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May 22, 2012

The Honorable Mayor and
Members of City Commission
City of Margate
1 South Washington Avenue
Margate, N.J. 08204

Dear Mayor and Commissioners:

We have audited the financial statements of the City of Margate (the "City") for the fiscal year ended December 31, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City of Margate are described in notes to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2011. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the City of Margate's financial statements was:

Management's estimate of the Compensated Absences liability is based on the termination payment method, whereby the liability is calculated based on the amount of vacation time which the employee has earned, sick leave and any compensatory time which was earned and is eligible for payment upon termination of any employee. The City estimates its accrued compensated absences liability based on the accumulated sick, vacation days, and compensatory time at the balance sheet date by those employees who are currently eligible to receive termination payments. The estimated value of compensated absences as of December 31, 2011 is \$2,195,118.52.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated May 22, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Information in Documents Containing Audited Financial Statements

This information is intended solely for the use of the Mayor and City Commissioners and management of the City of Margate and is not intended to be and should not be used by anyone other than these specified parties.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

We would also like to present, to the Mayor and City Commissioners, the following comments and recommendations regarding the operations of the City. Our comments are not to be taken as criticisms of any particular individual(s), but to disclose matters that we believe could adversely affect the operations of the City, if not given specific attention.

Our comments and recommendations are as follows, but not necessarily listed in terms of importance:

1. Beach Tag Operations

Our audit of beach tags included a reconciliation of tags purchased for inventory, tags sold, and tags on hand at the time of audit. As indicated in Finding #2011-3, our audit of the City's beach tags for 2011 resulted in 3,423 missing tags. Of the 3,423 tags unaccounted for, 3,388 were seasonal tags, 34 were senior tags, and 1 was a weekly tag. The sale price of the seasonal tags is \$7.00 through May 31st and \$15.00 thereafter. Senior tags, which are sold only through May 31st are \$3.50, and the weekly tags sell for \$10.00.

Taking into consideration these pre-season and regular season sale prices, the missing tags represent a potential loss of revenue to the City ranging anywhere from \$23,845.00 to \$50,830.00.

There is no valid explanation as to why such a significant number of tags is unaccounted for, especially considering the "Beach Fee Daily Reports" prepared by beach tag inspector supervisors do not indicate any discrepancies with beach tag inventory. This illustrates the severe lack of internal controls over beach tag operations, particularly with regard to segregation of duties. Had internal controls been in place, we feel that the safeguarding of tags would have been less susceptible to mishandling. Although no system is foolproof, a properly designed internal control system can provide reasonable assurance that misappropriation of assets or record-keeping errors will be prevented or detected.

We were quite concerned to discover during our audit fieldwork that two beachfront maintenance supervisors who had worked during the 2011 beach season were told by the City Clerk, who is also the Beach Tag Administrator, that they would have to wait for their last paycheck. It was explained to us that the two employees were told by the City Clerk that they could not be paid due to budget constraints. All other City employees were paid for that time period, and this is not a valid reason why the employees would have to wait until 2012 to be paid, especially considering that at December 31, 2011, prior to our audit, there was \$800,691.91 in appropriation reserves.

Fortunately, we know of no other City employees who were told that they would have to wait for their paychecks. After contacting the City Clerk regarding their unpaid wages to no avail, the two supervisors informed the City's Chief Financial Officer in April 2012 about their wages earned in 2011 which were never paid to them. After reviewing time sheets, it was confirmed that the two employees were indeed owed a paycheck for hours worked in 2011. The total gross pay for these individuals was \$3,047.00 and was paid to them in May 2012. Since the pay relates to the 2011 municipal budget, that amount was added to the Beachfront Maintenance Salaries and Wages budget line item which resulted in an overexpenditure in the amount of \$2,899.48, and a deferred charge which must be raised in the 2013 municipal budget.

A cash deposit in the amount of \$2,860.00 for cash received for beach tags sold on June 25, 2011 was not deposited until August 16, 2011, almost two months after receipt of the funds. Upon first realizing the deposit had not been received by the bank, several inquiries were made by the Chief Financial Officer to the Beach Badge Administrator and the City Clerk's Office without immediate resolution. According to the Chief Financial Officer, the Beach Badge Administrator, who was in possession of the deposit, had never taken it to the bank for processing. Instead the deposit remained in his possession from June 25, 2011 until the time the deposit was turned over to her. This was discovered when this employee turned the deposit over to her on August 16, 2011 without a valid explanation as to the why the deposit was never taken to the bank to be processed by a bank teller or deposited using a night deposit bag. Aside from being in direct violation of N.J.S.A. 40A:5-15 which requires deposit of municipal funds within 48 hours, the cash not being deposited in a timely manner poses a risk of loss of funds to the City.

