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**City of Providence, Rhode Island**

April 21, 2011

Ms. Anna M. Stetson  
City Clerk  
City of Providence  
25 Dorrance Street  
Providence, RI 02903

Dear Madam Clerk:

Attached is the "Corrective Action Plan to Restore Sound Financial Management," a report prepared by Matthew M. Clarkin, Internal Auditor, and Gary Sasse, Fiscal Advisor to City Council.

Please keep on file as a public document, and make available to interested parties, as necessary.

Also, please transmit a copy to the Rhode Island Attorney General, and to the Rhode Island Ethics Commission for their review.

Sincerely,

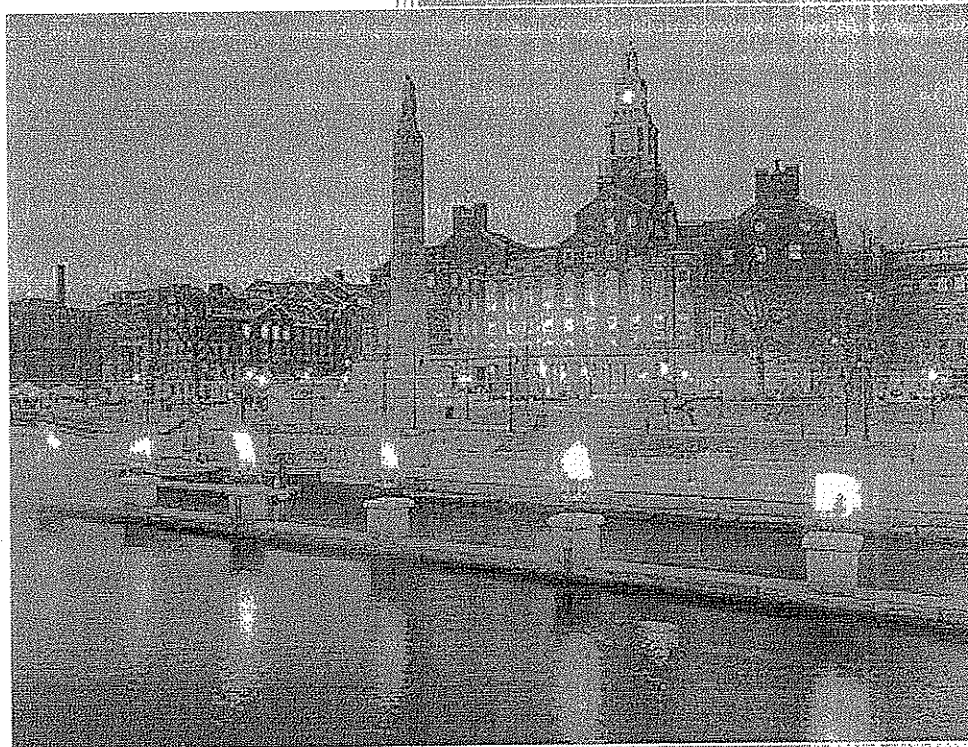
A handwritten signature in black ink, appearing to read "Michael A. Solomon".

Michael A. Solomon  
Council President

**IN CITY COUNCIL**  
**APR 21 2011**

READ  
WHEREUPON IT IS ORDERED THAT  
THE SAME BE RECEIVED.  
A handwritten signature in black ink, appearing to read "Anna M. Stetson".  
CLERK

## Corrective Action Plan to Restore Sound Financial Management



Commissioned by:

Providence City Council

By:

Matthew M. Clarkin, Jr. Internal Auditor

Gary Sasse, Fiscal Advisor to City Council

4/20/2011

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# INTRODUCTION

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The national recession, the collapse of the housing market, and the unprecedented reduction in state aid had a dramatic impact on the financial health of the City of Providence. Between fiscal years 2008 and 2011 state aid was reduced by 19% or \$49.6 million. The last fiscal year the City ended with balanced budget was 2008. In fiscal years 2009 through 2011, the City relied on non-recurring revenues (i.e. reserve funds and borrowings) to balance its budget. During the same period the City's "Rainy-Day Fund" shrunk from \$22.4 million to \$2.0 million.

While factors and events beyond the City's control contributed to Providence's weakening financial condition, the prior Administration did not recommend the difficult choices necessary to avert a fiscal crisis. The Administration did not present a corrective action plan that could have minimized the pending financial melt-down that the City has experienced. Furthermore, the City's financial challenges have been made more difficult to address because of a dysfunctional financial management system. A system where communication between the Administration and the City Council was problematic, where deadlines for providing information were missed, where an operating budget was enacted seven months after the fiscal year began, where requirements of the City Charter were ignored, where unrealistic budgetary assumptions were presented, and where effective monitoring of the Administration by the City Council was made difficult and was thus lacking.

The recent report of the Municipal Finance Review Panel stated that "The City's overall financial management should be significantly improved." The Review Panel specifically noted the need to improve budgetary controls, reestablish monthly budget monitoring, and to comply with City Charter requirements.

Based upon a review of fiscal years 2009-2011, the following examples are illustrative of some of the reasons a fiscal storm was transformed into what Mayor Taveras characterized as a Category Five hurricane.

1. The Administration transferred funds from the Undesignated Surplus (Rainy-Day Fund) without approval of a majority vote of the City Council as required by Section 810 of the Providence City Charter. The City's Rainy-Day Fund was reduced by \$5.0 million in fiscal 2009 and \$12.5 million in fiscal 2010.

