Auditor reviewing deficit accounts we recommend further that Departments also monitor their respective accounts to ensure deficit accounts are properly provided for.

Management response:

Management concurs with the auditors finding however would like to point out that the deficit accounts that most impacted free cash were grants that were not reimbursed within the fiscal cycle namely; 70K Public Safety grants, 75K Chapter 90 reimbursements, 43K Solar project reimbursement, and several other smaller deficit accounts. Management will continue to be certain that timely reimbursement from granting agencies is a priority when closing out year end.

2. Review Tax Title and Tax Foreclosure Accounts

Prior Year 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.

Status- 2014 Audit:

As of June 30, 2014 the principal balances in the tax title and tax foreclosure accounts are approximately \$2,313,663 and \$199,668 respectively. The City has implemented procedures to review and monitor the tax title and foreclosure accounts. We recommend that the City consider and review the guidelines of assigning tax title accounts at auction.

Management response:

Treasurer, Assessor and Administrative Officer are in the process of reviewing several entities for the purpose of procuring our tax title accounts.

3. Risk Assessment Procedures and Financial Policies and Procedures Manual

Prior Year 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.

Status- 2014 Audit:

The City Auditor has drafted a policy and procedure manual and at the time of our fieldwork has been provided to us for review. The policy and procedure manual should be finalized by July 1, 2015.

Management response:

As stated, a draft policy and procedures manual has been submitted. After review by the auditor the City will make necessary adjustments based on recommendations and adopt.