

TOWN OF UPTON, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2014

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TRANSMITTAL LETTER

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Town of Upton, Massachusetts (the "Town"), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Town's basic financial statements, and have issued our report thereon dated January 30, 2015.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Town's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Town's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
January 30, 2015

I. OVERVIEW

Fiscal year 2014 provided further improvements to the local, national and international economies. According to the U.S. Bureau of Labor Statistics, the Town's June 2014 unemployment rate of 4.5% was significantly better than both the state-wide unemployment rate of 5.5% and the unemployment rate of 6.2% 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 several years.

The Town ended fiscal year 2014 with approximately \$1.7 million in unassigned fund balance in its general fund. This represented approximately 8.8% of 2014 general fund expenses, which is significantly greater than the State-wide 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).

The Town continues to bolster its stabilization funds. In fiscal year 2014, the Town transferred \$100,000 into its general stabilization fund, which totaled nearly \$635,000. Furthermore, the Town maintains a capital stabilization fund and a stabilization fund committed to the regional school district, which totaled approximately \$189,000 and \$548,000, respectively, at June 30, 2014.

In May 2014, Standards & Poor's Financial Services LLC ("S&P") upgraded the Town's credit rating to AA+. S&P's AA+ rating classifies the Town's general obligations as "investment grade" and is one step below AAA, which is the highest grade possible.

Fiscal year 2014 marked the fourth year that we've been engaged to audit the Town's basic financial statements. The Town and its leadership have aggressively addressed the recommendations that we've made in each of our previous three letters to management. Since our last letter to management dated December 10, 2013, the Town implemented the following:

- The payment of its annual pension appropriation in July 2013, which resulted in an approximate \$8,400 cost savings;
- Changing the manner in which revenues and expenditures were recorded in the Town's special revenue and trust funds, which has made the reconciliation, review and oversight functions much easier and more reliable; and
- The formalization of approximately thirty administrative policies and procedures.

As many of our recommendations were expected to be multi-year action items, the Town is disposing of these as expected. 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

In June 2012, the GASB issued two new statements affecting the accounting and reporting of the Town's pension expense and liability that will become effective for the Town in fiscal year 2015 – GASB Statements No. 67 and 68. The provisions of these two statements become effective for the Town in fiscal year 2015 and for the Worcester Regional Retirement System for its fiscal year ended December 31, 2014.

These statements, among other things, require governments providing defined benefit pensions to recognize the long-term obligation for pension benefits as a liability for the first time in the government's statement of net position and to more comprehensively and comparably measure the annual costs of pension benefits.

The adoption of these two statements will have a material impact on the Town's financial statements. More specifically, the following areas of financial calculation and reporting will be impacted:

- 1) Certain actuarial methods of calculating the accrued pension liability will now be mandated, instead of optional.
- 2) The value of actuarially determined pension benefits that have been earned (by both active and non-active employees and pensioners) will now be reported as a liability on the Town's statement of net position and the applicable accrued costs included within the statement of activities.
- 3) Enhanced and more detailed financial statement footnote reporting relative to the pension plan.
- 4) Enhanced and more detailed financial statement required supplementary information reporting relative to the pension plan.

While the adoption of these standards will have a material impact on the Town's government-wide financial statements, it's important to note that no changes are being made to the underlying pension system or its funding schedule. The Town should expect that its reported net position in its statement of net position will decrease materially as a result of its proportional share of the Worcester Regional Retirement System's current unfunded actuarial accrued liability, which for all participating municipalities was approximately \$546.1 million as of the date of the last available actuarial study (January 1, 2012).

It is likely that the auditors to the Worcester Regional Retirement System will require additional documentation from the Town during their audit of the Worcester Regional Retirement System's 2014 financial statements. It is important that the Town promptly provide the requested documents to the Worcester Regional Retirement System's auditors to better ensure the timely completion of its audit, without which could result in issues related to the Town's fiscal year 2015 audit.

Other Postemployment Benefits

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 currently contributes approximately one-half of the cost of retiree and dependent comprehensive medical insurance.

The Town's latest actuarial valuation study (dated July 1, 2012) places the unfunded liability at approximately \$4.2 million with a correlative recorded liability of \$2.1 million in the current year's financial statements. At June 30, 2014, the Town committed approximately \$30,000 to finance its OPEB obligations.

