

FINANCIAL AUDIT ADVISORY COMMITTEE

Risk Assessment, Monitoring & Compliance Sub-Committee Report

Thursday, July 28, 2016

Present: Robert Fox (Chair), Councilor Jacob Auchincloss, Councilor Ruthanne Fuller, Councilor Victoria Danberg, David Spector, School Department Director of Finance Sue Dzikowski, Chief of Staff/Chief Financial Officer Maureen Lemieux, and Comptroller David Wilkinson

Recap

At the last meeting of the sub-committee, the sub-committee looked at what some of the primary areas of risk exposure are for the City of Newton and determined that the sub-committee should first focus on developing a program to address asset misappropriation and internal control risks. The sub-committee also decided to continue to narrow down potential risks to a priority list of manageable issues that the City Management should review each year. Since the meeting, David Spector worked on the attached memo related to the development of a risk assessment program.

Continued Discussion on Risk Assessment

The genesis of the risk assessment discussion is the external auditor's comment related to risk assessment and asset misappropriation, which appears in the auditor's Management Letter each year. Comptroller David Wilkinson stated that during a discussion with the external auditor, the auditor stated that he is willing to remove the comment from the letter if the City does not feel it is a priority. The auditor cannot point to another municipality that has developed a risk assessment program. The auditor has included the comment in the past Management Letters due to the changes in auditing standards that move towards a risk based approach to auditing. The auditors come in and look at different areas of management and size up existing controls to determine where they want to focus. The auditors look for the greatest chance for the potential of a misstatement on the financial statements, which is the impetus for the comment; however, the auditors do not have a framework for dealing with risk assessment, other than hiring people to address risk exposure. The City does not have the funds to create a position or positions to focus on risk or to hire consultants.

Some members were surprised that the auditor is willing to remove a repetitive comment from the Management Letter without the City doing anything to address the comment. David Wilkinson explained that the auditor's focus is the City's financial statements and compliance with federal and state reporting requirements pertaining to grant programs. The comments contained in the Management Letter are simply suggestions to the City.

The sub-committee discussed whether there is anything that they should ask City management to focus on in terms of risk management regardless of whether the comment is removed from the Management Letter. Chief of Staff Maureen Lemieux stated that the City's financial controls are very good. The City has worked on improving its controls related to cash payments. Ms. Lemieux explained that to her the biggest risks to the City are operational risks like public safety risks, weather events, and cyber-attacks. The City has already tested the information technology systems at City Hall and there are plans to test the Police Department's systems this year. The City will continue testing its IT systems on a regular basis. It is not surprising to the Sub-committee that the Chief of Staff focuses on the operational risks that the City faces but the question is should the Financial Audit Advisory Committee add to those focuses.

There are a number of categories of risk, both financial and operational, that City management may want to continue to think about on an ongoing basis. The categories include security/public safety, aging infrastructure, cyber security, internal controls, and access controls. One of the best things that the City can do in terms of internal controls is to continue to reinforce to its employees that there is a zero tolerance policy in Newton and if an employee misappropriates fund, they will forfeit their pension rights and health care coverage. In addition, there is a critical separation of duties between employees that create requisitions and those that pay bills. The City is vigilant in terms of risk management but it is hard to foresee all possible risks.

One way forward for the sub-committee to deal with risk assessment is to encourage the auditor to drop the comment from the Management Letter and to ask the auditor to continue to pay particular attention to one or two areas or departments each year during the audit that involve risk. The Financial Audit Advisory Committee would continue to think about risks and consider in the future whether to ask the auditor to do additional work related to risk management. If necessary, the City could consider hiring a consultant to look at a particular risk situation.

It may still make sense to create a simple risk assessment program that encompasses both operational and financial risk to more formally identify, talk about and evaluate risks on a regular basis. Discussing known risks could also help identify other possible risks to the City. It is the City management team's responsibility to look at risks related to their core responsibilities. The sub-committee realizes that there is no additional funding available but the City is already funding some risk mitigation like building security. The management team can also raise awareness of risk categories within departments. Department heads, the Chief of Staff and the Comptroller already think about risks on an ongoing basis. The sub-committee would look to formalize the review process for risk management rather than add work to the already busy management team. The group concluded that it makes sense to have City management annually meet with the Risk Assessment, Monitoring and Compliance sub-committee to discuss the nine highest risks to the City, how the City is addressing these risks

and evaluate whether there are effective internal controls in place; the CFP and the Comptroller agreed. The City is already addressing risk assessment in a systematic way and looking at ways to minimize operational and financial risk.

Sub-committee member David Spector will update his draft memo by incorporating the suggestions related to a formalized risk assessment program and circulate it to the other members of the sub-committee. In addition, Mr. Spector will include language stating that the City's taken the necessary steps to remove the Management Letter comment but will continue to look at the larger issues of risk assessment beyond misappropriation of cash.

The meeting adjourned at 9:45 AM.

Respectfully submitted,

Robert Fox, Chair

July __, 2016

To: Maureen Lemieux, Chief Financial Officer/Chief of Staff
David Wilkinson, Comptroller

From: Risk Assessment, Monitoring & Compliance Sub-Committee of the Financial
Audit Advisory Committee

Re: Development of a Risk Assessment Program

As you know, the city's independent auditors have been recommending, for successive years, the development and implementation of a risk assessment program to "periodically anticipate, identify, analyze, and manage the risk of asset misappropriation." The auditors recognize that progress has been made since their initial documentation of this issue. However, the continuation of this written recommendation reflects the level of risk inherent in the area of asset misappropriation, and broader attention being paid across the private and public sectors to the importance of developing and maintaining appropriate risk assessment programs.

The committee has been discussing this topic, and it was the primary agenda item at its June 24, 2016 meeting. This discussion included not only the auditor recommendations, but also an early stage assessment, based on input provided by you and various sub-committee members, of the top risks facing the city.

The committee recognizes and appreciates the resource constraints faced by management, and the quality of processes and controls in place at the current time, evidenced not only by the overall favorable audit results, but also the city's aggregate risk management track record.

However, given the recurring nature of the auditor recommendation, the level of inherent risk faced by the City given its size and complexity, the increasing importance of well documented risk assessment and management programs, and the sub-committee view that management should take further tangible steps to satisfy and eliminate the auditor recommendation, we recommend that management:

- Create a formal, documented, risk assessment program, including policies and procedures, focused on the risk of asset misappropriation.
- Per the auditor recommendation, develop and implement a monitoring program to periodically evaluate the effectiveness of internal controls.
- Leverage this process to develop a broader risk assessment program which will incorporate the continual (likely annual) identification and assessment of the top risks facing the city. It is the sub-committee view that these risks will reflect a

combination of 'typical' municipal risks (such as asset misappropriation or asset impairment), along with risks deemed lower probability but of higher potential impact, such as a major climatic event.

Via your input, and that provided by sub-committee members, the potential list of key risks includes, but is not limited to:

1. Asset misappropriation
2. Material financial reporting errors
3. Operational risk including internal control deficiencies and failed processes
4. Legal/contract risk
5. Credit rating impairment
6. Adverse revenue or expense impacts
7. Non-misappropriation asset loss/impairment
8. Information security
9. High impact external events

The sub-committee is cognizant of management's resource/staffing realities and need to prioritize. As such, the sub-committee would like to discuss these recommendations with management, focused on potential implementation approaches. Among other suggestions, the sub-committee believes that a longer term, three to five year, implementation plan would be workable provided that it is well laid out, with milestones. In addition, it is likely that this body of work would be a valuable project for a local college team, perhaps via an unpaid internship program.

We look forward to discuss these recommendations with you in more detail.