



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

40 Westminister Street
Providence, Rhode Island 02903

March 5, 1982

IN CITY COUNCIL
MAY 13 1982

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

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

Rose M. Mendonça CLERK

Gentlemen:

We have examined the combined financial statements of the City of Providence as of and for the year ended June 30, 1981, and have issued our report thereon dated December 31, 1981. 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 City's financial statements and to assist the auditor in planning and performing his examination of the financial statements. We have not reviewed the system of internal control subsequent to December 31, 1981.

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 the 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.



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Our examination of the combined 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, 1981, that was made for the purposes set forth in the first paragraph above, would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and related data. However, such study and evaluation disclosed the following conditions that we believe to be material weaknesses.

GENERAL INTERNAL CONTROL CONSIDERATIONS

Investments

Short-term investment activity is not recorded on the general ledger accounts of the City. As a result, there is a very poor trail of the investment activity which takes place. Further, reconciliation of the bank accounts is made more difficult resulting in extra effort expended by reconciliation personnel.

To provide an adequate trail of investment activity, a complete list of all short-term investments owned by fund should be maintained at all times. At periodic intervals, such as monthly, a reconciliation should be made between the actual investments owned and the amounts recorded on the City's books.

During our testwork, a non-negotiable certificate of deposit was noted to be maintained in an unsecured desk. All investments should either be maintained in safekeeping at the bank or maintained in an otherwise secure manner at the City.

The City presently has no method of determining that all interest and dividends are received by its investment trustees on its investment portfolio. It is recommended that a system be established whereby the income from investments is accrued on a regular basis.

Variances Between General Ledger Controls and Subsidiary Records

It was noted during the audit that reconciliations between general ledger accounts and subsidiary details are not performed, and variances were not reconciled in the areas of property taxes receivable, cash accounts, and various other subsidiary records. We recommend that timely reconciliations of all general ledger accounts with supporting subsidiary detail be performed to ensure that discrepancies are identified and resolved.



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Notes Payable

It was noted during the audit that General Fund tax anticipation notes incurred by the City were not being recorded on the general ledger. We recommend that notes payable activity be recorded on the general ledger. General ledger balances should be reconciled on a regular basis with available detail and with the balances reported by the lending institutions.

Data Processing

The City currently utilizes an outside servicer for computer processing of many City records. There have been many procedural problems associated with the present arrangement. Processing schedules should be established to ensure timely delivery of information.

It is strongly recommended that high priority be assigned to improvement of this area. If performed properly, expected benefits will include:

- . More timely processing of transactions which is a critical need of the City.
- . Improved programming to meet current and future needs.
- . Better communication between the data processing function and user departments.
- . Better information available to management.

PROPERTY TAX AND OTHER RECEIVABLES

The following is a summary of conditions noted in the area of property tax and other receivables which should be addressed by City management.

Reconciliations

The detail records of property taxes receivable maintained on the computer by the outside servicer has not been reconciled to the control book in the Collector's office in over a year. Neither of these records have been reconciled to the City's general ledger. There are several differences in the manner of recording activity including overpayments and abatements which can result in variances between control records. Also, errors in posting transactions can occur. The following steps should be taken:

1. All control records should be reconciled to each other including the detail record totals, control book in the Collector's office and the general ledger on a monthly basis. All daily work submitted to the service bureau should be reconciled to the Controller's office records.



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2. A comprehensive study should be performed on the entire tax collection system with emphasis on improving efficiency, reduction of processing time, determination of proper staffing levels, and improved record systems. Under the present system, processing of transactions is slow and useful information is not generated on a timely basis. For instance, some computer reports are generated over a month after the activity has occurred. Such a study should also address the formalization of responsibilities for each department involved. The offices of the Collector, Controller, and Assessor as well as the data processing function each perform activities which directly affect the tax records. Communication among these parties requires improvement.

