

CITY OF LOWELL, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2016

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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 fiscal year ended June 30, 2016, 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 several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding 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

January 31, 2017

CITY OF LOWELL, MASSACHUSETTS

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Prior Year Comments - Resolved

The following comments were resolved during the current year. Please see the June 30, 2015, Management Letter for the complete original comment.

OLD OUTSTANDING CHECKS

INVESTMENT INCOME ALLOCATION TO STABILIZATION FUNDS

INVESTMENT INCOME ALLOCATION TO THE OTHER POSTEMPLOYMENT BENEFITS TRUST

TAILINGS

Prior Year Comments - Unresolved

CASH RECONCILIATION PROCEDURES

Prior Year Comment

In previous management letter we reported the following deficiencies surrounding the reconciliation of cash:

- Although the Treasurer's Office reconciled the bank statements to the Treasurer's book balance during the year, no monthly reconciliations occurred to reconcile Treasurer's cash to the general ledger.
- Many account reconciliations include reconciling items that are between 1 and 3 years old that have not been researched to determine its nature and final disposition.
- Vendor and payroll account reconciliations are completed by the bank but have not been reviewed and approved by the Treasurer's Office. These reconciliations include multiple items for over/under funding of warrants, stop payments and other miscellaneous items.
- An unreconciled cash variance has existed between the Treasurer's records and the general ledger for fiscal years 2014 and 2015 totaling \$245,000 and \$184,000, respectively.

Without monthly reconciliations there is a significant risk that errors or irregularities in amounts that would be material to the City's financial statements may occur and not be detected within a timely manner by City employees in the normal course of performing their assigned functions. Furthermore, the potential for errors to occur is significantly reduced with regular reconciliation procedures.

Current Status

We observed the following regarding cash reconciliation procedures in the current year:

- Monthly reconciliation procedures have been implemented between the Treasurer's Office and the Auditor's Office, however the Treasurer is reporting approximately \$43,000 of old reconciling items to arrive at book balance. This is overstating the Treasurer's balance and should be adjusted.
- Cashbook reconciling items have very little description as to what they represent or how they originated. Accordingly, it took extensive audit procedures to verify these during our audit.
- The Treasurer does not reconcile book balance to bank balance. There were several unknown variances that exist when trying to reconcile the two balances.
- The vendor and payroll accounts were closed and moved to another financial institution. However, there are still unreconciled balances being reported in these accounts that need to be resolved.

Continuing Recommendation

- Although many old items have been removed, we recommend that old reconciling items be investigated and the proper disposition noted to assure that the amounts do not continue to carry over from month to month.
- We recommend that the Treasurer's Office include documentation of what reconciling items represent within the cashbook when items are identified.
- We recommend that the Treasurer formally reconcile the Treasurer's book balance to the reconciled bank balance on a monthly basis and properly account for any unknown variances.
- We recommend that the Treasurer work to close down the old vendor and payroll accounts. We also recommend that all reconciling items on the new accounts be reviewed and corrected in the following month.

FIXED ASSETS

Prior Year Comment

In previous management letters we noted that the City has worked to compile a detailed listing of all assets owned. Maintaining this list requires the recognition of additions, deletions, disposals and transfers of fixed assets. At this time the City has implemented procedures to account for yearly fixed asset additions however, procedures still need to be implemented to properly account for deletions, disposals or transfers. In order to maintain a complete and accurate fixed asset listing the City needs to work on developing procedures to facilitate accurate fixed asset reporting.

Current Status

No action to resolve this comment was taken during 2016. During 2016, the City did not account for any fixed asset activity including additions. The basic financial statements have been adjusted to reflect the 2016 fixed asset activity.

Continuing Recommendation

We continue to recommend that management consider implementing the use of fixed asset tracking software to facilitate the accounting for fixed assets. We also continue to recommend that management develop and implement procedures to track deletions, disposals and transfers of fixed assets.

OLD OUTSTANDING RECEIVABLES

Prior Year Comment

In previous management letters we noted that the Collector's Office is carrying many types of receivable balances that are greater than five years old. For receivables that cannot be liened the likelihood of collection at this time is significantly diminished.

Although the balances are deferred, they cause the reconciliation process to be more difficult.

Current Status

No additional write-offs occurred during 2016. The Collector is continuing to work to analyze old receivable accounts and expects to write off some old receivables in November of 2016. We noted that currently boat and motor vehicle excise receivables are being carried back to the year 2001 and 1999 respectfully.

Continuing Recommendation

We continue to recommend that the Collector's Office determine which receivable balances should be considered uncollectible and be written off.

TAX FORECLOSURES

Prior Year Comment

In previous management letters we noted that the City did not have procedures in place to reconcile the general ledger balance for tax foreclosures to the Collector's records during 2014 and 2015. Reconciling both the activity and the ending balance of tax foreclosures is an integral internal control procedure over an important revenue source of the City.

