CITY OF QUINCY, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2013

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To the Honorable Mayor and City Council
City of Quincy, Massachusetts

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City for the year ended June 30, 2013 and issued our report thereon dated March 10, 2014. Our opinions on the financial statements and this report, insofar as they relate to the Quincy Contributory Retirement System, are based solely on the report of other auditors. In planning and performing our audit of the financial statements of the City of Quincy, Massachusetts (the City) 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's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

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 *material weakness* is a deficiency, or 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. We do not consider any of the deficiencies noted to be a material weakness in internal control.

Our consideration of internal control was for the limited purposes described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

During our audit we became aware of other matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters. The City's written responses to the comments have not been subjected to the auditing procedures applied in the audit of the financial statements and accordingly, express no opinion on them.

This communication is intended solely for the information and use of management of the City of Quincy, Massachusetts and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Powers & Sullivan LLC

March 10, 2014

CITY OF QUINCY, MASSACHUSETTS

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Prior Year Comments Resolved

Please refer to the fiscal years 2008 through 2012 management letters for the full original wording of this comment as the content of this comment has changed over that time period.

PRIOR YEAR COMMENTS RESOLVED

WATER AND SEWER CUSTOMER DEPOSITS

Comment

The City currently charges hook-up and permit fees in order for private property owners to connect to the water and sewer systems. Currently, these charges are collected as permit applications are presented to the DPW and the turnover is made to the General Fund.

These amounts are not refundable to customers which means that most, if not all, of the liability is inappropriately presented. Amounts that are not refundable to user or customers should be recorded as current period revenue in the appropriate enterprise fund. The June 30, 2012 balances, and future collections relating to this type of transaction, should be transferred/directly deposited into the appropriate enterprise fund.

FY2013 Update

During fiscal year 2013, the City transferred the year-end balance of these accounts to the water and sewer enterprise funds. At the same time, appropriate measures were taken to ensure that future water and sewer deposits are posted to the respective enterprise funds as revenue.

OTHER POSTEMPLOYMENT BENEFIT ACTUARIAL REPORT

Comment

To present timely year-end financial statements, the entity preparing the financial statements must have a process in place to ensure the timely and proper estimates of significant transaction subject to estimation. The City's actuarial determined liability for postemployment healthcare benefits is one significant liability subject to estimation. The valuation must be completed every two years to be in compliance with GASB reporting standards.

Fieldwork for the fiscal year 2012 audit began in the middle of October 2012 and as of that time the City had not begun the process to solicit bids from qualified actuarial firms. The typical turnaround time for an actuary to produce the required reports is roughly 2 months from the time that the City hires the Actuary and they receive personnel and healthcare plan data. We have been informed that information that the Commonwealth was to provide the Actuary related to teachers was significantly delayed. The final report was not completed until late in fiscal year 2013.

The City could not complete their financial statements for fiscal year 2012 until the final report was completed.

The City had had completed all other aspects of the fiscal year 2012 financial statements and we completed our audit in early December 2012, except for the valuation.

FY2013 Update

The situation did not repeat in FY2013. Discussions with management indicate that the next valuation will be complete within the proper timeframe.

DEBT ACCOUNTING AND RECONCILATION PROCEDURES

Comment

The amount of long term debt carried by the City is a major component of the City's overall capital improvement plan. Having a proper method of communicating and reporting the level of outstanding debt at any given point in time has a direct bearing on budgeting decisions, capital investment decisions, and related financial reporting.

We note that the amount of outstanding debt reported to the State, via the Statement of Indebtedness (SOI), at the end of the fiscal year had omitted significant new loans and debt offerings that took place during the year.

The cause of the matter stems from the fact that the personnel in charge of preparing the SOI were relying on information that was prepared roughly 6 months prior to the end of the fiscal year. Our discussions with management indicate that the root cause of the matter, aside from reliance on outdated information, is due to improper communication across the key financial reporting departments. Communication is a key component of a sound internal control environment.

FY2013 Update

The City was able to complete its debt reporting to DOR in a manner that agreed with the ledger.

POLICE AND FIRE DETAIL FUND DEFICITS

In prior fiscal years the management letter addressed the existence of material fund deficits, lack of timely billing and collection practices, and undocumented account reconciliations and procedures relative to the Police and Fire Detail funds.

At the end of fiscal year 2012 the Police and Fire Detail funds had a combined cash deficit of ($1.044) million and this deficit has been covered a transfer of approximately $948,000 from the general fund.

Receivables of about $55,000 and $398,000 remain in the Fire and Police Detail funds, respectively. The City is currently in the process of identifying the validity of the remaining receivables. Receivables that are deemed uncollectible will be abated and amounts that are collectible will be pursued aggressively.