2. The Administration did not provide financial information on a timely basis to the independent auditor, the City Council or the Internal Auditor. Included in this report is a chart (see page #14) that sets forth a comparison between the deadlines the external auditor established for receiving information and the dates the information was provided. The City's Internal Auditor had to make an "Open Access to Records Act" request to obtain financial reports. Finally, on several occasions the Council's Committee on Finance requested answers and information from the Administration that were not forthcoming.
3. The Administration did not provide the City Council with monthly financial statements or with projections of year-end surpluses or deficits. Section 809 of the City Charter (Reductions to balance budgets) states; "At any time during the fiscal year upon notification by the finance director that it is indicated that actual revenue receipts will not equal the original estimates upon which the appropriations were based, the mayor, for the purposes of maintaining a balanced budget, shall recommend to the city council such reductions or suspension in the appropriation for any or all departments, offices or other agencies of the city government as well, in the mayor's opinion prevent the occurrence of a deficit."

This requirement was not fulfilled in fiscal years 2009 and 2010, which ended with \$5.0 million and \$12.5 million deficits respectively.

4. The Administration prepared budgets based on unrealistic assumptions.
  - i. In the fiscal year 2010 budget the Administration projected \$2.8 million from "Interest - Investments" revenue. Actual revenues from Interest-Investments totaled only \$252,000 by the end of fiscal 2010, and yet the Administration projected that Interest-Investments would yield \$2.8 million in fiscal 2011. As of April 11, 2011, only total is \$16,077 has been recorded under the Interest - Investments revenue account.
  - ii. The national and state economy had a significant impact on the City not only in the area of state aid but in various fees the City receives. Revenues received through fees charged by the Recorder of Deeds and the Department of Inspection & Standards are sensitive to the overall condition of the economy. In fiscal year 2010 a total of \$7.85 million in revenue was budgeted from these two departments and \$6.17 million was received. Despite these revenues falling \$1.7 million short of budget in fiscal 2010 and the fact that the city's economic condition had not improved, the Administration budgeted a total of \$7.5 million from these two sources in fiscal 2011. The Municipal Finances Review Panel projected in February that these revenues would end fiscal 2011 approximately \$1.7 million below budget.

<i>Revenue Description</i>	<i>Actual 2009</i>	<i>Budget 2010</i>	<i>Actual 2010</i>	<i>Budget 2011</i>	<i>Projected 2011</i>	<i>Projected Variance 2011</i>
Inspections & Standards	\$4,128,875	\$5,000,000	\$3,613,157	\$4,655,000	\$3,600,000	(\$1,055,000)
Recorder of Deeds	\$2,861,792	\$2,850,000	\$2,561,380	\$2,850,000	\$2,200,000	(\$650,000)
Interest on Investments	\$1,230,084	\$2,800,000	\$251,662	\$2,800,000	\$22,000	(\$2,778,000)

*\* Source: Municipal Finances Review Panel*

5. The Administration was not transparent in its use of the City's Capital Assets Account – Fund 856 (also known as the “Expendable Trust”). According to Section 810 of the City Charter (Transfer of Appropriations), the mayor must request in writing to the City Council for approval to transfer an amount in excess of \$5,000. There are differing opinions regarding the use of these reserves in recent fiscal years, but it is certain that a minimum of \$13.9 million in funds was transferred from the Capital Assets Account – Fund 856 to the City's General Fund without approval by the City Council.
6. Financial reports submitted to the State were inaccurate. According with state law (RIGL 45-12-22.2), the City is required to submit quarterly financial reports to the Rhode Island Division of Municipal Finance showing year-to-date revenues, expenditures versus budget, and end-year budget projections. The report submitted on January 31, 2011 for the quarter ending December 31, 2010 and signed by the Interim Director of Finance, projected a year-end surplus for fiscal year 2011 of \$587,403. On February 28, 2011 the Mayor's Municipal Review Panel issued a report with a projected deficit of \$28.6 million.
7. The City Council's checks-and-balances on the Administration were ineffective. While the Internal Auditor and Council Members did request financial information from the Administration, these requests were on an ad hoc basis; not based upon a formalized schedule; and systematic procedures and requirements to ensure that requisite reports and requested information was provided in a timely manner were lacking.

The primary objective of this report is not to recount recent history but rather to identify what can be done moving forward to reduce the risk of the City encountering a fiscal crisis of the current magnitude. The balance of this report presents findings and recommendations to reform the City's financial management practices. The financial practices focused upon in this report include the following:

1. Reserve Funds;
2. Annual Audit;
3. Annual Budget Submission; and
4. City Council Oversight & Monitoring of Budget.

### RECOMMENDATIONS

Following is a listing of the recommendations contained in this report:

#### Reserve Funds

##### *Undesignated "Rainy-Day" Surplus:*

- Establish a Minimum Reserve Goal
- Establish a Multi-Year Plan to Appropriately Fund Reserve
- Establish a Policy for the Replenishment of the Fund
- Establish Allowable Circumstances for Use of Reserves
- Establish Procedures for the Approval of Draw-downs from Reserve Funds

##### *Capital Assets Account – Fund 856:*

- Require a Comprehensive Annual Capital Assets Reserve Plan;
- Require an Annual Capital Assets Reserve Report
- Establish More Specific Restrictions on the Use of Reserves
- Increased Role of the City Treasurer

Annual Audit:

- Establish an Audit Committee
- Establish Deadlines for the Publication of the Annual Management Letter
- Develop An Accounting Procedures Manual

Annual Budget Submission:

- Full Compliance of Section 803 of the City Charter
- Full Compliance of Section 813 of the City Charter
- Full Compliance of Section 812 of the City Charter
- Revision of Budget Documents

