
Certified Public Accountants

July 3, 2018

Honorable City Council
City of Tonawanda, New York:

In planning and performing our audit of the basic financial statements of the City of Tonawanda, New York (the “City”) as of and for the year ended December 31, 2017, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City’s internal control over financial reporting (“internal control”) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that have not been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and another deficiency that we consider to be a significant deficiency.

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 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. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined below:

- *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
- *Probable.* The future event or events are likely to occur.

We consider the deficiencies presented in our audit in a separate communication dated July 3, 2018 as items 2017-001 and 2017-002 to be material weaknesses in internal control over financial reporting.

A significant deficiency is a deficiency or a 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. We consider the deficiencies presented in our audit in a separate communication dated July 3, 2018 as item 2017-003 to be a significant deficiency in internal control over financial reporting and item 2017-004 to be a reportable instance of noncompliance.

In addition, during our audit we identified certain matters involving the internal control, other operational matters and new reporting requirements that are presented for your consideration. This letter does not affect our report dated July 3, 2018 on the financial statements of the City. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. Our comments are summarized in Exhibit I.

The purpose of this communication, which is an integral part of our audit, is to describe for management and those charged with governance the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Drescher & Malecki LLP

July 3, 2018

General Fund – Deteriorating Financial Position

The City has reported operating deficits in the General Fund in each of the past four years, as total fund balance decreased approximately \$1.3 million since December 31, 2013. The City's 2018 General Fund adopted budget includes the appropriation of \$300,000 of fund balance to balance the estimated appropriations. The level of fund balance is and will continue to be a critical component of the City's future. As a means to keep municipalities more focused on providing structural balance in their operations, with less dependence on one-time reserves, and to minimize political considerations of adequate reserve levels, many, including the Government Finance Officers Association (the "GFOA"), recommend that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the General Fund. The GFOA recommends that this formal fund balance policy be set by the appropriate policy body.

The GFOA states that the adequacy of unrestricted fund balance in the General Fund should be assessed based upon the City's own specific circumstances. Nevertheless, the GFOA recommends, at a minimum, that general-purpose governments, such as the City, maintain an unassigned fund balance in their General Fund of no less than two months (approximately 16.67%) of regular general fund operating expenditures. At December 31, 2017, the City's unassigned fund balance was \$1,480,456, or 6.6% of 2018 budgeted expenditures. Risk factors such as the predictability of future revenues, the volatility of expenditures, exposure to significant one-time outlays (disasters, immediate capital needs, state budget cuts), legal claims and liquidity concerns need to be considered when developing such a policy.

As noted above, calculating a reserve requires consideration of the City's risk factors. Therefore, it is necessary to estimate highly uncertain events like natural disasters and economic downturns. To develop an adequate response the GFOA incorporates the "Triple A" approach. That approach utilizes the guidance as described below.

- **Accept.** First, the City must accept that we are subject to uncertainty, including events that they haven't even imagined.
- **Assess.** Next, the City must assess the potential impact of uncertainty. Historical reference cases are a useful baseline.
- **Augment.** The range of uncertainty the City really faces will almost always be greater than they assess it to be, so they should augment that range. Historical reference cases provide a baseline, but that baseline may not be adequate to account for all future possibilities.

We recommend that the City formally assess its financial risks and cash flow needs, analyze and quantify those risks and needs, and incorporate its findings into a formal policy outlining the level of fund balance in the City's funds. This policy should marry into the City's budget process, promoting awareness of deteriorating fund balance levels and the effects of appropriating such balances to offset rising costs.

Library Fund Activities

Similar to prior years, the City maintained two sets of records for recording the library cash receipts and cash disbursements. Additionally, the City maintains a separate donations account which is not included in the City's general ledger and does not have any policies for how it should operate. Finally, the library bank accounts are not reconciled or reviewed on a monthly basis.

We recommend that the City consolidate the cash receipt ledgers and include the donations account on the City general ledger. Additionally, the City should develop a policy for handling of funds through the donations account. All accounts should be reconciled by an individual independent of the bookkeeping functions and reviews should be performed and documented through a sign-off of a separate employee.

Future Reporting Requirements

The GASB has adopted several new pronouncements, which may have a future impact upon the City:

GASB Statement No. 75—The City is required to implement GASB Statement No. 75, *Accounting and Financial Reporting for Post-employment Benefits Other than Pensions*, effective for the fiscal year ending December 31, 2018. This Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, and will require more extensive note disclosures and required supplementary information about their OPEB liabilities.

GASB Statement No. 83—The City is required to implement GASB Statement No. 83, *Certain Asset Retirement Obligations*, effective for the fiscal year ending December 31, 2019. This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for asset retirement obligations (“AROs”).

GASB Statement No. 84—The City is required to implement GASB Statement No. 84, *Fiduciary Activities*, effective for the fiscal year ending December 31, 2019. This Statement establishes criteria for identifying fiduciary activities of all state and local governments.

GASB Statement No. 85—The City is required to implement GASB Statement No. 85, *Omnibus 2017*, effective for the fiscal year ending December 31, 2018. This Statement enhances consistency in the application of accounting and financial reporting requirements.

GASB Statement No. 86—The City is required to implement GASB Statement No. 86, *Certain Debt Extinguishment Issues*, effective for the fiscal year ending December 31, 2018. The objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

GASB Statement No. 87—The City is required to implement GASB Statement No. 87, *Leases*, effective for the fiscal year ending December 31, 2020. The objective of this Statement is to better meet the needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments’ leasing activities.

GASB Statement No. 88—The City is required to implement GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, effective for the fiscal year ending December 31, 2018. The objective of this Statement is to improve the information that is disclosed in noted to government financial statements related to debt, including direct borrowings and direct placements. This Statement also clarifies which liabilities governments should include when disclosing information related to debt.

GASB Statement No. 89—The City is required to implement GASB Statement No. 89, *Accounting for Interest Costs Incurred before the End of a Construction Period*, effective for the fiscal year ending December 31, 2020. The objectives of this Statement are to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period, and to simplify accounting for interest cost incurred before the end of a construction period.