

***CITY OF LAWRENCE, MASSACHUSETTS***

***MANAGEMENT LETTER***

***JUNE 30, 2013***

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

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Lawrence as of and for the year ended June 30, 2013, (except for the Lawrence Contributory Retirement System which is as of and for the year ended December 31, 2012) 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 opinions 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. However, as discussed below, we identified certain deficiencies in internal control that we consider to be 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 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 consider the deficiency in the City's internal control as presented in the memorandum that accompanies this letter to be a material weakness.

We also became aware of other matters that are opportunities for strengthening internal controls and enhancing operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

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

December 10, 2013

CITY OF LAWRENCE, MASSACHUSETTS

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JUNE 30, 2013

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# ***MATERIAL WEAKNESS***

## **BUDGETARY CONTROL AND REQUIRED FISCAL OVERSIGHT (MATERIAL WEAKNESS)**

On December 31, 2009, the Governor of the Commonwealth of Massachusetts proposed legislation "An Act Providing For The Financial Stability of The City of Lawrence." (Act) Under this Act, there was the establishment of a Fiscal Overseer appointed by the Secretary of Administration and Finance (Secretary) vested with comprehensive authority over all of the City's finances, including appropriations, borrowings, transfers of funds, and municipal spending authorizations. The Act also called for the establishment of a Capital Reserve Fund in Fiscal 2012, to which an amount equal to 1.5% of the amount of property taxes committed for the preceding fiscal year be deposited.

The Act provides that if the Fiscal Overseer concludes at any time after January 31, 2011 that the City is unable to achieve a balanced budget and fiscal stability, the Secretary may terminate the existence of the Fiscal Overseer and appoint a Finance Control Board (Board). Under the Act, the Board would not only have all of the powers of the Fiscal Overseer, but also the power to exercise any function or power of any municipal officer or employee, whether elected or otherwise, including certain powers to approve or disapprove contracts and have control over all personnel matters. Through Fiscal 2013, the Overseer has not recommended a Finance Control Board. This decision has been influenced by the following positive actions and results:

- Spending restrictions put in place via executive order whereby any commitments greater than \$1,000 require the Mayor's approval.
- Certified positive free cash ranging between \$4.7 million and \$6.6 million for Fiscal years 2010 through 2012.
- Improved bond ratings from both Moody's Investor Service and Standard & Poor's.
- The significant collection of past due taxes and the implementation of aggressive lien filings.
- The establishment of a capital improvement committee.
- The submission and approval of a balanced budget for Fiscal years 2011 through 2014 using realistic revenue estimates exclusive of one-time revenue sources.

However, even with the improvements noted above, the City at this time is still subject to a Fiscal Overseer and can possibly be subrogated to a control board. This indicates that it is not yet able to be fully accountable for its operations at the current time and, accordingly, we consider this condition to be a material weakness.

## ***PRIOR YEAR COMMENTS***

## **INTERNAL CONTROLS OVER MANUAL ADJUSTING ENTRIES**

### Prior Comment

Several City departments currently have the ability to post manual adjusting entries directly to the accounting ledgers without review or approval. Also, the majority of the supporting documentation for these manual adjusting entries is maintained at the individual departments.

The City should change the current procedures over manual adjusting entries so that only the comptroller's office has the ability to post manual adjusting entries directly to the accounting ledgers. If a City department requires an entry to be posted, a formal request should be submitted to the comptroller along with supporting documentation. The request should be reviewed and approved by the comptroller for reasonableness, at which time it would then be posted to the accounting ledgers by the comptroller. All supporting documentation for manual adjusting entries should be maintained in the comptroller's office.

### Current Status:

The City implemented procedures so that the Comptroller's office is the only department with the ability to post manual adjusting entries to the general ledger. Supporting documentation for all adjusting entries is now scanned into and maintained in the MUNIS accounting package.

