



Conor Baldwin
Chief Financial Officer

MEMORANDUM

TO: Thomas A. Golden Jr., City Manager

FROM: Conor Baldwin, Chief Financial Officer

CC: Kelly Oakes, City Auditor

DATE: April 30, 2022

RE: FY2021 Audit – Management Letter response from Finance Department

The City Auditor, Superintendent of Schools, and I—on behalf of the finance department—have signed off on release of the independent audit of the FY2021 financials. Three (3) major documents: the FY2021 Basic Financial Statements, the Schedule of Federal Expenditures (“SEFA”), and the FY2021 Management Letter, constitute the product of our annual engagement with the outside audit firm, Powers & Sullivan. This year, due to COVID-19 and the influx of federal funding to mitigate the impact of COVID-19 on municipalities, the federal government has extended the deadline for the SEFA and is currently still in final review.

Each year, the City—through the City Auditor’s office—engages an audit firm to conduct testing of the city’s financial activity, prepare the city’s basic financial statements, and provide commentary on the strength of the city’s internal controls over fiscal activities. The result of this year’s work is enclosed under the City Auditor’s portion of the agenda. This memo is intended to serve as a supplemental, informational item from the finance department in response to comments made by the audit firm. This document demonstrates the action plan for strengthening internal controls in the coming year.

Overall, the number of comments on the management letter is indicative of strong financial management. It is also notable that in this year’s management letter that there are no comments which rise to the level of *material weakness* or *significant deficiency* in internal controls; two of the strongest terms associated with an audit of this scope. Rather, there are recommendations or comments which indicate opportunities for strengthening internal controls, which will serve as the basis for internal audit projects in FY2022 and FY2023. For each comment, whether unresolved from a prior year or a new comment, a response is provided herein.

It is noteworthy to highlight in financial statements, that at the close of FY2021, the City’s governmental funds reported combined ending fund balance of \$100.8 million, an increase of \$32.1 million in comparison with the prior year (FY20). On the other hand, we must be cognizant of the City’s growing liabilities, such as post-employment benefits (“OPEB”). The net OPEB liability as of 6/30/2021 was \$883.2 million. The following pages represent the finance department’s response and corrective action plan for each of the comments listed on the FY2021 Management Letter as new and/or unresolved.



Prior Year Comments – Resolved

(For details of the management comment, please refer to the FY2020 management letter)

Resolved Comments Include:

1. Section 108 Loan Fund
2. Budget Reconciliation



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Prior Year Comments – Unresolved

1. PURCHASE ORDER DATES

DEPARTMENT(S):

All Departments (**Including Schools**)

CURRENT STATUS:

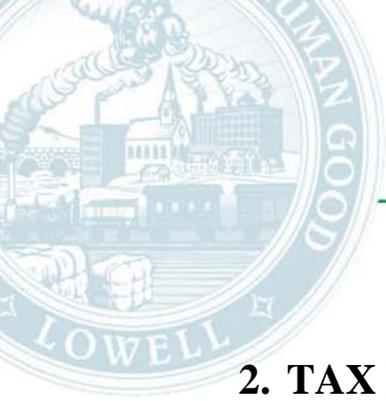
“[Powers & Sullivan] noted that there are still purchase orders with dates subsequent to the invoice date. We continue to recommend that a policy regarding the approval of purchase orders prior to the purchase of goods or services by any Department be implemented. A situation could arise where goods or services have been ordered and no budget is available to support the purchase.”

MANAGEMENT RESPONSE:

The finance department continues to take this issue very seriously. Adherence to the city’s existing financial policies and procedures is a critical component of good fiscal management. The city has a strong local, legal framework for procuring goods and services, found in the Code of Ordinances (Chapter §28-32), which requires Department Heads to wait for a purchase order award before procuring any goods or services.

In 2020 and 2021, management has discussed and disseminated reminders to all department leadership, documents related to the policy. The finance department and, specifically the purchasing department, continue to work with departmental project managers and finance staff to train them in the appropriate best practices. The city’s MUNIS accounting system provides excellent workflow procedures to guarantee the process is followed to a certain extent, but it cannot eliminate human error.

Revised policy reminders and training schedules will be released again in FY2022 to appropriate staff. The finance team is also considering revised policy language for the Reserve System Ordinance to recommend to the City Manager for consideration by the City Council to amend the Ordinance to strengthen and codify some internal controls and consider the implementation of pre-encumbrances within the MUNIS system to resolve issues related to delays in contract negotiations on larger projects.



