

TOWN OF WINCHENDON, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2015

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**MANAGEMENT LETTER
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Board of Selectmen
Town of Winchendon
Winchendon, Massachusetts

In planning and performing our audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Town of Winchendon, Massachusetts, (the "Town") as of and for the year ended June 30, 2015, 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 control deficiencies, significant deficiencies, or material weaknesses. We identified deficiencies that we have considered material weaknesses. Those are identified as such in the body of this report.

The Town has provided responses entitled Management Response for each of the comments in this report. Many of these responses discuss the action Management has taken to address the comments and relate to activity subsequent to the year under audit. We have not audited these Management Responses and provide no assurance on Management's action thereto.

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.

Roselli Clark & Associates

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
November 13, 2015

I. OVERVIEW

On January 6, 2015, the Massachusetts State Legislature adopted into law *Chapter 448 of the Acts of 2014; An Act Relative to the Financial Condition of the Town of Winchendon*.

This was in response to the financial emergency experienced by the Town that began in fiscal year 2013 and continued into fiscal year 2014. The events that led to this condition are well documented in prior year management letters and are incorporated within this report by reference.

Fiscal year 2015 was the first year the Town was subject to the strict requirements of the aforementioned legislation which included the following financial related mandates necessary in order for DOR to certify the annual tax rate:

1. Quarterly oversight by DOR of the Town's finances during the year.
2. Avoidance of deficits.
3. Adherence to the Town's deficit recovery plan.
4. Timely submission of year-end balance sheets and other financial data.
5. Timely completion of the year-end financial statement audit.

Fiscal year 2015 was also one of material transition in leadership as the Town Manager settled on a termination agreement with the Town and the Superintendent left to take a position in another school district. An interim Town Manager was appointed on a transitional basis and a consultant was also engaged to assist with the administration of the financial records.

Despite all this, while some improvements over the prior year were observed, the Town continued to struggle. The following summarizes the major obstacles identified which are discussed in more detail in the findings section of this report:

1. The conversion to a new payroll system.
2. The continued struggle with the MUNIS operating system and the workarounds necessary to properly understand the posted activity.
3. The transition from self-insurance to premium based health insurance and the incorrect postings associated with the transition.
4. The inability to reconcile cash at the end of the year.
5. The inability to reconcile withholdings at the end of the year.
6. The continued lack of poor communication between the departments; more specifically between the School Department and the Town Accountant's Office.

These issues led to an inefficient and inaccurate close of the fiscal year records; which in turn led to the Town engaging Eric Kinsherf, CPA, "Kinsherf CPA", to assist with the closing process. Specifically, Kinsherf was engaged to reconcile cash, payroll, and withholding balances and to review the close-out of the self-insurance trust. (This was the third straight fiscal year that Kinsherf CPA assisted the Town in closing the books.) At the conclusion of this process it was determined that multiple deficits in the aggregate amount of approximately \$660,000 existed. This resulted in additional borrowings with respect to the legislation "credit line", appropriations from the stabilization fund and the identification of multiple material weaknesses that are discussed in further detail in this report.

It is important for the Town to address these issues in an aggressive manner. Putting in place a process that is reliable, accurate and timely is the ultimate goal. The current process places the Town at risk of not being able to identify all deficits and other critical activity in a timely manner; which, given its financial condition, is not acceptable.

In addition, we also believe it's important to communicate that the entire financial team worked very hard to address prior year management letter comments and showed a willingness to put a better process in place. In retrospect, a one year solution to the significant issues that existed at the end of 2014 was overly optimistic; however this effort did result in the improvements of a number of items that can be summarized as follows:

1. Cash forecasts are now being prepared and updated monthly.
2. Most outstanding receivable balances are being reconciled; those that weren't are identified later in his report.
3. Revenues are being reported much more frequently to the Town Accountant.
4. Budget monitoring has improved dramatically.
5. The Town moved to a premium based plan from self-insured plan for health insurance.
6. Police details are being managed more efficiently and the year-end deficit is much lower.
7. Overdrafts in Special Revenue accounts related to the School Department are under control.
8. The School rental of property account is now used for eligible costs only.
9. Trust account cash has been reconciled to Trust account general ledger accounts and is now accurately reported.
10. The School Department set the 2016 budget with less reliance on Special Revenue funds and is in the process of doing the same for 2017.
11. Indirect costs are handled properly on the tax recap.
12. Accrued payroll was reported correctly at year-end.
13. The adoption of a line item budget instead of bottom line budget was put in play.
14. An Audit Committee was established.

