

**TOWN OF UPTON, MASSACHUSETTS**

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2013

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**ROSELLI, CLARK & ASSOCIATES**  
CERTIFIED PUBLIC ACCOUNTANTS

500 West Cummings Park  
Suite 4900  
Woburn, MA 01801

Telephone: (781) 933-0073

[www.roselliclark.com](http://www.roselliclark.com)

## TRANSMITTAL LETTER

The Honorable Members of the Board of Selectmen  
Town of Upton  
Upton, Massachusetts

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Town of Upton, Massachusetts (the "Town"), as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Town'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 Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town'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. However, material weaknesses could exist that have gone undetected.

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

A handwritten signature in black ink that reads "Roselli, Clark &amp; Associates". The signature is written in a cursive, flowing style.

Roselli, Clark & Associates  
Certified Public Accountants  
Woburn, Massachusetts  
December 10, 2013

## **I. OVERVIEW**

Fiscal year 2013 provided further improvements to the local, national and international economies. According to the U.S. Bureau of Labor Statistics, the Town's June 2013 unemployment rate of 6.3% was significantly better than both the state-wide unemployment rate of 7.3% and the unemployment rate of 8.3% for Worcester County. Furthermore, residential home values continue to improve and the market for new and existing home sales has been robust over the past year.

While these improvements provide optimism to the Town and its residents, the Town must be diligent in managing its finances. The Town has been successful in maintaining its reserve balances in trying economic times. Many towns have conceded to the pressure of maintaining services in lieu of building reserves and thus are facing the consequences of those decisions including downgrades to their credit ratings. The Town, however, has managed its financial operations well despite this prolonged challenge.

The Town ended the latest fiscal year with approximately \$1.4 million in unassigned fund balance in its general fund. This represented nearly 7.9% of 2013 general fund expenses, which is significantly greater than the State average. Credit rating agencies place strong value on these "reserve ratios." These credit rating agencies look favorably on reserve ratios exceeding 5% (a 10% ratio is generally considered optimal by credit rating agencies).

This is the type of consistency that has allowed the Town to earn and maintain an AA rating from Standards & Poor's Financial Services LLC ("S&P"), which classifies the Town's general obligations as "investment grade."

We were first engaged to audit the Town's basic financial statements in fiscal year 2011 and issued a comprehensive letter to management dated December 21, 2011. A follow-up letter to management dated January 23, 2013 was also issued. Many of the recommendations in these letters to management were expected to be multi-year action items. The Town and its leadership have aggressively addressed the recommendations in our letters to management including:

- The adoption of a Town-wide fraud policy;
- The development of many formal policies and procedures surrounding personnel and human resources functions;
- The implementation of several regionalization programs that are expected to result in significant cost savings; and
- The separation of all water and sewer business revenues from the general fund and into their respective enterprise funds.

The remainder of the report reflects informational items and findings and recommendations. We hope that Management will address comments in the current year report with the same motivation it has addressed comments in the prior years.

## **II. INFORMATIONAL ITEMS**

### ***Statement on Auditing Standards No. 115 – Audit Communications***

The American Institute of Certified Public Accountants (“AICPA”) recently issued Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (“SAS 115”). SAS 115 establishes standards and provides guidance on communicating matters related to an entity’s internal control over financial reporting identified in an audit of financial statements. In particular, SAS 115 provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements in the following order:

1. Deficiency in internal control
2. Significant deficiency
3. Material weakness

Deficiencies identified as *significant deficiencies* or *material weaknesses* are required to be communicated to those charged with governance. *Deficiencies in internal control* are not required to be communicated; however we have chosen to also report these types of deficiencies in this report.

We did not deem any of the findings in this report to be categorized as either a significant deficiency or a material weakness.

### ***Other Postemployment Benefits***

The Town implemented the Governmental Accounting Standards Board (“GASB”) Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefit Plans Other Than Pension Plans* several years ago. Other postemployment benefits, or OPEB, typically include health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits. The Town presently contributes 50% of the cost of retiree and dependent comprehensive medical insurance.

At June 30, 2013, the Town reported a net OPEB liability of \$1,670,000. However, the unfunded actuarial accrued liability for these future benefit obligations totals \$4,180,000 as of July 1, 2012 (the date of the most recent actuarial valuation study). The Town has recently begun funding an OPEB trust, which totaled approximately \$15,000 at June 30, 2013.