City Council Oversight & Monitoring of Budget:

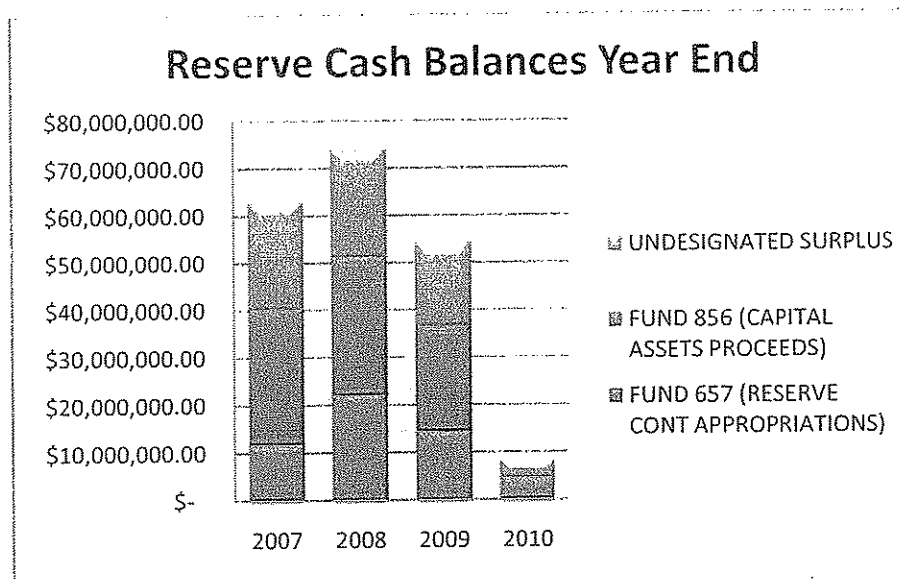
- Require Monthly Budget Reporting
- Require Quarterly Budget Reporting
- Require Monthly Cash-flow Analysis
- Require to Attesting to Accuracy of Reports
- Amend Section 810 of the City Charter
- Accountability in Reporting

# Reserve Funds

## Recent History of Reserve Accounts:

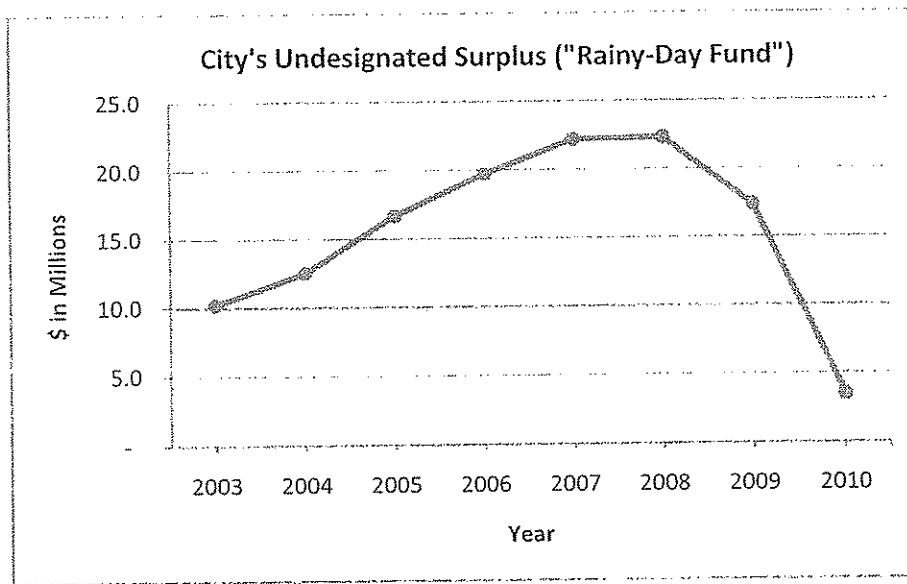
It is essential that the City maintain adequate levels of cash balances to mitigate risks such as unanticipated revenue shortfalls and emergency induced spending. Cash balance levels are also a crucial consideration in long-range financial planning. The following discussion is focused on the City's General Fund.

The cash balances in the City's three largest reserve funds (Undesignated Surplus, Capital Asset Proceeds-Fund 856, and the Reserve Continuing Appropriation -Fund 657) dropped from \$73.7 million at the close of fiscal 2008 to approximately \$8 million as of March 31, 2011. In many instances the draw-downs of these reserves were inconsistent with sound fiscal practices and Charter requirements.



### Undesignated Surplus:

The fiscal 2008 budgetary surplus of \$200,000, which represented the City's twenty-seventh consecutive and last budget surplus, increased the City's cumulative, undesignated surplus ("Rainy-Day Fund") to \$22.4 million or 3.6% of the City's budget. Fiscal years 2009 and 2010 resulted in the use of \$5.0 million and \$13.9 million respectively of this cumulative surplus to close end-of-year budget shortfalls. As of June 30, 2010, \$3.5 million or approximately a half of one-percent (.05%) of the City's budget remained in this reserve fund and \$2.0 million of the remaining balance had already been committed as revenue in the fiscal year 2011 budget.



### Capital Assets Account – Fund 856:

According to Section 808 of the City Charter, "...monies received by the City from the sale of capital assets shall be deposited in a special fund and used only for payment of the City debt or to finance capital expenditures authorized by the Capital Improvement Budget..." The Capital Assets Account – Fund 856 is the reserve account that was established to hold the net proceeds from the sale of all City property, including the sale of the Providence Civic Center.

