

ROSELLI, CLARK & ASSOCIATES
Certified Public Accountants

CAMBRIDGE REDEVELOPMENT AUTHORITY
(A Component Unit of the
City of Cambridge, Massachusetts)

Management Letter

Year Ended December 31, 2019



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(A Component Unit of the City of Cambridge, Massachusetts)

MANAGEMENT LETTER
YEAR ENDED DECEMBER 31, 2019

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Honorable Board of Directors
Cambridge Redevelopment Authority
Cambridge, Massachusetts

In planning and performing our audit of the financial statements of the Cambridge Redevelopment Authority (the “CRA”), a component unit of the City of Cambridge, Massachusetts, as of and for the year ended December 31, 2019, in accordance with auditing standards generally accepted in the United States of America, we considered the CRA’s internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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 CRA’s internal control. Accordingly, we do not express an opinion on the effectiveness of the CRA’s internal control.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This communication is intended solely for the information and use of management, the Board, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

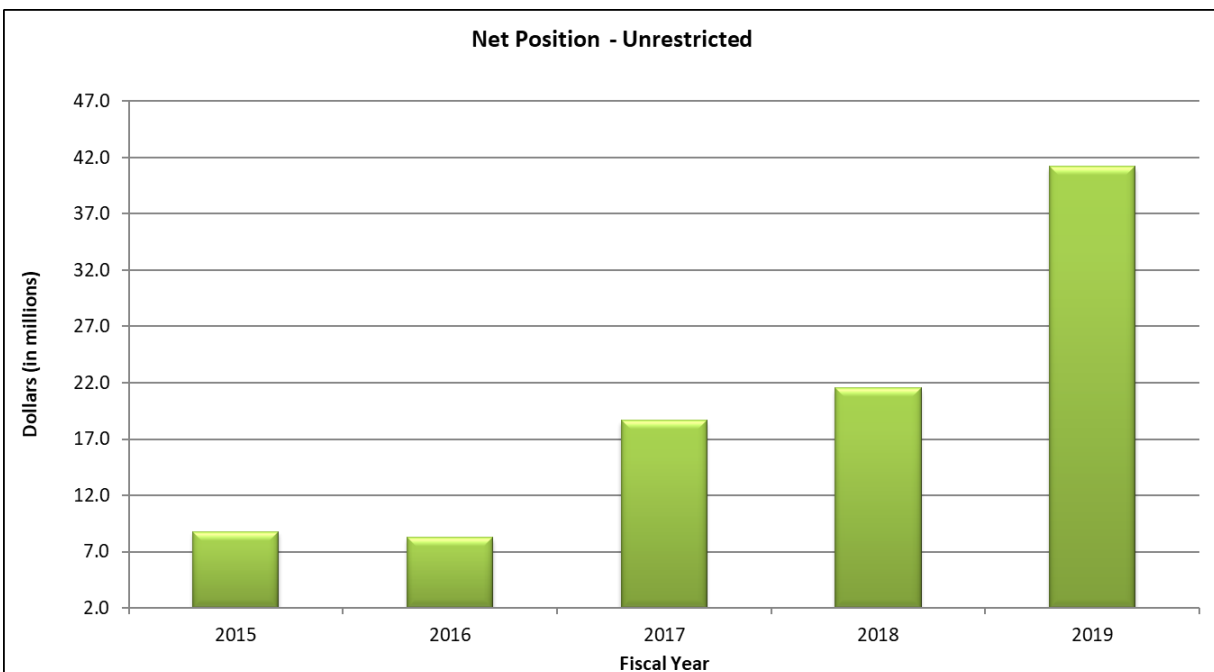
Roselli Clark & Associates

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
October 19, 2020

OVERVIEW

The CRA continues to build a strong financial footing through its sale of development rights to private developers within the Kendall Square Urban Renewal Project (KSURP) area with over \$20.6 million of such revenue recognized in 2019 alone and an additional \$28.7 million received previously from 2016 – 2018. However, such revenues are not at all consistently received annually and there are times when the economy impacts that little or no such development may occur for an extended period of time. Accordingly, the CRA is challenged to both pro-actively utilize such funds for its mandated purposes, while also insuring that sufficient liquid assets exist to maintain normal operations consistently and securely.