## **SEGREGATION OF DUTIES**

### Prior Comment:

It is critical in the prevention of fraudulent activity and abuse that the custody of an asset, and the ability to post transactions be segregated by different parties. In addition to the formally documenting procedures over the cash receipt process as previously mentioned, we recommend that City implement a cash receipt module where the Treasurer's office postings of cash receipts are inputted into a pending status until they can be reviewed by the comptroller's office. The Comptroller's office would then be responsible for changing the status of these postings from pending to active.

### Current Status:

The City has procedures implemented so that all departmental turnovers are first reviewed and verified with the Comptroller's office, and then entered into a cash receipts log. Although the Treasurer's office still makes the daily bank deposits, as well as posts the turnover to the general ledger; as a mitigating control procedure the Comptroller's cash receipt log is reconciled to the general on a monthly basis.

## **DEPOSIT AND INVESTMENT POLICY**

### Prior Comment:

GASB Statement 40 requires financial statement disclosure of key policies affecting the management of cash deposits and other long term investments of the City. This new accounting standard highlighted the need for governmental entities to consider adopting cash and investment policies that take into account custodial, credit and interest rate risk. Such policies establish guidelines for matters such as 1) the types of banks the District should have deposits with; 2) the maximum period that an investment can be held and; 3) the highest concentration the District can have in any one investment type or issuer.

Current disclosures indicate that there are no specific policies in place to ensure that deposits and investments are managed prudently or that such items are not subject to extraordinary risk.

### Current Status:

No significant progress has been made to resolve this comment.

### Continuing Recommendation:

We continue to recommend that the Treasurer adopt a deposit and investment policy that addresses key areas of the GASB Statement 40. Among other items, the policy should address collateralization of uninsured cash deposits and limits placed on the ability to invest in certain debt or equity issuers.

## **AUDIT OF STUDENT ACTIVITY FUNDS**

### Prior Year Comment

In fiscal 2012, we indicated that the Massachusetts General Law (MGL), Chapter 71, Section 47 requires annual audits of student activity accounts in accordance with guidelines issued by the Department of Elementary and Secondary Education (DESE). The DESE guidelines indicate that, at a minimum, such audits should include the following:

- A reconciliation of the cash balances as shown in the checkbook and bank statements.
- A review of compliance with the school committee's adopted procedures.
- A review of the supporting documentation for a randomly selected sample of payments.

These guidelines can be found in a letter, dated May 31, 1996, from the Commissioner of Education on the DESE website on the following link: <http://www.doe.mass.edu/news/news.aspx?id=6226>

The audit may be an internal audit conducted by personnel in the school business office or (municipal finance office), if so approved by the School Committee. The Massachusetts Association of School Business Officials (MASBO) published a student activity accounts manual, in May of 2007, to assist school districts with the operation and management of student activity accounts under the provisions of the MGL. Included in the manual is a recommendation that an audit be performed by an independent audit firm at least one time in every three year period.



If an internal audit is conducted, an audit report should be produced that includes the audit procedures performed and the results of the procedures. If the audit results in findings a written corrective action plan should be completed. The audit report should be distributed to the Superintendent, the School Committee and the independent auditor to review.

Current Status

The City's student activity funds were not audited in fiscal 2013.

Continuing Recommendation

We continue to recommend that the City implement policies and procedures to comply with the MGL audit requirement and the recommendations made by MASBO. We also recommend that an audit report is prepared to document the audit procedures performed and the results of the procedures. The audit report should be discussed with the Superintendent and the School Committee and should also be available for the independent auditor to review.

**PAYROLL PROCESSING AND SYSTEMS**

Prior Comment:

The City's payroll is processed using several different payroll systems. The School, City, and certain boards and commissions all use distinctly different, non-integrated systems to process payroll. Separate functions include the printing of checks, filing of W-2's, and communication/report filings with the Internal Revenue Service (IRS).

