

***CITY OF LAWRENCE, MASSACHUSETTS***

***MANAGEMENT LETTER***

***JUNE 30, 2010***



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

100 Quannapowitt Parkway  
Suite 101  
Wakefield, MA 01880  
T. 781-914-1700  
F. 781-914-1701  
[www.powersandsullivan.com](http://www.powersandsullivan.com)

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, 2010, (except for the Lawrence Contributory Retirement System which is as of and for the year ended December 31, 2009) 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 control deficiency 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 significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the deficiencies noted in the table of contents constitute 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 3, 2010

**CITY OF LAWRENCE, MASSACHUSETTS**

**MANAGEMENT LETTER**

**JUNE 30, 2010**

**TABLE OF CONTENTS**

	<b>PAGE</b>
Structural Budgetary Control (Material Weakness)	1
Line Item Budgetary Control	2
Establish Formal Departmental Receipts Procedures	2
Formalize Procedures for Tax Foreclosures	3
Tax Collection Policy	3
Water and Sewer Operations	3
Other Post-Employment Benefits – Actuarial Valuation	3
Fraud Risk Assessment	4
Establish an Internal Audit Function	5
Develop Disaster Recovery Procedures	6
Develop Internal Procedures Manual	7
Health Insurance Trust Fund	7

## **STRUCTURAL BUDGETARY CONTROL (MATERIAL WEAKNESS)**

### Prior Comment

Since approximately FY2003 the City has used non-recurring revenues, free cash, unobtainable revenue estimates, and debt service reserves to meet short-term budgetary goals at the expense of long-term financial sustainability. These budgetary actions have created and prolonged what is, in effect, a structural deficit. In other words, the City has been using budgetary techniques that, without modification, are inefficient to sustain the City's current and future operations.

The Massachusetts Department of Revenue, Division of Local Services (DOR), did an extensive review of the City's financial operation in February 2008. This report included a number of recommendations designed to eliminate the continuation of the City's budgetary and operating deficiencies. The majority of these recommendations have not been implemented.

As a result of the above, 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 will be 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 establishes a City of Lawrence Fiscal Stability Fund, into which will be deposited up to \$35 million of borrowing, to maintain and operate the City for fiscal years beginning July 1, 2009, and July 1, 2010. Amounts may be disbursed from this fund under conditions approved by the Commissioner of Revenue. The Act also 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.

### Recommendation

The need to rely on the Commonwealth of Massachusetts (Commonwealth) resources, and possibly be subrogating to a control board, indicates that the City is not able to manage its operations competently at the current time.

There are a number of recommendations in this report and the report issued by the DOR that, if implemented, would enhance the internal controls over several areas of the City's operations and help mitigate, if not eliminate, the need for reliance on the Commonwealth. We recommend that management establish clear objectives and timelines that will resolve the current fiscal crisis.

Status – In coordination with state officials, the City is in the process of reviewing all of its fiscal operations with the goal of eliminating the need for the current fiscal oversight.

## **LINE ITEM BUDGETARY CONTROL**

### Prior Comment

The City has been experiencing financial pressures in recent years that have required budget reductions. The budgets controlled by the City have been, for the most part, managed to make changes in operations that resulted in the approved budget exceeding actual expenditures. This did not occur for the health insurance appropriation. In FY2009 the City transferred funds into the health insurance trust that exceeded the budget by \$1.8 million.

The MUNIS system is designed to flag expenditures and/or encumbrance which exceed a voted appropriation. This appropriation deficit was remedied prior to the close of the City's books. However, the fact that the over-expenditure was able to occur without immediate management intervention represents a material weakness in budgetary control.

### Recommendation

The City's financial department needs to monitor appropriation levels to assure that actual expenditures never exceed the legal level of spending. We recommend that an evaluation be made of the MUNIS security profiles for all those involved in authorizing and recording expenditures. The goal of this evaluation is to assure that the override of appropriation balances is maintained at the appropriate management level.

Status - The MUNIS system was modified to "red flag" over expenditures and written internal control procedures have been enhanced

## **ESTABLISH FORMAL DEPARTMENTAL RECEIPTS PROCEDURES**

### Prior Comment

The City has several departments that receive and process receipts and that many of these departments have small administrative staffs that created an inherent risk that the receipts may not be properly reported, remitted or safeguarded. It was recommended that the City establish formal City-wide departmental receipt policies and procedures that would provide a framework upon which department heads could assess existing internal controls and, where deemed necessary, develop such controls via documented examples. It was also recommended that the City Comptroller's Office track revenue trends of departmental receipts and perform periodic site visits to assure compliance with City policies, with the goal being to improve oversight and reduce the risk of errors or irregularities occurring and going undetected.

Status – There has been improvement in this area, however, documentation of procedures and a more extensive implementation has not yet occurred.

## **FORMALIZE PROCEDURES FOR TAX FORECLOSURES**

### Prior Comment

It was noted that the City does not have a formal documented policy and procedure relative to this important and complex process that involves many City departments. It was recommended that the City document formal policy and procedures so that all parties (the City Attorney, Treasurer, Collector, Comptroller, and Assessor) involved in the process are aware of their responsibilities and the timing of their actions.

Status - The City has documented policies and procedures for tax title properties and foreclosures.