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2. TAX FORECLOSURES

DEPARTMENT(S):

City Treasurer/ DPD/ City Auditor/ Law Department

CURRENT STATUS:

“[Powers & Sullivan] continues to recommend any foreclosed property deemed to have a municipal use be reclassified from the foreclosure list and into the City’s capital asset listing.”

MANAGEMENT RESPONSE:

This matter will continue be researched/ analyzed by each department and, depending on the current use of each asset, will be categorized appropriately by the City Auditor. Because of COVID-19’s shut down of many in-person operations in 2020-2021 and the turnover in the Office of the City Auditor, sufficient progress was unable to be made in the current audit period.

3. GENERAL LEDGER MAINTENANCE

DEPARTMENT(S):

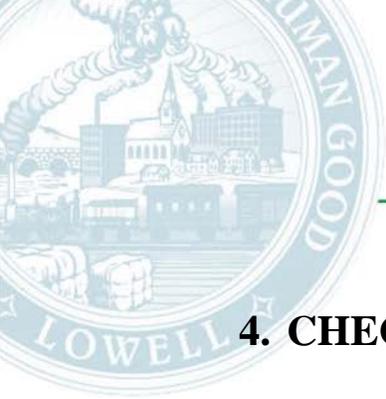
City Auditor/ Finance

CURRENT STATUS:

[Powers & Sullivan] continue to recommend that the City Auditor’s Office review the closed funds and make the appropriate adjustments to zero out all budgetary fund balance accounts.

MANAGEMENT RESPONSE:

The City Auditor had been actively involved in a comprehensive review of the general ledger. While not fully complete, the work done by the former Interim Auditor will be reviewed by the finance department so that an implementation schedule will be recommended. Because some of the remaining balances are associated with grants, additional research is necessary before determining final disposition of all balances. This project may require outside professional services from a CPA firm to accommodate some of the desires from the School Department to adjust their budgetary accounts. Pricing of such services is under review.



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4. CHECKS WRITTEN TO AND FROM THE CITY

DEPARTMENT(S):

City Auditor (Payroll)/ City Treasurer/ Human Relations/ All Departments

RECOMMENDATION:

[Powers & Sullivan] recommends that the City review its practice of issuing checks to itself and implement new policies to stop creation of these checks and alleviate the timing and reconciliation issues caused as a result.

MANAGEMENT RESPONSE:

This practice has existed in the City for decades and has been identified by the former City Treasurer/ current City Auditor as an antiquated process which has the potential to make the reconciliation process more difficult. As a result, the Treasurer had been working with the City Auditor and several of the larger departments who utilize this process to develop alternate procedures to accomplish the same result using journal entries on the city's general ledger.

The ultimate fix to this process involves some additional enhancements to the payroll process, specifically as it relates to employee deductions. This process is a component of the several comments included in the enhancements and modernization of the city's payroll process, discussed under the current year comment section.

6. PREPARATION OF THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARD

DEPARTMENT(S):

City Auditor/ City Treasurer/ DPD/ LPD/ DPW

CURRENT STATUS:

[Powers & Sullivan] understand[s] the City reviewed all general ledger fund names to ensure the CFDA numbers were properly reflected, to aid in proper reporting.

[Powers & Sullivan] continue[s] to recommend that the City work with all departments to develop a comprehensive listing of all Federal awards the City receives and expends, including where they are being recorded in the general ledger and establish procedures to allow for the



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compiling of this information in a timely manner each year. This file should be provided as part of the year end audit to be used in preparation of the City's SEFA.

MANAGEMENT RESPONSE:

As noted in the comment above, this process is completed and we expect this comment to be resolved in the FY2022 audit. Because of the timing of completion, it was unable to be resolved in the FY2021 audit.

7. LONG-TERM AND SHORT-TERM BOND PREMIUMS

DEPARTMENT(S):

City Auditor/ City Treasurer/ Finance

CURRENT STATUS:

[Powers & Sullivan] understand[s] the City moved the old premiums to the appropriate fund during fiscal year 2022 and the recommendation is now resolved.

MANAGEMENT RESPONSE:

As noted in the comment above, this process is completed and we expect this comment to be resolved in the FY2022 audit. Because of the timing of completion, it was unable to be resolved in the FY2021 audit.



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Current Year Comment

DEPARTMENT(S):

City Auditor/ School Department/ Finance/ All City Departments/ HR/ MIS

RECOMMENDATION:

[Powers & Sullivan] recommends that the City perform a full review of the internal controls in place surrounding the current payroll process focusing in on areas that need to be strengthened. As part of the review, we recommend general ledger access to the payroll module be reviewed to ensure employees' access matches their job descriptions.