There is strong disagreement between members of the City Council, the former Internal Auditor (current City Treasurer), and the former Administration concerning the appropriateness of the recent use of funds from the Capital Assets Account. Sufficient information to determine the use of all funds transferred from this account; the original plan established in the fiscal 2009 City budget for the transfer of funds from this account; and the specific purpose of the borrowing of funds from this account by the General Fund, while requested of the Finance Department, was not provided. The fact that this information was not readily available is a source of concern.

Below is a summary of findings concerning the Capital Assets Account – Fund 856:

1. At the close of fiscal 2008, the Capital Assets Account – Fund 856 had a cash balance of \$29.2 million;
2. As of March 31, 2011, the Capital Assets Account – Fund 856 had a cash balance of \$4.7 million;
3. In fiscal years 2009 and 2010, a total transfer of \$2.7 million from the Capital Assets Account – Fund 856 was approved by the City Council for capital projects throughout the City;
4. \$13.9 million in cash was transferred from the Capital Assets Account – Fund 856 to the City's General Fund without the approval of the City Council.

#### **Continuing Appropriation Account – Fund 657:**

Funds reserved in the "Continuing Appropriation Account – Fund 657" consists of portions of annual operating surpluses that were set aside for a wide array of purposes including: small capital projects; hurricane barrier capital improvements; snow removal expenditures; and other officially earmarked activities, such as First Source and RI Resource Recovery recycling education.

As is the case with the Capital Assets Account – Fund 856, there is strong disagreement between members of the City Council, the former Internal Auditor (current City Treasurer), and the former Administration concerning the appropriateness of the recent use of funds from the Continuing Appropriation Account – Fund 657. Sufficient information to determine the specific utilization of all funds transferred from this account in order to make a determination as to the appropriateness of the draw-downs, while requested of the Finance Department, was not provided. The fact that this information was not readily available is a source of concern.

Below is a summary of findings concerning the Reserve Continuing Appropriation Account – Fund 657:

1. At the close of fiscal 2008, the Reserve Continuing Appropriation Account – Fund 657 had a cash balance of \$22.2 million;
2. As of March 31, 2011, the Reserve Continuing Appropriation Account – Fund 657 had a cash balance of \$222,481;
3. \$16.4 million in cash was transferred from the Reserve Continuing Appropriation Account – Fund 657 to the City's General Fund without approval of the City Council.

## **Role of the City Treasurer:**

According to Section 602 of the City Charter, the City Treasurer has "... custody of all public funds belonging to or under control of the City, or any office, department or agency or city government." Strong oversight and management of the investing of idle cash, the approval of use of reserves and the transfer of cash between funds by the City Treasurer was lacking. The Director of Finance had complete control of the City's cash and reserves without a robust checks-and-balance from the Treasurer's Office.

## **General Discussion of City Reserve Policies:**

Given the City's recent financial management of reserve funds, the City Council should establish revised policies and procedures for the administration of reserve funds. These new policies and procedures should be designed to:

1. Provide a clear understanding of the goals and objectives of the reserves established;
2. Set forth limitations and guidelines for the use and replenishment of the City's reserves;
3. Outline a process for periodic reporting and reviewing the status of the City's reserves including the following funds: Undesignated Surplus; Capital Assets Account – Fund 856; and the Reserve Continuing Appropriation Account – Fund 657.

The Government Finance Officers Association (GFOA) recently updated its best practice on unreserved general fund balances to recommend that general purpose governments maintain at a minimum an unrestricted general fund operating balance of no less than two months of regular fund operating revenues or regular general fund operating expenditures. This amounts to 16.75% of either general fund operating revenues or regular general fund operating expenditures. The GFOA cautions that some governments may require much larger reserves based on their particular financial situation. Conversely, a lower level of reserves may be appropriate for governments such as states, cities, and counties because they are better able to predict and plan for contingencies and because they often have a more diversified revenue base that mitigates problems with revenue volatility.

How large should the rainy fund be? This is a contentious issue to which there is no one-size fits-all answer. For example, credit rating agencies may generally prefer large reserves so that there is a high degree of assurance that debt service payments will be made on time. The level of a municipality's undesignated general fund surplus as a percent of revenue has an impact on credit worthiness and the cost borrowing. Moody's reports that the median undesignated general fund surplus as a percentage of revenue for an Aaa was 11.9% in 2009, and 4.2% for municipalities with an A credit rating. Providence's undesignated general fund surplus is .05%. However, if a municipality consistently maintains large reserves it may raise concerns that property taxes are higher than they need to be. It appears that municipal reserves in the range of 5% to 15% are generally considered adequate depending on local conditions. The GFOA recommends that in

establishing a policy governing the size of a rainy day fund in the general fund, a municipality should consider several factors which include the following:

- The predictability of its revenues and the volatility of its expenditures;
- Exposures to significant one-time outlays (disasters, immediate capital needs, state budget cuts etc.); and
- Liquidity

#### **Recommendations - Undesignated "Rainy Day" Surplus**

- 1) **Establish a Minimum Reserve Goal:** It is recommended that the City establish first by Ordinance and then by Charter Amendment a policy that provides for a reserve range between five-percent (5.0%) and ten-percent (10.0%) of general fund expenditures. This reserve should be set so that it can withstand at least one, and possibly two, negative budget events before falling below the minimum rainy day fund of 5% of the previous fiscal year's general fund operating expenditure.
- 2) **Establish a Multi-year Plan to Appropriately Fund Reserve:** It is recommended that a multi-year plan be enacted to fund the reserve at a financially responsible level. Given the City's current fiscal condition it may not be feasible to fully fund the Rainy Day Fund at the levels recommended immediately or even over the next two fiscal years. Therefore, consideration should be given to implementing a multi-year plan to achieve this objective of providing for a prudent rainy day fund. One approach would be to earmark 1.0% percent of the property tax levy in Fiscal Year 2012, and 2% in each fiscal year thereafter until the City's Rainy Day Fund is fully funded at the maximum level.
- 3) **Establish a Policy for the Replenishment of the Fund:** It is recommended that in order to ensure the integrity of the Rainy Day Fund a "Replenishment of Reserves Policy" be adopted and strictly adhered to. It is recommended that this policy establish that in any fiscal year where the reserve fund falls below the mandated minimum, the fund should be restored to the 5% level in the next fiscal year's budget. If the fund falls below ten-percent (10%), it should be replenished over the next three fiscal years.