S&P has begun to assign an allocation of the credit evaluation to the management of long-term liabilities, which includes OPEB. This is a reminder to Management that as part of its long term planning, the Town should continue to reflect the effects of OPEB into its plan.

### **III. FINDINGS AND RECOMMENDATIONS**

#### **Part 1 – New Items**

##### ***Retirement System Funding***

The Town pays its annual appropriation to the Worcester Regional Retirement System (the “Retirement System”) in equal semi-annual installments, which is permitted by the Retirement System. The Town has historically utilized this installment method to manage its cash flows, particularly in the past when its financial condition was not as strong as it is today.

The Retirement System provides a financial incentive of nearly 2% should a municipal member pay their entire annual appropriation on July 1<sup>st</sup> of the fiscal year. Had the Town taken advantage of this financial incentive, it would have saved approximately \$7,800 in fiscal year 2013 and \$8,200 in fiscal year 2014. This return is significantly greater than most of the money market yields the Town is receiving on its excess cash balances.

As stated above, the Town’s decision to use semi-annual installments was born during a time in which the Town’s financial position was not as strong as it is today. The Town’s improved financial condition coupled with a recent change in the manner in which the Commonwealth of Massachusetts is paying state aid (monthly versus quarterly) suggest that the Town is in a position to benefit from the financial incentive offered by the Retirement System.

We recommend that during the Town’s preparation of its fiscal year 2015 budget, the Town evaluate the effect that this advanced payment will have on its financial condition and, if found to be positive, begin advance paying its annual retirement appropriation in fiscal year 2015.

##### ***Accounting System***

In our letter to management dated December 21, 2011, we recommended that the Town evaluate its accounting system. In connection with our fiscal year 2012 audit, we were informed that the Town was continuing to evaluate its accounting system. We continue to recommend that the Town evaluate its accounting system and the manner in which it records transactions outside its general fund and sewer and water enterprise funds.

Currently, the Town records all transactions in its special revenues, capital projects and trust funds as changes in fund balances. As a result, significant manipulation of recorded financial data is needed to determine the exact components of these changes (i.e., revenue from user fees versus interest income versus intergovernmental grants). As this process is somewhat manual in nature, there exists the risk that individual revenue and expense categories may be calculated erroneously.

Furthermore, departments whose operations are recorded in special revenues such as recreation, library and the board of health, cannot easily obtain an analysis of their turned-over revenues and expenditures. The ability of department heads to review their department’s revenues and expenditures is a key element in any internal control system

We recommend that the Town evaluate the manner in which it posts revenue and expenses in its special revenues, capital projects and trust funds and begin the process of recording these items in revenue and expenditure accounts versus against fund balance.

***Periodic Departmental Reviews***

In connection with our audit procedures, we made inquiries of members of Town management as well as members of its staff regarding internal controls. It was indicated that the Town does not perform periodic reviews of departmental adherence to the Town's financial policies and procedures.

We recommend that the Town develop a process whereby its Treasurer periodically visit departments to evaluate their adherence to the Town's revenue turn over policy and the procedures these departments have in place to safeguard their assets. In addition, this would be a good opportunity to review the department's procurement procedures and their understanding and adherence to state procurement laws.

## **Part 2 – Previously Reported Items**

### ***Policies and Procedures Manual***

We recommended that the Town develop and communicate a formal set of financial policies and procedures that focus on (i) purchasing, (ii) cash receipts, (iii) human resources, (iv) investment management, (v) fraud and (vi) fixed assets. As expected, this is a long-term project that the Town has informed us is underway. To that end, a fraud policy, reserve policy and personnel bylaws have been adopted by the Town. In addition, the Town is currently working on a departmental turn over policy for revenues not collected directly by the Town Collector. As these policies are adopted by the Town, they are being placed on the Town's website for use by its personnel and for public inspection.

### ***Town Treasurer is an Elected Position***

In our December 21, 2011 letter to management, we recommended that the Town consider a referendum to amend the selection method of its Treasurer/Collector to an appointment by the Town's Board of Selectmen or its Town Manager. While the current elected Treasurer/Collector possesses the skills necessary to support this position, future elected Treasurer/Collectors may not.

The Town has a population of less than 7,000 residents, which limits the available talent pool capable of being elected as Town Treasurer/Collector. Recently, two much larger surrounding towns (Milford and Franklin) approved bylaw changes to appoint their treasurer/collectors versus having this critical position being elected.