Management Response:

As the auditor discussed, fiscal year 2015 was a challenging year for the Town. Much of this was brought upon by transition issues, communication issues, and inefficiencies associated with deficit legislation administration; all compounded by a less than desirable processing system that has been well documented in management letters dating back to 2013. While progress has been made, we understand that there are still challenges ahead. New leadership is committed to working together in a manner that is productive and efficient. The onsite availability of Kinshurf, CPA also provides an independent role in the oversight process that has proved very reliable and productive and has had a positive impact on the turn-around efforts. We are hopeful that these efforts will be apparent in the 2016 audit results.

II. MATERIAL WEAKNESSES

Cash Reconciliation Process

The timely, complete, and accurate reconciliation of cash between the bank statements, Treasurer's cashbook, and Accountant's general ledger is the most important component to maintaining a reliable and valid set of financial records. This is also the strongest control to preventing or detecting misappropriation of funds. We observed that while the Treasurer's office was able to reconcile its cashbook balance to the bank statements on a monthly basis, the reconciliation between the Treasurer and Town Accountant was not performed timely or accurately for a significant portion of the fiscal year.

During the audit it was determined that cash as recorded in the general ledger and cash as recorded in the Treasurer's cash book varied by over \$400,000. After several efforts to reconcile the balances with limited results it was determined that the Town would be best served by outsourcing the solution to Kinsherf, CPA who, as previously discussed had assisted the Town through the 2013 and 2014 closing process.

Kinsherf, CPA discovered the following which are documented in a report (the Kinsherf report) issued to the Town in November 2015.

1. Cash reconciliations were not performed between October 2014 and July 2015.
2. Payroll was not processed timely, or accurately, during this entire period; (see more detailed discussion under caption – Payroll).
3. The close out of the self- insurance fund was not properly accounted for as information from the Treasurer's office directed the Town Accountant to post withholding receipts to the self-insurance fund rather than the withholding accounts (see more detailed discussion under the caption – Withholdings).
4. Numerous other minor items including coding errors in the processing of disbursements to the withholding liabilities instead of to the payroll appropriation and vice versa.

In the end, Kinsherf, CPA proposed 19 entries that netted to \$432,184 which brought the final variance to \$2,381.

We applied no further audit procedures to this variance and have reported this condition as a material weakness.

We suggest the Town, with the assistance of Kinsherf CPA, develop an efficient process of checks and balances as it relates to cash. A critical component of this process needs to include the reconciliation of general ledger cash to Treasurer's cash on a monthly basis. We understand that such a process is underway.

Management Response:

The cash reconciliation process has been fortified by the onsite visits of Kinsherf, CPA whom is referenced prominently in the letter. Processes that had been in place have been reviewed and improved upon. The first 6 months of this fiscal year have cash in proof between the Treasurer and Accounting office. The variance that is being carried forward is the same minor variance that was carried at year-end. It is identifiable and will be journalized as an audit adjustment at the close of this current fiscal year. With Kinsherf, CPA's direction, the

Accountant and Treasurer complete and sign a verification form at the completion of each month's cash reconciliation process. This form provides written confirmation that cash is reconciled. Cash receipts and the account payable warrants were reconciled during fiscal year 2015 and this continues; the issue was the inability to reconcile payroll and related withholdings which are addressed under a subsequent comment.

