

TOWN OF UPTON, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2017

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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, 2017, 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 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. 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.

This communication is intended solely for the information and use of management, the Board of Selectmen, and others within the Town, 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
February 14, 2018

OVERVIEW

Throughout fiscal year 2017, the local, state-wide and national economies continued to strengthen. Unemployment rates are low and property values are rising. The housing market, particularly within the Town and many of its surrounding communities, has been robust over the past several years. Residential real estate valuations are at all-time highs in many of the Town's neighborhoods.

In its governmental funds financial statements, which most closely resembles the Town's statutory accounting records, the Town's unassigned fund balance in its general funds approximated \$3.4 million at June 30, 2017. Included in the unassigned fund balance at June 30, 2017 was approximately \$1.4 million in stabilization funds.

Liquidity in the general fund is often measured by comparing both the unassigned fund balance to the current year's total fund expenditures. Credit rating bureaus often refer to this as a "reserve ratio." At June 30, 2017, the unassigned fund balance in the general funds approximated 16% of total general fund expenditures. Furthermore, the total fund balance in the general fund approximated 19% of that same amount. The Town's reserve ratio is very strong and provides the Town significant budgetary flexibility in the event of a downturn in the economy.

The Town established an OPEB trust fund several years ago. OPEB trusts are intended to assist the Town in funding its future postemployment health and welfare benefits to its employees. Prior to fiscal year 2017, the Town has made modest contributions into this fund to date. In fiscal year 2017, the Town contributed \$200,000 to this trust, whose June 30, 2017 fund balance was nearly \$317,000. The establishment of an OPEB trust and continuing contributions, while not currently mandated by Massachusetts General Law, are prudent business decisions that are viewed very favorably by credit rating bureaus.

The Town's budgetary flexibility, strong reserve ratio and planning/funding for its future obligations has undoubtedly been seen as positive factors to S&P. 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 possible credit rating. This high credit rating enables the Town to enjoy very favorable terms in the municipal bond market.

The remainder of the report reflects informational items and findings and recommendations.. This discussion is intended to provide the Town and its management with recommendations for improvement in accounting and financial operations. The Town should review these recommendations and, if determined to be cost-effective, implement these improvements. Items that have been repeated from past letters to management are so indicated. This letter should be read in conjunction with previously issued letters to management.

INFORMATIONAL ITEMS

New Financial Statement Disclosures – OPEB Part 1

The Town was required to adopt Governmental Accounting Standards Board, or GASB, issued Statement No. 74, *Financial reporting for Postemployment Benefit Plans Other Than Pensions*, in fiscal year 2017. Other postemployment benefits are commonly referred to as “OPEB” and includes health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits. The Town’s current policy is to contribute 50% of the cost of retiree health insurance costs, which comprises the vast majority of OPEB obligations.

The adoption of this accounting standard resulted in additional disclosures within the Town’s financial statements and the inclusion of the effects of retiree benefits paid and received (both from the Town and its retirees) in the Town’s fiduciary funds financial statements. However, certain disclosures and required supplementary schedules could not be made in fiscal year 2017; this information will be presented in fiscal year 2018. The omission of this information does not materially impair or affect the Town’s overall financial statements.

FY 2018 New Accounting Principle – OPEB Part 2

As discussed in our previous letter to management, the Town will be required to report the full amount of its net OPEB liability in its government-wide and proprietary funds financial statements in fiscal year 2018. The Town currently reports a net OPEB obligation in its government-wide financial statements calculated under GASB 45.

The Town’s net OPEB liability is expected to be significantly greater than its net OPEB obligation. The Town’s independent actuary determined that the Town’s unfunded actuarial liability, which closely resembles its net OPEB liability, at June 30, 2017 was approximately \$7,129,000 versus a net OPEB obligation of nearly \$3,676,000.

The Town’s independent actuary will remeasure the Town’s net OPEB liability at June 30, 2018. The Town will present this figure in its fiscal year 2018 affected financial statements. This will result in a further deterioration in the Town’s unrestricted net position.

The Town established an OPEB trust fund in fiscal year 2011 to assist it in funding this future obligation. As it stands at June 30, 2017, the OPEB trust fund is approximately 4% funded.

The Town should continue to include OPEB in its long-term planning.

Improvements to Property Tax Receivable Balances

We are pleased to report that the receivable balances for property taxes decreased by approximately \$92,500 at June 30, 2017 from the prior year. The Town's Treasurer/Collector has been working to reduce these balances for the past several years. We continue to recommend that the Town take steps to reduce these balances, which are a consumption of the Town's valuable resources. We refer you to previous letters to management for additional details on the multi-year build up of property tax receivable balances.

