

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Members of City Council
City of Richmond, Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Richmond (the City), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the City of Richmond's basic financial statements, and have issued our report thereon dated May 2, 2017.

Our report includes a reference to other auditors who audited the financial statements of the following discretely presented component units: Richmond School Board, Richmond Economic Development Authority, Richmond Ambulance Authority, and Richmond Behavioral Health Authority. We also did not audit the financial statements of the Richmond Retirement System which was included in the aggregate remaining fund information. The financial statements of the Richmond Retirement System were not audited in accordance with *Government Auditing Standards*. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Richmond's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Richmond's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Richmond's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses. 2016-001, 2016-002 and 2016-003.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies. 2016-004, 2016-005, 2016-006 and 2016-007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Richmond's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item: 2016-008.

City of Richmond's Response to Findings

The City of Richmond's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. The City of Richmond's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



CliftonLarsonAllen LLP

Arlington, Virginia
May 2, 2017

CITY OF RICHMOND, VIRGINIA
SCHEDULE OF FINDINGS AND RESPONSES
Year ended June 30, 2016

2016-001 – Accounting and Financial Reporting for Capital Assets – Material Weakness

Condition

The City did not properly account for capital projects in accordance with GAAP. The City completed construction on several capital projects and they were placed in service, however the City did not close those projects from construction work in process and begin to depreciate the capital assets. While total asset value was recorded correctly in construction work in process, the capital assets were required to be depreciated upon completion in accordance with GAAP and the City's capitalization policy.

Criteria

Capital projects should be capitalized in the period in which they are placed in service or are substantially completed.

Cause

The City has identified project managers with the responsibility of monitoring the progress on construction projects. However, communication between the project managers and those charged with financial reporting responsibilities are insufficient.

Effect

Failure to capitalize capital projects once they are completed could result in misstatement of depreciation expense for the year and improper reporting of capital assets.

Recommendation

We recommend the City establish policies and procedures to ensure that the City's project managers are reviewing all capital projects during the year to determine if projects are substantially completed. The City should also establish policies and procedures to improve communication between the project managers and those charged with financial reporting responsibilities.

Management's Response

Management concurs with the recommendation. The City had limited staffing during the fiscal year, but the Finance Department received funding in the FY2017 budget to fully staff previously vacant positions. In addition, the Department of Finance has engaged a consultant to review, assess and re-implement the Project & Grants configuration module in RAPIDS. General government employees will receive additional training on new policies and procedures regarding the use of Projects & Grants module for the reporting of Capital Assets once the re-implementation is complete.

2016-002 – Reconciling Suspense/Holding Accounts – Material Weakness

Condition

The City uses capital asset suspense accounts to "hold" transactions which require further research and classification. However, these accounts are not reconciled timely throughout the year.

Criteria

Guidance recommends that suspense accounts be used on a temporary basis. Transactions should be removed from the suspense accounts and moved to a permanent account once the permanent account is known.

Cause

Due to turnover, the City lacks sufficient accounting staff to ensure that reconciliations of the suspense accounts were performed on a timely basis.

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Effect

Failure to reconcile these suspense accounts timely could result in the balances in certain capital project accounts to be misstated. Further, the financial information provided to those charged with governance may not be accurate, timely or relevant.

Recommendation

We recommend that the City use these suspense accounts only when it is truly necessary and further research is required. We also recommend the City establish policies and procedures to ensure these suspense accounts are reconciled on a timely basis periodically throughout the year.

Management's Response

Management concurs with the recommendation. The accounts will be reconciled on a weekly basis to ensure posting to the appropriate accounts going forward. A Standard Operating Procedure will be developed and implemented to document the process of reconciling the account on a timely basis.

2016-003 – Timeliness of Reconciliation Processes – Material Weakness

Condition

There were numerous routine reconciliations that were not prepared timely. Certain reconciliations were not completed until after the end of the fiscal year. These reconciliations included monthly cash accounts, monthly investment accounts, and capital asset reconciliations from the subsystem to the general ledger.

Criteria

Guidance recommends that responsible personnel perform control activities in a timely manner as defined by the policies and procedures.

Cause

The City has not instituted sufficient monitoring controls to ensure that such reconciliations are prepared, reviewed, and approved timely.

Effect

Failure to perform routine reconciliations timely results in increased risk that a material error in balances may not be prevented and detected. In addition, the financial information provided to those charged with governance may not be accurate, timely, or relevant.

