

PEAT, MARWICK, MITCHELL & CO.

CERTIFIED PUBLIC ACCOUNTANTS

40 WESTMINSTER STREET

PROVIDENCE, RHODE ISLAND 02903

May 9, 1979

PRIVATE

Ms. Rose M. Mendonca
City Clerk
City Hall
Providence, Rhode Island

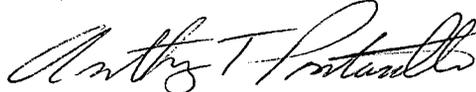
Dear Ms. Mendonca:

Enclosed are forty (40) copies of the management letter of the City of Providence for the year ended June 30, 1978.

Please hand deliver two copies, one each to The Honorable Vincent A. Cianci, Jr. and Ms. Carolyn Brassill.

Very truly yours,

PEAT, MARWICK, MITCHELL & CO.



Anthony T. Pontarelli, Partner

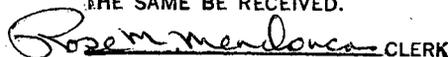
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cc: The Honorable Vincent A. Cianci, Jr.
Ms. Carolyn Brassill

IN CITY COUNCIL
MAY 15 1979

READ:
WHEREUPON IT IS ORDERED THAT
THE SAME BE RECEIVED.

 CLERK

PEAT, MARWICK, MITCHELL & Co.

CERTIFIED PUBLIC ACCOUNTANTS

40 WESTMINSTER STREET

PROVIDENCE, RHODE ISLAND 02903

November 30, 1978

CONFIDENTIAL

Honorable Mayor and
Members of the City Council
Providence, Rhode Island

Gentlemen:

We have examined the financial statements of the City of Providence for the year ended June 30, 1978, and have issued our report thereon dated November 28, 1978. As a part of our examination, we made a study and evaluation of the City's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards, the purposes of such evaluation are to establish a basis for reliance on the system of internal accounting control in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to assist the auditor in planning and performing his examination of the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived, and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control.

In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Honorable Mayor and
Members of the City Council
November 30, 1978

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Our examination of the financial statements made in accordance with generally accepted auditing standards, including the study and evaluation of the City's system of internal accounting control for the year ended June 30, 1978, that was made for the purposes set forth above, would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and related data.

This study and evaluation did disclose conditions that we believe to be material weaknesses. A material weakness in an internal accounting control is defined as, "... a condition in which the auditor believes the prescribed procedures or the degree of compliance with them does not provide reasonable assurance that error or irregularities in amounts that would be material in the financial statements being audited would be prevented or detected within a timely period by employees in the normal course of performing their assigned functions". Although certain material weaknesses were noted, our auditing procedures were appropriately adjusted to compensate for the weaknesses noted.

The following are the conditions which came to our attention, and which we believe to be material weaknesses.

PROPERTY TAXES

As in prior years, we noted that tax receivable balances on certain incorrectly assessed accounts have not been adjusted to reflect the proper assessment. Also of concern is the fact that the tax roll contains a significant amount of uncollected delinquent taxes. We recommend that the Assessor review the various tax rolls for possible errors in assessed valuations. Special emphasis should be placed on reviewing original assessments on the larger past-due balances. We also suggest that in an effort to increase collections, an objective study of the entire tax collection area be made and the results of the study be implemented as soon as possible.

Although progress has been made during the current period we feel this area requires attention as one of the City's highest priorities.

Honorable Mayor and
Members of the City Council
November 30, 1978
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TAXES RECEIVABLE

Proper control over taxes receivable requires the establishment of individual records for each piece of taxable property, and for each personal property taxpayer on which taxes receivable and payments are recorded thereon. Our review of the City's taxes receivable disclosed as in prior years' that the data processing printout of year-end taxes owed does not agree with the Tax Collector's control. It was also noted that the detail controls of taxes receivable were not properly handled due to errors in posting activity relating to property acquired at tax sale, abatements, the tax levy and overpayments of City taxes.