Current Status

The balance on the general ledger still does not agree to the detailed balance maintained by the Collector at June 30, and a correcting entry was required. Activity to the foreclosure account should be recorded as it occurs throughout the year.

Continuing Recommendation

We recommend that the City implement procedures to reconcile the foreclosure balances and activity from the general ledger to the Collector's records on at least a quarterly basis.

GENERAL LEDGER MAINTENANCE

Prior Year Comment

In previous management letters we noted that there were a number of general ledger funds and/or accounts that had not been used in several years and many that were reporting the same balance year after year. In some cases, the transactions or events for which these accounts were established no longer exists, or were discontinued.

Retaining unnecessary accounts and funds in the general ledger can lead to confusion and inaccuracy in posting transactions or creating journal entries. Also, undue time must be spent reconciling the contents of small balance accounts.

Current Status

Many accounts and funds still exist in which there is no activity and the balances remain the same as prior years.

Continuing Recommendation

We recommend that the general ledger chart of accounts and fund listing be periodically reviewed and that unused or stagnant accounts and/or funds be closed out.

CHAPTER 90 FUND

Prior Year Comment

In previous management letters we noted that the Chapter 90 fund has not been consistently reviewed and reconciled. We also noted that the City recorded a \$636,291 receivable that was recognized by the City during 2014 which ultimately led to a surplus in the fund. This fund operates on a reimbursement basis and therefore should always have a balance that is either zero or in a deficit awaiting reimbursements.

Until all requirements of the Chapter 90 program are met any receivable recorded which corresponds to the State's allocation to the City should be recorded as deferred revenue. Amounts that have been spent and requested can be recognized as revenue to offset the deficit at year end while awaiting reimbursement. However, in the subsequent year amounts recognized as revenue need to be reversed and a corresponding entry recorded for the current year receivable. This was not done.

Accounting adjustments have been made to reflect the proper fund balance at year end for financial statement purposes.

Current Status

We observed that the City has not adjusted the receivable balance since 2014 and formal reconciliation procedures are not in place for this fund.

Continuing Recommendation

We recommend that, at a minimum, quarterly reconciliation procedures be implemented to reconcile the Chapter 90 fund.

PAYROLL WITHHOLDING ACCOUNTS

Prior Year Comment

In previous management letters we noted that the balances in the City's payroll withholding liability accounts at year-end should approximate the amount that will be paid in the subsequent month to the appropriate vendors. We observed that there are no formal reconciliation procedures related to these accounts to reconcile the balances to expected payments due in subsequent periods. We also noted that many of the account balances have not changed since the prior year.

Inaccurate payroll withholding liability balances could result in an increase or decrease in the City's free cash.

Current Status

No formal reconciliation procedures have been implemented.

Continuing Recommendation

We recommend that the City implement procedures to reconcile the liability account balances on a monthly basis. We also recommend that the current balances be reconciled and a determination be made of what accounts require adjustments.

CURRENT YEAR COMMENTS

RELEASING FUNDS PRIOR TO AUTHORIZATION

Current Year Comment

The City transferred a payment from the bank account in June 2016 for the 2017 Lowell Contributory Retirement Assessment in the amount of \$23,095,548 prior to the issuance of the 2017 warrant. The warrant was not approved by the City Auditor or City Manager nor was it recorded in the City's general ledger at the time of the transfer, as a result the funds were released in direct conflict with MGL CH. 41§56 which requires approval prior to payment. One of the City's key internal control functions is the review and approval of all expenditures prior to the disbursement of funds. Releasing funds prior to the authorization and approval of the warrant by City officials is a breakdown in internal controls.

Recommendation

We recommend that all expenditures be subject to the City's authorization and approval process prior to the release of funds.

SCHOOL INDIRECT CHARGES

Current Year Comment

The School Department transferred approximately \$1.0 million from the Milk and Lunch revolving fund to account for indirect charges originally charged to the general fund budget. Normally any indirect charge transfers anticipated are incorporated as part of the formal budget process. This gives the City Council all necessary information to make an informed decision regarding the approval of appropriations. In this case, the \$1.0 million transfer was not approved in the formal budget. This is significant because had the transfer been part of the budget the City Council may have reduced the School's appropriation request by the amount of the anticipated indirect cost transfer. The transfer was determined after year end and had the impact of increasing the School's available appropriation by the \$1.0 million charged to the Milk and Lunch revolving fund.

Recommendation

We recommend that all anticipated indirect allocation inter-fund transfers be part of the original budget cycle to allow the City Council the opportunity to make budget decisions with all applicable information.