Improvements to Internal Controls

We are pleased to report that the Town adopted a comprehensive financial policies and procedures manual in June 2017. Furthermore, this manual (together with many other policies) is available to all via the Town's website.

Written policies and procedures serve as a critical component to any internal control system. However, a sound internal control system contains many elements and components including risk assessments, information technology and continual monitoring.

We encourage the Town to continue improving its internal control system and recommend that it evaluate the Green Book, which is the most commonly adopted internal control system used by U.S. federal, state and municipal governments, and implement additional internal controls that are cost-effective.

Governance Review

The Town's General By-Laws effectively establish the Town's ordinances and regulations and were last revised in November 2017 to update certain powers and responsibilities of the Town Manager.

A growing number of Massachusetts municipalities are evaluating the means by which they are governed. This includes evaluating appointed versus elected officials, terms of office, board composition, powers, duties and responsibilities of offices and many other various governance specific items. The form of this review is dependent on the municipality and its current form of governance. The aim of any governance review is to enhance operational efficiencies and improve transparency for the betterment of the community.

The Town periodically submits legislation under the Commonwealth's "home rule petition" guidelines, which is a long and rigid process to initiate change. This could be eliminated by adopting more flexible methods of governance such as adopting a charter subject to the provisions of Chapter 43B of Massachusetts General Laws ("MGL"). Charters have become the preferred means, over by-laws and policies, to achieve long-term continuity, transparency and stability as officials, board members and personnel change. As such, one outcome is that charters strengthen public confidence in government.

The Home Rule Amendment to the State's constitution provides several routes for framing or revising a charter; the most common being through a charter commission which requires a petition of 15% of the municipality's voters. Chapter 43B provides a specific framework, timeline, and set of responsibilities for the charter commission to fulfill. The commission has a maximum of sixteen months to produce a preliminary report and a maximum of eighteen

months to produce a final report. The statute requires that two public hearings be held. Both the preliminary and final reports must be printed and distributed.

The commission's work would include a review of town's similar to Upton and their method of governance as well as consultation with the Department of Revenue, Attorney General Town Counsel and Special Counsel.

We suggest the Town evaluate the creation of a Charter Commission and embark upon this mission. Further details of this may be reviewed at the following links:

<http://www.mass.gov/dor/local-officials/dls-newsroom/ct/charting-a-route-for-charter-change.html>

<https://www.mass.gov/files/documents/2017/09/09/homerule.pdf>

FINDINGS AND RECOMMENDATIONS

Enhanced Controls Surrounding Debit or Purchasing Cards

Municipalities have been increasingly adopting the use of purchasing cards primarily to facilitate the procurement of office supplies and other items used during the ordinary course of business. Purchasing cards are a payment tool designed to make the business purchasing process more efficient by reducing paperwork, providing greater control over spending (i.e., spending limits on cards) and visibility into spending patterns. Purchasing cards can also reduce the workload for accounting personnel and improve supplier relationship as payment is rendered almost immediately versus waiting for the normal vendor warrant process. The Town has a number of purchasing cards in use at various departments, which are internally referred to as debit cards.

While there are efficiencies to gain using debit cards, Massachusetts municipalities are bound to follow procurement requirements set forth in Massachusetts General Laws. In April 2012, the Technical Assistance Section of the Division of Local Services of the Massachusetts Department of Revenue issued guidance on the use of municipal purchasing cards, or P-cards. Contained in this guidance was the requirement to adopt a written P-card policy.

The recently adopted June 2017 financial policies and procedures manual does not contain such a policy. Furthermore, the Town has experienced issues in which debit cards have been used and these charges have not been reported to the Town Accountant and Town Treasurer in a timely manner. In fact, in its November 2017 Special Town Meeting, the Town approved an article to cover the expenditure of approximately \$10,000 in funds incurred from the prior fiscal year directly related to debit card activity.

We recommend that the Town Manager, Town Accountant and Town Treasurer develop a written policy and procedure for use of its debit cards (P-cards), including requirements for information communication from departments using debit cards and the Town's Accountant and Treasurer. Such policy and procedure should be communicated to all department heads and included in the Town's financial policies and procedures manual.

DEPARTMENTAL REVIEW

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

The Department's director indicated that he has a copy of the June 2017 financial policies and procedures manual and is following applicable portions of this manual as they apply to the Department.

Organization

The Department is overseen by a three-member elected Recreation Commission. Its day-to-day operations are managed by a director, who was hired as a full-time employee in January 2017. The department also utilizes a shared administrative resource, many part-time seasonal employees and a number of independent contractors.

