

CITY OF PROVIDENCE, RHODE ISLAND  
COMMUNICATION OF MATTERS  
PRESCRIBED BY  
STATEMENT ON AUDITING STANDARDS #115  
FOR THE FISCAL YEAR ENDED  
JUNE 30, 2010

To the Honorable City Council  
City of Providence, Rhode Island

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Providence as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered City of Providence'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 of Providence's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Providence's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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 and correct 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. The attached memorandum identifies several significant deficiencies which we believe constitute material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our audit, we also 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.

The City of Providence's written response to the significant deficiencies, material weaknesses, and other comments identified in our audit has not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of management, Members of the City Council and School Committee, others within the organization, and the Office of the Auditor General of the State of Rhode Island and is not intended to be and should not be used by anyone other than these specified parties.

*Braver PC*

Braver PC  
Providence, Rhode Island  
June 3, 2011

**We believe the following significant deficiency constitutes a material weakness:**

***Complete General Ledger:***

Governmental Accounting Standards Statement #34 requires governmental entities to prepare a government-wide financial statement utilizing the full accrual basis of accounting. Accordingly, the government-wide statements include all long-term debt obligations and capital assets of the governmental activities as well as those reported in the business-type activities. During our audit we noted that the City of Providence does not have adequate policies or procedures in place for maintaining and updating these records. The City does not maintain a comprehensive and centralized ledger to support outstanding balances of long-term debt obligations.

As of June 30, 2010 the City was maintaining the capital asset records for Providence Public Building Authority utilizing Excel spreadsheets. City personnel are utilizing spreadsheets to maintain the capital asset records and must review all financial activity at year end in an attempt to compile complete and accurate capital asset schedules.

***Recommendation:***

We recommend that the City update the general ledger accounting records to properly include balances and activity of long-term debt obligations, as well as capital asset balances and related depreciation expense. We further recommend that the City shift from the excel spreadsheets to an integrated capital asset software system as noted below to track all capital assets at the time the purchase order is created and or the invoice is processed. Proper utilization of a fully integrated capital asset module should reduce the risk of misstating capital asset acquisitions and related depreciation expense within a fiscal year.

***Management's Response:***

Management concurs, Management has relied upon confirmation of debt-service amounts with our Fiscal advisors published debt-service book and reconciling to our Debt Service Master Schedule maintained in a excel spreadsheet format.

Management has begun to explore enhanced software options of our current accounting software system to better enable tracking and reporting of debt service and capital assets.

**We believe the following significant deficiency constitutes a material weakness:**

***Cut-off Procedures:***

A sound internal control system includes policies and procedures which provide guidance for monitoring year end cut-off to ensure that financial activity is reported in the proper period. Based on our audit procedures we believe that the City, has a material weakness in its ability to properly report all liabilities and revenue to the appropriate fiscal year. We noted several instances where accounts payable at June 30, 2010 were not properly recorded. Failure to properly establish sound year end cut-off procedures increases the risk of financial statement misstatements from occurring and going undetected by management. In addition, these misstatements may have an adverse affect on management's ability to make sound financial decisions.

***Recommendation:***

We recommend that the City Finance personnel review current cut-off procedures and develop a policy and procedures for strengthening controls to ensure that all financial transactions are reported in the appropriate period. We recommend that these cut-off procedures be evaluated to determine the cost/benefit of implementing them throughout the year to ensure that accurate interim financial information is readily available.

***Management's Response:***

The City has always and consistently utilized procedures to segregate transactions into the appropriate year. Direct payments are clearly marked "old-year and" "new-year" during the period that covers the close of the current fiscal year and the opening of the new fiscal year.

During the FY2010 examination with regards to subsequent –testing and cut-off procedures, it was discovered that a number of items pertaining to purchase orders were processed incorrectly into the new-year. This was a pure oversight, in part due to staff shortages that have occurred during the past fiscal year in the Accounts Payable section of the Controllers' Office.