Payroll System

Payroll is the single largest expenditure of a municipality and consists of numerous constantly moving parts. It is often the most difficult activity to manage, and thus it is critical that an efficient system is in place to capture all activity in a seamless manner both timely and accurately. During fiscal year 2015 the Town converted its payroll process from the internally based MUNIS to an outsourced vendor (Harpers). The conversion was a very challenging process for the Town and this led to numerous errors in the accounting records which were compounded due to the lack of cogent cooperation between departments, especially the School Department and the Town Accountant's office. The payroll trails were difficult to follow during the audit and the errors as discussed led to many of the variances in the cash reconciliation process previously discussed.

The Kinsherr Report identifies numerous findings that are summarized as follows:

1. Town payrolls were not posted accurately to the general ledger from October 2014 to June 2015.
2. The Town's payroll was not reconciled when entered into the general ledger.
3. The School department did not post any payrolls from October 2014 – January 2015. In order to catch up, a lump sum entry was made that included all 3 months of payroll. Since these disbursements were not included in the general ledger it was not possible to reconcile cash for any of those 3 months and led to the beginning of the cash reconciliation issues. (Cash reconciled through the end of September).
4. In subsequent months, general ledger entries for the School Department payrolls were not posted currently but rather in batches of 3 and 2 months posted as a single entry. This also contributed to the inability to reconcile cash since the disbursements for these months were reduced from the cash book but not from the general ledger cash.

When taking on a conversion the magnitude of payroll it is important that all parties involved can work in a harmonious manner. This will facilitate a more efficient conversion in the process. It is our understanding that the School Department was unable to provide a format that was satisfactory to the Town Accountant and the Town Accountant was not flexible in all situations. This exacerbated the adverse sentiment towards each other and led to some of the delays noted. In instances such as these, it is critical that the two parties can deliberate and vet in an amicable manner and/or reach out to third parties such as the Department of Revenue to help mediate the situation.

In addition to mending relationships moving forward, it is incumbent on the Financial Offices to put a system in place that includes the reconciliation of activity in the general ledger to the original payroll registers and the entries recorded by the Town Treasurer to the cash book. This should be conducted with each payroll. Also, the Town should consider assigning the payroll process to the Treasurer's Office since this is the office typically responsible for payroll in the majority of municipalities in Massachusetts. This will remove any issues with segregation and allow the Town Accountant to reconcile payroll independently of the processing function.

The Kinsharf Report stated that as of October 2015, the Town payrolls were being posted properly while some issues still existed with the School Department payrolls.

We also understand that a payroll backup person has been chosen and trained to process the bi-weekly payroll. The current backup person will assume the responsibility of being the employee who processes payroll and the new Assistant Town Accountant will be the new backup.

Management Response:

The payroll reconciliation process is no longer faced with the issues that plagued it during fiscal year 2015. Payrolls are being entered in the general ledger in a timely manner; with the correct posting dates for each payroll. No longer is the school duplicating its payrolls by entering the payroll in two different software applications. Both the Town and School are in agreement with using only Harpers payroll for all entries; and then importing the Harpers payroll journal to the general ledger through a MUNIS bridge. Kinsharf, CPA continues to assist with payroll reconciliations as a component of the overall monthly cash reconciliations. The current process in place assures that each payroll is entered and in balance during the week it is initially processed. Communication between the School Business Office and the Town Accountant's office has greatly improved, with weekly meetings being held in the Town Accountant's office. During these meetings a representative from the business office and the Town Accountant discuss, and then act, on the tasks and issues that need attention. The communication between School and Town departments has strengthened due in great measure to the professional relationship and positive philosophy of the new leadership group including the Town Manager and Superintendent. We have full support in making improvements and in open cordial communication. Training the payroll back up person is underway. We agree with the assessment made as to the responsibility of the payroll processing .

Withholding Accounts

Hand in hand with the payroll issues was the discovery of numerous errors in the withholding accounts. Preliminary procedures during the audit determined that the withholding balances were not consistent with the expected balances. This was compounded by the fact that the Town transitioned from a self-insurance plan to premium based. We alerted Kinsharf, CPA to this assertion and as a result, he identified a number of detail errors as follows:

1. February employee deductions in the amount of \$90,220 were posted to the self-insurance trust rather than to the withholding accounts. This is how the turnovers from the Treasurer's Office were coded.
2. February retiree deductions in the amount of \$88,890 were posted to the self-insurance trust rather than to the withholding accounts. This is how the turnovers from the Treasurer's Office were coded.
3. Numerous other entries were required to the other dozen various withholding accounts and appropriation; these were pluses and minuses that netted to \$253,074.
4. There were no reconciliations conducted between the insurance appropriation expenditure balance and the actual source documents.