- 4) **Establish Allowable Circumstances for Use of Reserves:** It is recommended that the allowable uses of the Rainy Day Fund be limited to replacing unanticipated declines in revenues and emergencies as determined by the City Council. The Rainy Day Fund should not be used to fund overspending of adopted budgets. The use of reserves is a one-time non-recurring funding source, and therefore must be utilized carefully and judiciously. Because reserves are built up over a series of years, drawing down on reserves should also be done in measured amounts. If a structural budget imbalance occurs, a multi-year plan should be developed to address this imbalance concurrently with the planned reserve draw-down.
- 5) **Establish Procedures for the Approval of Draw-downs from Reserve Funds:** It is recommended that procedures be implemented to ensure effective oversight of reserve fund transfers by the City Council. The City Council was not proactive and aggressive enough in overseeing draw-downs of reserve funds. Therefore, it is recommended that the following requirements be established and met before funds can be drawn from the Rainy Day Fund.
- All request for transfers shall be made in writing by the mayor as required by Section 810 of the City Charter, shall include an analysis and justification signed by the Director of Finance, and then only be allowed with a majority vote of the City Council.
  - The Director of Administration shall submit to the City Council for approval a Reserve Policy Procedures Manual that includes all reserve funds under the control of the mayor.
  - An annual "Reserve Level Status Report" that identifies all activity during the most recent three-year period in the Rainy Day Fund, the Capital Assets Account – Fund 856, the Continuing Appropriation Account – Fund 657, and any other Internal Service or Enterprise reserve funds that exist or are established shall be submitted in September to the City Council.

## **Recommendations - Capital Assets Account - Fund 856**

The Capital Assets Account receives and holds the proceeds from the sale of capital assets until those funds are needed to finance capital projects or pay City debt. To ensure proper utilization of these reserve funds, the following recommendations are made.

- 1) **Comprehensive Annual Capital Assets Reserve Plan:** At the time of the budget submission for the ensuing fiscal year, the mayor shall submit a comprehensive and detailed plan for the use of any funds that are in the Capital Assets Account at that time or any funds that the mayor expects will be added to the Capital Assets Account during the ensuing fiscal year. It is vital that the specific sources and purposes of the allocation of all funds be included in this plan. For example, if funds are being used to pay City debt, the plan must specifically list the bond issue and the amount of debt being paid with those reserve funds. Any capital expenditures that are planned for the ensuing year from these reserve funds must be specifically identified in the plan and in the City's annual budget.
- 2) **Annual Capital Assets Reserve Report:** The Director of Finance, no later than September 1st of each year, shall provide the City Council with a report that compares activity in the Capital Asset Account with the Comprehensive Annual Capital Assets Reserve Plan that was submitted for the previous fiscal year.
- 3) **Establish More Specific Restrictions on Use of Reserve:** It is recommended that the reserves from the Capital Assets Account be restricted to paying only the principal on existing debt or to finance capital projects in excess of \$100,000.
- 4) **City Treasurer:** It is recommended that the City Treasurer take a much more active role in the oversight and management of the City's cash, investments, and use of reserves. Specifically, the City Treasurer's approval should be required for the transfer of any funds into or out of any of the City's reserve accounts.

# Annual Audit

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## City Charter and State Requirements

Section 817 of the City Charter requires that no later than six months after the close of each fiscal year an audit be completed by state auditors or an independent certified public accounting firm. In addition, Rhode Island General Law 45-10-5 requires Rhode Island municipalities to file their annual audit reports with the Auditor General and the state's Director of Revenue no later than six months after the close of the fiscal year. This includes any findings and recommendations made as a result of the audit. General Law Section 45-10-5.2 and 45-10-5.3 provide for sanctions for communities that fail to comply with this requirement. The law does provide that the Auditor General may grant extensions in the filing of the annual audit when reasonable cause for such an extension is demonstrated by a municipality.

## Fiscal 2010 Annual Audit

Since fiscal 2007, Braver PC has audited the City's financial statements and government activities. Braver shared that they believe the prior Administration did not make completing the annual audit within the six month deadline a high priority. For the first time in more than a decade the City requested a one-month extension from the Auditor General for the 2010 audit.

In August 2010, Braver submitted a list documents and information to the Director of Finance that were required to complete the annual audit, as well as a deadline for the submission of each item. Braver was forced on several occasions to extend those deadlines. According to Braver, some of the information requested was not delivered until the day the report was released on January 31, 2011.

Below are examples of some items that were requested by Braver but the deadlines were not met.