Property taxes are the most significant source of revenue for the City. Management should consider carefully the need for improvement of systems and controls in this area. Under the present system, the possibility of nonreceipt of revenues due to the City is not precluded.

Abatements

In order to improve control over the recording of abatements approved by the City Council, there should be timely reconciliation of abatements approved with those recorded on the automated detail records. This procedure would reduce the possibility of errors and omissions in posting activity going undetected.

Overpayments

Under the present system, overpayments of property taxes are initially recorded as revenue, subsequently reversed, and refunded. Under the modified accrual basis of accounting now utilized by the City, overpayments should not be classified as revenues but rather should be posted directly to a liability account.

File Maintenance

Many of our tax confirmation requests mailed to property owners were returned as undeliverable. When tax bills cannot be sent to the correct address, tax collections are not received on time. The name and address file should be updated as soon as possible to aid in collection of taxes due.

Property Tax Exemptions

When a property tax exemption is granted by the Assessor's office for veteran or elderly status, an exemption card is prepared for the taxpayer. An application form for elderly taxpayers is also filed, however no supporting documentation for veterans is maintained. In both cases, no approval of the exemption is documented by signature or initial of the Assessor or his designee.



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It is recommended that a complete application form, signed by the applicant and approved by the Assessor be obtained for all property tax exemptions granted.

Other Receivables

Detail records of receivable amounts for other revenue sources should be reconciled to the general ledger on a timely and regular basis. Differences should be investigated and resolved as soon as possible.

BANK ACCOUNTS

The City maintains many checking and savings deposit accounts with various local banks. Accuracy of records in this area is crucial to making cash management decisions. Following are findings and recommendations noted during our examination of this area.

Inventory of Accounts

The City maintains many bank accounts. In many cases, the individual bank accounts do not correspond with specific general ledger accounts. In the Trust and Special Funds and Revolving Funds, the bank accounts for various funds often overlap. As a result, the task of reconciling the bank accounts to the City's books is made more difficult.

To improve operations in this area, the City should make a complete inventory of accounts in existence. The nature and purpose of each account should also be noted. Where possible, bank accounts should be realigned to correspond to general ledger accounts. This will simplify the reconciliation function.

Bank accounts not required by law and not necessary to maintain accountability should be eliminated. This will improve operational efficiency and decrease bookkeeping efforts and costs.

Reconciliation Function

Reconciliation of bank accounts is presently under the control of the City Treasurer. This arrangement is somewhat inefficient because many of the accounting records necessary for this function to be done properly are maintained in the office of the City Controller.

It is recommended that responsibility for the reconciliation function be transferred to the Controller's office. Such a transfer would not result in a control weakness so long as the personnel performing the reconciliations have neither the ability to make cash disbursements nor the ability to make general ledger entries.



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Timeliness of Reconciliations

The bank reconciliation procedure is most effective when performed on a timely basis. It often detects errors in recording transactions, misclassifications between accounts, and errors made by bank personnel. However, in some cases, the bank reconciliations are performed many months after the receipt of the bank statements. Often this is due to untimely posting of activity to the general ledger.

Management should ensure that all reconciliations are performed as soon as possible. Any conditions which would prevent the reconciliations from being performed on a timely basis should be corrected as soon as possible.

All reconciling items should be explained and investigated promptly. Items which remain outstanding for a significant amount of time (such as two months) should be referred back to the responsible department. All monthly reconciliations should be reviewed and initialed by a responsible official such as the City Controller.

Federal Program Funds

The scope of our audit did not include examination of the various Federal programs administered by the City. However, during our examination of regular City bank accounts it was noted that the reconciliations for many Federal program bank accounts were also not being performed on a timely basis. In this regard, the previous recommendations concerning the City's bank accounts should be considered as applicable to Federal programs as well.

Outstanding Checks

Many accounts have checks which have been outstanding for over one year. Each time an account is reconciled, all outstanding checks must be accounted for. It is recommended that checks which have been outstanding for over one year be reclassified into a single liability account.