5. There were no reconciliations conducted between any of the various withholding liability accounts and the payroll records.
6. There were no reconciliations conducted between the activity in the health insurance trust and the supporting documentation.
7. Contributing to this, as previously discussed were the School payrolls which also have a withholding component. The transition to premium based was in February, at a time when the School was still batching payroll in two month intervals thus causing these entries to overlap the transition date and adding to the complexity of this task.

Kinsherp CPA conducted all the reconciliations in arriving at the entries described above.

As discussed in the two prior material weaknesses, the Financial Offices should work with Kinsherp CPA in developing a procedure that includes the reconciliation of all withholding accounts on a monthly basis.

Management Response:

As mentioned, along with the payroll posting issues were the associated withholding posting issues. Compounding this, the timing of the transition from self-insured to premium based health insurance. This occurred in February, thus it was crucial for all payroll postings to the general ledger to occur on the appropriate date. Charges to the health trust needed to be identified to the February payrolls. This did not happen as the school payrolls were combined for the months of February and March; and entered under one date in the general ledger in April. This contributed to incorrect postings to the payroll withholding accounts as well as the health trust accounts. In the months prior to this conversion (July – September) Town cash, withholdings, and payroll were reconciled through a process that worked well. I am pleased to report that those adverse communication conditions discussed by the auditor no longer exist and we are working together to address the issues at hand in a spirit of full cooperation, with the goal to have all accounts reconciled.

Operating System

One of the most significant issues confronting the Town is the inefficiencies in the Town's operating system. While MUNIS is often considered the most powerful municipal operating system on the market, the manner in which it was set up at the Town has historically required a work around approach to efficiently analyze data and available fund balance amounts. This was exacerbated by an upgrade made in fiscal 2013 that resulted in the functionality of MUNIS being adversely impacted and causing incorrect data anomalies regarding carryover funds and their proper carryover balances. Compounding the issue is the Collector modules are administered through a completely segregated stand-alone operating system and the Treasurer modules do not integrate automatically; thus requiring numerous manual entries to MUNIS to complete.

As a result, the process of posting monthly activity, analyzing the activity and preparing monthly and year-end reports bogs down the entire financial process to the point where it is extremely inefficient to operate adequately.

We understand that the Town Accountant has contacted MUNIS to determine if the current data can be reliably moved to a new version of the MUNIS software. If the data is determined to be reliable the new software will be uploaded to the system and the data moved. In addition, the Town Accountant and Treasurer/Collector have worked with the

Collector's software vendor to establish a "bridge" between the Accountant and Collector's software to post journal entries that have historically been made manually. The bridge is being tested currently.

Management Response:

The Accounting office is making strides toward the complete overhaul of the MUNIS financial operating system. Many significant operating functions have been identified as very troublesome and time consuming. The data integrity review has been completed by the Accounting office and has been recently turned over to the Town's IT employee. He will be working along with representatives from MUNIS to convert the system to amore current version. After the conversion, the work will begin on overhauling the account structures and restoring functionality to the system. The software bridge from the Treasurer's system to the Town Accountant's has been designed and will be beta tested soon. If the bridge is successful it will eliminate the manual postings of revenue and adjustments to the receivables.

Water and Sewer Usage Receivables

In our letter to management dated January 29, 2015, we identified a material weakness regarding the manner in which the application of liens to water and sewer usage receivables were being handled in the accounting records. Water and sewer liens in fiscal year 2014 were not relieved from the usage receivable balances in the accounting records. As a result, audit adjustments totaling approximately \$300,000 were recorded in fiscal year 2014. This same error occurred in 2015 and audit adjustments totaling approximately \$309,000 were recorded in fiscal year 2015.