Item Requested	Original Deadline	Date Received
Trial balances	9/20/2010	11/5/2010
Cash reconciliations for all cash and investment accounts	9/13/2010	11/16/2010
List of Abatements 7/1/09-6/30/10	9/20/2010	11/16/2010
Due to/from schedule	9/20/2010	11/16/2010
Detail of Accounts Payable- General Fund	9/20/2010	11/16/2010
Listing of Employee Loans in Fund 700	9/20/2010	12/10/2010
Fixed Assets (Including PPBA)	9/27/2010	12/3/2010
Debt limit calculation	9/27/2010	12/1/2010
Detail listing of all potential claims and judgments pending at year end	9/27/2010	1/7/2011
Backup for CIP, Fixed assets additions testing and Bids selections	9/27/2010	1/21/2011
Net Pension Obligation	10/12/2010	12/17/2010
Total payroll and covered payroll for the City and Board of education, as of June 30, 2010 for pension disclosures.	10/12/2010	1/10/2011
Information for pension disclosure including total payroll, total covered payroll, # of retirees receiving benefits, current employees covered by plan broken down by vested and non-vested at June 30, 2010.	10/12/2010	1/10/2011
Number of individuals receiving post-employment retirement benefits other than pensions and amounts expended during 2010 for OPEB.	10/12/2010	1/10/2011
60 Day Rule collections report (by date and type)	9/20/2011	11/16/2010
Schedule of Federal Awards	ASAP*	12/22/2010

\* ASAP is as soon as possible from the original August request.

### Key Findings Concerning Audit

The Auditor General granted the City a one-month extension and the fiscal 2010 audit was published on January 31, 2011. According to Braver, the completion of the audit was delayed for the following reasons:

1. The City did not assign a Project Manager for the audit whom Braver could coordinate all the tasks required to complete the audit on time. Instead, several changing finance staff members were assigned to assist Braver. As a result of this lack of consistency, Braver found it difficult to get reliable information within mutually-agreed upon deadlines.

2. The City Controller was involved in many tasks unrelated to the City's accounting systems and audit. In several instances, Braver found that the receipt of information and reports important to the audit process was delayed because the Controller was involved with other budget-related tasks.
3. According to Braver, September 15<sup>th</sup> is a reasonable timeframe for trial balances to be completed by a municipality. Braver did not receive the 2010 trial balances from the City until November 5, 2010.

### **Management Letter**

A "Management Letter" is issued as a part of the annual audit process. This letter is written by the independent audit firm and addressed to a client. The letter contains the audit firm's conclusions regarding the organization's accounting policies and procedures, internal controls, and operating policies. The auditor includes its evaluation of the present system, pointing out problem areas and making recommendations for improvement in these areas. It is customary for the client to have an opportunity to review a draft of the auditor's letter and respond to the various comments and findings made by the audit firm.

### **Fiscal 2009 Management Letter**

The fiscal 2009 Management Letter, which customarily would be issued by the end of March 2010, was not issued by Braver until April 2011. Braver delayed the issuance of the Management Letter at the request of the prior Administration because more time was needed to prepare responses.

- On March 26, 2010, Braver sent an email to the City Controller to inquire when the administration's responses for the Management Letter would be available. The Controller responded on the same day via email that the Director of Finance was "finalizing the responses."
- On March 31, 2010, Braver sent an email to the Director of Finance to inquire when the Administration's responses for the Management Letter would be available. The Director of Finance responded on the same day that "I plan to be preparing responses next week and will keep you informed."
- According to Braver, many other attempts were made to get the Administration's responses but each time they were assured that the comments were almost complete. Based upon these assurances, Braver continued to delay the publishing of the 2009 Management Letter.

## Recommendations – City Audit:

*"Establishing an audit committee helps to reduce risks to citizens and elected officials and ensures proper oversight of a government entity's financial process. When the audit committee properly oversees the maintenance of financial reporting, the goal of transparency is also achieved. The audit committee concept has been successfully implemented for many years in the private sector. It is a best practice that should be applied to the government sector."*  
- Rhode Island's former Auditor General Ernest Almonte

1. **Establish an Audit Committee:** It is recommended that the City Council establish an Audit Committee. An Audit Committee will enable the City Council to more effectively focus on issues of financial accountability. This lack of focus made it difficult for the City Council to effectively monitor an Administration whose actions did not meet the highest standards of financial transparency.

The Audit Committee's mission should be to oversee financial reporting practices, internal control procedures, assure compliance with laws and regulations relating to financial controls and related matters.

According to the American Institute of Certified Public Accounts, the creation of an effective audit committee function can help a government establish accountability because it can focus specifically on issues related to fiscal accountability. Furthermore, a government audit committee can devote more time to fiscal accountability matters, resulting in greater benefits for the following:

- Improve financial practices and reporting;
- Influence appropriate action against fraud;
- Enhance the internal audit function; and
- Enhance the external audit function.

It is recommended that the Audit Committee be composed of five (5) members and be staffed by the Internal Auditor's Office. The members of this Committee should be appointed by the City Council and include the following;

- Two members of the City Council appointed to serve terms consistent with their Council terms;
- Three members who shall be certified public accountants appointed from the business community for three-year terms. These members should not be employees of the city of Providence or of any quasi-city agencies or organizations.

An ordinance should be prepared that sets forth the mission, authority, objectives and reporting requirements of the Audit Committee. A critical responsibility of the Committee will be to periodically meet with the City's independent external auditor to ensure audits are completed on time, that information and financial data is provided on a timely basis, and that independence is maintained between the auditor and those responsible for the management of the City. Creation of this Committee will provide a vehicle to keep the City Council and the public informed on efforts to maintain appropriate internal controls, timely and meaningful financial reports, and whether the Administration's financial and business practices are transparent. In general, the implementation of this recommendation will enhance financial transparency and improve the City's Council's oversight of City finances and will provide the public with a better understanding of the City's financial situation.