Authorized Signatures

It was noted that many bank accounts continue to maintain signatory authorization for persons who are no longer employed by the City. Maintenance of control to access of City funds is essential to prevent any unauthorized use or misuse of cash accounts. We recommend that an update of authorized signers be performed.



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PAYROLL

During our examination in this area, the following weaknesses were noted which should be addressed by City management.

Variances

There are currently no documented reconciliations of variances between the payroll amount approved by the department head and the actual payroll register amount. All variances of this type should be investigated, explained, and documented.

Employment Levels

Ceilings on the maximum number of employees in each department as stipulated by City ordinance were sometimes exceeded. No explanations for such exceptions were noted. The existence of these exceptions may indicate that departmental budgets are being exceeded and that corrective action should be taken as soon as possible. It is recommended that the payroll system be modified to produce exception reports when this occurs. Such exception reports should be sent to the department head and other members of management so that corrective action may be taken.

Payroll Tax Withholdings

Many employees were noted whose payroll tax withholdings were less than normally expected amounts. Although there may be valid reasons for the amount of payroll tax withholdings, the payroll department does not maintain sufficient records to support this. The City has responsibility to make proper payroll tax withholdings and remittance to taxing authorities. It is recommended that documentation and controls in this area be reviewed. Corrective action should be taken where necessary for all employees whose payroll tax withholdings are less than would otherwise be expected.

Transfers

Often there is a lag between the transfer of an employee from one department to another and the reflection of that transfer on the automated payroll system. When this occurs, the employee's former department head authorizes the payroll department to charge the cost of service to the new department. Approval from the new department head is not obtained. It is recommended that approval from the head of the department actually charged be obtained. This will enable department heads to monitor their labor costs as well as provide additional control over the existence and amount of labor cost.



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LEASES AND CONTRACTS

The City should maintain a comprehensive, organized file of all leases, contracts and other agreements into which it has entered. Such a file should include both those leases in which the City is the lessor as well as the lessee. City ordinances require that all lease agreements must be submitted to the Controller's office. The Controller's office does maintain some leases and agreements but the file is incomplete. It is recommended that a complete file be established and that copies of all future contracts be sent to the Controller. A complete file would result in the following benefits:

1. The City would be able to determine its outstanding liability on contracts at any point in time. This will aid in preparation of cash flow analysis.
2. Payments by the City on contracts and leases could be compared to the controlling document for propriety.
3. Research time would be reduced should questions concerning any contract or lease arise.
4. Lease expenditures should be accounted for through the encumbrance system rather than as direct payments. This will result in proper matching of expenditures against departmental budget appropriations.

It should be noted that all contracts should be reviewed and approved by the Law Department prior to execution.

MAXIMIZING REVENUES

Collection of Overdue Receivables

The City has a significant amount of overdue accounts receivable. Expansion of collection efforts could result in improved cash flow and a reduction in borrowing requirements.

The following procedures are suggested to expedite collection of overdue receivables in all areas including but not limited to property taxes, Water Supply Board, sewage disposal, sewer rental, municipal docks and other rents.

1. An aged detail of accounts should be generated on a regular basis, such as monthly. Such a detail would identify overdue accounts for analysis by responsible officials.
2. Specific policies and procedures should be developed for collection of overdue accounts. Policies should include a specific time limit at which collection efforts should commence. Procedures should indicate the nature, extent and documentation of actual collection efforts.



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3. Responsibility for collection efforts should be assigned to specific personnel. A realistic effort should be made to assign sufficient and competent persons to this function.

The following matters, which are not considered to be material weaknesses, are conditions for which corrective action by management may be practicable in the circumstances.

IMPROVING OPERATIONAL EFFICIENCY

Develop an Accounting Procedures Manual

The City should develop an accounting procedures manual to codify the many and diverse accounting procedures. The manual can also be used to set forth job descriptions, lines of authority and supervision for all departments, report formats, account codes and descriptions, and similar descriptive materials. The existence of such a manual should help to reduce the incidence of procedural violations and misunderstandings that presently occur, especially among newer employees.

