

**CITY OF PROVIDENCE, RHODE ISLAND**  
**COMMUNICATION OF MATTERS**  
**PRESCRIBED BY**  
**STATEMENT ON AUDITING STANDARDS #115**  
**FOR THE FISCAL YEAR ENDED**  
**JUNE 30, 2011**

To the Honorable Members of the 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, each major fund, and the aggregate remaining fund information of City of Providence as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the 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 governmental unit's internal control. Accordingly, we do not express an opinion on the effectiveness of the governmental unit'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 significant deficiencies and other deficiencies 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 deficiencies which we believe constitute material weaknesses.

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 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 Audit Committee, 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*

Providence, Rhode Island  
December 29, 2011

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Needham  
Boston  
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**We believe the following deficiencies constitute material weaknesses:**

***Complete General Ledger:***

Governmental Accounting Standards Board 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 (including the School Department) does not have adequate policies or procedures in place for maintaining and updating these records. The City does not maintain a general ledger to support outstanding balances of long-term debt obligations. In addition, the schedule maintained by the City was not complete as it had not been updated for debt issued during the year.

As of June 30, 2011 the City was maintaining the capital asset records for PPBA 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. The schedule for fiscal year ended June 30, 2011 was not updated for acquisitions related to the planning department.

***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. Utilization of a fully integrated capital asset module should reduce the risk of understating capital asset acquisitions within a fiscal year.

***Management's Response:***

Management concurs. Management has relied on confirmation of debt-service obligations with our fiscal advisor's published debt-service book. Management then reconciles to our debt service master schedule which is maintained in an excel schedule.

Management has begun the process of integrating the PPBA fixed assets into City software to better track and report the City's fixed assets.

***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 significant deficiency in its ability to properly report all liabilities and revenue to the appropriate fiscal year. We noted instances where accounts payable at June 30, 2011 were not properly recorded. Failure to properly establish sound year end cut-off procedures increases the risk of financial statement misstatements occurring and going undetected by management. In addition, these misstatements may have an adverse effect on management's ability to make sound financial decisions.

**We believe the following deficiencies constitute material weaknesses (Continued):**

***Cut-off Procedures: (Continued)***

***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 procedures to include expenses in the proper year. Direct payments are marked "old year" and "new year" during the closing period of the fiscal year. During 2011 it was discovered that purchase orders were expensed to the incorrect year. This oversight was due in part to staff turnover and shortages in the Accounts Payable and Controller's Office. Management recognizes this shortcoming and has begun the necessary procedures to fill positions, consistent with City's fiscal restraints and collective bargaining-unit provisions of its labor contracts.

***Department of Planning and Development:***

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

Our audit procedures revealed that during fiscal year ended June 30, 2011 there was no systematic method of ensuring that timely and complete monthly reconciliation and closing procedures take place. Bank reconciliations were not prepared and loan receivable subsidiary ledgers were not reconciled to the general ledger on a monthly basis. 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. This situation should be corrected as soon as possible with the establishment of a system of consistent and timely monthly reconciliations and closing procedures.

***Recommendation:***

We recommend that the Planning Department develop 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. As of January 2012, the Planning Department has implemented a formal reconciliation process for all cash accounts and loan accounts which are completed on a monthly basis.

**We believe the following deficiencies constitute material weaknesses (Continued):**

**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 the Planning Department 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 control over decentralized departments and component units whose accounting and fiscal operations are not sufficient to maintain reliable and accurate accounting. Management has taken action to expand fiscal oversight and review of decentralized departments and component units. Internal control, management and supervisory procedures necessary to provide timely account reconciliations have been implemented.

***Accounting Policy and Procedures Manual:***

We noted that the City of Providence currently does not have a formal up-to-date accounting policy and procedures manual. Written procedures, instructions, and assignments of duties will prevent or reduce misunderstandings, errors, inefficient or wasted effort, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. A well-devised accounting manual can also help to ensure that procedures used are proper, and that records are produced in the form desired by management. A good accounting manual will also aid in the training of new employees.

***Recommendation:***

We recommend that an accounting policy and procedures manual be prepared. The procedures manual should identify the controls that are in place to help reduce the risk of fraud, errors, or irregularities from occurring and going undetected by management. 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 accounting 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.

**We believe the following deficiencies constitute material weaknesses (Continued):**

***Accounting Policy and Procedures Manual: (Continued)***

***Management's Response:***

Management concurs. Management has begun the process of developing and writing an accounting manual. This will be an important tool management will use in training and supervising accounting personnel. The process will also allow management to evaluate its internal control and improve procedures.

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

***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 year-end schedules. There is no formal reconciliation process in place. In addition, the City and PPBA are unclear as to how the capital assets are tracked and who is responsible for maintaining the PPBA fixed asset schedules.

During our audit we noted the following related to capital assets:

The City does not maintain a comprehensive fixed asset listing. During our testing we noted instances of new fixed assets not included in the fixed asset listing.

The City has a policy that a physical inventory of capital assets is taken on an annual basis by department coordinators. We noted that this physical inventory was not taken for fiscal year ended June 30, 2011.

***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 and new assets are recorded. In addition, projects which have been started during the year and are not yet completed are properly recorded as construction-in-process.

***Management's Response:***

Management concurs that a physical inventory of fixed assets has not occurred and has taken steps to begin a physical inventory count.

The City has procedures in place to account for additions to fixed assets. During the audit it was discovered that an asset purchased during the fiscal year was not included in additions. This was an oversight that management has recognized and has taken steps to ensure that all fixed assets are included and tracked appropriately in the City's fixed assets system.

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

***School Department:***

***Student Activity Funds:***

During testing of the student activity funds it was found that not all of the schools provided bank reconciliations or current year activity for the year ended June 30, 2011. Current and updated activity will help provide for accurate record keeping among each of the funds and help to avoid comingling of funds.