Due to the existence of these individual separate systems the City:

- is not able to monitor and coordinate internal controls over payroll processing and reporting in a cohesive and efficient manner and,
- certain authorization processes are duplicated each payroll.

In general, the payroll environment lacks standard operating policies, places reliance on manual interfaces, and demonstrates an inconsistent use of technology.

Current Status:

The City has hired a new payroll director and has begun the process of evaluating all payroll processes and has implemented a plan to consolidate the City payroll into a single system.

Continuing Recommendation:

We continue to recommend that the City continue to work towards achieving this plan, and to maintain a focus on enhancements to internal controls, the elimination of inefficiencies, and a coordination in the use of technology aligned with best practices.

## **GRANT MANAGEMENT AND THE USE OF BUDGETS**

### Prior Comment:

The City receives millions of dollars in federal and state funds annually. The administration of these funds requires controls over compliance with laws and regulations and financial reporting. In reviewing these controls we noted that grant expenditures, unlike general fund expenditures, are not being monitored at a line item budgetary level in MUNIS.

### Current Status:

The City has implemented the use of budgets in MUNIS for the management of federal and state grants for all departments, with the exception of the school department.

### Continuing Recommendation:

While the school department currently has mitigating controls to ensure compliance with federal and state grant budgetary requirements, we continue to recommend that they work towards maintaining a budget in MUNIS for all grant awards.

## **AUTOMATION OF TREASURY FUNCTION**

### Prior Comment:

The Treasurer serves as the City's cash manager. In this role, the Treasurer maintains custody of all municipal funds and possesses responsibility for the deposit, investment and disbursement of these monies. The Treasurer must administer the municipality's resources to ensure the availability of adequate liquid assets to pay obligations as they become due.

In this capacity the Treasurer must monitor all the receipts and disbursements of the City and, each month, reconcile the monthly balances to the general ledger. For the most part this responsibility has been carried out using a combination of spread sheets and manual processes using information extracted from MUNIS.

### Current Status:

The City has received approval to purchase a Treasury Management Module; however, the office is still performing many of its functions manually.

### Continuing Recommendation:

We continue to recommend that the City purchase this module and begin the process of automating and streamlining the functions currently performed manually by the Treasurer's office.

## **ESTABLISH FORMAL DEPARTMENTAL RECEIPTS PROCEDURES**

### Prior Comment

The City has several departments that receive and process receipts; many of which have small administrative staffs that created an inherent risk that the receipts may not be properly reported, remitted or safeguarded. We noted that there has been improvement in this area, however, documentation of procedures and a more extensive implementation has not yet occurred.

### Current Status:

No significant progress has been made to resolve this comment.

### Continuing Recommendation:

We recommend that the City establish formal City-wide departmental receipt policies and procedures that would provide a framework upon which department heads could assess existing internal controls and, where deemed necessary, develop such controls via documented examples. It was also recommended that the City Comptroller's Office track revenue trends of departmental receipts and perform periodic site visits to assure compliance with City policies, with the goal being to improve oversight and reduce the risk of errors or irregularities occurring and going undetected.

## **FRAUD RISK ASSESSMENT**

### Prior Comment

The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the City perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the City's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

The fraud risk assessment can be informal and performed by a management-level individual who has extensive knowledge of the City that might be used in the assessment. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the City, its environment, and its processes. The fraud risk assessment process should consider the City's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

- What individuals have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.

- Are there any known pressures that would motivate employees with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.
- 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.

Current Status:

No significant progress has been made to resolve this comment.

Continuing Recommendation:

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

**ESTABLISH AN INTERNAL AUDIT FUNCTION**

Prior Comment

The City does not have an internal audit function. We believe that the City has grown to a size and complexity that warrants consideration of an internal audit function. Internal auditing is an independent appraisal activity within the City for the review of accounting, financial, and other operations. The overall objective is to carry out a program of tests of the City's financial and operational activities and transactions to provide management with information about the effectiveness (and efficiency) of established accounting and operational policies, procedures, and controls, and the extent to which they are being followed. In the course of gathering such information, the reliability of accounting and other data generated within the City may be evaluated. Another objective is the prevention and detection of fraud through the performance of audit tests and procedures.

