

**TOWN OF WINCHENDON, MASSACHUSETTS**

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2014

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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, 2014, 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  
January 29, 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.

In summary, appropriation deficits were nearly \$1.2 million; health insurance claims deficits were over \$1.8 million; grant and other special revenue deficits were nearly \$0.3 million. These deficits caused the general fund to experience a cash overdraft of nearly \$1.9 million as of June 30, 2014.

As we reported in our letter to management dated July 21, 2014, these conditions led the Town to reporting the lowest free cash of all 351 communities in the Commonwealth and caused severe liquidity issues leading to challenges in the Town's ability to meet its basic operating needs thus requiring a State-Aid advance of \$2 million subsequent to year-end.

This also adversely impacted the Town's reserves which led to the Town's inability to fund the deficits that existed at the close of fiscal 2014 as is required by law. The imbalance in the budget precluded the Town from setting a tax rate for fiscal 2015 and thus the driving factor for the legislation highlighted above.

There are numerous issues that contributed to this situation. In that regard, due to the degree of urgency in addressing the Town's fiscal crisis, we worked very closely with the Town and School throughout the course of this audit and informally communicated findings immediately as they were being observed during the audit rather than as is customary, at the end of the audit. The presence of the Department of Revenue who conducted their own independent process during this same time period also had the same impact. In addition the Town engaged the services of a separate CPA who provided a third set of eyes and worked almost daily to close the fiscal year 2013 and 2014 records. Therefore the Town has been aware of the issues throughout the course of the last 4 or 5 months and has publicly already addressed most of the issues with their financial and executive boards and committees.

The most significant issue 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.

The retirement of the previous Town Accountant, who had also served as the Town Treasurer/Collector in prior years was a major loss in institutional knowledge. This individual had learned to work through the anomalies in MUNIS, and also understood the Treasurer/Collector applications thus allowing her to efficiently manage the collection and treasurer modules as they related to accounting. In addition, the Town Treasurer retired, and there were three Assistant Town Treasurer/Collectors, two Assistant Town Accountants and significant turnover in the School Business office which only served to add to the issues with

the operating system and led to the current Town Accountant who had no previous MUNIS experience requiring a CPA consultant with MUNIS experience to assist in the close the books for fiscal year 2013 and 2014.

The financial functions, which will be discussed in more detail in this report, most affected by this situation were as follows:

1. Lack of timely reconciliation procedures for key financial items such as cash and receivables between the Treasurer and Town Accountant.
2. Lack of timely reconciliation procedures of grants and other critical balances administered by the School Business Office.
3. Inadequate monitoring of the general operating budget.
4. Delays in closing the Town's books for fiscal year 2013.
5. Delays in communicating key transactions to the Accounting office for posting to the general ledger.
6. Inadequate monitoring of health insurance claims.

In addition, functional items outside of the Town's operating system also increased the severity of the situation and include:

1. Inconsistent, and in many instances, poor communication between the Town's Departments and the Finance Offices.
2. Lack of familiarity by most of the department heads, including the Town Accountant, Town Treasurer, and School Business Office of the MUNIS operating system.
3. Inadequate collection policies.
4. Poor cash forecasting process.
5. Significant unanticipated catastrophic medical claims.
6. Desegregated and thus ineffective leadership of the entire financial function.

We understand the Town is evaluating its operating needs and is in the process of seeking a request for information from various software vendors who specialize in municipalities. This process will not be completed in fiscal 2015; thus we anticipate similar issues with respect to closing the books to occur. We also understand payroll issues have emerged with respect to the conversion of the payroll system in fiscal 2015. This is beyond the scope of this report however this is typical of the type of obstacle that will prevent efficient progress and we urge the Town and School to commit the necessary resources to correct these inefficiencies.

The legislature has also imposed many mandates on the Town including the timely completion of audits, submission of timely balance sheets, and quarterly oversight amongst many others. Without an efficient system in place, these mandates will be difficult to complete.

Working together to develop better team chemistry and philosophy as well as improvements, better training and a plan with respect to the Town's software system is a critical goal for the Town to complete by the end of fiscal year 2015 for implementation in 2016. Consequently, the Town has an enormous challenge ahead of it. Despite the State Legislature providing the Town with relief for fiscal year 2015 it is incumbent on the Town to put in place an efficient system of financial operation and to begin to do so immediately or the issues will continue to repeat.

