

***CITY OF LAWRENCE, MASSACHUSETTS***

***MANAGEMENT LETTER***

***JUNE 30, 2016***



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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, 2016, (except for the Lawrence Contributory Retirement System which is as of and for the year ended December 31, 2015) 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 9, 2016

CITY OF LAWRENCE, MASSACHUSETTS

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JUNE 30, 2016

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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 2012, to which an amount equal to 1.5% of the amount of property taxes committed for the preceding 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 2016, 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 \$12.1 million for years 2010 through 2016.
- 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 adoption of a five-year capital plan and five-year financial forecast.
- The submission and approval of a balanced budget for years 2011 through 2017 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 the State believes 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***

## **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:

The City hired a full-time Comptroller in 2016. A portion of the new Comptroller's roles and responsibilities mirror those of an internal auditor.

## **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:

The City has drafted a Comprehensive Financial Management Policy manual which includes both policies and procedures for a significant number of financial areas and City departments.

## **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:

As part of the City's Comprehensive Financial Management Policy manual the City has drafted an investment policy that addresses the areas as recommended above.

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

### Prior 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.

### Current Status:

The City has implemented an electronic approval process for all employee actions. All employee actions now require the approval of the Department Head, Human Resources, Comptroller and Mayor. Automatic notifications are also sent to certain departments to provide an additional level of control.



## **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.

## **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 towards resolving 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.

**ABANDONED PROPERTY - TAILINGS**

Prior 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.

Current Status:

No significant progress has been made towards resolving this comment.

Continuing 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.

## **DENTAL INSURANCE INTERNAL SERVICE FUND**

### Prior 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.

### Current Status:

No significant progress has been made towards resolving this comment.

### Continuing Recommendation:

We recommend that the City record all dental insurance activity in the Dental Insurance Internal Service Fund only.

## **CAPITAL ASSET ACCOUNTING**

### Prior Comment

With the implementation of GASB # 34 came the responsibility of capital assets for financial reporting purposes, and the City subsequently conducted an initial capital asset inventory. Since that time the City has relied on the year end audit to account for and classify capital asset additions, deletions, and transfers.

The City should have policies and procedures to in place to accurately and timely account for capital asset additions, deletions, and transfers. In order to maintain a complete capital asset listing the City should develop procedures to facilitate accurate capital asset reporting for financial reporting purposes.

### Current Status:

No significant progress has been made towards resolving this comment.

### Continuing Recommendation

We continue to recommend that the City work to develop and implement policies and procedures to ensure the proper accounting for all capital assets and that they also work towards maintaining a complete and accurate capital asset listing by both function and location. In addition the City should consider replacing the excel spreadsheet currently used to track capital assets with an automated capital asset accounting module. As the City has a significant number of capital assets, utilizing manual excel spreadsheets can become cumbersome and prone to error.

## **IMPROVE CONTROLS OVER STUDENT ACTIVITY FUNDS**

### Prior Comment

Prior management letters recommended that the Schools have an audit of student activity funds performed by an outside independent audit firm in accordance with Massachusetts General Law (MGL), Chapter 71, Section 47. During 2014 the City contracted to have an agreed upon procedures engagement performed on the student activity funds, the report from which was issued subsequent to year end. The report issued in relation to the agreed upon procedures engagement highlighted several areas where the Schools should improve internal controls over student activity funds. Specific recommendations from the report include:

- Develop and formally adopt policies and procedures over the operations of student activity funds. Such policies and procedures should document items including: defining checking account balance limits, procedures over the establishment of new student activity accounts, procedures for issuing large checks, procedures for dissolving inactive accounts, etc.
- Develop and maintain a separate accounting for the tracking of the receipts, disbursements, and balances for student activity funds as a whole, as well as the individual programs operated under student activity funds at each school location. Additionally, once a separate accounting has been implemented at each school location, formal reconciliation procedures should be implemented between the accounting ledgers and the checking and savings bank statements.
- Implement procedures to ensure student activity savings and checking accounts are operated under the imprest account method.
- Develop procedures to ensure an adequate, organized, and consistent level of supporting documentation is maintained for all transactions within the receipt and disbursement transaction cycles.

### Current Status:

The School implemented procedures so that the student activity funds are now operated under the imprest account method; however, additional policy and procedural changes to ensure a sound system of internal controls over student activity funds have yet to be made.

### Continuing Recommendation

We continue to recommend that the School implement procedures to improve internal controls over student activity funds, as outlined in the agreed upon procedures over student activity funds engagement report.