Establishment of an internal auditing function could result in substantial benefits to the City in terms of strengthened internal control and increased efficiency. Some benefits of an internal audit function are as follows:

- Strengthening the City's internal controls over assets and increasing the reliability of the accounting records.
- Reducing the time spent by management in the development of City procedures.

- Increasing assurance that City policies are being adhered to and that departmental procedures and controls are being reviewed objectively.
- Ensuring that each department is accounting and reporting in a consistent manner and that they are operating in accordance with management's wishes.
- Making procedural reviews to determine that the various departments are operating efficiently.
- Providing an excellent training ground for future secondary and top management positions.

Current Status:

No significant progress has been made to resolve this comment.

Continuing Recommendation:

We recommend that management evaluate the costs and potential benefits of establishing an internal audit function.

We offer the following recommendation of steps for the internal auditor, once hired, to take in setting up an internal audit function:

- Meet with the Mayor and senior management to obtain a clear idea of their expectations for the internal auditor, including their assessment of the most significant risks the City faces and problems the auditor should address. The internal auditor would also establish his or her expectations of those parties' support of the internal audit function and that they will promote the internal audit function, and call for cooperation with it, throughout the City.
- Obtain and review the City's written policies and procedures, including those relating to management's responsibilities in managing the City.
- Identify the departments, locations, processes, and operations (including IT) that will be subject to internal audits.
- Meet with department heads and operations (including IT) managers to gain an understanding of their concerns and the risks they face.
- Meet with the independent auditors and review their communications to identify internal control issues or deficiencies they may have identified and to learn their perspective of the risks the City faces.
- Assess the internal and external risks the City faces.
- Develop a charter for internal audit that includes a description of its objectives, authority, independence, responsibility, and scope of work.
- Develop an internal audit plan, based on the risk assessment and requests from management.
- Develop a budget for internal audit, including personnel and travel, if necessary.
- Develop a staff training plan, if applicable.
- Establish a reporting channel and process for following up on recommendations in internal audit reports.

We believe that this blueprint can demonstrate the City's commitment to the internal audit function, convey the City's expectations of the internal auditor, and serve as a guide to the auditor in meeting those expectations. The City can obtain free guidance (such as sample internal audit charters) and information about resources on establishing an internal audit function from the Institute of Internal Auditors' website at [www.theiia.org](http://www.theiia.org) (select the "guidance" tab).

## **DEVELOP INTERNAL PROCEDURES MANUAL**

### Prior Comment

A number of City departments do not currently maintain a formal internal procedure manual documenting day-to-day processing and controls. Since the City is limited in its number of employees, the City is at risk if critical tasks cannot be completed due to an extended absence.

### Current Status:

No significant progress has been made to resolve this comment.

### Continuing Recommendation:

We continue to recommend that each department-head develop an internal procedure manual. The document should be written with sufficient detail to allow a new employee the ability to complete day-to-day tasks. This document should be updated for any system changes and a master manual of all procedures should be maintained and stored in a secure location.

## **WHISTLEBLOWER POLICY**

### Prior Comment

In most cases, potential instances of fraud or abuse come to the attention of responsible parties from employees or citizens who become aware of such practices. The City should take practical steps to encourage and facilitate such reporting through the adoption of a formal whistleblower policy. This policy should provide employees and citizens with a means of reporting potential fraud and abuse with anonymity, and without fear of repercussion

### Current Status:

No significant progress has been made to resolve this comment.

### Continuing Recommendation:

We recommend that the City consider adopting a formal whistleblower policy.