Also in fiscal year 2013, management established a standard set of procedures that defines the billing and collection requirements along with the roles and responsibilities of each department that has an effect on the recording of the associated activity.

For purposes of the management letter we consider this matter to be resolved.

Other Matters Previously Presented

Please refer to the fiscal years 2008 through 2012 management letter for the full original wording of these comments as the content of the comments has changed over that time period.

INTERNAL CONTROL POLICIES AND PROCEDURES MANUAL

Previous Comment

This comment addresses the fact that the City does not maintain formal internal control policy and procedures manual documenting day-to-day processing and controls. By not having a formally document set of policies and procedures, the City is at risk of not being able to complete critical tasks due to an extended or unforeseen absence. The risks arise when a department head, other departmental employees, is required to train new departmental employees, or are required to learn “on the fly” critical department operations outside of an employee’s normal course of duties. This reduces the time available to spend on regular duties and also raises the risk of misstatement or error.

Recommendation

Key financial related departments need to develop a written internal control policy and procedures manual that includes proper reviews and approvals by management and is written in a manner that allows an employee the ability to complete the task by reviewing the manual. All department heads will need to be familiar with all policies and procedures within their office and be able to complete all necessary tasks in order to sufficiently train employees. The manual will also need to be reviewed on an ongoing basis to ensure its relevancy at any given point in time.

FY2013 Update

The Municipal Finance Office and Planning Departments have developed documents that are at varying stages. Management needs work cooperatively so that all key financial related departments/offices have a formally documented and centrally available set of policies and procedures. Existing policies and procedures should be expanded upon so that all aspects of financial reporting are covered. The City should consider using the MUNIS documentation as a primary source of how all processes should be documented.

Although significant progress has been made in this area some documents need to be finalized.

While we no longer consider this to matter to be a significant deficiency we do consider the comment to be valid as another continuing matter.

Management’s Response

In conjunction with other procedural and policy related comments discussed later on in this document, the City is currently assessing the direction that the final document will take.

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MAJOR CAPITAL PROJECT ACCOUNTING

Comment

The City did not make any progress in changing how this activity is reported in their general ledger during FY2013 and the first six months of FY2014.

The City is currently involved with various stages of planning, design and construction activity relative to various major capital projects including infrastructure, downtown development, buildings, building improvements and similar projects. The projects can be funded from one to several different sources including federal, state, local, and private-public partnership levels. Each of these funding components has a need for multiple levels of financial reporting to granting authorities, oversight boards and committees and external users.

At any given time the City can have multiple capital projects, each of varying scope, duration and cost, occurring at the same time. The associated activity is reported within a variety of capital project funds maintained in MUNIS. We noted that different capital project funds were being used in a manner that that did not provide a clear accounting trail of the planning, design, or construction periods and the fund names did not match up with the original and intended purpose of the funds. This may have a negative effect on future external and internal financial reporting decisions.

Status - Unresolved

The matter noted in fiscal year 2012 was not addressed until February 2014. In addition to the matters discussed above, the accounting currently used for some of these funds was not in accordance with the Uniform Massachusetts Accounting System (UMAS) or with generally accepted accounting practices. A review of some of the capital project funds indicates that, the City was posting all revenues and all expenditures to one or more expenditure accounts in each fund. The netting of revenues and expenditures within the same account is prohibited by UMAS and with generally accepted accounting principles.

An example of the netting occurred during fiscal year 2013 can be found in MUNIS fund 3204 that reported no revenues and total expenditures as a negative balance of $1,380,432. An in depth review of ledger detail, invoice history, and grant drawdown information, indicates that the City received about $9 million of state grants and that actual expenditures were about $7.6 million. This accounting process does not provide a true representation of the revenues and expenditures and inhibits the preparation of internal and external reporting requirements. Appropriate journal entries were made to the audited financial statements to present the true activity of these major funds.

Fund 3204 is a Planning Department fund and discussions with Planning Department personnel indicate that the netting occurs because formal project budgets have not been established in MUNIS. By not establishing project budgets the City is unable to process invoices through MUNIS; however, by posting the revenue to the expenditure account the City is able to override the MUNIS controls which then allows the City to pay bills associated with the project. This action is a further violation of UMAS and sound internal controls.

The underlying project(s) will be long lived, require financial reporting to various internal and external stakeholders, and involve significant sums of money. If the current accounting treatment is not changed to be in compliance with UMAS the City is at risk that financial statements generated from MUNIS are either unreliable or not presented in a timely fashion.