On March 28, 2012, while we were conducting audit fieldwork at City Hall offices, we were told by the Chief Financial Officer that the parent of a beach badge inspector who had worked for the City in 2011 came to City Hall to return a small plastic storage bag containing \$20 in cash and 18 2011 season beach badges. We were told that the parent discovered the bag in their house and thought it should be returned to the City. However, a review of the "Beach Fee Daily Reports" prepared by the beach tag supervisors for this employee did not indicate that there was a shortage and did indeed reflect that this beach tag inspector's tags were returned. This raises question as to the integrity of the 2011 daily reports prepared by beach tag supervisors and the degree that they can be relied upon to accurately reflect actual beach tag sales activity. It also raises concerns as to the opportunity for fraud to occur if records maintained do not reflect actual results.

The preceding paragraphs indicate a severe lack of internal controls over beach tag operations for the year 2011. Had an effective internal control structure been in place, it is unlikely that the incidents noted above would have occurred.

We understand that, as of the date of this letter, oversight of beach tag operations has been assigned to a different employee, and internal controls have been implemented to reduce the risk of loss of funds and ensure that beach tag revenues reach their full potential by safeguarding inventory and properly accounting for sales of beach tags. According to the Chief Financial Officer, revenues from pre-season beach tag sales for the period ending April 30, 2012 exceeded revenues from the same period in 2011 by \$44,205.00. This increase in revenues may be attributed to the internal controls established for beach tag operations in 2012.

2. Overexpenditures Due to Payroll Adjustments

In addition to the 2011 Beachfront Maintenance Salaries and Wages not paid until 2012 as noted in the section above, there was also an overexpenditure in the amount of \$20,770.64 in the budget line item for Lifeguard Salaries and Wages. This overexpenditure resulted after having to make an audit adjustment in the amount of \$26,011.04 from charges to Electrical Inspector Salaries and Wages to Lifeguards Salaries and Wages. The adjustment was made after it was discovered the Lifeguard Captain's salary for part of 2011 was charged, intentionally, to the Electrical Inspector Salaries and Wages budget line item even though the employee did not work in that department, as evidenced by review of time sheets submitted by the Construction Code Official. Also, the Construction Code Official confirmed that this employee did not perform work for his department.

3. Payroll Matters

Our audit of payroll revealed that the Construction Code Official was not aware that salaries for two employees were being charged to the Electrical Inspector Salaries and Wages budget line item. In one instance, one of the two employees was performing work for another department (as referred to in item number 2 above.) That employee submitted a separate time sheet via email to the Payroll Clerk with no approval by the Construction Code Official.

In the other of those two instances, a Public Works employee, whose regular salary was charged to Street Repairs Salaries and Wages was also paid a stipend for another public works position even though the duties were never actually performed by the employee. Neither the Construction Code Official, nor the Supervisor of Public Works was even aware of the matter until after the end of 2011, when they were provided with payroll reports for their departments by the acting City Administrator. In both instances, the determination to charge the two individuals' salaries to the Electrical Inspector Salaries and Wages budget line item was made by the Municipal Clerk.

Beginning in 2011, the City established a formal system to record sick and vacation time allotted and used during the year. It was explained to us that prior to that time employees were in charge of keeping track of their time allowed, used, and accumulated over time. In addition, we noted during tests of payroll that a proper timekeeping system was not established for all City employees. The City reports an estimated liability of \$2,195,118.52 for accumulated absences at December 31, 2011. The balance of the compensated absences liability is simply too significant to allow the recording of the liability dependent upon the record-keeping abilities of individual employees. While a formal system has been established to account for compensated absences, we feel that the current system can still be improved upon. As a matter of good internal controls, a timekeeping system should be used which would allow for reporting accuracy with regards to hours worked and sick or vacation time that is used.

From our testing and review of documentation it became clear that the City Clerk has substantial influence over payroll matters. As stated in the City's Employee Handbook, the governing body has appointed the City Clerk to implement personnel practices. However, there were no procedures in place to minimize the opportunity for error or fraud to occur without detection.