We further recommend the City continue to explore the implementation of the Employee Action Entry program within MUNIS. This general ledger module would move all payroll and employee information changes to an electronic process and eliminate the need for carbon copy forms and duplication. Electronic entry and approval would improve efficiencies and reduce the likelihood of errors or irregularities. Finally, we recommend that the payroll change edit reports be reviewed on a regular and timely basis to ensure all changes were appropriate and properly approved prior to running of the payroll warrant.

MANAGEMENT RESPONSE:

This comment was initially brought to the attention of the outside auditors after a review of internal controls by the City Auditor, who oversees the payroll function. The largest section of the employee base—and therefore the largest component of the payroll cost—is with the school department, who have their own payroll department. Significant staffing turnover, both within the City Auditor's office, as well as at the Central Administration at the School Department, has contributed to issues within an overly antiquated process. It has also presented an opportunity for the city to modernize the payroll operation by all departments. Payroll is the city's largest expense each week, at approximately \$5 million per week.

Upon review, there are many areas of concern relative to payroll. In response, management has put in place an ad-hoc working group to make recommendations and to implement certain efficiencies and internal controls, in an effort to mitigate risk with the payroll process and to modernize the current, overly manual process, for processing payroll each week. Ultimately, the goal of this group is to also implement the bi-weekly payroll system, which has previously been negotiated with each of the city and school unions.



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Since early January, this payroll working group has been meeting every other week to identify and address operational issues with the payroll process and work towards implementation. Members from the City Auditors Office, City Hall HR, Finance, MIS, School payroll, School HR, and the School Central Office participate in the meetings every other Thursday. It is the goal to prioritize and implement several of the process changes identified by Powers & Sullivan, especially those whereby the city will utilize the MUNIS system to its full extent, as it relates to payroll and HR. The immediate priorities include adjusting payroll clerk's access pursuant to the recommendation, and implementing the Employee Action Entry function in MUNIS. These process improvements are prerequisites to affording the personnel in payroll and HR the time necessary to conduct regular internal audits of the weekly payroll.

Once this first phase is complete and functioning, the city can move towards implementation of the bi-weekly payroll. This, however, will represent a significant impact to the entire employee base and will require additional communication to employees and the City Council and School Committee. It will also require the support of the Council and the School Committee to ensure a successful transition. The least disruptive time for a transition would be on the January 1 accrual date, as the end of the fiscal year (July 1st) would add additional complications for summer pay for teachers. The finance department and the working group will issue additional communications on our progress as it becomes available.

Please let me know if there are any questions.

CITY OF LOWELL, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2021



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CPAs AND ADVISORS

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To the Honorable Mayor and City Council
City of Lowell, 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 Lowell, Massachusetts as of and for the year ended June 30, 2021, 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.

However, during our audit we became aware of other matters that we believe represent opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various City personnel and will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

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

Powers & Sullivan, LLC

March 31, 2022

CITY OF LOWELL, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2021

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Prior Year Comments – Resolved

Section 108 Loan Fund

Prior Year Comment

In previous management letters we noted that, as part of the Federal Section 108 loan program, the City received federal funds in the form of loans from the Department of Housing and Urban Development (HUD) to then loan out to eligible companies for urban development. The City receives loan payments of principal and interest from the eligible companies and then pays HUD the required loan payments due. The activity related to this Section 108 loan program was accounted for in fund 2267 and the balance of the loans outstanding was recorded in fund 1134.

Additionally, fund 1134 has a cash balance of \$79,000 that has not changed for multiple years. The City is further maintaining another Section 108 fund, fund 1135, and is reporting a cash balance of \$126,000 that has not changed for multiple years.

We recommended that procedures be implemented to assure that when debt payments on Section 108 loans are made that the liability balance maintained in fund 1134 be adjusted accordingly. We also recommended that management determine the nature of the cash balances in funds 1134 and 1135 and determine the proper disposition of these balances.

Current Status

Resolved. The City researched and reclassified the remaining cash balances within the funds.

Budget Reconciliation

Prior Year Comment

The City's general ledger accounting system, MUNIS, is utilized to maintain budgetary control. The City was unable to provide a complete and accurate reconciliation of the original and final budget recorded in the general ledger to the tax rate recapitulation and City Council votes. This can put the City at risk of overspending appropriations.

Current Status

Resolved. The City completed an accurate fiscal year 2021 budget reconciliation.

