

February 20, 2015

Kenneth Rust, Chief Financial Officer  
Fred Miller, Chief Administrative Officer  
Andrew Scott, Director, City Budget Office  
Lois Summers, Acting City Controller  
Mike Abbaté, Director, Bureau of Parks & Recreation  
Chief Larry O'Dea, Portland Police Bureau  
Anna Kanwit, Director, Bureau of Human Resources  
Other Bureau Directors  
City of Portland  
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Portland, OR 97204

We have completed our audit of the financial statements of the City for the year ended June 30, 2014 and have issued our report thereon dated December 19, 2014. In planning and performing our audit of the financial statements in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures and for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

During the course of the audit, one significant deficiency in internal controls over financial reporting was identified and reported to the City in a separate communication. We also noted certain other matters involving the internal control structure, operations, and financial reporting that are presented for your consideration that we would categorize as 'best practices', which are reported to you below. Our comments and recommendations have been discussed with appropriate members of management, and are intended to improve the internal control structure or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience, and to perform any desired additional study of these matters.

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Our comments are as follows:

### **Best Practices Observations**

#### **Police Bureau and Bureau of Human Resources**

**Supervisory Approval of Time** - During our payroll internal controls testing, we noted that certain Police Bureau supervisors have the role of approving their own time. The explanation provided was that the payroll system presently only allows for a single approval process. As a supervisor of a Responsibility Unit (RU), the supervisor approves the time for the entire Uniform Daily Assignment Roster (UDAR) assigned to the shift, which includes his own time. While we understand a mitigating control of high level reviews of bureau payroll input takes place each payroll cycle at the Bureau of Human Resources, allowing an individual to have the role of approving their own time is a violation of the segregation of duties concept.

**Recommendation:** We recommend the implementation of a secondary approval of the entire shift's time or approval of the shift supervisor's time by someone else. We understand there is a UDAR project underway that will provide for a double approval process.

#### **Bureau of Parks & Recreation and Bureau of Human Resources**

**Review of payroll data entered into SAP** - During our payroll internal controls testing, we noted several cases where the Parks & Recreation supervisor responsible for approving time entered data for the pay period into SAP with no subsequent review that the data was properly entered into SAP.

**Recommendation:** We recommend that, consistent with Human Resources Administrative Rule 1.07 Time Review and Approval, in circumstances where data entry into SAP from other systems or hard copy is necessary, an individual other than the individual entering the data be assigned to review that the entered data is consistent with the approved time.

#### **All City Bureaus, Bureau of Parks & Recreation, and Bureau of Revenue and Financial Services**

**Completeness of Capital Assets** – In the 2012 management letter, we noted that the City's real property is not routinely included in the City's periodic capital asset inventory procedures. Physical observation of the assets is a common effective internal control procedure addressing the existence and completeness of the capital asset records. It is our understanding that based on 2012 recommendation, the City Controller communicated a requirement at an Accounting Advisory Committee meeting on February 19, 2013 that all City Bureaus that have real property cross check their current property listings against County records as part of the annual evaluation of capital

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assets, and that bureaus were offered training, consulting, and guidance from the Central Accounting Division in this effort. The Bureau of Parks & Recreation implemented the new procedure to check recorded real property against County records as part of the physical observation process. As a result of implementing this new procedure, during 2013 and 2014, the Bureau of Parks & Recreation has identified real property with an initial acquisition price totaling approximately \$20 million that had not been capitalized and properly included with other capital assets in the City's financial statements. We commend the Bureau of Parks & Recreation for progress to date on the implementation of this procedure; however, we understand that as yet not all properties have been cross checked due to the volume of properties. An additional \$11 million of Parks properties are expected to be added as a result of completing this process by June 30, 2015.

**Recommendation:** We recommend that City Bureaus fully implement and complete the search of Counties Assessor records as part of its physical observation procedures to improve internal controls and accounting for capital assets. Similar to the approach taken by the Bureau of Parks & Recreation and other Bureaus with a significant number of individual properties, the procedure could be performed over time with a goal of checking all real property to the Counties' records over some reasonable number of years.