Payroll and related costs are the largest expenditure for most local government budgets. The design of effective internal controls over payroll ensures that employees are paid their approved salaries and wages correctly, proper budget line items are charged for payroll expense, and that the volume of information required for every payroll is processed accurately and efficiently.

Our findings and comments illustrate the need for the City to design and implement stronger internal controls over payroll. Such procedures include proper oversight and approvals by the governing body. For example, new hires, changes in employment status, salary and pay rates should be authorized and approved by the governing body and documented in the meeting minutes. While we did note during our audit that an "Employee Rate Change Form" was utilized, it was not always complete and was signed only by the City Clerk without apparent approval by supervisory personnel.

We also noted weaknesses with regards to the record keeping function of hours worked and vacation/sick time used. Some employees are required to use a time clock, some are not. Time sheets examined for one department, which reported hours for four employees, did not include the name of the department or the signature of a supervising employee. This time sheet, while it included a date range, had columns for hours worked but no date listed at the top of each column, and no indication as to even what year it pertained to. In addition, on several time sheets, hours for one of the four employees did not add equal the total number of hours reported for each day. While in many cases the total hours reported as worked equaled more than the total reported, the time sheets submitted are inaccurate.

When considering the design of internal controls, we recommend that the City consider the use of a uniform timekeeping system and procedures that include approval by department supervisor or other supervisory personnel. While we understand that a uniform approach may not be appropriate for certain departments, we feel it should be considered.

4. Health Coverage Opt-Out and Buy-Down

The City allows employees to waive health insurance coverage offered by the City when the employee is covered under an alternative plan. Employees may participate in either the “Opt-Out” or the “Buy-Down” plan. When participating in the “Opt-Out” plan, an employee is paid a lump sum for waiving health insurance coverage provided by the City. If participating in the “Buy-Down” plan, an employee is compensated for choosing lesser coverage than entitled to. For example, an employee may be entitled to coverage under a family plan but can be compensated for the difference in electing coverage as a single person.

During our audit, it appeared that one employee was over-compensated for participation in the “buy-down” option. The employee claimed that they were entitled to family coverage and opted to buy-down to parent-child coverage. However it was later determined that the employee was not entitled to family coverage but rather parent and child and therefore should not have received compensation.

Policies and procedures had been in place to verify the level of health insurance coverage that employees are eligible for. Accordingly, proof of eligibility had been obtained for all participants in the “Opt-Out”/“Buy-Down” plan with the exception of this employee. According to the Chief Financial Officer, employees are frequently reminded to inform her of any changes in their status that may affect the employee’s level of coverage, i.e., marriage, divorce, or change in dependents.

It is our understanding that beginning in 2012 payment will no longer be made to employees participating in the plan unless proper documentation verifying health insurance coverage eligibility is provided.

5. Investments

At December 31, 2011, the City held 481 shares of Prudential Financial, Inc. Common Stock, which was valued at \$24,199.11. Investments in common stock are clearly prohibited by N.J.S.A. 40A:5-15.1. Regardless of how the shares were acquired, the position should be liquidated and funds deposited into the current fund checking account to comply with statutory requirements regarding investments.

6. Municipal Clerk’s Office

Our review of commission meeting minutes for the year 2011 revealed that many meetings were not signed by the Municipal Clerk and one/all of the Commissioners. In addition, we noted a few instances where meeting minutes were not noted as approved by the governing body. Also, all resolutions and ordinances that were adopted during 2011 were not signed by the Clerk.

All meeting minutes must be listed on the following meeting’s agenda and signed by the Municipal Clerk. If it is the City’s policy to also have the Commissioners sign meeting minutes once approved then all approving Commissioners should sign the minutes at the time of approval.

It is unclear why the resolutions and ordinances adopted in 2011 were not signed by the Municipal Clerk as they had been in previous years. Allowing those documents to remain unsigned, including the meeting minutes, exposes them to the risk of being tampered with.

We also noted that while the meeting minutes reflected the Commissioners’ approval of the bill list, the bill list referred to was not included in the minutes as required for several meetings during the year. All bill lists should be included in the minutes or referred to specifically if maintained in a separate volume.