The advantages of an accounting procedures manual are that it can

- . Provide documentation, in one location, of the entire financial operations of the City, thereby facilitating an overall understanding of those operations by management and providing detailed guidance to all personnel involved in the financial function.
- . Facilitate the training of new personnel.

ACCOUNTING POLICIES AND METHODS

The City has recently adopted certain accounting principles and financial statement presentation required under generally accepted accounting principles. Preparation of the City's financial statements on this basis from the existing underlying accounting records requires significant effort. The following are suggestions which we recommend to reduce the effort required to prepare financial statements and prepare them on a more timely basis.

Fiduciary Funds

The Fiduciary Funds of the City include the Trust and Special Funds, the Employees' Retirement System and the Revolving Funds. The Trust and Special Funds and the Retirement System do not have revenue and expense accounts. Instead, revenue and expense transactions are posted directly to fund balance. As a result, it is not practical to monitor activity in these funds.



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It is recommended that detail revenue and expense ledgers with classifications of revenue by type be established for all Trust and Special Funds, Revolving Funds, and the Employees' Retirement System. Expenditures should also be classified by the various object codes as well as transfers to other funds.

Implementation of these changes will enhance the quality of information available to management.

Capital Projects Fund and Long-term Debt Group of Accounts

The accounts of the Capital Projects Fund and the Long-term Debt Group are currently commingled. To properly reflect activity of the two separate functions, it is recommended that separate sets of general ledger accounts be established. The accounts of the Capital Projects Fund should be used to account for the expenditure of proceeds from debt issuances on various capital projects. The accounts of the Long-term Debt Group should be used to account for the issuance and retirement of debt.

Interfund Transfers

Under generally accepted accounting principles, all transactions between the City's funds should be designated in the financial statements. The present accounting system does not clearly identify all interfund transactions. As a result, considerable time must be spent to identify such transactions.

To reduce the effort necessary to prepare proper financial statements, it is recommended that accounts be established to segregate and identify interfund activity. It is likely that this could be accomplished without significant effort and still provide all information now generated under the current system.

ACCOUNTING RECORDS

It was noted that accounting records are not always maintained in a secure manner. To adequately safeguard the accounting records, it is recommended that all important records be maintained in locked, fireproof cabinets. Such a precaution will protect the City from disruption of normal procedures in the event of a disaster and preclude access to the records by unauthorized persons.

ESTABLISH FIXED ASSETS RECORDS AND CONTROLS

Sound financial administration in safeguarding the City's investment in fixed assets is of utmost importance in the exercise of stewardship responsibilities. These responsibilities can be effectively discharged only through adequate fixed assets accounting.



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By maintaining fixed assets records, the City will realize several benefits:

- . Fixed assets can be inventoried periodically to ensure that they are properly controlled.
- . Responsibility for custody and effective use of fixed assets can be clearly established.
- . Information regarding sources of supply, prices, and useful lives will be readily available. If information regarding maintenance costs is also included in the subsidiary ledgers, ratios of cumulative maintenance costs to original costs can be developed.
- . Records will be readily available to substantiate the amount of grants used to finance expenditures for fixed assets. Furthermore, the determination of costs for building or equipment use is facilitated. The latter is important to obtain reimbursement for the use of buildings and equipment in Federal and state aid programs.
- . Information is readily available both to determine insurance needs and to substantiate losses recoverable from insurance.
- . Information is available for the preparation of a Statement of General Fixed Assets.