## **OTHER POSTEMPLOYMENT BENEFITS - ACTUARIAL VALUATION**

### Prior Comment

The City implemented Governmental Accounting Standards Board (the GASB) Statement No. 45 in fiscal 2008, which required disclosure and recognition of other postemployment benefits liabilities (OPEB). For financial reporting purposes, an actuarial valuation is required every two years.

Net OPEB obligations associated with the City departments and enterprise funds, from which contributions are made should be, and have been, separately identified in the City's actuarial valuation report so that the Net OPEB obligation can be accurately allocated to the various City departments and enterprise funds. The most recent actuarial valuation; however, separately reported current retirees and did not assign the corresponding net OPEB obligation and contributions to the applicable departments. This made it difficult for management to allocate a portion of the total current retiree's net OPEB obligation and contributions to each applicable City department and enterprise funds.

### Current Status:

The City is currently in the process of working with an actuarial firm to complete the Other Postemployment Benefits actuarial valuation dated July 1, 2012.

### Continuing Recommendation:

We continue to recommend that the City include in the scope of its next actuarial valuation that the net OPEB obligation and corresponding contributions for current retirees be allocated to the City departments and enterprise funds.

## ***CURRENT YEAR COMMENTS***



## **ABANDONED PROPERTY - TAILINGS**

### Current Comment

The Treasurer's Office does not currently maintain a comprehensive and up to date listing of all items considered to be tailings. We also noted that formal procedures to reconcile the balance of tailings reported in the general ledger to the outstanding balance per the Treasurer did not exist.

### Recommendation:

We recommend that the Treasurer analyze the items that are being carried as part of the tailings balance and reconcile the tailings balance to the general ledger. We further recommend that the Treasurer follow the Massachusetts Abandoned Property Laws, as applicable to municipalities, to determine the most appropriate course of action to arrive at a final disposition tailings liability.

## **AUDIT OF HEALTH INSURANCE PLANS**

### Current Comment

The City does not currently perform periodic audits of the health insurance enrollment to determine eligibility of the current subscribers. As a result, there may be individuals receiving health care benefits that are not eligible to be enrolled in the City's health care plan. Having ineligible subscribers enrolled in the plan would have an adverse effect on health insurance premiums for the City and eligible subscribers.

### Recommendation:

We recommend that the City adopt a policy requiring monthly spots checks and semi-annual audits of the health care plan enrollment to verify eligibility of the subscribers.

## **DENTAL INSURANCE INTERNAL SERVICE FUND**

### Current Comment

The City has an established internal service fund used to record the activity associated with providing City employees with dental insurance. The City; however, currently records all accumulated withholdings and corresponding claim payments in a single withholding account within the General Fund. A year-end audit adjustment has been required to reclassify this activity from the General Fund to the Dental Insurance Internal Service Fund.

### Recommendation:

We recommend that the City implement procedures so that all dental insurance activity is recorded in the Dental Insurance Internal Service Fund.

## **SEGREGATION OF DUTIES – ABILITY TO ADD, DELETE OR MODIFY PAYROLL AND VENDOR MASTER FILES**

### Current Comment

The individuals responsible for processing payroll and accounts payable also have the ability to add, delete and modify employee records included in the payroll and accounts payable master files and there is no system in place to monitor, review or approve changes to the master files. Having these permissions would allow an individual to create a fictitious employee or vendor and to process a check for payment to the fictitious individual or entity through the warrant process.

### Recommendation

We recommend that the City consider segregating these functions or, as an alternative, having someone perform a role that would include monitoring, reviewing and approving all changes to the payroll and accounts payable master files.

# ***INFORMATIONAL COMMENTS***

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

### Current 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 the City's 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. See below for a brief summary of these new standards:

- GASB #63 and GASB #65 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 inflows – 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

While the most significant changes from these GASB's do not go into effect until FY2014 and FY2015, we wanted to make the City aware of the magnitude these changes will have on financial statement reporting and disclosures. The City should plan to meet with your actuaries and financial advisers as more information becomes available. You may also want to consider how and when this information should be communicated to financial statement users.