Recommendation

In order to make the financial reports generated by the accounting system as meaningful as possible, the City should reconcile the general ledger accounts for cash, investments, and capital assets to supporting documentation on a monthly basis. A benefit of monthly reconciliations is that errors do not accumulate. Such errors can be identified, attributed to a particular period, and corrected, which makes it easier to perform future reconciliations.

Management's Response

Management concurs with the recommendations. The City had limited staffing during the fiscal year and was in the process of finalizing three fiscal year CAFRs within a span of 22 months with limited staff. The Finance Department has since received funding in the FY2017 budget to fully staff previously vacant positions with the anticipation of providing timely reconciliations and final reporting.

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2016-004 – Recording of Retainage Payable- Significant Deficiency

Condition

Retainage payable represents a liability attributable to the acquisition, construction, or improvement of capital assets (in this case, construction in progress). The retainage payable amount is included on construction in progress invoices as a reduction of total expenditures incurred. The City has not been recording a liability for retainage payable related to these construction in progress invoices.

Criteria

Accounting standards require that transactions of an entity be accounted for in accordance with generally accepted accounting principles.

Cause

The City has a history of not accounting for these transactions and therefore, has not established the appropriate policies and procedures to ensure the proper accounting.

Effect

Failure to record retainage payable may result in the misstatement of liability and expenditures. Further, the financial information provided to those charged with governance may not be accurate or relevant.

Recommendation

We recommend that the City recognize retainage and establish ongoing training for those individuals responsible for the accounting of these transactions as well as those departments required to provide information needed by the Finance Department to properly account for retainage.

Management's Response

Management concurs with the recommendations. Purchase orders are created for the entire amount of the project which encumbers the funds. Currently, projects are paid in phases and a hold is placed on a portion of the funds until the completion date of the project. Once the project is complete, the balance on the purchase order which is encumbered, is released/paid to reflect the retainage amount which was held. The City has a mechanism in the system that identifies retainage as a type of payment but this was not used in previous years as an identifying marker for the final payment (retainage). The Finance Department has communicated with all applicable departments to identify the release of the final retainage amounts prior to the payment being released. In future years, the City will track and record those retainages that have not been paid at year end and record them as a liability.

2016-005 – Recording of Other Post-Employment Benefits- Significant Deficiency

Condition

The City's Other Post-Employment Benefit (OPEB) obligation represents employees from different departments and funds within the City. The City has accounted for its Other Post Employment Benefit (OPEB) obligation as a long term liability at the governmental activities level. However, the City did not allocate the portion of the OPEB obligation to business type activities, proprietary, and internal service funds.

Criteria

Accounting standards require that transactions of an entity be accounted for in accordance with generally accepted accounting principles.

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Year ended June 30, 2016

Cause

The City has a history of not accounting for these transactions and therefore, has not established the appropriate policies and procedures to ensure the proper accounting.

Effect

Failure to allocate the Other Post-Employment Benefit obligation amongst all funds could result in a misstatement of liabilities. In addition, the financial information provided to those charged with governance may not be accurate or relevant.

Recommendation

We recommend that the City establish a policy for determining the amount of the Other Post-Employment Benefit (OPEB) obligation that should be allocated and recorded to all funds.

Management's Response

Management concurs with the recommendation. The City had limited staffing during the fiscal year, but the Finance Department received funding in the FY2017 budget to fully staff previously vacant positions. Finance staff will work to properly segregate and report the aforementioned transactions, and has included additional actuarial work in the upcoming engagement in order to more specifically allocate OPEB obligations across funds.

2016-006 – Journal Entry Approvals – Significant Deficiency

Condition

Certain individuals within the accounting function have the ability to prepare and post journal entries without a secondary approval.

Criteria

Journal entries should be reviewed and approved by someone other than the preparer.

Cause

The lack of sufficient employee resources within the City during the year resulted in an inappropriate segregation of duties.

Effect

Lack of segregation of duties results in an increased risk of financial reporting errors or misappropriation of assets.

Recommendation

We recommend that the City establish policies to ensure regardless of the staffing constraints that segregation of duties is always maintained. Additionally, the City should enable controls within the system that prevent the same user to prepare, post and approve an entry.

Management's Response

Management concurs with the recommendation. The City adopted ORACLE's standard password management and system security settings for the RAPIDS application. The adopted settings included procedures for complex password settings, locking out of a session after a specified period of inactivity and locking an account after a predetermined number of invalid log-on attempts.