### All City Bureaus, Office of Management and Finance, City Budget Office

**Progress Made in Addressing the Declining Financial Position of the City's Governmental Activities** - In the previous two years, we have reported to you our concerns about the City's costs of providing its general governmental services exceeding the revenues used to finance them. The cost of providing the City's governmental services has exceeded governmental revenues by over \$1.5 billion over the past twelve years as evidenced by a decline in net position from \$1.788 billion at the end of 2002, to \$0.212 billion at 2014 fiscal year end. The net position trend is a measure commonly used to determine whether a government's financial condition is improving or declining. It also is a measure of how well the City's financial policies are addressing intergenerational equity, or in other words, how well the current actual costs of providing services are covered by current revenues.

We reported to you previously that the two most significant drivers of the excess costs over revenues is the use of capital assets in excess of investing in replacements or retaining revenues and placing them in reserve funds for the purpose of funding future replacements, and the annual funding of employee post-employment benefit programs at amounts less than the cost of annual benefits actually earned, the majority of which is associated with the City's police and firefighter retirement plan. The City's retirement plan for police and firefighters hired before 2007, and the City's other post-employment benefit programs, are not pre-funded on an actuarial basis, but rather, funded as benefit payments are made to retirees. The annual benefit payments for the City's retirement plan for police and firefighters are funded with a dedicated property tax.

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In prior years, we recommended that management develop financial policies and metrics based on the full accrual basis of accounting for its general government activities to supplement the policies and metrics previously applied based on the budgetary basis of accounting. In addition, we recommended that management review its current capital replacement policies and evaluate if revisions to the policies and metrics would be prudent to address the deferred maintenance inherent in the trend of significant decline in the net book value of the capital assets.

**Status and Recommendations:** We understand that steps have been taken to partially address the City's capital asset maintenance and replacement needs including a recent resolution brought before Council to implement a policy of dedicating a portion of year-end fund balances for replacement of capital assets. In addition, we understand that the City has been evaluating new revenue sources that would be dedicated to investments in infrastructure. We have learned that you are considering new capital asset replacement policies that will accelerate maintenance and replacement projects. Finally, we note that the City's investment in capital assets will improve by virtue of adjusting for properties acquired in prior years that were not properly capitalized as noted in our Schedule of Findings and Questioned Costs included in the separately bound single audit report.

The City has also taken steps to address the declining net position caused by the police and firefighters disability and retirement fund by placing all new police and firefighters hired after 2006 in Oregon PERS and funding their benefits currently on an actuarial basis. The remaining risk to the City is the limitation on the property tax millage rate restricted to funding the benefit payments for those hired before 2007. We are aware that management periodically reviews the risks associated with the dedicated property tax revenue stream, and the latest review revealed a very small probability, and a reduced risk to the City compared to previous such reviews, that dedicated property tax revenues would be insufficient to fund retiree benefit payments when due in certain future years.

Further, we note that the City decided to reinstate the Chief Financial Officer (CFO) position within the Office of Management and Finance, with a directive for the CFO to report directly to the City Council on long-term sustainability metrics. Our understanding is that one of the purposes of the periodic reporting of these metrics is to assist the Council in the establishment of financial policies designed to assist in making decisions that will enhance the City's ability in ensuring its long-term financial health.

We commend management for taking these steps, and recommend that you continue to work with City Council on additional steps that will be necessary to successfully address these issues. One such additional step to consider is the broader use of capital asset reserve funds where either existing revenues would be set aside, or broader based use charges would be assessed departments that use capital assets to assist in the financing of future maintenance and replacement projects.



## Comments and Observations Relating to Future Year(s)

For your information, we are noting changes to accounting and auditing standards and other regulatory issues that we expect will have an impact on the City's future CAFR preparation and audit. While management at the Office of Management and Finance are aware of these forthcoming changes, you may need to be aware that implementing these changes may have a significant impact on the City's financial statements, and might require additional resources for OMF to prepare future CAFRs timely.

