

CITY OF LOWELL, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2018



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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 City of Lowell, Massachusetts, as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Lowell, Massachusetts' internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances 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 was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

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 a 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. As described in the memorandum that accompanies this letter, we identified certain deficiencies in internal control regarding the City's School Department holding bills until the next fiscal year due to insufficient funds that we consider to be a material weakness.

Additionally, during our audit we became aware of several matters that we believe are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter also 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

April 22, 2019

CITY OF LOWELL, MASSACHUSETTS

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TABLE OF CONTENTS

	PAGE
Material Weakness	1
School Budget Over Expenditures.....	2
Prior Year Comments - Resolved	4
Parking Ticket Receivable	5
Treasurer's Cash Draw Over/Under Policy.....	5
Tax Foreclosures	5
Prior Year Comments - Unresolved	6
Cash Reconciliation Procedures.....	7
School Grant Management	8
Section 108 Loan Fund.....	8
Purchase Order Dates	9
Late Invoices.....	9
Current Year Comments	10
Compensated Absences for the School Department.....	11
Documentation of Internal Controls	11

Material Weakness

School Budget Over Expenditures

Material Weakness

The City's School Department has consistently had issues in meeting their net school spending. As a result, the School Department should have implemented controls over the years to properly monitor and track their budgeted versus actual expenditures to help with the determination of net school spending, but also to assist in allowing the School's finance team to monitor the budget and be able to identify situations that could occur causing the School to miss bill payments or overspend their overall budget.

During 2018 the Assistant Superintendent of Finance left the District at which time invoices were discovered that should have been paid in fiscal 2018. This resulted in the School hiring a consulting firm to complete a forensic review of School finances for the year ended June 30, 2018.

The forensic review report noted \$1,431,206 of food service bills for April, May and June of 2018 that remained unpaid and accrued at June 30, 2018. These bills would have caused the fund to go into a deficit position of \$776,000. There was also approximately \$200,000 of invoices that relate to the School general fund operating budget that were not recorded. This would have caused a budgetary deficit in the education line item of the City's budget.

We have concluded that School management intentionally withheld food service and general fund invoices during 2018 with the intent to charge the expenditures to the 2019 budget.

The cumulative effect of the School Department intentionally hiding invoices ends with the general fund education line and the food service fund being over expended at the end of 2018. The general fund education line is approximately \$214,000 overspent and the food service fund is in a deficit of approximately \$776,000.

The consulting firm's report also mentioned that the School Department has been charging inflated indirect costs to the food service program. A similar situation occurred in 2016 and was highlighted in the City's management letter. The School continues to use inflated indirect cost allocations to charge budget items to the food service program and has not had the indirect plan approved by the Massachusetts Department of Elementary and Secondary Education.

Adjustments have been made to the City's 2018 financial statements to properly record the invoices identified that relate to 2018.

We believe the above constitutes a material weakness in the School's system of internal controls.

Recommendation

We recommend that the City implement procedures to strengthen controls to provide reasonable assurances that expenditures are properly reported in the City's financial records and in the proper period. This would include a process for the School Department to address any future operating deficits by implementing a budgetary plan to reduce expenditures to amounts available to them through the general fund appropriation or other funding sources.

We also recommend that the School work with City finance personnel and develop an indirect cost allocation plan that can be approved by the Massachusetts Department of Elementary and Secondary Education.

Finally, the City may want to reach out to the Commonwealth of Massachusetts Bureau of Accounts who provides oversight on financial issues related to all Mass cities and towns. They could assist the City in determining the best way to handle the education line item and fund balance deficit.

Prior Year Comments - Resolved

The following comments were resolved during the current year. Please see the June 30, 2017, Management Letter for the complete original comment.

PARKING TICKET RECEIVABLE

TREASURER'S CASH DRAW OVER/UNDER POLICY

TAX FORECLOSURES

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.

Status

During 2018, the City's interim Treasurer resigned which resulted in untimely and incomplete cash reconciliations for 2018. Subsequent to June 30, 2018, the City has hired a Treasurer who began to reconcile the accounts with immaterial variances. Reconciliations are almost up to date, and remaining variances are being identified and corrected.

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 supporting all reconciling items identified.
- We recommend that the Treasurer formally reconcile the Treasurer's book balance to the reconciled bank balance monthly and properly account for any unknown variances.
- We recommend that the Treasurer work to close 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.

SCHOOL GRANT MANAGEMENT

Prior Year Comment

In previous management letters we noted, the Lowell Public Schools receive significant federal education grant funds. We noted during 2016 that the City returned \$508 thousand and during 2017 returned \$807 thousand of federal funds 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 been used.

We recommended 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.

Status

During 2018, significantly less funds were sent back. A total of \$118,000 of grant proceeds were returned at the end of fiscal year 2018. Management should continue to review the grant programs and work to assure that the maximum benefits are being derived from all grant funds received and determine what the underlying reasons for needing to return funds each year are and if any changes are deemed necessary.

SECTION 108 LOAN FUND

Prior Year Comment

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

We recommended that procedures be implemented to assure that when debt payments on Section 108 loans are made that the liability balance maintained in fund 1134 be adjusted accordingly.

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

Status

Procedures were implemented to ensure when the debt payments are made the liability balance is adjusted accordingly. No determination of the nature of the cash balances maintained within these funds was determined during 2018.

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

PURCHASE ORDER DATES

Prior Year Comment

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

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

Status

We noted that there are still purchase orders with dates subsequent to the invoice date.

We continue to recommend that a policy regarding the approval of purchase orders prior to the purchase of goods or services by any Department be implemented.

LATE INVOICES

Prior Year Comment

In previous management letters we noted that, invoices paid after year end may not have been recorded in the proper period. We noted several invoices related to Engineering, Wastewater, and the School Department. This occurs because the City does not have a well-defined policy outlining the timeliness of processing invoices. The lack of a policy over the timeliness of paying invoices can lead to inaccurate financial reporting and can mask overspending and deficit balances if invoices are intentionally held until the next year.

We recommended that the City implement procedures to ensure the timely submission and payment of departmental invoices.

Status

During the current year review of invoices, we noted there are still several invoices that are months old being paid after fiscal year end. Also, please see the material weakness section at the beginning of this document regarding the School Department invoices.

CURRENT YEAR COMMENTS

Compensated Absences for the School Department

Current Year Comment

During fiscal year 2018, the School Department was unable to provide sick or vacation compensated absences balances in a timely manner and the figure was estimated for the financial statements.

Recommendation

We recommend that the School Department utilize their financial software to track these balances and that these reports be reviewed more frequently than once a year. The amounts should be compared to the contracts and collective bargaining agreements to ensure appropriate accruals. This would ensure timely preparation of the information for inclusion in the City's financial statements.

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) 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 were 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 follow 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).

Management is responsible for internal controls 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 must incorporate the 5 major components of internal control, while addressing the 17 principles of internal control that support the COSO framework. Refer to www.coso.org for articles describing the 5 components and their 17 principles in detail.

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 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.