Management has recognized this short-coming and has begun the necessary procedures to fill positions, consistent with the collective bargaining-unit provisions of the labor contract and the City's fiscal constraints. The City is exploring consolidation and re-deployment measures that may enable more efficiency within the bargaining-unit labor pool.

These positions are considered critical to the flow of work and to ease the strain of a diminished workforce.

**We believe the following significant deficiency constitutes a material weakness:**

***Cash:***

Although the City has established procedures and controls related to bank reconciliations, we found that these procedures are not being followed. During our field work we noted bank reconciliations were not prepared on a monthly basis. As a result, material misstatements of the cash accounts and the misappropriation of cash may occur and not be prevented or detected and corrected on a timely basis

***Recommendation:***

We recommend that all bank accounts be reconciled on a monthly basis to reduce the risk of unintentional errors from occurring and going undetected for extended periods of time. This will improve the reliability of the City's interim financial reporting and expedite the year end closing process.

***Management's Response:***

Management concurs with the importance of timely-prepared bank account reconciliations. It should be noted that by exception, that the City experienced a delay in completing the "core" responsibilities of the Fiscal Section of the Controllers' Office, in part, due to over-capacity of the staff assigned to other significant time consuming projects.

Management has immediately corrected this practice and is confident that all core duties have been completed and are considered current. Management notes for the record that this practice was not experienced prior to the FY2010 fiscal year

**We believe the following significant deficiency constitutes a material weakness:**

**Increase Oversight of Decentralized Accounting**

At present, the City does not require its departments and component units with decentralized accounting to report detailed financial information on a regular basis to aid in the interim and year-end reporting of the financial statements. It became evident as the year-end closing progressed that insufficient control had been exercised over certain accounting policies of these departments during the year. Interdepartmental accounts, which had not been reconciled in detail for some months were found to be out of balance.

***Recommendation:***

We recommend the City take the following steps to affect proper accounting control over its decentralized operations, which will improve the financial validity of financial information and aid in closing schedules:

- Issue detailed instructions on the processing and recording of intercompany transactions.
- Develop standard workpapers covering interfund accounts and other accounts relevant to the year-end financial reporting process and require they be submitted monthly
- Develop a standard format for reporting monthly financial information to aid in management's analysis.

***Management's Response:***

Management concurs with the need to exercise greater and more regular control over decentralized departments and component units whose accounting and fiscal operations are not sufficient to maintain reliance upon accurate reporting. Management has taken immediate action to expand the process of oversight and review of decentralized departments and component units and has immediately instituted internal-control and management and supervisory procedures necessary provide timely account reconciliations.

**We believe the following significant deficiency constitutes a material weakness:**

***Timely Reconciliation of Accounts and Closing Procedures:***

Our audit procedures for fiscal year ended June 30, 2010 revealed there was no systematic method of ensuring that timely and complete monthly reconciliation and closing procedures take place. This situation leads to a continuing and growing backlog of transactions and journal entries that are not posted into the accounting system in a timely manner, which limits the accounting information's usefulness in making well informed business decisions. This accounting function deficiency may ultimately cause significant errors in the financial records and financial statements, as well as allow possible irregularities, including fraud, to exist and continue without notice. During the course of our audit we noted that numerous work papers and information for the fiscal year ended June 30, 2010 were not updated until requested during our fieldwork. As a result of lack of timely account reconciliations and closing procedures, the fiscal 2010 audit could not be completed by the December 31<sup>st</sup> deadline.

**Recommendation**

This situation should be corrected as soon as possible with the establishment of a system of consistent and timely monthly reconciliations and closing procedures. We recommend that the City develop such a formal month and year-end closing schedule that indicates specific personnel responsibilities and corresponding time requirements. Strict adherence to this schedule should be required because this will allow for the year-end work and audit preparation to be a much less time-consuming and arduous process.

***Management's Response:***

Management concurs and acknowledges delays in staff duties due to other Department staffing shortages that utilized and re-deployed the services of the Fiscal Office accounting and fiscal officer personnel. Please see Management Response to Management Comment at 2010-3 for similar corrective action.