Establishing fixed assets records when none existed before can be a difficult and time consuming task. One approach is to:

1. Define clearly what constitutes the fixed assets categories, (e.g., land, buildings, improvements other than buildings, equipment); a fixed asset (i.e., minimum dollar value and useful life); and the location "control" areas.
2. Plan and perform a complete inventory of all fixed assets. In creating the inventory records, obtain as much of the information to be included in the individual assets records as is possible, e.g., asset description, location, vendor or manufacturer, acquisition date. Fixed assets identification tags should be affixed at the time the physical inventory is taken.
3. Assign values to each fixed asset according to accepted principles. More specifically, such assets should be recorded at historical cost, or estimated historical cost, if the original cost is not available, or, in the case of gifts or contributions, at the fair market value at the time received.



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Several procedures can be used to determine the valuation.

- . Reference to the historical records, such as vendors' invoices, contracts, purchase orders, capital expenditure authorizations, canceled checks, gift acknowledgements, or other documents on hand.
- . Correspondence with vendors, donors, etc.
- . Use of an asset valuation reasonably reflective of historical value, provided it is reliable, if historical or fair market value is not available.
- . Historical cost as reasonably estimated by employees for small items of relatively low value, e.g., tools, office furniture, and equipment.
- . Reliance on independent outside appraisals for assets which cannot be valued by one of the above methods or some other reasonable method. It is important to emphasize, however, that the appraisal should be based upon estimated historical cost, not on replacement cost or some other basis.

Evaluation of fixed assets in the above manner will enable the City to establish reasonably accurate initial fixed asset values.

Once initial records are established, the City will want to concurrently implement the kinds of controls and procedures enabling it to maintain control over the fixed assets. These procedures should include:

- . Control over the proper input into the records for all fixed asset additions, sales, abandonments, and transfers.
- . Periodic reconciliation of detail ledgers to the general ledger.
- . Periodic inventory of fixed assets by location.
- . Verification that any asset traded in for a new acquisition is properly removed from the records.

IMPLEMENTING CHANGES

The implementation of changes recommended in this letter can be facilitated if City management:



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- . Consider and establish priorities for implementing the changes.
- . Develop an overall plan and method of implementation that reflects the priorities.
- . Assign the responsibility for carrying out each change to a specific individual.
- . Establish time-frames for implementation of each change.
- . Schedule progress reports from the responsible City officials and conduct progress meetings to further discuss progress and to resolve problems that arise.

These steps should provide assurance that City management's desires are carried out in a timely and responsible manner. If assistance is required, we stand ready to provide whatever effort deemed appropriate on a similar fee and expense basis.

As stated, our examination referred to in the first paragraph of this letter was based on selective tests of accounting records and related data. Accordingly, it would not necessarily disclose all opportunities for improvement or all weaknesses in the City's system of internal accounting control. The City must rely upon an adequate system of internal accounting control as its principal safeguard against irregularities and it is management's responsibility to ensure that the system is adequate.

Furthermore, this letter is not intended to imply that our tests failed to disclose many commendable features in the current operating procedures of the City. However, from the standpoint of practicality, this letter is limited to situations which merit or could benefit from corrective action.

Finally, the comments contained in this letter were considered in determining the nature, timing, and extent of audit tests to be applied in our examination of the City's combined financial statements, and do not modify our report dated December 31, 1981 on such financial statements.



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We wish to take this opportunity to thank officials and employees of the City for the help and cooperation which our staff received during the course of the examination.

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,

Peat, Marwick, Mitchell & Co.

FILED

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DEPT. OF CITY CLERK
PROVIDENCE, R.I.



Peat, Marwick, Mitchell & Co.

Certified Public Accountants

40 Westminister Street
Providence, Rhode Island 02903

May 3, 1982

PRIVATE

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

Dear Ms. Mendonca:

Enclosed are twenty-seven (27) copies of the City of Providence management letter including one copy with original signature. Also, we have provided twenty-five (25) additional copies to the Director of Finance, Mr. Baron.

Very truly yours,

PEAT, MARWICK, MITCHELL & CO.

David V. Devault, Supervisor

DVD:bal

Enc. 27

cc: Mr. Jerome Baron