We recommend, as we have since 1971, that the City make every effort to reconcile the detail listings to the City Collector's controls. Control totals can be reconciled through the use of the weekly detail receivable listings received from the computer center.

In addition, many tax confirmations were returned "addressee unknown". A current address file would facilitate collection of taxes due.

CITY PENSION PLAN

As disclosed in the notes to the financial statements, the City's policy of recording pension costs is not in conformity with generally accepted accounting principles.

As of June 30, 1976, the date of the latest actuarial valuation, the City's liability for unfunded past service costs amounted to \$93,677,474. The June 30, 1976 actuarial valuation, based on 1976 plan members and salary ranges, was the basis for a recommended \$9,651,714 contribution during the fiscal period beginning on July 1, 1977. Of the approximate \$9 million recommended (\$9,651,714 less \$717,111 paid over by the Providence School Department), \$4,113,013 was budgeted and \$1,350,000 actually paid; the balance of \$2,763,013 was encumbered at June 30, 1978. Because of certain changes in the plan, contracts and arbitrations with various unions, increasing personnel and salary levels plus the fact that the City had not funded as recommended over the past years, the information contained in the 1976 actuarial report is outdated.

Although the valuation has been brought current through 1976, we recommend that the City prepare and submit current personnel data to their actuaries so that a liability for unfunded past service cost in terms of current operating levels and current dollars may be determined. We feel it is critical that the City make every effort to bring the plan assets up to the required level by making appropriate contributions to the plan in the future.

The Honorable Mayor and
Members of the City Council
November 30, 1978

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CAPITAL EXPENDITURES AND DEBT SERVICE

A review of the City's various bonding authorizations and transactions under these authorizations indicated that although formal contracts have been entered into, there have been certain instances where purchase orders are not utilized for capital expenditures and as such the status of contracted work is not determinable.

The City has hesitated to bond under authorizations approved by the City Council and General Assembly. As an alternative to bonding, the City has borrowed under short-term instruments to fund capital project construction and the carrying costs of this debt.

We recommend that a purchase order system be implemented for all capital expenditures, and that the City review the status of all projects to determine their stage of completion and the adequacy of funds available under the original authorization as they relate to interest costs capitalized and current purchasing power of the dollar.

PERSONNEL ORDINANCE

Personnel service costs represent a substantial portion of the City's annual expenditures. The personnel ordinance, as approved by the City Council, is an important element in the budgetary process. Our examination indicated that a revised personnel ordinance, reflecting an arbitrator's award, was not approved by the City Council. We recommend that any and all adjustments to the originally approved personnel ordinance be approved by the City Council.

VOUCHER SYSTEM

We noted during our examination of cash disbursements that the payment and approval procedure was not consistently applied. We recommend, as we have since 1975, that specific persons be authorized to approve invoices for payments, and that only invoices approved by these employees be processed for payment. Such a procedure would disclose the existence of any unauthorized purchases. We also recommend that each invoice processed for payment be consistently reviewed for:

1. Accuracy of footings and extensions,
2. Comparison of quantities with purchase orders, and
3. Comparison of quantities billed with receiving report.

Honorable Mayor and
Members of the City Council
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COMPETITIVE BIDDING

It was noted that on occasion, several purchase orders of the same date for like items from the same vendor were used when it appears that one purchase order would have been sufficient. There may be instances where the use of multiple purchase orders are required; however, no documentation was available for our review that indicated the reasons for not obtaining the required bids.

At June 30, 1977 we recommended that the Department of Public Property - Purchasing implement procedures to screen all multiple purchase orders and document why a competitive bid was not required. An executive order to this effect was issued and rescinded during the current period.