The CRA’s available, unrestricted net position at the end of 2019 reflects the continued growth of available financial resources for future project funding as compared to the four prior years:



Additionally, what is not reflected above are the financial resources allocated and restricted, for specific program use by the Board relative to the KSTEP and Foundry projects which held \$6.0 million and \$7.0 million, respectively as of December 31, 2019.

During the fiscal year ended December 31, 2019, the CRA’s net position increased about \$19.6 million. This was primarily the result of recording recurring revenues from one-time revenues of nearly \$20.6 million from the sale of developer rights and investment earnings that generated nearly \$2.9 million. Total expenses were about \$4.2 million which was approximately \$1.7 million higher than the previous year expenses. Some of the expenses are representative of non-cash, current year decreases from the provision of non-collectability on a loan in the future for over \$0.5 million and donation of land to the City of Cambridge which had previously held a value of nearly \$0.15 million by the CRA as a parcel available for development. Project consulting expenses increased approximately \$2.2 million which was about a 68.8% increase over such costs in the prior year and primarily related to a required payment of \$2.0 million due to the City of Cambridge for The Foundry; however, some of this increase was offset by one-

time expenses in the prior year for project note forgiveness and disposition of property losses of nearly \$0.69 million in total. Such project expenses are anticipated to increase in subsequent years, as the CRA will be looking to broaden and expand to implement various ideas to support and encourage development in the KSURP area, as well as community investments citywide.

Additionally for 2019, the CRA purchased a commercial property for approximately \$9.0 million that it will be leasing out to tenants in promotion of its KSURP requirements to provide services to the community, as well as, hopefully to serve as a revenue generating enterprise in future years. However, the CRA financed the purchase of the property with a mortgage note through an area bank in the amount of \$7.0 million and for the foreseeable future, a significant portion of the lease rental income will be utilized to paydown the annual debt service on the note. The CRA has contracted with a property management company to run the day to day operations of the commercial property on-behalf of the CRA.

In conclusion, we would continue to note that the CRA's level of accounting and financial reporting is rapidly changing to encompass a much broader range of financial transactions which are more advanced and challenging than has been the normal for the CRA over the last dozen years or more. To assist in addressing this fact concerning CRA operations, a Director of Finance was hired in 2019 to oversee financial operations. The CRA is offering loans and payment agreements with multi-year payback options, restriction/earmarking and tracking of cash funds for projects, investment of monetary holdings, issuance of debt as the loan recipient for project financing, landlord with commercial space leases, and potentially more types of transactions that may only be an idea or future idea at this time, but that will require the CRA to adapt its financial reporting, processing, and monitoring. Therefore, we encourage the CRA not to overlook both the internal and external financial support resources that will be necessary to sustain the accounting as it adapts to the forthcoming changes so that the financial side can aid in making project ideas a reality in the future.

This letter to management is intended to provide the CRA and its management with recommendations for improvement in accounting and financial operations and informational items. The CRA should review these recommendations and informational items, and, if determined to be cost-effective, implement these improvements.

INFORMATIONAL ITEMS

Network Security (General Informational Comment by Auditor)

Ransomware is an insidious type of malware that encrypts, or locks, valuable digital files and demands a ransom to release these files. The most common ransomware attack involves a victim opening an emailed file or clicking an attachment that appears legitimate like an invoice, but it actually contains the malicious ransomware code. As these emails often appear to be legitimate, the victim is unknowingly baited into executing the ransomware code.

The frequency of ransomware attacks on U.S. municipalities continues to rise. Especially in smaller communities with limited staffing and resources.

