FINANCIAL AUDIT ADVISORY COMMITTEE

Risk Assessment, Monitoring & Compliance
Sub-Committee Report

Friday, June 24, 2016

Present: Robert Fox (Chair), Councilor Jacob Auchincloss, Councilor Ruthanne Fuller, Councilor Victoria Danberg, David Spector, and School Department Director of Finance Sue Dzikowski

Review of Past Work

In 2012 and 2013, the sub-committee worked on and developed a Whistleblower Policy. Once the Whistleblower Policy was complete, the sub-committee focused on the financial relationships between the City and affiliated units including the Commonwealth Golf Course, NewTV, the Newton Municipal Credit Union, the Newton Community Farm, Inc., neighborhood area councils, the Newton Historical Society, Newton Schools Foundation and Newton Pride. In 2014, the focus shifted to cash collection and the risk of misappropriation. The sub-committee looked at the departments that took cash in on a regular basis and reviewed the policies and procedures that are in place for cash collection. The sub-committee recommended that the annual external audit include a review of policies and procedures of cash collection in two City departments or schools that collect significant amounts of cash.

Developing Risk Assessment Policies and/or Program

The sub-committee reviewed the comment in the external auditors' management letter related to risk assessment and monitoring. The comment first appeared about five years ago and has occurred each year since; however, each year the focus of the comment has become narrower. The current management letter comment focuses on asset misappropriation of cash and materials. The auditors recommend that the City develop and implement a monitoring program to evaluate the internal controls for asset misappropriation. The City's response to the recommendation is that there are no available resources to dedicate to the development of an asset misappropriation risk program. The management response includes a statement that the Comptroller will discuss options for obtaining resources with the Financial Audit Advisory Committee.

The City currently inventories assets that have a value of $15,000 or more and that inventory does not happen on a regular basis. It may not be a good investment of time to inventory all of the assets on a regular basis; it would be very time consuming. One thought is to look at the aggregate value of the assets.

The private sector organizations look much more broadly at risk and the management team is involved in assessing risk. The management team spends time thinking about those

risks and building strategies and action plans to address risks. The Risk Assessment, Monitoring and Compliance Sub-committee is not the Administration for the City. The Administration needs to be on board with any recommendation that the sub-committee makes or it will be a wasted effort. There needs to be a change in the culture around City Hall in relation to risk, starting with the top-level management team and department heads. The sub-committee members feel that there needs to be specifics and prioritization of the risks to get management on board with any policy or program associated with risk assessment. The sub-committee should also think about its role in developing a risk assessment policy. It may want to focus primarily on practical risks and come up with specific risks.

Comptroller David Wilkinson provided a list of what he believes are the City's areas of principal risk exposures. It was suggested that the sub-committee review the Comptroller's list for any gaps and then scan the lists submitted by other committee members to determine if there are other risk items that should be listed. All of the submitted lists are attached. The sub-committee will also need to check with department heads to determine if risk areas are already covered by specific department policies and procedures.

The sub-committee also needs to think about how critical it is to address the risk exposures because there is currently no City staff available to dedicate time to develop policies to address risk. The sub-committee needs to determine if it wants to ask the Administration to put resources towards risk assessment by hiring a consultant. There have been a few recent issues related to risk, like Verizon bills that were not paid for a few years, the Director of Transportation exceeding the Transportation Division budget by several hundred thousand dollars and the Administration was unaware of that fact until the invoices were discovered, and salary charges for storm water work being paid for by the Water Salaries Account. The issue with the Verizon bills is not consequential and is not considered a misappropriation of funds. The Administration dealt with the issue related to the uses of salary accounts within the Utility Division by developing a daily log to ensure that employee time spent on storm water maintenance is being correctly billed to the Storm Water Salary Account. The issue that raises the most concern is the Transportation Division bills because there is not a control system to ensure that departments remain within their budget and there is an unexpected cost to the City; however, in the transportation situation, the City's procedures were not followed in terms of acquiring requisitions before placing orders. It is difficult to address human error. The Administration subsequently addressed the issue and the person no longer works for the City.

The sub-committee brought up cyber risk and what types of security the City has in place to guard against malware. Several Police Departments in Massachusetts have been hit with a hack that encrypts their software and the Police Department is forced to pay a fee for decryption. The City recently underwent a cyber risk audit and addressed all issues found during the audit. The Police Department will be undergoing a simulated cyberattack in the next few months to see how well the Police Department's cybersecurity holds up.