Recommendation

We recommend that the Municipal Finance Office and the Planning Department coordinate efforts to determine the most effective general ledger mapping process, account number assignment and account naming conventions, that can be utilized over the entire timeline of a project so that federal fund expenditures, state fund expenditures, the local share and any third party payments are readily identifiable and reported in a financially accurate manner.

We also recommend that the Municipal Finance Office and the Planning Department determine the most realistic manner to establish project budgets within the funds so that the accounting information can become more transparent.

Management's Response

During February and March of 2014 the City has researched the histories of the non-compliant capital project funds and determined the adjustments required to MUNIS to bring the past accounting into compliance. The City is examining the best long-term solution to determine what how to implement changes that will be UMAS compliant. These changes are expected to be implemented in April 2014. The new changes will be incorporated into an overall policies and procedures manual.

FRAUD RISK ASSESSMENT

Comment

The City needs to perform a risk assessment to identify, analyze and manage the risk of asset misappropriation and/or financial reporting manipulation. Risk assessment, including fraud risk assessment, is one element of internal control. The City's internal control should include performance of this assessment.

The fraud risk assessment can be informally documented and performed by a management-level individual who has extensive knowledge of the City that might be used in the assessment. In performing the assessment a management-level individual will conduct interviews and/or lead group discussions with personnel who have extensive knowledge of the City, its environment and its processes.

Some key questions to consider when conducting the self-assessment follow:

- What individuals have the opportunity to misappropriate assets or manipulate the financial statements?
- Are there any known pressures that would motivate employees with the opportunity to misappropriate assets or manipulate the financial statements? When making this assessment an employee's personal/social life should be considered.
- What assets of the City are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use.

- How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running through an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.

Recommendation

We recommend that management develop and implement a fraud risk assessment program to identify, analyze and manage the risk of asset misappropriation.

Status – Partially Resolved

Although the City did not take any significant action during fiscal year 2013, management is in the process of conducting a fraud risk assessment that is expected to be completed by the end of fiscal year 2014.

Management's Response

This process will begin in March 2014 with a preliminary assessment completed in the Spring of 2014.

MAINTAINING SUPPORT FOR YEAR END BALANCES

Comment

The City has procedures in place to reconcile the Collector's summary records to the general ledger at fiscal year-end; however, the City was unable to provide us with evidence that detailed records of the Collector's office was part of the reconciliation process.

Comparing summary records to detail records acts as a control to ensure that the Collections reporting system is working as designed. Additionally, the Collector's office is responsible for analyzing taxpayer and enterprise fund user accounts to ensure that the City is exercising all efforts to ensure future account collections. We have been told that this analysis occurs however a centralized document to support this process does not exist.

Status – Partially Resolved

The City was able to provide us with detail and summary reports for motor vehicle excise taxes, personal property taxes, and boat excise taxes. These reports all agreed with the general ledger and with documented Collector to ledger account reconciliations.

The reports for the real estate and tax deferrals receivables did not agree with documented reconciliations for those accounts.

Recommendation

We recommend that the City Collector, in conjunction with the IT Department, determine the cause of the differences between the documented account reconciliations and the Collector detail provided during audit fieldwork.

Management's Response

In May or June of 2014 the Collector's Office, IT and the outside auditors will collectively review the current reporting system to determine where the breakdown in report generation is occurring. Potential changes to the reporting environment will be determined at that point in time.

SETTLING OF INTERDEPARTMENTAL CHARGES

Comment

In prior audits we made note of instances in which the City would settle interdepartmental charges through a check issued from a City bank account and made payable to the City. The method of settling interdepartmental charges is time consuming, prone to error and misstatement, and generally ineffective.

MUNIS is constructed in a manner that will allow for the settling of interdepartmental charges to be handled electronically on ledger concurrently, and if necessary, with a wire or EFT transaction between bank accounts in the Treasurer's office.

Status – Unresolved

Recommendation

We recommend that the Treasurer's Office, the Director of Municipal Finance, the School Department and any other department that generates an interdepartmental chargebacks to investigate the most logical manner to effect the necessary changes in MUNIS in a manner that eliminates the need for a check to be written while recognizing the appropriate expenditure on the ledger.

Management's Response

The Treasurers' Office and Municipal Finance will review the current process for settling interdepartmental charges and together will determine the most appropriate response to cut down the administrative burden and cost of tracking outstanding checks issued from one department to another.

STUDENT ACTIVITY FUNDS

Comment

Massachusetts General Laws allow for the Schools to maintain student activity funds but places certain requirements on how they are to be managed and accounted for. The School has only partially implemented the legal requirements as there has not been either an internal or external audit conducted and documented in accordance with the best practice guidance of the Massachusetts Association of School Business Officials.