The Recreation Commission submits an annual budget at each Annual Town Meeting to cover a number of fixed costs. The fiscal year 2017 and 2018 approved Department budgets totaled \$34,750 and \$33,275, respectively. The vast majority of the Department's activities are accounted for in a separate revolving fund, which had revenues in excess of \$211,000 in fiscal year 2017.

The Department's director has offices at the Town Hall and at the Town beach and athletics complex, which is more commonly referred to as Kiwanis Beach. The Department director generally works at Kiwanis Beach during the summer (its peak season) and at Town Hall the remainder of the year.

Financial Summary

The following is a summary of the fiscal year 2017 accounting for the Department:

Program revenues (a)	\$ 211,258
General fund budget	<u>34,750</u>
Revenue sources	<u>\$ 246,008</u>
Personnel costs (b)	140,548
Other operating costs (c)	90,626
Capital improvements (d)	<u>13,000</u>
Operating costs	<u>\$ 244,174</u>
Capital improvements (e)	<u>\$ 177,866</u>

- (a) Revenues are entirely related to usage fees and are recorded in a special revenue revolving account.
- (b) Portions of personnel costs (\$26,129) were paid from the general fund budget; the remainder was paid from a special revenue revolving account.
- (c) Portions of operating costs (\$8,000) were paid from the general fund budget; the remainder was paid from a special revenue revolving account.
- (d) Paid from general fund budget.
- (e) Paid from CPA funds.

Effective fiscal year 2018, the salary for the Department's director will be paid entirely from the special revenue revolving account, which resulted in a decrease in the general fund budget.

Revenue Sources

The Department has three significant sources of revenues:

1. Children's programs;
2. Adult programs; and
3. Field rentals

The summer programming for children represent the largest portion of the Department's revenues. Additionally, the Department's director's internal reporting indicates that Kids at Play, which is an all-day summer recreation program run at Kiwanis Beach for ten weeks during the summer, represents approximately 52% of the Department's fiscal year 2017 revenues. Other children's programs include Youth Theater, swim lessons, Lego building and Fin & Feather day programs, which is similar to the Kids at Play program.

Adult programs are entirely fitness and sports related and include such programs as Zumba, yoga, fitness boxing and volleyball. There are also a number of private youth organizations and corporations that rent Kiwanis Beach.

Pricing these programs involves an element of market conditions and cost. The Department evaluates the pricing it charges for its services to substantially similar programs offered by neighboring communities. In addition, it is refining its methods by which it evaluates costs and operating margins for the programs it offers to better ensure that its pricing is sufficient to meet direct and indirect Department costs (i.e., overhead). The Department's internal 6:1 child-to-instructor ratio is significantly greater than state-mandated ratios for "day camps" and result in higher costs and therefore higher selling prices.

The Department utilizes an Internet-hosted application called "Myrec" to manage the registration, attendance, payment processing and general management of its program. The Department's director estimates that approximately three-quarters of its revenues are paid by credit card in advance of services. Program directors conducting the Department's programming have access to this system via a Town-supplied computer or tablet or, in the case of independent contractors through their own device, including smart phone.

Revenue turnovers are accompanied by attendance sheets. Data from attendance sheets are compared to Myrec records and "drop ins" are manually input into Myrec to better ensure complete attendance records. In addition, the shared administrative resource maintains a master financial spreadsheet that tracks all Department receipts outside the Myrec credit card receipt process, which facilitates review of accounts and programs.

There exists an inherent risk that services are being provided in which revenues are not being turned over to the Town. To address this risk, the Department's director will periodically visit a program unannounced and review their attendance and payment records versus actual program participants. With respect to the daily beach fee process, the Department is in the process of implementing a point-of-sale system offered within the Myrec system to better ensure that completeness of daily beach ticket sales.

Other revenue controls in place at the Department include cash drawer reconciliations and budget to actual reviews.

Sources of Future Revenues

The Department is evaluating offering concession sales in the near future at Kiwanis Beach. The Department's director expects that the Myrec point-of-sale system will be adequate to account for these activities.

We recommend that the Department communicate all relevant policies and procedures surrounding cash handling with those involved with this activity, implement enhanced controls surrounding cash drawers, particularly as it is likely that multiple seasonal employees will be handling cash from the sale location each day, and monitor its inventory levels.

Personnel Controls

Salaries and wages represent the largest portion of operating expenses. The Department's director submits weekly timesheets to the Recreation Commission and/or the Town Manager for review and approval. All Department staff submit their timesheets to the director for review and approval.

Independent contractors and other operational costs are paid through the vendor warrant process, which is subject to a number of controls and review levels. Independent contractors submit W-9 information to the Town and receive Form 1099's if their income exceeds \$600 in a given calendar year.

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