SCHOOL GRANT MANAGEMENT

Current Year Comment

The Lowell Public Schools receive significant federal education grant funds. We noted during 2016 that the City returned approximately \$508 thousand of federal funds that were not spent during the grant year to the Department of Elementary and Secondary Education.

Although these funds can generally be re-applied for in subsequent periods the City is at risk for having future funds under the programs reduced because current year funds have not used.

Recommendation

We recommend that management evaluate these programs to determine the underlying reason for the return of funds and develop a plan to maximize the benefits that these programs provide.

ACCOUNTING FOR LONG-TERM DEBT ACTIVITY

Current Year Comment

We noted during our audit that the City did not properly account for its long-term debt. The Amounts to be Provided and the corresponding Long-Term Debt accounts were not reflected in the City's General Long-Term Debt Account Group as required under the Uniform Massachusetts Accounting System (UMAS).

Recommendation

In order to improve internal controls over financial reporting we suggest that the City follow the requirements of the UMAS and adjust its general ledger for long-term debt accordingly.

BUDGETED OPERATING TRANSFERS

Current Year Comment

During the year, the City voted various transfers between funds to supplement the operating budget, fund capital projects, fund stabilization funds, water, sewer, and parking enterprise indirect costs. We noted that several of these transfers were posted as an "other financing source/use" in one fund and as an offset to an expenditure in the corresponding fund. Voted transfers between funds should be recorded as a transfer-in and a transfer-out between the applicable funds.

Recommendation

We recommend that all transfers between funds be recorded as an other financing source or use.

PARKING TICKET RECEIVABLE

Current Year Comment

The City uses a third party vendor to track the balance of outstanding parking tickets. Persons are able to pay their tickets either at the third party office or at City Hall. If the ticket becomes flagged at the registry they also have the ability to pay at the registry upon trying to register their vehicle. The third party vendor periodically sends a turnover of receipts collected at their office; however they are not providing the City with an outstanding receivable balance. Currently, City personnel have the ability to log into the third party system and print a receivable report themselves.

We noted that periodic receivable reports are not being reviewed and reconciled to the general ledger. The balance listed in the City's general ledger at year end is the same balance as recorded in the prior year.

Recommendation

We recommend that the City, on at least a quarterly basis, run the receivable report and reconcile the balance with the general ledger.

WATER AND SEWER USER CHARGES

Current Year Comment

We noted that although the Collector is working to reconcile the outstanding water and sewer user charges to the general ledger, there is no procedure to reconcile the outstanding balances to the detail as maintained by the water and sewer departments.

This can lead to a situation when the detailed receivable records do not agree to the summary balances as maintained by the Collector and reported in the general ledger.

Recommendation

We recommend that the Collector implement procedures to reconcile the water and sewer user charges to the detail as maintained by the water and sewer departments on a monthly basis and investigate any variances.

SECTION 108 LOAN FUND

Current Year Comment

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 is accounted for in fund 2267 and the balance of the loans outstanding is recorded in fund 1134. Although fund 2267 correctly reports the debt service payments and revenues received under this program in the current year, fund 1134 has not been adjusted to reflect the actual loan balance at year end. Each year adjustments are required to appropriately report the Section 108 loans in the financial statements.

Also, fund 1134 has a cash balance of \$79 thousand that has not changed for multiple years and the City is maintaining fund 1135 as Section 108 also and is reporting a cash balance of \$126 thousand that has not changed for multiple years.

Recommendation

We recommend 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 recommend that management determine the nature of the cash balances in funds 1134 and 1135 and determine the proper disposition of these balances.

CDBG LOANS RECEIVABLE

Current Year Comment

The City maintains balances of various CDBG loans receivable in fund 2202. We noted that the balances have not been updated for any loan activity that occurred during 2016. Correcting journal entries have been made for financial statement purposes.

Recommendation

We recommend that the loan balances maintained in fund 2202 be reconciled on at least a quarterly basis.

INFORMATIONAL COMMENTS

Future Government Accounting Standards Board (GASB) Statements for Pensions and OPEB

Current Year 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 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 other postemployment benefit liability will be immediately recognized as other postemployment benefit 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.

Other Postemployment Benefit Actuarial Valuation

Current Year Comment

The City has met the requirements for the implementation of GASB Statement #45, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, and must acknowledge the requirements necessary to stay in compliance with the GASB and obtain the information necessary to complete the City's annual audit. For financial reporting purposes, an actuarial valuation is required by the City at least biennially. Consequently, the City is required to have a new actuarial valuation dated July 1, 2016, in order to remain compliant with GASB Statement #45 for 2017 and 2018.

Recommendation

We recommend that the City become familiar with the upcoming reporting requirements and work with the actuary to remain compliant with GASB Statement #45 and to prepare for the upcoming reporting changes.

Documentation of Internal Controls

Current Year 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.

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 throughout the organization; 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.