The Associated Press reported in August 2019 about a coordinated ransomware attack that affected more than twenty local governments in Texas on a single day by what was then believed to be perpetrated by a single source. Once penetrated, ransomware attackers can cause a municipality's technology resources to come to a standstill.

The Town should assess its current environment and put in place the processes that will best protect it:

- Consider having an outside security assessment conducted by a specialist.
- Provide periodic training to its employees regarding proper use of email and corresponding clicks to hyperlinks and attachments.
- Introduce simulated internal phishing schemes to determine if there are areas or employees where the Town may be vulnerable.
- Assure that all files are backed up offsite.
- Review insurance policies and determine if cyberattack insurance is part of the policy.

Small steps can go a long way in protecting a community from these attacks.

New GASB Pronouncements (General Informational Comment by Auditor)

The GASB has approved a new pronouncement that will go into effect starting January 1, 2022.

GASB 87 requires the Town to revise the manner of accounting for its operating leases. Previously, governmental entities reported their leases similarly to how private entities reported leases under ASC 840.

While finance leases would be capitalized on the balance sheet, operating leases would be reported in the footnotes. However, GASB 87 requires that all operating leases now be accounted for as finance leases.

As a result, leases previously classified as operating leases will not only be capitalized on the statement of net position, but also be reported differently in the statement of revenues, expenses, and changes in net position.

OPERATIONAL COMMENTS

Governmental Accounting Software (updated from prior year)

The CRA had been operating with constrained financial resources for many years heading into 2017, and the CRA Board and management had only implemented various limited activity projects to be pursued. At that time, the CRA was able to modify its general ledger accounting system, Quickbooks, to accommodate classification reporting of revenues and expenses for those projects which was adequate since many of the projects were either being directly funded through annual budgeted line items or were short-term endeavors where earmarks were appropriated and utilized within approximately a year. Accordingly, under that model of operation, it was not deemed a notable concern that each project didn't maintain its own segregated cash or remaining fund balance amounts for financial reporting purposes in Quickbooks because the activity was segregated but not the financial resources.

In 2017, with the large influx of monetary resources from development rights proceeds (with significant additional proceeds in 2018 and 2019), the CRA Board and management have begun a more aggressive approach towards increasing the scope of its endeavors to now encompass larger financial dollar projects, that in some cases can be reasonably expected to exist for a long-term period. A well-developed general ledger accounting system designed to segregate, track and report on these projects individually would be required to provide clearer and more usable financial transactional and status reporting for each individual project with which to assist the Board and management in its decision-making processes, as well as, transparency to the public. Furthermore, with the CRA now engaging in rental property ownership, a fund-based accounting system can more easily provide financial information specific to that enterprise since the rental operations could be setup as its own fund, allowing for a more distinct segregation of such operations from the CRA's other, much different operations.

However, Quickbooks is not a true governmental, fund accounting-based software program, and as such, it is limited in its ability to perform such project/fund segregations, and while not impossible, would require significant effort in performing separate project tracking on Excel spreadsheets in order to track, reconcile, and calculate such amounts for manual journal entry adjustment in Quickbooks, and even then such processes can be limited in providing real-time financial or retro-active financial status data. As the CRA is expanding its operations and exploring new areas to pursue, it is important that from an office infrastructure perspective, CRA personnel be provided the proper tools to meet the expectations that follow such expansion, and accounting should not be discounted as a key component to supporting project operations. It is our observation that the CRA is continuing to rapidly transition its financial activities beyond just basic bill payments and general payroll for office operations; therefore, we have concerns that Quickbooks is no longer a long-term viable accounting system software for the CRA. Fund and project-based accounting is not basic or easy accounting. Accordingly, specialized accounting software specifically designed for those purposes are a larger financial investment than a retail version of Quickbooks. Therefore, we are highly encouraging the CRA Board and management to evaluate other accounting system options that can follow with and adapt to the financial and operational changes occurring within the CRA at this time.

Governmental Accounting Software – continued

CRA Management Response:

Income received from development fees are not dedicated to any particular project. The allocation of funds is determined by the Board and the Executive Director. Expenses for each project are tracked for management purposes.