Many communities are establishing OPEB trusts or OPEB stabilization funds to address this matter. Credit agencies such as S&P are assigning 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.

Fraud Prevention Measures

Fraud activity throughout the Commonwealth's municipalities is at the highest level in recent memory and the Town should consider taking action to better help protect itself from this unfortunate trend. The Town has already formalized and published a written fraud policy; the Town should take a number of additional steps to address fraud risk including:

1. Perform a risk assessment of its most vulnerable business processes. This risk assessment should be performed at the highest level of the Town's management with inputs and interaction with the Town Treasurer and its Town Accountant. The documented results of this risk assessment should be evaluated and significant flaws in the design of the Town's current processes should be documents and steps for remediation taken.
2. As we indicated in our December 10, 2013 letter to management, the Town should perform periodic internal reviews of business processes, particularly those that include cash handling. The Town Treasurer and Town Accountant should identify departments whose business operations should be reviewed by evaluating the dollar amount and frequency of cash transactions within these departments. On a quarterly or semi-annual basis, a finance team should meet with these departments on a rotational basis to evaluate their current processes and, if necessary, recommend and implement enhancements and/or improvements. Furthermore, we recommend that this finance team establish dedicated days in its calendar for these procedures. By dedicating and reserving these dates, expectations can be better set and met regarding this important on-going monitoring process.

Municipal Data Breaches

Within the past few years, there has been an alarming increase in the number of intrusions into municipal networks throughout the United States. These breaches, many of which targeted relatively small cities and towns, have resulted in the unauthorized access of resident, student and employee data and the theft of several hundred thousand dollars. Given that most cities and towns lack a structured information security program their systems are increasingly at risk to this type of event.

Recently, a select number of highly qualified companies have emerged that conduct “data security audits” for municipalities. This type of audit is a comprehensive examination of the administrative, technical and physical security controls that a municipality has implemented to protect personal information. The resulting audit report identifies each condition that exposes the municipality to potential unauthorized access and offers practical recommendations to remediate these conditions. The Town should evaluate its information technology security and evaluate the use of one of these specialists or use in-house resources.

III. FINDINGS AND RECOMMENDATIONS

Part 1 – New Item

Growth in Receivables

The Town's receivable for property taxes has been growing at a significant rate. Since June 30, 2011 (the first year in which we were engaged to audit the Town's financial statements), property tax receivables have increased by over \$373,000. This is an approximately 7% compound annual growth rate, as illustrated in the table below.

	As of June 30,				
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>CAGR</u>
Property taxes	\$ 797,205	\$ 842,154	\$ 875,275	\$ 880,735	2.52%
Tax title, liens and foreclosures	<u>394,976</u>	<u>381,622</u>	<u>577,462</u>	<u>684,475</u>	14.74%
	<u>\$ 1,192,181</u>	<u>\$ 1,223,776</u>	<u>\$ 1,452,737</u>	<u>\$ 1,565,210</u>	7.04%

Growth in property tax receivables is a consumption of the Town's available resources and may indicate a weakness in its collections process. The Town's Treasurer/Collector is aware of this trend and has determined that this is the result of growth within tax title receivables, which has grown at a compound annual growth rate of nearly 15% since June 30, 2011.

As of June 30, 2014, there were approximately fifty-five (55) properties within the Town's tax title receivable records. Several of these properties have unknown owners; others have disputes between the Town and the property owner regarding valuation and other assessing matters. In addition, a single property which represents approximately 17% of the entire tax title balance is an unsalable lot whose owner hasn't paid property taxes since the early 1990's.

We recommend that the Town's Board of Assessors and its Treasurer/Collector work with each other and the Massachusetts Department of Revenue to determine the best manner to collect and/or abate these outstanding amounts.

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, approximately thirty (30) administrative policies have been adopted by the Town including a fraud policy, reserve policy and personnel bylaws. The Town is in need of a departmental turn over policy for revenues not collected directly by the Town Collector, which we understand is in-process. 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 8,000 residents, which limits the available talent pool capable of being elected as Town Treasurer/Collector. In fiscal year 2013, two much larger surrounding towns (Milford and Franklin) approved bylaw changes to appoint their treasurer/collectors versus having this critical position being elected.

