

CITY OF LAWRENCE, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2015



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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, 2015, (except for the Lawrence Contributory Retirement System which is as of and for the year ended December 31, 2014) 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, 2015

CITY OF LAWRENCE, MASSACHUSETTS

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JUNE 30, 2015

TABLE OF CONTENTS

PAGE

MATERIAL WEAKNESS

Budgetary Control and Required Fiscal Oversight (Material Weakness) 1

PRIOR YEAR COMMENTS 2

Deposit and Investment Policy 3

Automation of Treasury Function 3

Fraud Risk Assessment 4

Establish an Internal Audit Function 5

Develop Internal Procedures Manual 6

Abandoned Property - Tailings 7

Audit of Health Insurance Plans 7

Dental Insurance Internal Service Fund 8

Segregation of Duties - Ability to Add, Delete or Modify Payroll and Vendor Master Files 8

Enterprise Fund Indirect Cost Allocations 9

Capital Asset Accounting 9

Improve Controls over Student Activity Funds 10

CURRENT YEAR COMMENTS 11

Parking Garage Operations and Internal Controls 12

INFORMATIONAL COMMENTS 13

Government Accounting Standards Board (GASB) Statements for OPEB 14

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 2015, 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 \$9.5 million for years 2010 through 2015.
- 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 years 2011 through 2016 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

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:

The City has begun the process of formulating a deposit and investment policy that addresses key areas of the GASB Statement No.40. As of year-end; however, the document has yet to be formally adopted by the City.

Continuing Recommendation:

We continue to recommend that the Treasurer formally 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.

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.

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 towards resolving 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 (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:

The City has formally documented its procedures over the cash receipts transactions cycle. Additionally, that City has begun the process of drafting other various policies and procedures; however, these are currently in the compilation/draft phase of completion.

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.

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.

AUDIT OF HEALTH INSURANCE PLANS

Prior 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.

Current Status:

The City, on a monthly basis, spots checks the payroll for proper deductions and, on a semi-annual basis, audits the health care plan enrollment to verify eligibility of the subscribers.

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.

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:

No significant progress has been made towards resolving this comment.

Continuing 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.

ENTERPRISE FUND INDIRECT COST ALLOCATIONS

Prior Comment

The City does not currently maintain adequate documentation to support the methodologies used to charge overhead costs and fringe benefits to the City enterprise funds. While a documented process and methodology does exist, this methodology at times was not followed and did not agree to the actual amounts charged to the enterprise funds.

Current Status:

The City has a cost allocation plan that identifies all fringe benefit and overhead costs that support the enterprise fund operations. This plan is now followed so that the general fund is no longer subsidizing the operations of the enterprise funds.

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.

CURRENT YEAR COMMENTS

PARKING GARAGE OPERATIONS AND INTERNAL CONTROLS

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.

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