2. **Establish a deadline for publication of the annual Management Letter:** The City Charter and state law requires that the City's annual audit be completed no later than six months after the close of the fiscal year and that the City's Single Audit be completed no later than ninety days after the close of the fiscal year. There is not a deadline for the publication of the Management Letter. Therefore, it is recommended that City Council establish by ordinance that the Management Letter be issued within thirty (30) days of the release of the annual audit report on City financial statements.

The establishment of this deadline will allow the City Council and the public to learn in a timelier fashion about the City's financial and operational deficiencies as determined by the auditors.

3. **Development of an Accounting Procedures Manual:** Currently the City does not have an established Accounting Procedures Manual. This manual can be developed either internally or externally, but in either case the final version of the Accounting Procedures Manual should be reviewed by the City's Audit Committee and adopted by the City Council.

The development of a comprehensive Accounting Procedures Manual 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 will also 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. Finally, a comprehensive accounting manual will aid in the training of new employees.

# Annual Budget

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## Charter Requirements

The requirements for the submission of the annual budget to the City Council are established in Section 803 of the City Charter. Many of these requirements were not been included with recent budget submissions. The budget requirements established in Section 803 are shown below along with a notification as to whether the individual items were included in the most recent budget submissions.

<u>Description of Requirement</u>	<u>Requirement Met</u>
Submission of Proposed Budget no later than sixty (60) days prior to the start of the fiscal	Yes
Estimate of the amount of any general fund surplus in the current fiscal year available for appropriation in the ensuing fiscal year	No
An estimate of receipts for the ensuing fiscal year from taxes on real estate and tangible and intangible personal property	Yes
An estimate of other receipts for the ensuing fiscal year itemized by sources	Yes
Debt service requirements for the ensuing fiscal year	Yes
An estimate of any deficit from the operations of the fiscal year and any other charge or obligation required by this Charter or by law to be paid in the ensuing fiscal year	No
An estimate of the expenditures recommended by the mayor as necessary or desirable for the purpose of carrying on the work of the several departments, offices and agencies of the city for the ensuing fiscal year itemized by activities and objects and related to the performance goals of each department, office agency of the city under guidelines established by the finance director	Yes
An overall statement of the financial condition of the city at the end of the last completed fiscal year, the estimated financial condition at the end of the current fiscal year, and an estimate showing what the financial condition at the end of the ensuing fiscal year would be in the event that the financial proposals contained in the budget should be adopted	No
Estimated expenditures and revenues for the ensuing two (2) fiscal years	No

Four of the nine requirements established in Section 803 were not met in the fiscal 2011 budget submission and this has been the case for many years. These four requirements are not trivial and have a considerable impact on the City Council's ability to effectively evaluate the current financial condition of the City, the proposed budget before them, and how both impact the longer-term financial health of the City.

It is vital that the Council be presented with an estimate of the current year's projected surplus or deficit as it begins to review the proposed budget for the ensuing year. The Council's effectiveness in making wise decisions regarding revenues and expenditures priorities in the ensuing fiscal year is significantly compromised without accurate information as to the year-to-date results and projections for the current budget.

The inclusion of these four items in future budget submissions will provide the Council with a wider view in which to evaluate the proposed budget ensuing fiscal year and the City's overall financial health.

### **Annual Budget Presentation**

The annual budget is established through the passage of four Ordinances (Compensation, Classification, Appropriation and Levy). The Compensation Ordinance establishes salaries for the various positions in the City. The Classification Ordinance establishes the title and number of positions allowed in each City department. The Appropriation Ordinance establishes the City's expenditure budget, while the Levy Ordinance establishes the City's taxation of all categories of property for the fiscal year. The City's annual budget is presented virtually as a series of numbers and without much context.

The City Council is also presented with supporting budget documents (i.e. Expenditure & Revenue Book and the Personnel Supplement), but these documents are simply a further breakdown of the budget numbers contained in the Ordinances. An explanation of the goals of the proposed budget and changes in the proposed revenues and expenditures from the previous year are not provided. The lack of a narrative and therefore context in the City's current budget documents makes it virtually impossible for an average citizen to look at the City's annual budget and understand the financial plan for their City for the next fiscal year.

## Five-Year Financial Plan

A Five-Year Financial Plan can be used to create a tool for evaluating the annual budget, to establish a baseline for measuring the long-term effects of decisions, to test the economic effects of best-case and worst-case funding scenarios, and to establish a baseline projection of revenues, expenditures, and future cash flows and fund balances. If prepared and managed properly, a forecast can also help public officials evaluate the financial effects of proposed initiatives, and it can help educate constituents about the City's present and potential financial capabilities.

According to Section 813 of the City Charter the Finance Director is required to prepare a Five-Year Financial Plan. The last time Five-Year Financial Plan was submitted was in 2000.

**Section 813 – Finance Department** - “The Finance Director should develop a five-year financial plan for the city which shall be deposited by the mayor with the city clerk to be open for public inspection. The plan shall include projections of anticipated revenues and general estimates of expenditures during the five (5) fiscal years next ensuing, with appropriate supporting information, arranged so as to identify the planning goals, planning objectives and anticipated programs of city government for the ensuing five (5) years. The plan shall be revised annually.”

## Five-Year Capital Budget:

A Five-Year Capital Budget identifies and prioritizes the City's capital needs, establishes project scope and cost, details estimated amounts of funding from various sources, and projects future operating and maintenance costs. In addition, the Five-Year Capital Budget is critical in maintaining transparency in the use of the reserves from the sale of City property.