## **PARKING GARAGE OPERATIONS AND INTERNAL CONTROLS**

### Prior Comment:

Based on our review of the Parking Garage operations, we noted that internal controls can be enhanced through the implementation of certain additional procedures within the Parking Garage's operations. The areas for improvement are as follows:

- Implement the use of pre-numbered receipts for all issued monthly passes. We noted that Parking Garage makes available for sale monthly passes in which the purchaser gains unlimited access to City parking garages in exchange for a fixed fee. Currently the City provides the purchaser of the monthly pass a receipt when payment is tendered; however, these receipts are not pre-numbered. Utilizing pre-numbered receipts and implementing procedures to ensure any gaps in pre-numbered receipts are accounted for helps ensure that all cash received by the Parking Garage in connection with monthly passes is deposited with the City.
- Implement a system to account for parking validations and voided transactions. Currently the cash register system utilized by the Parking Garage allows the cashier to void a transaction and open the service gate without any cash payment being received. There is currently no system in place to effectively account for the total number of voided transactions and to ensure all voids were for a legitimate purpose. Similarly, the current system does not have the ability to track the total number of times the service gate was opened for a parking validation transaction. Ultimately the ability exists for a cashier to open the service gate without accepting payment, and for it to go unmonitored or accounted for.

Additionally, we noted that the cash register system currently being utilized does not provide an adequate level of controls to ensure all customers are charged the appropriate fee, as well as that all cash collected is deposited with the City. The lack of appropriate controls exists primarily due to the outdated cash register system, as well as the cash register system not being integrated with the gate monitoring system. We recommend that the City strongly consider implementing a new, updated cash register system which is integrated with a service gate monitoring system. This new system should have the ability to effectively track the total number of times the service gate is opened, as well as the ability to match each opening with a corresponding cash register transaction.

### Current Status:

No significant progress has been made towards addressing the recommendations of this comment.

### Continuing Recommendation

We continue to recommend that the City implement the financial controls as described at the various parking garage locations. Improving the level of controls at City parking garages will reduce the risk of misappropriation or theft.

## ***CURRENT YEAR COMMENTS***

## **TIMELINESS OF CHAPTER 90 REIMBURSEMENT REQUESTS**

### Current Comment

At June 30, 2016, the City had a cash deficit in the Chapter 90 grant account of approximately \$431,000. As of the date of our fieldwork in September 2016 the City had yet to request reimbursement for \$137,000 of this year-end deficit from MassHighway through the Chapter 90 program.

The Chapter 90 program requires funds to be spent on approved projects prior to requesting reimbursement from the state. The process of not requesting reimbursement of Chapter 90 project expenditures in a timely fashion develops internal control weaknesses. First, the City experiences decreased cash flows and lost investment earnings while awaiting reimbursement. Second, the City is at risk of jeopardizing its reimbursement from the State if the reimbursement request is delayed. Finally, a deficit balance has a negative impact on the City's certified free cash, leaving fewer funds available for appropriation and immediate use for other City purposes.

### Recommendation

We recommend that the City review its policies and procedures for requesting Chapter 90 reimbursements and implement procedures to request funds on a quarterly basis at a minimum.

## **SCHOOL LUNCH OPERATIONS**

### Current Comment

We performed a review of financial operations at the School Lunch department and noted that internal controls can be enhanced through the implementation of additional procedures, specifically with regard to how funds are collected at the school cafeterias.

Currently, the employees responsible for closing out the cash drawer at the end of each day views the total daily collections per a system generated report prior to the drawer close-out. In order to achieve a true check and balance the staff member responsible for the end-of-day cash count should not have the ability to view system cash totals. Procedures should be implemented where a separate staff member will print the system generated daily cash totals report, then the two staff members will meet to compare daily totals and resolve any differences.

The point-of-sale (POS) system utilized by the school cafeterias has the ability to void a transaction after being processed. Currently, an employee operating the system can void a transaction without outside approval or oversight. Voiding a transaction without oversight or approval increases the risk of misappropriation or theft. The School should implement procedures so that either a voids report is reviewed at the end of each day by the cafeteria manager, or a void cannot be processed without approval of the cafeteria manager.

### Recommendation

We recommend that the School Lunch department implement the procedures as detailed above in order to strengthen internal controls over operations.

## **CONSIDER ESTABLISHING A COMPENSATED ABSENCES STABILIZATION FUND**

### Current Comment

Massachusetts General Law Chapter 40, Section 13D, became effective July 3, 2012, and provides a city, town, or school district who adopts this section of the law with the ability to establish a reserve fund for the future payment of accrued liabilities for compensated absences due any employee or fulltime officer upon termination of employment.