Long-Term and Short-Term Bond Premiums

Current Year Comment

As part of Massachusetts General Laws Chapter 218 of the Acts of 2016, the Governor signed into law “An Act to Modernize Municipal Finance and Government (Act)”. The Act prescribed two methods of accounting for premiums received as part of a bond issue.

They are as follows:

- 1) The municipality may apply the premiums to reduce the amount required to borrow for a particular project. The statute provides that such an authorization *must be made* in the vote authorizing the borrowing in accordance with MGL CH44, Sec. 20.
- 2) A municipality may apply the premium in a manner similar to previously issued bond authorizations. The premium would then be recorded in a “Receipts Reserved for Appropriation Fund”. The premiums can then be appropriated to pay for capital related costs in accordance with MGL CH44, Sec. 20.

In both cases, the total borrowing authorization of the project is reduced by the premium appropriated to the project.

The City had premiums received in 2018 and again in 2020 that were deposited into the capital stabilization fund. These premiums, if not voted to fund the project, should be recorded in a “Receipts Reserved for Appropriation Fund” or in the corresponding enterprise fund. The City Council can then vote to move the governmental premiums to the capital stabilization fund.

During fiscal year 2021, the City set up receipts reserved for appropriation funds for new premiums received and flowed current activity through the new accounts. We understand it is the City’s intent to move the old premiums to the new fund during fiscal year 2022.

Current Status

Resolved. The City moved the old premiums to the appropriate fund during fiscal year 2022.

Prior Year Comments – Unresolved

Purchase Order Dates

Prior Year Comment

In previous management letters we noted during expenditure testing several purchase orders were dated later than the corresponding invoice dates. Creating purchase orders after the invoice is received bypasses the City's purchasing policies and defeats the internal control that a purchase order system is intended to provide. Purchase orders allow the City to ensure that budgetary funds are available and that the purchase has been properly approved before funds are expended.

We recommended the City implement a process to ensure that purchase orders are initiated prior to the procurement of goods and services.

Current Status

We noted that there are still purchase orders with dates subsequent to the invoice date. We continue to recommend that a policy regarding the approval of purchase orders prior to the purchase of goods or services by any Department be implemented. A situation could arise where goods or services have been ordered and no budget is available to support the purchase.

Tax Foreclosures

Prior Year Comment

In accordance with the Massachusetts General Laws, the City has taken ownership, through the foreclosure process, of various properties as a result of prior owners not being current with real estate and other applicable municipal charges. The City maintains an accounting of activity relative to the items included in the foreclosure account. A review of the list of foreclosed properties indicates some are currently being utilized by the City for a municipal function.

Current Status

We continue to recommend any foreclosed property deemed to have a municipal use be reclassified from the foreclosure list and into the City's capital asset listing.

General Ledger Maintenance

Prior Year Comment

The City maintains hundreds of individual funds within the general ledger. At times, the activities accounted for in a specific fund are completed and the fund is labeled as closed and subsequently used again for another purpose.

While the re-use of closed funds is an acceptable practice, we noted through review of the general ledger closed funds that the budgetary fund balance accounts have not been closed out. Although they net to zero and do not impact the financial reporting of the City, retaining unnecessary accounts and funds in the general ledger can lead to confusion and inaccuracy in posting transactions or creating journal entries.

Current Status

While the City has begun the process, we continue to recommend that the City Auditor's Office review the closed funds and make the appropriate adjustments to zero out all budgetary fund balance accounts.

Checks Written to and from the City

Prior Year Comment

The City currently issues actual checks to the "City of Lowell" as part of the weekly payroll warrant. These checks are issued when the payroll warrants are run and include GIC withholdings, dental withholdings, life insurance withholdings, and other fringe benefits such as Medicare and workers compensation. The Human Resource Department then brings the checks to the Treasurer's Office to be deposited back into the City's bank account. The process should be completed via standard payroll entries within the general ledger software, MUNIS, instead of issuing checks. The need to issue checks instead of completing journals within the ledger indicates there is an underlying set up issue within the payroll process.

The process of issuing checks to the City as part of the payroll or vendor warrant process increases the risk of the City funds being misappropriated, causes additional reconciliation work for the Treasurer's and Auditor's Offices, and creates year end cut off issues, if deposits are not made timely. At June 30, 2020, there were checks totaling \$288,334 made payable to the City that had not been deposited in the bank and therefore caused a timing issue between the Treasurers cash and the cash balance recorded in the general ledger.

During our review of the checks written to and from the City, we noted other checks written for: parking, water utility, police details and some checks written to the Lowell Public Schools. Eliminating the process of writing checks to ourselves will reduce risks associated with the warrant process.