REVOLVING FUNDS

The Public Works Department submits an inventory to the City Controller's office at year end based upon quantities on perpetual inventory cards maintained at the Department. In our test of these perpetual cards, we noted exceptions in a number of instances between the card quantity and our actual count. We suggest, as we have since 1971, that these perpetual cards be updated with an initial physical count followed by staggered physical counts through the year, since there has not been a physical inventory taken by the Public Works Department in more than four years. This procedure will result in a more accurate year-end inventory value.

Details of fixed assets are maintained by the Inventory Control Department. Our review of fixed asset additions and deletions disclosed a variance between the fixed asset balance per the general ledger and the detail maintained by the Inventory Control Department. This variance arose because there are no effective procedures to notify the Inventory Control Department of changes involving fixed asset accounts. To provide effective accountability over equipment owned and ensure reliability of the records maintained, we recommend the Inventory Control Department receive a monthly statement of fixed asset purchases. This monthly statement would give the Department timely notification of additions and allow for the prompt preparation of perpetual inventory cards. The Public Works Department should promptly notify the Inventory Control Department of all deleted assets and submit monthly activities for reconciliation.

ACCOUNTING RECORDS

We noted that the cash disbursements journals, general ledgers, and City tax rolls are not secured at night. We further noted that the City Assessor's records are not adequately protected against the perils of fire. We recommend that these and all other important City records be adequately safeguarded in a locked and fireproof safe or cabinet. This practice would preclude the possibility of unauthorized access and the potential destruction by fire.

Honorable Mayor and
Members of the City Council
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INVESTMENTS

The items listed below were noted during the current year's examination:

1. Purchases and sales of securities are not recorded on a timely and consistent basis.
2. Under the present system, only one official is needed to gain access to the City's security safe deposit vault. A majority of the City's investments are in the form of bearer paper.

Although ultimate responsibility for this area lies with the City Treasurer, we recommend that a clear line of communication between the Treasurer and Finance Directors offices be initiated to insure a timely accounting of investment activity. We also recommend that the Treasury Department establish procedures that require the presence of two responsible City officials in order to access the City's safe deposit vault.

OTHER COMMENTS

In addition to the above-noted comments on material weaknesses in internal control, our study and evaluation also disclosed the following conditions we feel merit your attention.

PAYROLL

Based on our examination, we believe that implementation of the following recommendation would improve internal accounting controls in the payroll area.

1. The responsibility of distribution of payroll checks be rotated from time to time.
2. All withholding authorizations be updated and signed by each employee.

Our review of reconciliations prepared on the City's payroll bank account disclosed several accounting errors which were not corrected on a timely basis. It is our recommendation that in light of the dollar activity in this account, all errors be immediately corrected.

BUDGETING PRACTICES

Starting with the budget submitted and approved for the fiscal year beginning July 1, 1974, property tax collections fell short of estimates by nearly \$1,000,000 and the amount of surplus at June 30, 1974 available for 1975 appropriations fell short of the budget estimate by \$1,542,000. This practice of over-estimating revenues has been consistently followed through 1978 - particularly in the area of property taxes for the past two years.

Honorable Mayor and
Members of the City Council
November 30, 1978
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The following schedule indicates the magnitude of over-estimated revenues used in the City's budgeting process for the past five fiscal years:

<u>Fiscal year ended</u> <u>June 30</u>	<u>Deficiency of budgeted</u> <u>to actual revenues</u>
1974	\$ 2,099,554
1975	3,883,725
1976	2,752,694
1977	10,576,145
1978	<u>6,761,020</u>

We recommend that the City Council when setting the levy assure themselves that the revenue estimates adopted are realistic.

For the past several years, the City has not had an operating budget or a levy until well into the fiscal year. We suggest that steps be taken to move up the budgeting process in order to have the budget and data supporting such budget estimates in place prior to July 1.

ACCOUNTING PRINCIPLES

As noted in our report, the City is not in compliance with generally accepted accounting principles as defined by the National Committee on Governmental Accounting, in that the City follows the practice of recognizing revenue on a cash basis. We recommend that the City consider the adoption of the accrual basis of revenue recognition, and those principles promulgated by the National Committee on Governmental Accounting and the American Institute of Certified Public Accountants.