Status - Unresolved

The matter remains unresolved. By not fully implementing the provisions the School is in violation of the law. From a practical standpoint, we have found that when these funds are subjected to the requirements of the law it is likely that funds are being held and spent on purposes outside the scope of the law. We have also found that many times the account detail, maintained by the principals, does not reconcile to the actual cash balances and/or the general ledger.

Recommendation

We continue to recommend that the School Department, comply with all provisions of the law, establish procedures on how each account is maintained, reconcile the detail accounts with the actual cash balances and provide the Auditor's Office with a full accounting of the activity and the reconciliations and obtain an external audit.

Management's Response

Municipal Finance and the School Department will coordinate this effort during the fiscal year 2015 budgeting process.

Current Year Comment

TIMELINESS OF CHAPTER 90 GRANT REIMBURSEMENT REQUESTS

Comment

From August 2012 through April 2013 the city processed roughly $1.7 million of expenditures incurred under the Chapter 90 program. The Chapter 90 program is administered on a reimbursement basis, by the Commonwealth, in which the City must submit paid invoices to the Commonwealth for reimbursement. The City did not receive any reimbursement during fiscal year 2013 because the program administrators for the City did not submit the paperwork on a timely basis to the Commonwealth. This created a cash deficit within the Chapter 90 fund in MUNIS.

A cash deficit in Chapter 90 may affect the free cash calculation that is certified by the DOR and used by the City to fund the subsequent year budget. In addition to the free cash effect, the City could face, in the future, the possibility of having to reimburse the Chapter 90 fund for any reimbursements denied by the Commonwealth because of untimely submittal of the reimbursement request. Should this situation occur, it would be up to the general fund to raise the deficit in the tax rate.

Recommendation

We recommend that management make the appropriate changes to the policies and procedures for the Chapter 90 program so that future reimbursement requests are prepared and submitted timely to the Commonwealth.

Management's Response

Municipal Finance and the DPW will work together to ensure that, in the future, policies are documented and enforced so that this situation may be avoided.

Informational Comment

FUTURE GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS FOR PENSIONS AND OPEB

Comment

The GASB has issued new pronouncements that will significantly affect the accounting and reporting requirements for Pensions and Other Postemployment Benefits (OPEB). These new standards will start to phase in during fiscal year 2013 and will substantially impact your financial statements and will also affect the requirements for accumulating the necessary data to meet the reporting requirements.

The new standards that have been issued and their effective dates are as follows:

- The GASB issued Statement #65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented in fiscal year 2014.

- The GASB issued Statement #67, *Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25*, which is required to be implemented in fiscal year 2014.

- The GASB issued Statement #68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*, which is required to be implemented in fiscal year 2015.

The GASB is expected to issue additional standards following #67 & #68 for Pensions, which will similarly affect accounting and financial reporting for OPEB Plans. The GASB is encouraging earlier application of these standards.

To briefly summarize these new standards –

- GASB #65 will require reporting each of the financial position elements in a separate section in the statements of financial position. These elements are Assets, Deferred Outflows, Liabilities, Deferred Inflows, and Net Position; where assets + deferred outflows – liabilities – deferred inflows = net position. These new requirements will affect certain aspects of the financial statements currently and they will pave the way for the new reporting requirements of the new Pension and OPEB standards.

- GASB #67 and #68 will substantially change the reporting for pension liabilities and expenses. Changes in pension liability will be immediately recognized as pension expense or reported as deferred outflows/inflows of resources depending on the nature of the changes. Substantial changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes will be required. Current actuarial methods may continue to be used to determine funding amounts. Employers will report in their financial statements a *net pension liability (asset)* determined annually as of the fiscal year end. *Net pension liability (asset)* equals the total pension liability for the plan net of the plan net position. Pension liability is the actuarial present value of projected benefits attributed to past service, and plan net position is the accumulated plan assets net of any financial statement liabilities of the plan.

The City should expect to record significant pension and OPEB liabilities in the future.

Recommendation

We recommend that management of the City begin the process of coordinating efforts with the Quincy Contributory Retirement pension board and applicable actuaries so that everyone is fully aware of the requirements of these Statements and future statements. Coordinating at this level will also ensure that management is able to assemble any and all necessary information to its actuaries in a timely manner.

Additionally, the current accounting standards require that actuary valuations be conducted every two years unless significant accounting changes or plan design change have occurred. The next OPEB valuation is required to be completed based on data as of June 30, 2014. The next pension valuation is required to be completed based on data as of January 1, 2014. Implementation of these Statements qualifies as a significant accounting change therefore consideration will need to be given to the timing of upcoming valuations so that unnecessary and duplicative costs are avoided.