We recommend that the Town perform quarterly reconciliations of all of its receivable balances between its Collector and Accountant. Variances should be promptly investigated and adjustments recorded as needed. We understand that such a process is currently underway.

Management Response:

The water and sewer liens occur once a year, usually in the month of March. It was previously assumed that the receivables were adjusted automatically in the operating system, as water and sewer receivables do not have manual journal entries to the receivables, as those in the general fund have. This is another flaw in the operating system that requires a manual receivable adjustment. Now that the Treasurer and Accountant are aware of this, we have discussed the need to make the adjustment to the receivables after the lien occurs. We are hoping that the new bridge will address this and make the entry automatically. This will be monitored closely.

III. FINDINGS AND RECOMMENDATIONS: GENERAL OPERATIONS

Tax Collection Process

We have documented deficiencies in the Town's tax collection process in each of the last 2 management letters. In summary, the Tax Collector had not used all available means to collect taxes such as an aggressive lien policy, sending demand letters at the earliest possible time, advertising delinquents, negotiating with delinquents, auctioning foreclosures, and maintaining an overall casual approach to the enforcement of collection. When approached, the Collector indicated she had not received an appropriation for lien costs in 3 years and the Town's philosophy was to not be aggressive in the collection of taxes.

During fiscal year 2015, the Tax Collector was more aggressive in this process; foreclosures were taken to auction, the demand letters were sent in May and attempts to collect taxes though installment in hardship cases were more active.

At the same time last year, we also recommended that the Town evaluate options under Chapter 60, Sections 2C and 52 of MGL and consider assigning taxes that are outstanding to a third party and receiving lump sum payment up front for the outstanding balances that are assigned.

The benefit of this is the immediate infusion of significant cash into the Town coffers, the return of delinquent accounts to the active rolls and the time savings of processing tax liens internally. The detriment was the loss in interest from the collection point forward. This is a very attractive option for Towns with cash flow needs such as Winchendon; in fact the Town highlighted this as an item it would complete as part of its deficit reduction plan that leveraged the deficit legislation. This it is currently out of compliance with its plan.

We continue to recommend that the Town evaluate this option as a means to improved liquidity.

Management Response:

We are currently in discussions with Counsel to determine the best course of action regarding the collection of delinquent taxes. We fully understand the change in philosophy needed if the decision is to go the assignment route. This will be discussed with the Board of Selectmen in reaching a decision as there are pros and cons involved with this process.

Title V Betterments

The Town maintains a long-term receivable in a special revenue fund for Title V betterments. Each year, the Town bills a small group of residents in its third fiscal quarter an amount that includes both principal and interest. The accounting for these transactions requires communication between the Town Collector and the Town Accountant so that the Town Accountant can reduce the carrying amount of the unapportioned (i.e., unbilled) betterment by the principal amount of the current year's billing. Furthermore, in the event that a resident pays off their unapportioned betterment in advance of the scheduled repayment date, this payoff needs to be applied against the unapportioned betterment in the amount of the principal portion only.

This communication did not take place in fiscal year 2015 as the year end unapportioned betterment receivable balance remained unchanged from the previous fiscal year end. As such, the recorded balance was overstated by approximately \$5,000.

We recommend that the Town Accountant develop a reconciliation process for these receivables with the Town Collector. Accounts receivable and deferred revenue balances for the current year billings should be aligned with receivables and the unapportioned betterment balance should be trued up.

Management Response:

This is the same issue that applies to the water and sewer liens previously discussed; and we are confident the same solution will address this prior to the end of fiscal 2016.

Retiree Health Insurance Withholdings

Retirees are required to pay one-half of their health insurance policy premiums to the Town. The Town permits retirees to pay their portion of health insurance in more than one manner either monthly or quarterly. As a result, the Town had a receivable from retirees of \$15,786 for health insurance at June 30, 2015.

The Town should standardize the manner in which retirees pay their health insurance policy premiums to monthly. Standardization of payment frequencies would permit the Town to more easily reconcile this agency account and better ensure that the Town collects these monies accurately so that neither it nor the Town's retirees are adversely affected.