**We believe the following significant deficiency constitutes a material weakness:**

***Maintenance of General Ledger***

During the fiscal year ended June 30, 2010, we noted that the City did not have adequate controls in place for reviewing and maintaining the general ledger accounting records on a periodic basis. At the commencement of the audit fieldwork management provided trial balances for the numerous funds maintained by the City. Upon initial review of these trial balances, we noted instances where the inter-fund balances were not in agreement. In addition, during the course of our audit, management provided multiple versions of certain trial balances. The lack of a completed and reconciled trial balance is an indication that the general ledger is not being appropriately reviewed and accurately maintained on an ongoing basis.

**Recommendation**

We recommend that the City establish adequate internal control policies and procedures which will include provisions requiring the general ledger accounting records to be reviewed on a monthly basis by qualified personnel and ensuring that the financial records are accurate and up to date. When reviewing the general ledger trial balance report finance personnel should ensure that the continuing balances agree to the amount reported in the most recent previous period.

***Management's Response:***

Management has consistently relied upon very reliable career-accounting personnel to conduct the day-to-day activities of maintaining the City's accounting system. There are no material weaknesses in the City's accounting and internal control systems that would require any major change in accounting or management policy.

Management proposes to re-organize the structure of the current day-to-day duties and expects that a more comprehensive management reporting system will enable management to better utilize its existing personnel and provide for more efficient utilization of staff responsibilities. This will improve the reliability and integrity of all financial and reporting systems.

**We believe the following significant deficiency constitutes a material weakness:**

***Accounting Manual:***

The City does not have a formal up-to-date accounting procedure manual. A well-devised accounting manual can help to ensure that all similar transactions are treated consistently, that accounting principles used are proper, and that records are produced in the form desired by management. A good accounting manual should aid in the training of new employees and possibly allow for delegation to other employees of some accounting functions management performs.

***Recommendation:***

It will take some time and effort by management to develop a manual; however, we believe this time will be more than offset by time saved later in training and supervising accounting personnel. This is also an important tool when there is a turnover in personnel. Also, in the process of the comprehensive review of existing accounting procedures for the purpose of developing the manual, management might discover procedures that can be eliminated or improved to make the system more efficient and effective. The manual should include references to applicable applications and monthly closing procedures.

***Management Response:***

Management concurs and will develop a work-plan during fiscal year 2012 to accomplish this task and to determine whether or not this should be developed in-house or through an outside accounting consultant.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency.**

***Account Reconciliations:***

During the audit, we noted that account reconciliations are being prepared by personnel who are directly involved with the daily account activity. Reconciliation is the process of comparing transactions and activity to supporting documentation and resolving any discrepancies that may have been discovered. If the reconciliation is performed by someone other than the person who is directly involved with account activity, the City will improve its internal control over accounts reconciliations.

***Recommendation:***

We recommend that someone other than those directly involved in the daily account activity prepare the account reconciliations. Employees involved in the reconciliation process should be knowledgeable and clear on their responsibilities and expectations. This will allow an additional overview of the account activity which would strengthen internal controls and consequently, increase the detection rate of errors or fraud. In addition, a proper reconciliation process ensures that unauthorized changes have not occurred to transactions during processing.

***Management response:***

Management is not aware of any occasion where this practice has been cited previously and has determined that in all instances, particularly in smaller-sized departments, great efforts are taken to segregate duties.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency (Continued).**

***Capital Assets:***

While capital assets are not presented on the governmental funds statements, GASB 34 requires major categories of fixed assets to be presented on the government-wide statements. Therefore, a governmental fund still must maintain adequate records of major capital assets.

The City does not have a clearly defined policy for determining responsibilities relating to maintaining the capital assets records for the Providence Public Building Authority. (PPBA)

The City does not incorporate the capital assets associated with the PPBA on its internal year-end schedules and there is no formal reconciliation process in place

The City has a policy which requires a physical inventory of capital assets be taken on an annual basis by department coordinators. We noted that this physical inventory was not taken for fiscal year ended June 30, 2010.