***Recommendation:***

We recommend management of the Providence School Department review the current policies and procedures governing the reporting and maintenance of the financial records related to student activity funds administered by the School Department.

***Management's Response:***

Management concurs that not all schools provided bank reconciliations at year end. This was mainly due to school closings and change of Principals. The School Department is taking steps to train all new Principals on the student activity fund policies and procedures.

***Federal Grant Revenue and Expense Reporting***

The City of Providence has numerous individual Special Revenue non-major funds. Special Revenue Funds are used to account for proceeds of specific revenue sources that are legally or administratively restricted for certain expenditures. Under the terms of funding agencies, some of these funds have requirements that any unspent funds be returned to the funding agency. Accounting for these grants should take this into consideration and unspent funds should be properly recorded as deferred, if applicable. During our audit, we noted instances where unspent funds were recorded as revenue when received and a deferred liability had not been recorded.

***Recommendation:***

We recommend that management review the various funds, determine whether any revenue should be deferred, and record a liability if applicable.

***Management's Response:***

Management concurs. The City is taking steps to ensure grant revenue and expense reporting is recorded properly and is in the process of implementing a new grant management system.



**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, 2011 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 the City 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. 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 2012, the City Controller's Office has begun training the Planning Department accounting staff in the City's Lawson accounting system. The Planning Department is now utilizing Lawson to record, track, and reconcile the bank statements each month.

***GASB Statement #54:***

Governmental Accounting Standards Statement #54 became effective for the fiscal year ended June 30, 2011. This standard revised the definitions of Special Revenue Funds and Capital Project Funds. In addition, the Statement changed the classification of fund balance into five categories: non-spendable; restricted; committed; assigned; and unassigned. We noted that as of June 30, 2011 the City has not adopted a spending policy or fund balance policy related to this Statement and as a result, the City financial statements report the spending policy in accordance with the default policy stipulated in GASB Statement #54. Since the City is using the default policy stipulated in GASB Statement #54, only the City Council is authorized to make assignments of fund balance.

***Recommendation:***

We recommend that the City Council in conjunction with the City's Finance Director review the requirements of GASB Statement #54 and that the City Council adopt a formal spending policy in accordance with those requirements. We further recommend that this spending policy also include provisions which define the City's top level of government and also those that are given authorization to make assignment of fund balance and the process for doing so.

***Management's Response:***

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. Early implementation has been encouraged. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented. The City of Providence will endeavor to comply with GASB 54 reporting with the audit of the June 30, 2012 financial statements

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

***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:***

We commend the City for establishing a written code of ethics which is the first component of its fraud prevention activities. A comprehensive, written code of ethics 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.

While we are not aware of any instances of fraudulent activities, we 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. Per City Ordinance, the position of Municipal Integrity Officer has been established. This position would be in charge of maintaining a hotline and website for employees to report any suspected fraud and to provide easy access to the City's Code of Ethics. However, due to fiscal constraints, the City has not been able to fill this position.

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

***Postemployment Benefits (Other Than Pension) OPEB:***

Over the past few years, government accounting principles have undergone significant changes. One of the most significant areas of change concerns accounting for benefits being provided to former employees (health insurance, life insurance, etc.). Currently, amounts paid for these benefits are treated as expenditures when they are paid. As a result, costs are not being matched against the period in which the employee provides services to the City. The Governmental Accounting Standards Board recognizes this inequity in the financial reporting structure, since future taxpayers are being burdened with paying for the costs of employee services which were provided in previous periods. In addition to recognizing the theory behind a change in this area, one must evaluate the costs associated with providing post-employment benefits.

The City of Providence recently completed a valuation of the OPEB liability as of July 1, 2010. The results of the valuation indicated that the City had an unfunded OPEB liability of approximately \$98 million.

***Recommendation:***

Although we realize that it is impossible for the City to fully fund the ARC (annual required contribution) in accordance with the actuarial report, we recommend that City officials take a proactive approach to funding these post-employment benefits by creating an Irrevocable Trust Fund and including a budget appropriation transfer on an annual basis.

***Management's Response:***

Management concurs. The City has established a trust fund for the OPEB, in the amount of \$1,000,000 along with the per pay-period contributions of the City's Firefighters equaled to 1.5 percent of their salary. Given the size of the City's unfunded OPEB liability, the City is not in a position to fund the future OPEB (non-pension) and chooses to fund the current portion of the OPEB on a pay-as-you-go basis

***Pension Plan:***

At June 30, 2011 the City had a net pension benefit obligation (NPO) of approximately \$136 million for the City Pension Plan. In addition, as of July 1, 2011 (most recent available information) the unfunded actuarial accrued liability was approximately \$908 million for this plan. The NPO represents the cumulative deficiency of the actual contributions made versus the actuarial contributions required by the City as of June 30, 2011. The unfunded actuarial accrued liability represents the projected liability in excess of the assets available at July 1, 2011.

During the fiscal year ended June 30, 2011 the City had not funded these pension trust funds in accordance with the actuarial valuation (Annual Required Contribution (ARC) and Annual Pension Costs (APC)), resulting in an increase in NPO at June 30, 2011. The plan was funded at approximately 47%.

***Recommendation:***

We recommend that members of the administration and City Council develop a formal pension funding policy that focuses on developing and adopting a funding policy that provides guidance for developing the annual contributions made to the Pension Trust from the General Fund during the budgeting process.

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

***Management's Response:***

Management concurs. The administration is committed to funding 100% of the ARC and accounts for the payment in its budget submission to the City Council. The value of the annual contribution to the pension plan is based on an actuarial value of future pension obligations based on its current workforce and retirees.