Management Response:

We try to work with the retirees as many are on fixed incomes and need to save to make the health payment. Presently no retirees are in the default and the Town is never more than a quarter in arrears on collection. If this process begins to fail, we will rethink the billing process.

Special Revenue Funds

Recently, the Department of Revenue appointed a new Director of Accounts. The individual has significant government finance skills which were accrued in her earlier career as a CPA in the municipal sector. One of the initial requests made by the new Director to the State auditing group was to review the status of stale special revenue accounts. Many of these accounts have become forgotten over years as individuals in charge of them retire or posting errors occur and are never corrected. In these instances, the new Director suggested that efforts are made to determine the true origin and purpose of the funds and if efforts fail, to make a one-time house cleaning entry to journalize these funds to the general fund as miscellaneous revenue or if a net deficit occurs to raise the amount on the tax recap. This will make efforts at the DOR level more efficient as it would remove the need for the field reps to review these stale accounts year after year to no avail and also create efficiency with the Accounting Department as they no longer would have to account for these funds when reconciling activity and it would cut down on the number of active funds in the general ledger.

We filtered through the Town's approximate 200 Special Revenue accounts and determined about 30% (sixty) of the accounts, totaling about \$160,000 did not have any activity during 2015. This account is a net balance as many of these are deficit balances that have been carried over for years.

We suggest the Town conduct the following housekeeping process:

1. Review all accounts with deficits and determine if other accounts in the same cluster/family have surpluses that are stagnant. For example, the CDBG cluster has funds that have been in deficit for at least 3 years with no activity but also has funds with surpluses. In all likelihood, coding errors between these accounts existed and this would be an opportunity to clean these up by netting them with each other.
2. Review all the revolving funds and determine if these should continue to be active revolving funds or if they should be discontinued, closed to the general fund and have the activity accounted for in the general fund.
3. Review all remaining accounts and categorize them into buckets by department. Then schedule meetings with department heads and determine if the account is valid and should be maintained or if it has no further purpose and closed out.
4. For all those accounts remaining after this process has been conducted, consider making a housekeeping entry as discussed above.

Management Response:

In the past, the Department of Revenue maintained a much more rigid process with respect to the closing of stagnant accounts. Under the new Director, we are pleased to see this philosophy changing. In house, we have been undergoing our own review of the special revenue funds since many old deficits and stagnant accounts have existed. This review included discussions with department heads regarding their special revenue accounts. As a result, in the past two years, we have identified several special revenue accounts that have been closed as suggested, to the general fund and others whose revenue stream will now flow through the general fund. Several more have been earmarked in the same manner. A continued effort will be made to 'clean up' these accounts now that the Department of Revenue philosophy in this area is more favorable to such a disposition.

Compensated Absences Calculation Procedures

A process should be put in place to calculate compensated absence liability at both the School and Town level in a more efficient manner than it currently is compiled. While the information was compiled and received by our audit team, neither had been prepared as part of the closing process until requested. The risk associated with this is that if there is transition at these positions, the new individuals will not know how this was calculated in the previous year and could lead to errors. In fact, with respect to the School Department, the balance calculated in the current year was significantly different than the prior year. When questioned, we were told the prior year balance had been compiled in error due to the unfamiliarity with the process of the person compiling the data.

Management Response:

We understand this has been an issue for the last two years and we are in the process of designing a system of capturing compensated absence data through the new payroll system. Our goal for completion is the end of fiscal year 2016.

Ambulance Receivable Monitoring and Write-Off Policy

The Town uses a well-established, third-party billing company to administer the general ambulance billing and collection duties so we believe the billing process is sound. In fiscal year 2013 we reported to the Town that the delinquent balances (those greater than 180 days) had increased from 45% to 60% and this could be an early warning sign of collection issues. Fiscal 2014 reflected more deterioration in the aging balance which increased to over 60% and further, in fiscal 2015, the balance continues to deteriorate as the greater than 180 day amount is now up to 76%.