We continue to recommend that the Town evaluate a referendum to amend its selection method of the Town Treasurer/Collector.

#### **IV. DEPARTMENTAL REVIEW**

In connection with the financial statement audit, we performed certain procedures surrounding the cash management and recordkeeping for the fire department. This departmental review was limited to areas of accounting and financial significance and therefore does not focus on operational effectiveness or efficiency.

As we reported in previous letters to management, we continue to observe the absence of formal policies and procedures relating to some areas of departmental finances (refer to our general recommendations in Section III). Effective policies clearly communicate what is expected of employees along with the intent and purpose behind the expectations. The use of this control mechanism would better ensure that transactions are authorized and assets are adequately safeguarded. Furthermore, in the event of personnel turnover, effective policies and procedures facilitate the transition of new personnel.

Although many formal policies and procedures do not exist, the Town's control environment is strong and there are clear indications that departments are well aware of the financial and internal control expectations of the Town on them. For example, it is generally well understood that all departmental vendor warrants submissions must be duly authorized and submitted to the Town Accountant each Thursday. In addition, departments know that revenue turnovers should be made weekly to the Town Treasurer/Collector regardless of the amounts in their possession.

We continue to recommend that the Town endeavor on a process over the coming fiscal years to have each department analyze their operations, assess the business and operating risks inherent within their operations and outline their key processes and internal controls. Policies and procedures should then be developed that are easy to understand and follow.

#### ***Fire Department***

The Town's fire department generates revenue from (i) permits and fees and (ii) ambulance services. Expenses are primarily related to salaries and wages. The following revenues and expenses were reported in the fiscal year 2013 accounting records:

	<b>Fiscal Year 2013</b>		<b>Variance</b>	
	<b><u>Actual</u></b>	<b><u>Budget</u></b>	<b><u>Dollars</u></b>	<b><u>Percent</u></b>
Permits and fees	\$ 14,569			
Ambulance	<u>208,595</u>			
Total revenues	<u>223,164</u>	\$ 212,000	\$ 11,164	5%
Fire department salaries and wages	463,639			
Ambulance salaries and wages	130,429			
Other expenses	<u>212,499</u>			
Total expenditures	<u>806,567</u>	<u>820,956</u>	<u>14,389</u>	2%
Funded through tax base	<u>\$ 583,403</u>	<u>\$ 608,956</u>	<u>\$ 25,553</u>	4%

### ***Fee Schedules***

The price of permits and fees are set periodically by the fire chief upon approval of the Town's board of selectmen. The last approved fee schedule became effective January 10, 2013 and replaced the November 28, 2011 fee schedule. The fire chief indicated that the fees the fire department charges are based on an analysis of the fees surrounding communities assess as well as from data gathered from the Fire Chiefs Association of Massachusetts, or FCAM.

The fire department increased its fee assessments for its ambulance service in early fiscal year 2014 based on the fire chief's communications with FCAM members.

Based on this, it appears the fee review and revision process is working adequately.

### ***Receipts Processing***

The Town recently implemented an online permitting application that the fire department is enthusiastically embracing. This online permitting application will permit residents to apply for various permits from the fire department online and pay for these permits using a credit card, thereby greatly reducing cash handling by the fire department. Today, the majority of permit and fees collected directly at the fire department are from either in-person transactions or through the US mail. Receipts are logged onto a standard *Schedule of Departmental Payments to Treasurer* and are generally turned over to the Town's Treasurer/Collector weekly. Users receive a receipt in the form of their permit.

For ambulance services, the Town began using a third party billing and collections agent in fiscal year 2011. As a result, the Town's actual collections have improved greatly as the complexities of insurance billings often require specialized insurance billing skills that agencies like the Town's third party provider possess.

### ***Technology***

In addition to the new online permitting application recently deployed throughout the Town, the fire department has recently implemented enhanced software tools to track and bill ambulance services more accurately and efficiently.

### ***Capital Requirements***

The operation of the Town's fire department is very capital intensive, particularly since there are regulatory requirements that are in place that the Town's fire department must adhere to protect its residents. The fire chief and town accountant are investigating financing methods including either general obligation borrowings or leasing to finance needed capital projects. We recommend that the fire chief work closely with the Town Manager, finance managers and Capital Budget Committee to determine the most cost effective and efficient manner to meet the fire department's capital requirements that work within the Town's financial framework.

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