## **TAX COLLECTION POLICY**

### Prior Comment

It was noted that the City did not follow an aggressive policy for collecting delinquent taxes, especially meeting the Massachusetts General Laws (MGL) time lines for liening and foreclosing on properties. This situation has reduced the availability of free cash and because the City has not perfected its legal right (via a secured interest in real estate) to collect on a property if it is sold.

Status – To date the has collected over \$3.7 million in delinquent taxes and has perfected liens on receivables through fiscal 2009

## **WATER AND SEWER OPERATIONS**

### Prior Comment

The City has struggled in the past in making water and sewer operations sustainable to meet its current and long-term costs of operations. While the City has made progress in this area we noted that personnel resources allocated to the department may be insufficient. The City, in the past, has relied on outside consultants to assist in the development of usage rates and, among other day-to-day activities, fixed asset accounting.

While recognizing the improvement in revenue generation through an adjustment in rates, we recommend that the City create an organizational structure that will be able to meet both the current and long-term needs of these enterprise funds.

Status - Due to budget constraints, people leaving service with the City and layoffs, the Water Department staff has not been able to maintain the accounting function.

## **OTHER POST-EMPLOYMENT BENEFITS - ACTUARIAL VALUATION**

### Prior Comment

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

Net OPEB obligations associated with the school department and enterprise funds, from which contributions are made, need to be displayed as liabilities in the financial statements.

The City's actuarial valuation report did not separately report the annual OPEB cost and the employer's contributions to the plan for the school department and enterprise funds. This made it unable for management to allocate a portion of the total net OPEB obligation to each applicable City function and enterprise fund.

Status - The City has increased its scope of financial services relative to OPEB benefits and is securing a firm through the procurement process.

## **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.

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

Status - The City is still developing a fraud risk program to identify, analyze and manage the risk of assets and misappropriation of funds. Senior management and financial staff will cross check internal controls to ensure proper processing of financial documents.

## **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.

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

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

- Meet with the Mayor and senior management to obtain a clear idea of their expectations for the internal auditor, including their assessment of the most significant risks the City faces and problems the auditor should address. The internal auditor would also establish his or her expectations of those parties' support of the internal audit function and that they will promote the internal audit function, and call for cooperation with it, throughout the City.
- Obtain and review the City's written policies and procedures, including those relating to management's responsibilities in managing the City.
- Identify the departments, locations, processes, and operations (including IT) that will be subject to internal audits.

- Meet with department heads and operations (including IT) managers to gain an understanding of their concerns and the risks they face.
- Meet with the independent auditors and review their communications to identify internal control issues or deficiencies they may have identified and to learn their perspective of the risks the City faces.
- Assess the internal and external risks the City faces.
- Develop a charter for internal audit that includes a description of its objectives, authority, independence, responsibility, and scope of work.
- Develop an internal audit plan, based on the risk assessment and requests from management.
- Develop a budget for internal audit, including personnel and travel, if necessary.
- Develop a staff training plan, if applicable.
- Establish a reporting channel and process for following up on recommendations in internal audit reports.

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

Status – No progress was made on this comment in fiscal 2010.

## DEVELOP WRITTEN DISASTER RECOVERY PROCEDURES

### Prior Comment

The City does not have a well defined, written disaster recovery plan. We strongly encourage management to develop and monitor the plan on a regular basis in the future. The time to make contingency plans is before disaster strikes, so that all personnel will be aware of their responsibilities in the event of an emergency situation that precludes the use of the existing facilities.

We recommend that management develop a disaster recovery plan for all departments that includes, but is not limited to, the following matters:

1. Location of, and access to, off-site storage.
2. A listing of all data files that would have to be obtained from the off-site storage location.
3. Identification of a backup location (name and telephone number) with similar or compatible equipment for emergency processing. (Management should make arrangements for such backup with another organization, a computer vendor, or a service center. The agreement should be in writing.)
4. Responsibilities of various personnel in an emergency.
5. Priority of critical applications and reporting requirements during the emergency period.

Status – The City has a full back-up and restoration procedure implemented for its MUNIS financial software application and data. We recommend that similar procedures be documented for other City operations.

## DEVELOP INTERNAL PROCEDURES MANUAL

### Prior Comment

During our examination, we noted that a number of departments do not 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.

### Recommendation

We 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.

Status – As an immediate enhancement to internal controls the City issued an executive order requiring that all purchases greater than \$1,000 be approved by the Mayor's office. The City will continue to work with all Department Heads in developing and documenting proper internal procedures.

## HEALTH INSURANCE TRUST FUND

### Prior Comment

The City maintains a Health Insurance Trust Fund (the Fund) for the following purposes:

- To provide health insurance benefits to its active and retired employees.
- To accumulate reserves to pay "run-off" claims if the Fund ceases to exist or experiences increased claim activity.

At year end the, the fund had a positive balance of only \$579,000, a decrease of \$7.1 million from FY2008. The decrease is due to budget adjustments made by the City in FY2009 to reduce funding and higher than anticipated costs incurred during the year. Furthermore, the City elected to provide for a free month in July 2009. As a result, the solvency of the fund is in serious jeopardy.

We recommend that the City review the recent operations of the fund and create a plan to 1) replenish the depleted reserves and 2) assure that the normal fluctuations involved in operating a self-insured plan can be absorbed.

Status – Effective November 1, 2010, the City transferred its health care plan to the Group Insurance Commission.