At the same time the City's annual budget is submitted to the City Council, the mayor is required by Section 812 of the City Charter to submit a five-year capital budget. The most recent Capital Budget to be approved by the city council was for the period 2004-2008.

**Section 812 - Capital Budget** - “At the same time that the mayor submits the operating budget to the city council, the mayor based upon estimates and recommendations of the city plan commission as provided for in Article X, section 1013, shall prepare and submit to the city council a capital budget for the ensuing fiscal year and the next four fiscal years thereafter. Said capital budget shall embody the mayor's estimates of cost and recommendations of means of financing each project contained with the capital improvement program, provided that no project shall be included in said budget which has not been favorably considered by the city council. In acting on the capital budget, the city council may accept, reject or modify the projects described therein or the proposed methods of financing the same.”

#### **Recommendation – Annual Budget:**

1. **Compliance with Charter Requirements:** The City Council should require that the mayor submit the Proposed Budget in full compliance with the requirements established in Section 803 of the City Charter.
2. **Five-Year Financial Plan:** The City Council should require that the Director of Finance submit the Five-year Financial Plan required in Section 813 of the City Charter.
3. **Capital Budget:** The City Council should require that the mayor submit the Capital Budget as required in Section 812 of the City Charter.
4. **Require Additional Information with Budget Submission:** It is recommended that the annual budget be submitted with additional narratives describing the City's revenues and expenditures. More specifically, it is recommended that the mayor submit at a minimum the following items with the annual proposed budget:
  - A complete explanation of any new revenue initiatives included in the proposed budget;
  - A listing and complete explanation of any non-recurring revenue sources in the proposed budget;
  - A brief narrative of each department and expenditure category highlighting any changes in the financial or overall operations of the department or category;
  - A comprehensive analysis of personnel costs including across-the-board salary increases, a listing of newly established or eliminated positions, salary increases beyond scheduled step increases, and changes in fringe benefits.
  - A complete analysis of the healthcare budget, including a comprehensive breakdown of the proposed budget, assumptions made for the upcoming fiscal year, and a year-to-date projection for the current fiscal year.

# City Council Oversight & Monitoring of Budget

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## Overview:

Prudent financial management requires periodic review of the status of the City's financial condition by the City Council. Financial reporting should serve as a tool to better enable the council to identify potential deficits before they materialize. A review of the Council's monitoring and oversight activities suggests there are several deficiencies that need to be addressed. For example, the City Council does not receive monthly operating statements showing actual versus budget revenues and expenditures; budget projections; and cash-flow analysis. Furthermore, the Council does not appear to have a systematic procedure to follow-up on requests for information made of the City Administration.

## Recommendations:

It is recommended that the following procedures and policies be enacted in order to ensure that the City Council exercises effective monitoring the City's budget and financial operations.

1. **Monthly Reporting:** It is recommended that the Director of Finance be required to submit to the City Council and the Internal Auditor an operating statement on a monthly basis. This analysis should be submitted no later than the end of the subsequent month and should include year-to-date expenditures and revenues on a departmental basis, including the school department, along with year-end budget projections and variances.
2. **Cash-flow Analysis:** It is recommended that the Director of Finance should be required to submit a cash-flow analysis on a monthly basis to the City Council. This analysis should be submitted to the Council no later than fifteen days after the close of the previous month and should include an analysis of all funds.
3. **Attesting to Accuracy of Reports:** The Director of Finance, according to Section 813 of the City Charter, is the chief fiscal officer of the City and is responsible for the sound and prudent financial direction of the City. Therefore, it is recommended that all analysis and reports submitted to the City Council or the City Council's Finance Committee must be signed by the Director of Finance, but it is also important that these reports be signed by the Director of Administration.
4. **Amend Section 810 of the City Charter:** It is recommended that the annual maximum appropriation transfer amount established in Section 810 of the City Charter be increased to \$30,000 from the current maximum of \$5,000, but this new amount must be strictly enforced.

5. **Quarterly Report:** In addition to the quarterly budget report required by the state law, it is recommended that the City Council enact an ordinance requiring quarterly financial reports be submitted to the City Council and the Internal Auditor within thirty (30) days of the first day of January, April and October. A fourth quarter report is not suggested given that the City Council will be considering the budget during that period.

The ordinance requiring this quarterly financial report should set forth the format of the report, including the information to be reported, as well as assigning responsibility for the preparation of the report. It is recommended that this report include estimates of the revenue and expenses in the categories provided in the budget ordinance effective for three months preceding the issuance of the quarterly report and for the year-to-date, showing the variance of those items to the budgeted amounts. The report should also include current month and year-to-date information on revenues and expenditures as well as comparison to the prior year.

6. **Accountability in Reporting:** The City's budget is much more than just a grouping of revenues and expenditures listed in columns on an Excel spreadsheet. The budget is the financial plan for how City officials will employ the citizen's hard-earned income to provide for the infrastructure and city services the community needs. Therefore, it is vital that the City officials be required to report on the City's financial condition in an accurate and timely manner.

Using, as a model, the federal law "Sarbanes-Oxley" - which was enacted by Congress to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws - it is recommended that the City Council pass an ordinance that imposes a fine of \$2,500 on both the Director of Administration and the Director of Finance if the monthly reports recommended earlier in this section are not submitted to the City Clerk within thirty (30) days of the end of the previous month or if the quarterly reports recommended earlier in this section are not submitted to the City Clerk within thirty (30) days after the first day of January, April and October. A Charter Amendment may be necessary to impose this fine on the Director of Administration.