Current Status

We continue to recommend that the City review its practice of issuing checks to itself and implement new policies to stop creation of these checks and alleviate the timing and reconciliation issues caused as a result.

Preparation of the Schedule of Expenditures of Federal Award

Prior Year Comment

As part of the annual audit, the City is required to prepare and file a Schedule of Expenditures of Federal Awards (SEFA) with the Federal Audit Clearinghouse. To meet the reporting requirement, the following information is necessary:

- The Catalog of Federal Domestic Assistance (CFDA) number associated with each grant.
- The Federal agency the funds were received from or State agency the funds were passed through.
- The amount of funds expended in the year under audit by CFDA number.
- The pass-through entity identifying number for each grant received through a State agency.
- The amount provided to subrecipients, as applicable.

The City attempts to identify this information by including the CFDA number within the applicable fund name of the City's general ledger system, however, we have noted these numbers are not updated as the CFDA numbers change, or as the ledger funds are reused. Further, new grant funds are not always set up with the CFDA number

within the fund name. Additionally, there are some significant Federally funded projects which are not entirely recorded within the City's general ledger system. This leaves the City susceptible to the risk of not reporting all expenditures of Federal awards on the SEFA, as required by the grant agreements.

Current Status

We understand the City reviewed all general ledger fund names to ensure the CFDA numbers were properly reflected, to aid in proper reporting.

We continue to recommend that the City work with all departments to develop a comprehensive listing of all Federal awards the City receives and expends, including where they are being recorded in the general ledger and establish procedures to allow for the compiling of this information in a timely manner each year. This file should be provided as part of the year end audit to be used in preparation of the City's SEFA.

Current Year Comments

Review and Restructure the Payroll Process

Current Year Comment

Payroll is one of the most significant expenditures of the City and requires strong system of internal controls to mitigate the risks associated with the process. The City's weekly payroll run, and payroll system, is a manual payroll process which does not utilize the MUNIS general ledger software to the fullest. Currently, the City is communicating all payroll changes via carbon forms which require a departmental employee to hand write a form, and the data entry to facilitate the change occurs at the City Auditors office. Due to the large number of employees working within the City, this is a very time-consuming process. Further, turnover within key payroll positions can lead to significant issues as historical knowledge is not being documented within the general ledger.

The current process in place has led to the following issues:

- Direct deposit registers being sent to the bank late.
- Terminated employees continuing to be paid.
- Teacher summer payroll options, i.e., balloon payment at the end of the school year for all summer payroll, or payments weekly over the summer, are not being properly monitored, resulting in overpayments.

The current process also requires checks being written to the City, as discussed further in a previous comment, instead of transfers within the general ledger. Further, year end adjustments are required for accrued payroll as the system set-up charges the accrued warrants to cash as if they have been paid out and this process then requires the Auditor's office to make journal entries adjusting the cash hits to a liability accrued payroll.

Additionally, access level controls within the current payroll system have not been properly established based on employee role and responsibilities. Department level data entry clerks should only have access to enter time worked for employees within their department, access to review other employees and confidential employee information must be restricted.

The current process and MUNIS set up increases the chance of error or irregularity as recommended internal control processes such as payroll change edit reports are not being reviewed regularly. The risk of errors or irregularities increases when regular edit reviews are not reviewed timely and in their entirety before each payroll run. Examples of common edits that occur could relate to pay rate increases/decreases, an employee being terminated or retiring, and step increases within the School Department.

The lack of strong internal controls surrounding the payroll process leads to a situation in which errors or irregularities can occur such as, the possibility of fictitious employees being created and paid, and as mentioned at times terminated/retired employees are continuing to receive pay checks, or teachers whom received a balloon payment continue to receive weekly payroll checks and once discovered resources must be allocated to track down and try to obtain reimbursement for the overpayments.

Recommendation

We recommend that the City perform a review of the internal controls in place surrounding the current payroll process focusing in on areas that need to be strengthened. As part of the review, we recommend general ledger access to the payroll module be reviewed to ensure employees' access matches their job descriptions.

We further recommend the City continue to explore the implementation of the Employee Action Entry program within MUNIS. This general ledger module would move all payroll and employee information changes to an electronic process and eliminate the need for carbon copy forms and duplication. Electronic entry and approval would improve efficiencies and reduce the likelihood of errors or irregularities.

Finally, we recommend that the payroll change edit reports be reviewed on a regular and timely basis to ensure all changes were appropriate and properly approved prior to running of the payroll warrant.