***Recommendation:***

We recommend the following related to capital assets.

1. The City should implement steps to determine that physical inventories of capital assets be taken as stipulated in its policy, and these physical inventories be reconciled to capital asset records on a timely basis.
2. A procedure should be put in place whereby a reconciliation process is done at year-end to ensure projects are properly transferred out of construction-in-process and capitalized upon completion. In addition, projects which have been started during the year and are not yet completed are properly recorded as construction-in-process.

***Management response:***

1. Management concurs. The City will institute the necessary procedures during Fiscal year 2012.
2. The City will review its policies and procedures in greater detail and develop any new and necessary internal control procedures during Fiscal Year 2012.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency (Continued).**

***Deposits:***

During our audit, we noted instances where deposits were not being made in a timely manner. Several departments in the City of Providence hold checks for two or more weeks before making bank deposits. It was noted that the Recreation Department holds checks in a locked desk drawer and the Department of Inspections holds checks in an unlocked drawer, only making deposits twice per month. We believe that deposits should be made on a daily basis to reduce the risk of intentional or unintentional misappropriation of City funds.

***Recommendation:***

We recommend that each department review the current process for depositing collections on a regular basis and keep any cash on hand locked in a secure location. Checks should be marked as received when collected from customers and procedures should be implemented requiring designated individuals in each department to sign all collection reports certifying the agreement between the amounts presented in the deposit and the details noted on the collection report. Additionally, to effectively segregate duties, two different employees should be preparing deposits and delivering them to City Hall to reduce the risk of theft.

***Management response:***

Management concurs. Management was not critically aware of any defalcations or incidents that would cause concern or would compromise the integrity of securing assets. Management will review the information provided by our outside auditors and will institute necessary safeguards where required.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency (Continued).**

***Payroll:***

During our audit we noted that the current payroll process requires considerable manual input. Each department does not have access to the payroll system on Lawson. Payroll is submitted by each department to City Hall manually, in pencil, on spreadsheets provided by City Hall. The process for submitting payroll manually allows for the possibility of errors, as data must be transcribed multiple times by different employees which increase the risk of misstatement.

***Recommendation:***

We recommend that Lawson is set up to allow each department's payroll coordinator to have access. By having each department have access and submit their own payroll, the City could increase efficiency, reduce the risk of errors, and decrease costs associated with payroll. Training should also be provided to management in other departments on how to use all of Lawson's features, especially areas that are pertinent to the roles and tasks being performed in the department to enhance accuracy, efficiency, and understandability by management in each department. Another benefit for having access to Lawson in each department is that various reports can be viewed on a regular basis. By granting management access to reports such as "Budget vs. Actual" the City could reduce the possibility of overspending as department managers would be more aware of their current financial position.

***Management response:***

Management concurs, subject to developing the necessary training, while instituting a transition process to ensure the reliability of payroll data-input and subsequent payroll output and processing practices.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency (Continued).**

***Fund Balance Deficits:***

The City of Providence has numerous individual non-major funds comprised of Special Revenue Funds and Capital Project Funds. Special Revenue Funds are used to account for proceeds of specific revenue sources that are legally or administratively restricted for certain expenditures while Capital Project Funds are used to account for resources that are restricted to the acquisition or construction of specific capital projects or capital items.

There were several funds with a cumulative fund deficit of approximately \$2.8 million at June 30, 2010.

***Recommendation:***

We recommend that management review the various funds which have cumulative fund deficits at June 30, 2010 and that a plan is developed to fund these deficits. We further recommend that, in the future, separate funds only be established to account for programs or projects that will be completely funded through grant awards, bond or capital lease proceeds, and special appropriations or designations by the City Council. Establishing and maintaining funds that do not have proper funding mechanisms may have a detrimental impact on the tax rates and assessments to future taxpayers.

***Management's Response:***

Management concurs. Where practical, management expects to restore reserve balances with deficits, in accordance with the elimination of due to/due from accounts through proper off-sets and cash-flow availability for any remaining deficit fund replacement during the remainder of Fiscal Year 2011 and Fiscal Year 2012 if necessary.