The City's external auditors would like to see the City's management develop a risk assessment program to address asset misappropriation, document it and add it to the Financial Management Policies and Procedures. The auditors are also focusing on robust internal controls with documentation. Once City management addresses these issues, the comment in the Management Letter should disappear. Management needs to set the tone and culture around a risk management program.

It may make sense to have the Chief Financial Officer/Chief of Staff Maureen Lemieux and Comptroller David Wilkinson attend the next meeting and ask them to rank departments by the level of concern related to asset misappropriation and internal controls. Once there is a list, Management and the sub-committee could work together to develop a three to five-year action plan. Management could look at collaborating with interns from a college to develop a program for a volunteer summer project for students. It is likely to be important to develop the program for little or no cost to the City. It would need to be a good volunteer team that did not require constant oversight, as City staff does not have much time to dedicate to managing volunteers. Management would need to develop very precise instructions to ensure that a project team understood what it was developing.

Once the City addresses asset and internal control risks, it is worth discussing other risks like low probability risks with very high financial implications, like weather events or unforeseen disasters. The sub-committee will review each of the submitted risk assessment priority lists and develop a document of risks to the City that Management can review on an annual basis and ask for a more specific plan on asset misappropriation and internal controls. David Spector and Bob Fox agreed to work on developing the list for the document to review at the next sub-committee meeting.

Respectfully Submitted

Robert Fox, Chairman

CITY OF NEWTON, MASSACHUSETTS

FINANCIAL AUDIT COMMITTEE RISK ASSESSMENT/MONITORING PROJECT

PRINCIPAL RISK EXPOSURES

- **A material error and/or omission will occur in the preparation of internal or external financial reports.**
    A) Assets
        1) Cash & temporary investments
        2) Investments
        3) Accounts Receivable
        4) Pre-paid items
        5) Capital assets
    B) Liabilities
        1) Warrants Payable/Accrued Expenses
        2) Accrued Payroll & payroll deductions
        3) Revenue Refunds Payable & Allowances for Abatements/Exemptions
        4) Other Liabilities
    C) Revenue
    D) Expenditures
    E) Fund Balance

- **The City's credit rating will be impaired**
    A) The City will fail to maintain financial reserves at policy levels
    B) The City will fail to make progress in funding long term pension liabilities
    C) The City will fail to develop and implement an OPEB funding plan
    D) The City will fail to address capital infrastructure needs
    E) The City will fail to attract/retain experienced professional management staff

- **City assets will be stolen or misappropriated.**
    A) Cash & Investments
    B) Capital Assets

- **The City will breach a legal or contractual obligation.**
    A) City Charter/Code of Ordinances
    B) Municipal Finance Laws
    C) Federal IRS/DOL Laws/Regulations
    D) State/Federal Grants
    E) Trust/Gifts
    F) Agency Relationships
    G) Collective Bargaining Contracts

H) Goods/Services Contracts

- **City assets will be lost or impaired for reasons other than fraud; theft; or misappropriation such as unintentional errors or omissions/ investment market, credit or counter-party losses /uninsured losses.**
    A) Cash Receipts
    B) Payroll
    C) Procurement
    D) Accounts Payable
    E) Capital Assets
    F) Invested Cash
    G) Uninsured/Underinsured Physical Assets
    H) Uninsured/Underinsured Liability Exposures

- **The City's revenue structure or expenditure obligations will be negatively impacted in a manner requiring material increases in local taxation and/or reductions in City services over a short period of time.**

- **Budget objectives will fail to be met even though taxpayers have been taxed to fund the accomplishment of the objectives.**

From:	Ruthanne Fuller <ruthannefuller@gmail.com>
Sent:	Thursday, June 23, 2016 4:20 PM
To:	Robert Fox; Ruthanne Fuller
Cc:	David Spector; Jake Auchincloss; Shawna Sullivan
Subject:	Re: Fwd: Risk Assessment Sub-committee Meeting

Using the PriceWaterhouseCoopers list, the ones that are most relevant to the City of Newton are:

- Operational risk: risk of loss from inadequate or failed internal processes, people, and systems, or from external events
- Compliance risk: risk from not meeting the City's compliance obligations, including laws and regulations, policies and procedures, ethics and business conduct statndards, and contracts
- Internal audit risk: risk from not meeting strategic, financial, operational and compliance objectives
- Financial statement risk: risk related to a material misstatement of the financial statements
- Fraud risk
- Security risk: risk from a breach in our physical assets and information protection and security
- Information technology risk

I would also add to the list:
- Financial risk: risk from long-term liabilities being unfunded

Ruthanne

On Thu, Jun 23, 2016 at 2:44 PM, Robert Fox <robertclintonfoxjr@yahoo.com> wrote:
Ruthanne,

Just think about top top risks, not sure I can add a lot to David's list of financial risks, but I do think we need to open the aperture a bit. So I looked at what we used at MMC (which is just a standard corporate list of 14 risk categories) and here are my thoughts for you and the rest of the sub-committee on how we might think about a broader list for our city:

1. Strategic Risk - not particularly relevant
2. Operational Risk - from inadequate or failed internal processes, people and systems, and from external events
3. Compliance Risk - a broad area covering laws and regulations, policies and procedures, ethics and business conduct standards, and contracts
4. Internal Audit Risk - I think David's list covers most of this topic
5. Financial Statement Risk - I think David's list covers most of this topic
6. Fraud Risk - mostly involving sales, accounting and purchasing processes, people and policies.
7. Market Risk - interest rate, currency, option, and commodity. In this category, only interest rate is relevant I think.
8. Credit Risk - My guess is that the bond agencies and state and federal oversight agencies are pretty thorough on this one
9. Customer Risk - not particularly relevant
10. Supply Chain Risk - not particularly relevant

11. Product Risk - not particularly relevant
12. Security Risk - physical assets and infrastructure
13. Information Technology Risks - processing capacity; back up of hardware, networks, applications and data; access control; intrusion detection; data protection and privacy; cyber crime
14. Project Risks - not particularly relevant, except for large capital projects, e.g. schools, fire stations, etc. when its hugely relevant!

Just a few thoughts on what I think are the big ones, maybe in rough order (without having done the work)

2. We've begun to address some of these more BAU topics with the whistle-blower work, etc. but the big one that you read about in the literature - unrelated to processes and people during the normal course of business - is external events, e.g. weather (floods, earthquakes, hurricanes), health related (epidemics), and terrorism, which are all low probability/high impact events. And while many of them are likely to be regional events, local authorities (first responders, hospitals, etc. here in Newton) are on point to respond.

3. My thoughts here are shaped by the recent lead scares in drinking water/old lead or lead-soldered pipes, but I would guess that there are scores of potential environmentally related risks (asbestos, stored chemicals, underground tanks, abandoned property, etc.) that could be of concern. Also, all the stories about gas leaks going unfixed while not Newton assets, run under Newton streets and sidewalks and there would be lots of finger-pointing at the city if something catestrophic occurred here. This category as defined is potentially huge and I think we need to brainstorm what might be of value here.

13. I don't know if the City Council has looked closely at IT, but this is in the top 3 of every company I know and at the Board level.

12. We've had some discussions about "movable objects" in the city inventory and the lack of a physical inventory for items below a specific clip level. This might be worth revisiting in the aggregate, i.e. what is the total estimated number of items and aggregate value, to see whether this is worth pursuing.

6. We have talked about some of the processes in place but has the Finance Committee ever done a formal review of procurement and purchasing practices and compliance thereto?

4,5, 7 and 8. I am not trying to discount these but I think the Finance Committee, the Finance team and the external auditor are all in sync on the big issues. We should review David's list to see if there are big areas which could be reviewed.

12. Not sure about this one. I am sure that the discussion of securing the schools a couple of years back put a spotlight on this topic for public buildings. But this category is broader and would include for example, the risk of not fixing potholes in the city's infrastructure which causes a major accident. In thinking about this one, it might be a good step to get the Law Department to come to a discussion about risks since they are the ones who have to defend the city or settle various claims.

BTW, there are lots of frameworks out there, though not many tuned to municipalities. Some good work done in Canada and the UK but a bit dated.

Generally, once we agree on the Top 10, we would score them on Likelihood, Impact, Ability to Mitigate (e.g. insure, manage, recover). If we decide we are going to embark on a broader ERM-like undertaking, I can dig up some frameworks and processes we used.