7. Tax Collector

Our test of refunds of tax overpayments revealed that refunds were made to taxpayers without obtaining a resolution prior to such refund. We recommend that resolutions be obtained prior to refunding all tax overpayments. However, where there are instances where immaterial balances exist, a blanket resolution may be adopted cancelling/refunding all balances under a certain threshold (i.e., \$5.00 or \$10.00).

8. Trust Funds

We noted that there was no dedication by rider for the Election Signs, Skate Park and the Lifeguard Boat Escrow Trust Funds. The City should adopt resolutions and obtain proper approval from the Director of the Division of Local Government Services to comply with N.J.S.A. 40A:4-39.

9. Petty Cash/Change Funds

At the conclusion of our fieldwork we performed counts of the various petty cash and change funds utilized by City departments. We counted the City Clerk's petty cash fund and noted a shortage of \$27.10 after taking into consideration the authorized amount of the fund and cash receipts found in the drawer. While the amount was immaterial, it points to a lack of internal controls over petty cash funds. Monies should not be paid out of the petty cash drawer without receipts for purchases. We recommend that the custodians of all petty cash and change funds ensure that funds are adequately safeguarded.

10. Recreation Department

We reviewed the activities of the City's Recreation Department to determine if fees charged for various activities were in accordance with a fee ordinance. Activities tested included only those taking place during the summer due to the volume of activities offered during that season. Fees assessed could only be traced to a brochure that lists the various activities as the City did not have an ordinance in place setting forth the fees to be charged for various recreation activities. We recommend that ordinances be adopted setting forth all recreation fees and understand that City officials are presently in the process of creating such a fee ordinance.

Our testing of Recreation Department activity included examination of the cash receipts log and deposits for 2011. When we inquired about a large deposit in July 2011 it was explained to us that the deposit was for basketball camps that were operated by a City employee. It was explained to us that since the camps took place on City property, the employee remitted an agreed upon payment to the City in return for use of the City property. However, we could not locate any written formal agreement to support this, nor was there a resolution on file in the Municipal Clerk's office to document that such an agreement had been made. Without a formal agreement stipulating the amount to be paid for operation of the camp on City property, it cannot be determined whether or not the City received a fair amount in return for use of its property. Many local municipalities request public bids for the operation of sports camps even when not required by Local Public Contracts Law. We recommend that City officials consider the benefits of requesting such bids to ensure that the City is receiving maximum value for use of its athletic facilities by outside organizations.

In our experience, municipal recreation departments require special attention with regards to establishing internal controls. Many municipalities like the City of Margate offer a wide array of activities to local residents, adding to its appeal as a shore community. While it is understandable that the Board of Commissioners wants to continue to offer these activities to the public, we recommend that operation of these activities be reviewed to determine that appropriate internal controls are implemented. For example, many activities offered through the City's Recreation Department require a small fee to participate which many individuals pay in the form of cash. An effective system of internal controls provides assurance that monies received are properly receipted and recorded, adequately safeguarded and promptly deposited. Proper recording would also provide assurance that fees charged are in accordance with the corresponding fee ordinance.

11. Temporary Budget

Our examination of the 2011 temporary budget, adopted on January 6, 2011 revealed that the temporary appropriations for the current fund exceeded the statutory maximum by \$6,709.54. While this overage is insignificant, it is not in compliance with N.J.S.A. 40A:4-19. We recommend that a calculation be performed each year prior to the adoption of both the current fund and water and sewer utility fund budgets to ensure compliance with this statute.

In closing, our comments illustrate the fact that for 2011, management of City operations has been centered in the Office of the Municipal Clerk without sufficient oversight by the governing body. The effect is substantial influence over City affairs by one individual with no compensating controls.

Establishing effective controls and consistently adhering to them will help to ensure that the City is using public assets efficiently and protecting against risk of loss. While it is not always cost-effective to implement certain controls, other procedures should be considered as a method of mitigating risk.

As stated earlier, our comments are not to be taken as criticisms of any particular individual(s) or department(s). We would like to extend our thanks to all the staff in the City of Margate for their full cooperation and amicable assistance. We would be pleased to discuss this letter at any time, and look forward to providing assistance with implementing our recommendations.

Respectfully submitted,

**FORD, SCOTT & ASSOCIATES, L.L.C.
CERTIFIED PUBLIC ACCOUNTANTS**

Leon P. Costello

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Certified Public Accountant
Registered Municipal Accountant
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