Based on our reading of the Uniform Accounting and Reporting Standards for Rhode Island Municipalities as promulgated by the State Auditor on February 21, 1978 and effective for the fiscal year beginning July 1, 1978, we recommend that the City establish the required funds needed to comply with these regulations. A General Fixed Asset Group of Accounts, Capital Projects, Debt Service and Enterprise Funds should be established.

VARIANCES BETWEEN GENERAL LEDGER CONTROLS AND SUBSIDIARY RECORDS

While analyzing tax reverted property accounts receivable, water accounts receivable, and various reconciliations, we noted discrepancies between the general ledger and subsidiary records. To prevent future errors of this type, we recommend monthly reconciliations be performed between all detail subsidiary records and the general ledger in order to identify existing discrepancies on a timely basis.

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ACCOUNTING MANUAL

There has never been a written manual defining accounting policies and procedures. Manualization of accounting policies and procedures would provide an excellent tool for department supervisors and assist in maintaining continuity of operations in the absence of key employees.

TRUST AND SPECIAL FUNDS

As in the past, the accounting for transactions involving Trust and Special Funds are processed manually. Due to the complexity and time involved in processing these transactions, we recommend computerization of this system.

SYSTEMS AND AUDIT GROUP

The City of Providence is a large and complex organization. We again recommend that the City originate a systems and audit group. The resultant benefits of such a plan would be as follows:

1. As each segment of the City is audited, recommendations for improvement of current procedures and work flow would be made.
2. The group would not only be in a position to make recommendations, but could follow up on these recommendations through implementation.

BANK ACCOUNTS

Our review of the City's bank accounts at June 30, 1978 disclosed that checks were not being issued in numerical sequence. In order to insure proper accounting cut-offs, we recommend that checks be issued in numerical sequence.

Our review of the bank reconciliation process highlighted various reconciliations which were two to three months in arrears, certain checks outstanding for more than one year, and authorized check signers no longer in the City's employ. We recommend timely reconciliation of all bank accounts, reinstatement to cash of all checks outstanding greater than one year, and updating of list of authorized check signers.

PETTY CASH

It was noted during our examination that there were certain weaknesses regarding control of petty cash funds. To improve control over the City's petty cash funds, we suggest the following:

1. All petty cash funds should be placed on an imprest basis. The imprest system is a procedure whereby cash is disbursed and from time to time restored to its original amount through reimbursement equal to sums expended.

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2. Petty cash vouchers should be prenumbered and used in support of all payments from petty cash funds.
3. All slips should be signed by both the individual receiving the cash and the person in charge of the fund.
4. Petty cash slips should be canceled when reimbursement is made to the fund.
5. Cash funds should be counted at irregular intervals by someone other than custodians and any differences should be investigated.

* * * * *

The City's various financial departments have responsibility for safeguarding the City's assets, recording financial transactions, and reporting financial data accurately and on a timely basis. Implementation of the above recommendations would improve internal control over these financial responsibilities. However, during the past year, efforts to improve fiscal management have been hampered by hiring freezes and salary scales too low to attract qualified applicants for unfilled job positions. In addition, in July of the current year an arbitrator's decision eliminated certain positions in the various financial departments.

We believe that it is imperative that all branches of City government make a commitment to improve its budgeting, collection, and reporting practices. This could be started with an objective review of job descriptions, positions and salary levels. This review would provide the basis for improved fiscal management.

The foregoing conditions were considered, where necessary, in determining the nature, timing, and extent of audit tests to be applied in our examination of the financial statements, and this report of such conditions does not modify our report, dated November 28, 1978, on such financial statements.

Should you have any questions concerning the matters presented herein, we shall be pleased to discuss them with you at your convenience.

Very truly yours,

Pent, Maxwell, Mitchell & Co.