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2016-007 – Information Technology Controls – Significant Deficiency

Condition

Our review of the general computer controls at the City's Department of Information Technology (DIT) disclosed several internal control deficiencies. These general computer control deficiencies included:

- Strategic Plan – The City's DIT has not developed a strategic plan for the short- or long-term objectives for IT resources and projects to meet the City's needs
- Risk Assessment – The City's DIT has not recently documented an assessment of the risk associated with delivering on their objectives nor has DIT performed an assessment of the technical vulnerabilities of the network or infrastructure
- Termination of User Access – The City's does not effectively communicate and act upon terminations to remove user access from the City's resources. Of a sample of 15 terminations occurring during the period, we noted that 10 employees continued to have access to one or more systems after their termination date.
- Periodic Review of Access – The City has not developed a process to periodically review active user listing for either the continued need for access or the appropriateness of access retained.
- Password Configuration – The City has not configured password setting in conformance with the established policy or leading practices where a policy statement has not been established. The configurations included password history, minimum password age, and account lockout settings.

Criteria

A well-designed system of internal controls related to application access and security suggests that sound general computer controls be established and functioning to reduce the risk that the City's operations are out of compliance with management's objectives and expectations and industry best practices.

Cause

The lack of sufficient employee resources within the City during the year resulted in their inability to perform the required steps necessary to ensure controls are operating and effective. In addition, the City does not have sufficient policies and procedures, including monitoring controls.

Effect

An ineffective control environment results increased risk that financial data integrity is not being maintained.

Recommendation

We recommend that the City evaluate the items noted and implement updated procedures to improve the general computer controls to include:

- Develop an IT strategic plan to develop resources in alignment with the overall City direction and strategy.
- Document the risk to the organization and develop corrective actions for risk that are not adequately mitigated. The risk assessment should include independent validation of network and infrastructure configurations and vulnerabilities.
- Develop an improved process to communicate and validate that system access are removed upon an employee's termination

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- Develop a process to periodically review active system list to validate that appreciations of account and their associated access rights.
- Implement configuration changes to conform to City policies and periodically assess that configurations continue to align with management's expectations.

Management's Response

Management concurs with the recommendation. The City adopted ORACLE's standard password management and system security settings for the RAPIDS application. The adopted settings included procedures for complex password settings, locking out of a session after a specified period of inactivity and locking an account after a predetermined number of invalid log-on attempts. The City does not have design control over these elements as we would for a self-developed system.

The Department of Information Technology will conduct a review of the current settings, to determine if there are options to match more closely these recommendations. To further assist with this effort, the City Administration has engaged Astyra Corporation to assist the City with reviewing existing access controls and making recommendations to ensure that conflicting/competing access is eliminated. That project is expected to alleviate the segregation of duty concerns.

2016-008 – Failure to Comply with the Single Audit Act and Virginia Reporting Requirements - Material Noncompliance

Condition

The City of Richmond is required to obtain an audit of its schedule of expenditures of federal awards as it expended greater than \$750,000 in federal awards during fiscal year ending June 30, 2016. As of the date of this report, the City has not yet issued this required audit. In addition, the City did not issue their audit report by November 30, as required by Virginia.

Criteria

Uniform Guidance 2 CFR section 200.512 requires the following:

The audit must be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section must be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period.

In addition, the City must submit the final audited financial report to the Auditor of Public Accounts by November 30 of each year in accordance with Section 15.2-2510 of the Code of Virginia.

Cause

The lack of sufficient employee resources within the City during the year resulted in their inability to perform the required steps necessary to produce the schedules necessary for the single audit and to complete the financial statement audit on time.

Effect

Failure to comply with Uniform Guidance 2 CFR could result in additional scrutiny of reimbursable expenditures by federal awarding agencies and could possibly jeopardize continued participation in those programs. In addition, the City is not in compliance with Virginia requirements to submit their audited financial statements by November 30.

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Year ended June 30, 2016

Recommendation

We recommend that the City implement policies and procedures to ensure that federal grant program reports and the required financial statement schedules and reconciliations are available for audit to allow sufficient time for completion of the audit process by the prescribed deadlines.

Management's Response

Management concurs with the recommendation. The City had limited staffing during the fiscal year, but the Finance Department received funding in the FY2017 budget to fully staff previously vacant positions. The Single Audit for FY2017 will begin in a much timelier manner than the previous years, which will greatly enhance the opportunity for it to be completed on time in coordination with the external auditor.