It is important that the Fire Chief in conjunction with the billing company determine why this is occurring. In addition, now may be an opportune time to create an abatement policy and evaluate the listings and determine if abatements should be presented to the Board of Selectmen.

Management Response:

We will be working with the Fire Chief to develop a process of cleaning up the delinquent uncollectible accounts; part of this process will be the development of a formal abatement process to write off those accounts that are not deemed collectible and conduct this process at least on a quarterly basis.

Transfer Station

The Town's Transfer Station operated at a deficit for at least 2012 through 2014. In fiscal 2015 it operated at a slight surplus and prior year deficits were funded with deficit bonds. We continue to identify this activity as a high risk activity. The operation has many moving parts. Bags are sold at numerous locations, thus the handling of revenue is desegregated. Independent haulers remove the trash and transport it to a tipping station and invoices are received for both of those services. There has been some turnover at the facility and overall the amount of revenue generated is fairly sizeable. With the reduction in users, it appears as though without a significant increase in fee structure that the long-term viability of the Transfer Station is in question. At a minimum this activity should be reviewed as part of the risk assessment previously discussed in the informational section of this report by a representative of the Town's financial staff. This risk assessment could also be an extended procedure as a part of a future independent audit.

Management Response:

We understand the risks associated with cash handling at remote departments. As part of the fiscal 2016 audit, we have requested that our audit firm conduct a review of the cash handling and operating procedures of the transfer station and report back to us with results, including whether the activity is self-sustaining or if rates need to increase to minimize the occurrence of deficits.

IV. INFORMATIONAL ITEMS

Statement on Auditing Standards No. 115 – Audit Communications

The American Institute of Certified Public Accountants (“AICPA”) in 2009 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 that type of deficiency in this report.

We determined that five of the findings in this report should be categorized as material weaknesses and were included as part of Section II in this report. These are the findings that the Town should prioritize when considering corrective action.

Effect of Adoption of New Accounting Principal – Pensions

In fiscal year 2015, the Town and virtually all municipalities in the Commonwealth adopted new pension accounting standards. The new pension accounting standards required, for the first time, that the Town present its portion of the unfunded pension liability owed to its current and former employees in the government-wide financial statements. At June 30, 2015, the net pension liability for the Town is approximately \$16.7 million.

It is important to note that the new pension accounting standards do not affect the underlying regional pension system or its funding schedule. All Massachusetts pension systems are required by Massachusetts general law to be fully funded by June 30, 2040. The Worcester Regional Retirement System, which is the pension system the Town participates in, is currently 48% funded based on a December 31, 2014 actuarial study and actual pension plan net assets as of that date.

The new pension accounting standards will require that the Town to become a more active participant in the audit of the Worcester Regional Retirement System. The Town can expect to have its retiree and employee census data tested on a rotational basis. It is therefore important that the Town promptly provide the requested documentation to the Worcester Regional Retirement System and its auditors in a timely manner so as to not delay the annual process of it and all other employer units of the retirement system

New Accounting Principal – OPEB

The Governmental Accounting Standards Board, or GASB, has issued a new pronouncement related to other postemployment benefits, or OPEB, that is substantially similar to the pension standard described above. OPEB typically includes health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits. The Town presently contributes 60% of the cost of retirees' comprehensive medical insurance offered through Blue Cross Blue Shield of Massachusetts.

Currently, the Town reports a net OPEB obligation in its government-wide financial statements. However, the proposed new accounting standards will require that the net OPEB liability, which can be substantially larger than the net OPEB obligation, be reported in the government-wide financial statements. Adoption of this new accounting standard is two years away for the Town.

While this proposed accounting standard will likely materially affect the Town's government-wide financial statements, the Commonwealth has not passed legislation requiring municipalities to begin setting aside monies for this unfunded obligation like it has with pensions.

Currently the Town has set aside approximately \$10,000 into an OPEB Trust while the unfunded obligation is over \$28 million. So the Town has really not begun to address this obligation. We understand that given the financial crisis in Town that this has not been given top priority but caution management to keep this obligation in its long term financial plans.