**The following comments are other matters that we believe are opportunities for strengthening internal controls and operating efficiency (Continued).**

***Investigate Old Outstanding Checks:***

During the fiscal year ended June 30, 2010 audit, Braver noted that the planning department's bank account reconciliation included very old outstanding checks. Some of the outstanding checks date back to March 2006. The City does not have a formal, clearly defined policy for disposition of uncashed checks. Because no such policy exists, long-outstanding checks are not handled in an organized fashion.

***Recommendation***

We recommend that review the requirements of the State of Rhode Island escheat laws and that a formal policy and procedure be adopted to ensure compliance with the requirements of the law. We further recommend that documentation be maintained to support compliance with the requirements. This documentation should include a copy of the correspondence sent to the State as well as a copy of the canceled check paid to the General Treasurer of the State of Rhode Island proving remittance of the unclaimed funds.

***Management's Response:***

Management concurs and acknowledges that the Planning Department is knowledgeable in the State of Rhode Island Escheat laws, with respect to outstanding and/or stale-dated checks. Effective Fiscal Year 2011, The City Controller's office has begun training of Planning Department accounting staff members in the City's Lawson accounting system. The Planning Department accounting staff is now utilizing the Lawson accounting system to record, track and reconcile outstanding checks each month.

***The following comments are general recommendations for the City and School Department and are not based on any specific deficiencies noted during our audit of the financial records maintained by the City's Finance Department or the School Department.***

***Fraud Prevention Program:***

There have been a number of highly publicized cases in the past two years that have heightened the awareness of fraud within governments and public organizations. As a result, numerous studies have been undertaken to provide guidance aimed at helping to prevent and detect fraud. From one such study, the American Institute of Certified Public Accountants and the Association of Certified Fraud Examiners has published a joint report encouraging organizations to take proactive steps to prevent and deter fraud. The City currently does not have a proactive fraud prevention program. We believe that the cornerstone of an effective program is the development of a government-wide code of conduct.

Other components of a fraud prevention program may include telephone hotlines and internal audit functions, among other initiatives.

Financial fraud may involve the misstatement of financial statements or the misappropriation of assets. Misstated financial statements contain intentional concealment or distortion of facts by management. Misappropriation of assets can be accomplished by one or several individuals, including management. Misappropriation of assets can also be accomplished by people inside and outside of the City. Some examples of asset misappropriation include internal embezzlement, theft of assets, conflict of interest schemes involving vendors, bribery and corruption schemes, and false billing schemes. While fraudulent activities are not always material to the financial statements individually, over time the activities can result in substantial losses to an entity.

During our audit, we noted that the City's practices do not include any formal or well communicated mechanisms for employees to report suspected fraud or abuse. In the Association of Fraud Examiners latest "Report to the Nation on Occupational Fraud and Abuse," the most frequently cited method of fraud detection was employee tips, which accounted for roughly 40% of all cases studied.

***Recommendation:***

While we are not aware of any instances of fraudulent activities, we recommend the City establish a written code of conduct as the first component of its fraud prevention activities. A comprehensive, written code of conduct can be an effective tool to communicate and create a culture of honesty and high ethical behavior, while making individuals aware of the likelihood of the detection and punishment of any undesirable conduct.

We further recommend that management consider the establishment, and communication of, reporting mechanisms for fraud, abuse and misconduct. Internal reporting channels, such as manager open-door policies, employee surveys, and electronic intranet or e-mail procedures, have been found to be effective. External hotline services have been found to perform better for anonymous tips and certain other types of suspected misconduct, such as harassment.

***Management's Response:***

Management concurs, but wishes to note for the record that we are not aware of any material weakness in the City and/or School Department's internal control systems that would expose the City or School Department to fraudulent, and/or abusive activities. The City and the School Department are willing to explore the potential of new practices and procedures designed to further protect the City and School Department's financial integrity and assets.