In fiscal year 2014, the Town's legislative body voted to continue electing its Treasurer/Collector. We continue to recommend that the Town amend its selection method of the Town Treasurer/Collector by offering referendums at a future Town meeting.

IV. DEPARTMENTAL REVIEW

In connection with the financial statement audit, we performed certain procedures surrounding the cash management and recordkeeping for the council on aging, or COA. 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 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.

COA Organization

The COA operates under the statutes of Massachusetts General Law Chapter 40, Section 8B and the By-Laws of the Town. The COA is managed by its full-time Executive Director, who reports to the Town Manager. A seven-member board to the COA is appointed by the Town's Board of Selectmen. In addition to the Executive Director, the Town employs one full-time social services coordinator, a part-time department specialist and three part-time bus drivers (a fourth bus driver is an unpaid volunteer). The COA's director and social services coordinator have each been working in their capacity with the COA for less than one year.

It is the COA's mission to mobilize the resources necessary to meet the supporting needs of the Town's senior citizen population. The COA designs programs to improve and enrich the quality of life for the Town's seniors by providing outreach, transportation services, health clinics, exercise programs and social activities.

The COA operates in a rented facility owned by a private organization and is adjacent to the privately-owned, federally subsidized senior living community. The COA pays \$1 per year in annual rent to this private organization.

There currently is no functioning "friends of" organization that is assisting the COA in its mission.

COA Financial Overview

The majority of the COA's operations are funded through the Town's tax base and run through the Town's general fund. The COA also maintains a revolving fund and a separate fund to account for its state formula grant. The following unaudited financial information is presented for information purposes only:

	Fiscal Year 2014		Variance	
	<u>Budget</u>	<u>Actual</u>	<u>Dollars</u>	<u>Percent</u>
<i>Council on Aging - General Fund</i>				
Salaries and wages	\$ 124,825	\$ 109,148	\$ 15,677	13%
Other expenses	<u>36,876</u>	<u>25,569</u>	<u>11,307</u>	31%
Total funded through tax base	<u>\$ 161,701</u>	<u>\$ 134,717</u>	<u>\$ 26,984</u>	17%

	Fiscal Year	
	<u>2014</u>	<u>2013</u>
<i>Council on Aging - Revolving Fund</i>		
Fund balance (deficit) - Beginning of year	\$ (541)	\$ (872)
Revenues	4,249	3,738
Expenditures	<u>(2,973)</u>	<u>(3,407)</u>
Fund balance (deficit) - End of year	<u>\$ 735</u>	<u>\$ (541)</u>

<i>Council on Aging - State Grant</i>		
Fund balance - Beginning of year	\$ 2,902	\$ 2,898
Revenues	6,714	8,414
Expenditures	<u>(9,616)</u>	<u>(8,410)</u>
Fund balance - End of year	<u>\$ -</u>	<u>\$ 2,902</u>

As illustrated above, personnel costs represent the largest costs for the COA. In reviewing the COA's internal records, expenditures are primarily made for utilities, office expenses, van fuel and repairs, software renewal fees and outside services.

Revenues are primarily generated from the sales of bus tickets and exercise program fees. The COA uses the state formula grant primarily to subsidize the COA's exercise and other social programs.

Findings and Recommendations

Turnover Frequency – We observed that the COA generally turns over the cash it receives on a monthly basis. As stated in several other areas of this letter to management, while a formal departmental turnover policy is in-process, it is generally understood throughout the Town that turnovers should be made weekly, at a minimum. We recommend that the COA make weekly turnovers to the Town in conjunction with its weekly payroll submissions.

Policy Formalization – The COA director indicated that she was developing a series of operational policies and procedures. We encourage the COA director to complete this endeavor and communicate these policies and procedures, which includes rules for use of the COA facility and its vans, to the COA employees and its customers.

Rental Risk – The COA operates in a facility that is owned by and adjacent to a privately-owned, federally subsidized senior living community. The current annual rent is \$1. While there does not appear to be any pending or immediate risk that the owners of this senior living community will change the terms of COA’s rent, this is a significant and material risk to the COA. The COA and the Town should be aware of this risk and develop a contingency plan in the event that the COA can no longer operate in this facility.

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