Changes to Single Audit Requirements

The Office of Management and Budget, or OMB, raised the threshold for OMB A-133 compliance audits (i.e., single audits) from \$500,000 to \$750,000. This new threshold is expected to apply to the Town in fiscal year 2016. However, the Town generally exceeds the new \$750,000 threshold so it should continue to plan on having a single audit performed for the foreseeable future.

Also included in the new audit requirements is a requirement that the Town's internal control structure should be in compliance with recognized internal control framework such as the Green Book or COSO. At first pass, this requirement doesn't seem overly complicated. However, history has shown that seemingly harmless words similar to these can cause an entity to expend significant time and monetary resources in order to comply.

Take for instance the Sarbanes-Oxley Act in 2002. Tucked into this law was Section 404, which required that a public company's management assess and attest to its internal control system. Public companies of a similar size to the Town expended hundreds of hours of resources and tens of thousands of dollars to comply with this law and created a cottage industry for accountants and consultants.

Adopting a formal internal control framework is new to municipalities and will likely require a good deal of evaluation, documentation, remediation and ongoing monitoring. We recommend that the Town commence this process by taking a common sense approach and tackle the areas in which the Town is most susceptible to an internal control deficiency. Over a period of time, the Town should complete the formal adoption of an internal control framework.

Policies and Procedures Manual

While the Town attempts to follow standard policies as delineated by the Department of Revenue and MGLs, and formalizes some policies through interoffice memorandum, the Town does not formally document policies, procedures and controls for key financial transactions in one comprehensive manual. As a result, these transactions are at risk of being performed in an inconsistent and inefficient manner by the Town's departments.

The Town should endeavor to create a policy and procedure manual that would establish consistency in financial policies between departments. Given the size of the Town and its limited resources, we would understand that the Town would not be able to compile such a manual within a year; however, completing the task over a 2 or 3 year period may be reasonable.

Risk Assessment and Fraud Identification Measures

As discussed in prior years we continue to caution our municipal clients regarding the risks of fraud and theft. In these trying economic times, it is reasonable to expect that the frequency of fraud and theft by employees, customers and vendors may increase. The Town should be well aware of this increased risk, and accordingly should evaluate and enhance measures to better safeguard the Town's cash and other assets. Fraud can include theft, the misappropriation of assets such as cash or easily marketable equipment like computers, the execution of transactions with related parties that are not disclosed and not completed "at arm's length," or the modification or fabrication of financial records to protect job security. The Town must increase its focus and awareness of fraud risks throughout all areas of local government. Suspicious or unusual activity, particularly in cash handling areas, should be promptly investigated.

The Board of Selectmen took a significant step a few years ago by adopting a Town government Fraud Policy. This is important because it establishes a baseline as to what the Town will define as fraud, and how the Town will approach potential fraud incidents brought to the attention of management.

In addition, we further suggest the Town consider implementing the following:

Establish a Limited Internal Audit Process – The Town does not have sufficient, existing personnel resources to dedicate to an autonomous, internal audit function. However, under Chapter 41 of Massachusetts General Law ("MGL"), the Town Accountant or equivalent position has the ability to examine books and records of any department on a periodic basis, and at least on an annual basis.

We suggest that the Accounting office cycle audit the cash handling departments. A different department should be chosen each month, and the cash handling for that month should be reconciled independently. Such a process would provide an excellent deterrent against risk of fraud and would not take long to complete. We have previously advised the Town towards implementing this recommendation.

Additionally, due to timing and staffing constraints within the accounting offices, some communities are instead engaging their external auditor to perform additional, departmental review procedures as part of the audit process. Generally, one or two departments are selected by Town management annually for such a review.

The ultimate goal is that over a period of a few years, all cash handling departments could be reviewed, and a report issued citing areas of needed improvement that can be used as document for evaluating corrective action implementation.

The Town should be aware that our audit procedures are designed to provide reasonable assurance that the financial statements are fairly presented and free of material misstatement. Our audit includes considerations for fraud; however, no assurances can be given that we would detect fraud through our audit. Our audit cannot be relied upon to detect fraud or illegal acts that may exist.