### New Accounting Standards

**Liability recognition for the City's Pension Plans.** In June 2012, GASB issued Statement No. 68 on reporting of pensions by employers involved in multi-employer pension plans. This statement will require the reporting of a liability on the face of the financial statements if the organization's share of the pension plan's net position is less than the actuarially determined liability. In addition, the new standard will require expanded footnote and required supplementary information disclosures. Implementation of GASB 68 will have a significant impact on the City's government-wide statement of net position. If the new standards were implemented by the City as of June 30, 2014, the City's total governmental net position would decrease by an estimated \$1.4 billion resulting in an overall negative net position balance of \$1.2 billion, not counting the impact of the City's involvement in Oregon PERS, due primarily to costs associated with the City's police and firefighter retirement plan. While the City has access to a dedicated revenue stream through property taxes approved by the voters to fund payments to beneficiaries of the plan, GASB 68 did not change the existing guidance on the accounting for property taxes. Therefore, the City will not have an asset to report for future property tax revenues to offset the requirement to record the net pension liability.

In addition to the reporting of the liability and expanded disclosures, we want to bring to the City's attention several reporting challenges it will face in the implementation of GASB 68 for the City's involvement in Oregon PERS. The challenge will be primarily in obtaining audited pension numbers specific to the City and related supporting schedules that will be the basis for reporting balances in the City's CAFR. We have been working with the AICPA, GASB, OMFOA, and Oregon PERS on the identification of the issues and the development of possible solutions. The City has had several staff members involved in this as well, and based on the support from the City and other stakeholders in Oregon, a bill was introduced and passed in the February 2014 legislative session in an effort to address the challenges noted above. This bill was a critical piece to allowing Oregon PERS to incur costs on behalf of participating employers to provide audited information with which to base the numbers that will appear in the City's financial statements. Management will need to obtain the Oregon PERS auditor's report on the pension information, as well as the supporting schedules of pension numbers, and review this information to determine if it is adequate to properly support the numbers and disclosures that will be reported within the City's CAFR.

**Government Combinations.** In January 2013, GASB issued Statement No. 69 providing guidance on financial reporting for government combinations accomplished through mergers and

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acquisitions. The effective date of this new standard will include the City's year ending June 30, 2015.

**Non-exchange Financial Guarantees.** In April 2013, GASB issued Statement No. 70 providing guidance on the accounting and financial reporting for financial guarantees issued or received by a governmental entity. The effective date of this new standard will include the City's year ending June 30, 2015.

### **New Regulatory Issues:**

**Proposed changes to the Single Audit Act and OMB Circular A-133.** On December 26, 2013, the Office of Management and Budget (OMB) issued new rules affecting the scope of single audits. Among the key changes is an increase in the single audit threshold from \$500,000 in federal award expenditures to \$750,000, an increase in the major program Type A threshold from \$300,000 (or 3% of total expenditures, whichever is greater) to \$500,000 (or 3% of total expenditures, whichever is greater). It also provides for a consolidation of several different OMB cost circulars, reduction in the possible compliance requirements below the 14 that currently exist, and a number of other changes to auditee and auditor requirements. The effective date for observing these new rules is for years beginning on or after January 1, 2015, but certain compliance requirements are applicable to the City now. We have provided some education to City staff in the spring of 2014, and will look for opportunities to provide additional training to the City in the spring of 2015, on these new rules.

### **Status of prior year best practice observations and recommendations**

We found the City had taken action and otherwise made improvements with all the issues we included in the prior year management letter.

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We wish to thank Lois Summers, Samina Gillum, Satish Nath, Sheila Black-Craig and other members of OMF staff for their support and assistance during our audit, the direction and leadership provided to them from Fred Miller, as well as LaVonne Griffin-Valade, City Auditor during the 2014 audit engagement, and Fiona Earle of the City Auditor's office, who were very professional and pleasant to work with regarding the administration of our audit contract with the City.

*Moss Adams, LLP*

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cc: Mary Hull Caballero, City Auditor  
Fiona Earle, Audit Contract Manager  
Lois Summers, Acting City Controller