With respect to the newly purchased building, the CRA Board and Executive Director recognized the need for an experienced property manager with strong data and accounting tracking software to manage the newly purchased building operations and financials. The accounting entries are made in aggregate for the rental income and expenses of the building. The CRA has a unique bank account set up for the property and all transactions to separate the activity and provide the data for analysis. The staff of the CRA review these reports each month with the property manager for accuracy.

Furthermore, using the Class function on Quickbooks, the CRA can identify all transactions related to the Bishop Allen property. We also can rely on the property management reports and their data for more detailed information.

The CRA acknowledges that there will be a need for a more robust system as the complexity and the number of projects increase. Research on suitable solutions is ongoing.

Retiree Personnel File Documentation

As part of our other postemployment benefits census testing, we were told that the CRA maintains no retiree files in their office. They indicated that the actuary obtained the census data for retirees for the other postemployment benefits calculation from the Group Insurance Commission (GIC). The contributory retirement system would have the benefits paperwork for pension. However, as these retirees or their surviving beneficiaries are attached to the CRA, it would seem proper to maintain certain records and information on past CRA employees. Even though these individuals are covered by insurance managed by the GIC, the CRA is the entity responsible for paying for the premiums and receiving invoices relative to the retirees they are providing insurance for. We suggest that the CRA evaluate this records retention policy and consider implementing enhanced file maintenance for retirees.

CRA Management Response:

Personnel records of CRA employees, past and current, are maintained by the CRA. Each quarter, the GIC invoices the CRA for its financial share for its insureds. The invoice only lists the total cost for each of three categories – active employees, retirees, and survivors. The CRA will contact the GIC to obtain more detailed information with regards to payment for retirees and survivors for its records.

Loan Tracking System

The CRA in recent years, started to transition some of its public support through the issuance of long-term notes receivable to assist entities within their targeted project areas by providing loan funding to help sustain those entities and allow them to continue operations. Presently, most of the loans have differing payment terms that extend for decades into the future, and the CRA is recording these loans individually and classified as short-term and long-term as well as maintaining allowances for potential non-collection on the general ledger. As a result of what appears to have been a bit of a reorganization of the loans within the general ledger for 2019 a couple audit adjustments had to be proposed to bring the loan balances on the general ledger in-line with actual amounts owed to the CRA as of December 31, 2019.

Given our other experiences with redevelopment authorities and planning departments in other municipal entities that carry long-term notes receivable, and the fact that the CRA continued to issue loans in 2020, we believe that it would be beneficial for the CRA to purchase a loan management and tracking software and setup the various loans within that program. This program could then provide supporting reports on a monthly basis that could be used as the de-facto loan receivable sub-ledger and would thereby be the supporting document for a much more consolidated and easier to maintain set of loan/note receivable accounts on the general ledger.

As the number of such receivables continues to expand, it will become more challenging to maintain on any general ledger system that is not programmed to track multi-layered loan terms that are inconsistent amongst the loan recipients. It additionally provides for enhanced information retainage, as the facts and circumstances of the various loans can be archived within the loan tracking software and not just regained within individual persons' memories – especially since many of these loans will not mature until many board members and employees are no longer involved in CRA operations.

CRA Management Response:

The loan portfolio of the Cambridge Redevelopment Authority consists of three long term loans as of 12/31/2019, two for Just-A-Start and one for the Margaret Fuller House. Going forward, the Operations Director will send the “borrower” an annual statement detailing the loan balance, interest owed, and other relevant information for acknowledgement. These will be filed with the loan documentation. This will ensure that the ongoing financial obligation is monitored and acknowledgement.

Should the loan portfolio exceed a threshold that cannot be supported with the current process, the CRA will undertake specialized software for loan processing.

The CRA created a COVID relief loan program in 2020, however the servicing of those loans is to be conducted by Cambridge Savings Bank through a servicing agreement.