At June 30, 2016, the City's estimate of the liability for compensated absences totaled approximately \$17.8 million.

### Recommendation

We recommend the City consider accepting the provisions of this section of the law with the goal of incrementally funding this liability.

## **DOCUMENTATION OF INTERNAL CONTROLS**

### Current Comment

In December 2013, the U.S. Office of Management and Budget (OMB) issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) in an effort to (1) streamline guidance for federal awards while easing the administrative burden and (2) to strengthen oversight over the expenditure of federal funds and to reduce the risks of waste, fraud and abuse.

The Uniform Guidance supersedes and streamlines requirements from eight different federal grant circulars (including OMB Circular A-133) into one set of guidance. Local governments are required to implement the new administrative requirements and cost principles for all new federal awards and to additional funding to existing awards made after December 26, 2014 (fiscal year 2016).

In conformance with Uniform Guidance, the non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States (the Green Book) and the "Internal Control Integrated Framework", issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The COSO internal control framework is generally accepted as a best practice within the industry including the best practices prescribed by the Government Finance Officers Association (GFOA). COSO is a joint initiative of 5 private sector organizations dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence. The original COSO framework was published in 1992 and has been revised several times for changes in operations, technology, and audit risk. The most recent updates to the COSO Internal Control - Integrated Framework were issued in 2013 and are available at [www.coso.org](http://www.coso.org).

Management is responsible for internal control and to see that the entity is doing what needs to be done to meet its objectives. Governments have limited resources and constraints on how much can be spent on designing, implementing, and conducting systems of internal control. The COSO Framework can help management



consider alternative approaches and decide what action it needs to take to meet its objectives. Depending on circumstances, these approaches and decisions can contribute to efficiencies in the design, implementation, and conduct of internal control. With the COSO Framework, management can more successfully diagnose issues and assert effectiveness regarding their internal controls and, for external financial reporting, help avoid material weaknesses or significant deficiencies.

The COSO internal control framework incorporates 5 major components of internal control, which are supported by 17 principles of internal control as follows:

1. CONTROL ENVIRONMENT
  - 1) Demonstrates commitment to integrity and ethical values
  - 2) Exercises oversight responsibility
  - 3) Establishes structure, authority, and responsibility
  - 4) Demonstrates commitment to competence
  - 5) Enforces accountability
2. RISK ASSESSMENT
  - 6) Specifies suitable objectives
  - 7) Identifies and analyzes risk
  - 8) Assesses fraud risk
  - 9) Identifies and analyzes significant change
3. CONTROL ACTIVITIES
  - 10) Selects and develops control activities
  - 11) Selects and develops general controls over technology
  - 12) Deploys through policies and procedures
4. INFORMATION & COMMUNICATION
  - 13) Uses relevant information
  - 14) Communicates internally
  - 15) Communicates externally
5. MONITORING
  - 16) Conducts ongoing and/or separate evaluations
  - 17) Evaluates and communicates deficiencies

Management should evaluate and assess the government's internal control system to determine whether: each of the five essential elements of a comprehensive framework of internal control is present; whether each element addresses all of the associated principles; and whether all five elements effectively function together.

#### Recommendation

We recommend management follow the best practice for establishing and documenting their internal control system using the COSO Internal Control Framework.

# ***INFORMATIONAL COMMENTS***

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

### Current Comment

The GASB has issued new pronouncements that will significantly affect the accounting and reporting requirements for Other Postemployment Benefits (OPEB). These new standards will start to phase in during 2017 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 #74, Financial Reporting for Postemployment Benefit Plans Other Than Pensions, which is required to be implemented in 2017.
- The GASB issued Statement #75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, which is required to be implemented in 2018.

See below for a brief summary of these new standards:

- GASB #74 and #75 will substantially change the reporting for other postemployment benefit liabilities and expenses. Changes in the other postemployment benefits liability will be immediately recognized as other postemployment benefits 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. Employers will report in their financial statements a net other postemployment benefit liability (asset) determined annually as of the measurement date. Net other postemployment benefit liability (asset) equals the total other postemployment benefit liability for the plan net of the plan net position. The other postemployment benefit liability is the actuarial present value of projected benefits attributed to past service. The plan net position is the accumulated plan assets net of any financial statement liabilities of the plan.

The City should expect to record significant OPEB liabilities in the future. While these GASB's do not go into effect until 2017 and 2018, we wanted to make the City aware of the impact that these new standards will have on financial statement reporting and disclosures.