Regards,

Robert C. Fox, Jr. robertclintonfoxjr@yahoo.com 617-838-5901 (mobile)

On Monday, June 13, 2016 4:20 PM, Ruthanne Fuller <ruthannefuller@gmail.com> wrote:

Folks,

Here is David Wilkinson's list. Thank you David ....

Ruthanne

R
---------- Forwarded message ----------
From: **David C. Wilkinson** <dwilkinson@newtonma.gov>
Date: Mon, Jun 13, 2016 at 3:42 PM
Subject: RE: Risk Assessment Sub-committee Meeting
To: Ruthanne Fuller <ruthannefuller@gmail.com>

Ruthanne,

I'm not going to be able to make the meeting on 06/24, but attached is another copy of my principal risks that I forwarded in late April, after our last meeting.

From: Ruthanne Fuller [mailto:ruthannefuller@gmail.com]
Sent: Wednesday, June 08, 2016 3:43 PM
To: Shawna Sullivan; David C. Wilkinson
Cc: Robert Fox; David Spector; Jacob Auchincloss
Subject: Re: Risk Assessment Sub-committee Meeting

Folks,

This is summary of what the agenda will be. All of us will want to come with our own draft version of the top 10 risks:

The Committee felt that the Risk Assessment, Compliance and Monitoring Sub-committee should meet in the near future to develop a top ten list of risks to the City. Once the list is complete, the Finance Committee should review it. The Committee members thought that Maureen Lemieux, David Wilkinson and the Treasurer James Reardon could layout a framework for a risk assessment program

and present it to the Financial Audit Advisory Committee in the fall. The team could use the City's financial policies as a model. When the framework is available, it should be provided to the Finance Committee, School Department, and Executive Department for comment.

The Chair volunteered to work with Bob Fox, the Chair of the Risk Assessment Sub-committee to schedule the sub-committee meeting to develop the prioritized list.

On Wed, Jun 8, 2016 at 9:14 AM, Shawna Sullivan <ssullivan@newtonma.gov> wrote:
Good Morning,

It looks like the best date for a Risk Assessment Sub-committee meeting is on Friday, June 24th at 8:15 AM. Please let me know if you are available.

Have a nice day.

-Shawna
When responding, please be aware that the Massachusetts Secretary of State has determined that most email is public record and therefore cannot be kept confidential.

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Ruthanne Fuller
City of Newton
Councilor-at-Large, Ward 7
163 Suffolk Road
Newton, MA 02467
617-738-5311
ruthannefuller@gmail.com
www.RuthanneFuller.org
www.ruthannefuller.blogspot.com

When responding, please be advised that the Secretary of the Commonwealth has determined that email may be considered a public record.
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Ruthanne Fuller
City of Newton
Councilor-at-Large, Ward 7
163 Suffolk Road
Newton, MA 02467
617-738-5311
ruthannefuller@gmail.com
www.RuthanneFuller.org
www.ruthannefuller.blogspot.com

David Spector
6/23/2016

Top Ten Risks to the City of Newton
(Not listed in order of importance)

1. **Information Security/Cyber Risk**: data theft, external network penetration, related reputational, media and financial risk.
2. **Fraud/Misappropriation of funds**
3. **Legal/Compliance Risk**: including failure to comply with laws and regs, and litigation risk (which can in turn precipitate reputational and financial risk).
4. **Credit Rating downgrade** (could have various triggers including pension issues)
5. **Impact of an economic and/or real estate downturn** on revenues and overall financial stability.
6. **External events: environmental, terrorism, natural disaster, etc.** Low prob/high impact
7. **Employee/people risk**: ability to attract and retain high quality employees for key city roles, and/or the reliance on individuals to manage key functions and processes.
8. **Reputation/quality of the school system deteriorates**, causing a decline in the attractiveness of the city as a place to live.
9. **Vendor risk**: risk that a key vendor fails to perform and/or engages in inappropriate/illegal behavior.
10. **Data/systems risk**: risk that management information systems failures or inadequacies could lead to inaccurate, incomplete or otherwise faulty reporting, and/or create operational risk (e.g. payment processes).

Typical risk management frameworks will include, among other aspects, a focus on people, process, systems and external risks, the identification of sub-risks focused on the highest risk items, the creation of testing and monitoring protocols to continually assess the highest risks and related processes, assignment of accountabilities, escalation and reporting, and control/remediation. Self-assessments, stress testing, scenario analysis and other tools can be used to enhance the framework.