### **Management Response:**

First and foremost, we recognize the significance of our financial position; and all our elected and appointed leaders in addition to every member of staff ----both general government and school---have been working fastidiously to address the issues since they were first identified late in fiscal year 2014.

*The issues described herein are serious issues but not new issues. The deficits discussed are serious deficits but not new deficits as these are the same deficits discussed in our November Special Town Meeting and issues we have been working together to address since early Fall.*

It is important to note that it is very unusual for back to back Management Letters to be issued only 5 months apart. This was the unfortunate consequence of closing fiscal year 2013 almost a year after the fiscal year had ended due to the issues noted in the Auditor's overview. Since the fiscal year 2014 Management Letter is being issued shortly after the issuance of the fiscal year 2013 Management Letter the Town did not have ample opportunity to address all of the findings of the fiscal year 2013 Management Letter, thus many of the comments have been repeated and in certain situations compounded due to not knowing there was an issue.

Also, since issues were being communicated to us by the Auditor, the DOR and the CPA consultant during the course of the audit, we have had the opportunity to already publicly discuss these issues prior to the availability of this public report and this report does not raise any other matters of substance that have not already been publicly vetted.

The aggregate, actual fiscal year 2014 and projected fiscal year 2015 deficit remains at \$3.472 million; of which \$2.972 million (rounded by DOR to \$3 million) is currently being borrowed under the referenced deficit legislation. The balance of, the potential fiscal year 2015 deficits of \$400,000 in health insurance and \$100,000 in Veterans Benefits will only be borrowed if those deficits materialize by fiscal year 2015 year-end.

As a part of this management response, it is critical to highlight the fact that the Town experienced significant transition in every single financial management position during this time period. There were three school Business Managers and the long serving Treasurer, Assessor and Accountant all retired. The Town even had three incumbents in the very critical Assistant Treasurer /Collector position during this span. The most significant impact of this entire turnover, however, was felt in the loss of the prior Town Accountant.

As noted above by the Auditors, the prior Town Accountant, who retired in fiscal year 2014, was a long serving incredible asset to the Town. She had over 30 years of municipal finance experience as a Town Accountant and she had even served as the Treasurer/Collector in Winchendon in the past. The Town benefited greatly in having her service because she was hardwired to take on not only job functions that were typically those of the Town Accountant, but she would also regularly take on a variety of functions that would more regularly be handled in other financial offices such as the Assessor and the Treasurer/ Collector (the position she had previously held in Town) in order to assure that they were completed to her standards.

Additionally, as also referenced by the Auditors above, the Town's financial software package, MUNIS, was a poorly configured and trouble laden system that was terribly difficult to navigate and use to its full benefit and purpose. It is worth noting, however, that the prior

Town Accountant had developed a great number of technical “workarounds” both inside and outside of the MUNIS system in order to get the work done.

Inasmuch as the Town benefitted from the depth and breadth of the prior Town Accountant’s service and all that she managed, the Town also suffered greatly when she was unexpectedly no longer here.

Even though the Board of Selectmen arranged for the hiring of her replacement, with a scheduled two month period where both would serve concurrently for training purposes, as has been previously publicly reported, the prior Town Accountant became gravely ill in the summer of 2013 and never returned to work. As a result, the prior year’s books were left unfinished and unclosed and the planned transition period with both Accountants never occurred.

Without the benefit of the two month transition of both Town Accountant’s working together, the new Town Accountant missed out on not only all of the usual and customary benefits realized with a proper transition, but even more concerning, she never had the opportunity to receive the promised MUNIS training from the prior Town Accountant (including the benefit of her “workarounds”) and she was never given the chance to fully appreciate or become familiar with all of the other tasks that the prior Town Accountant had historically handled that a new Town Accountant would never presume to have been handled out of that office. Most notable of these tasks, as referenced later in this report by the Auditors, was the prior Town Accountant having served as the de-facto point person for the Health Insurance Trust.

We are also happy to report that the payroll issue noted above was recently resolved. While this was a challenge, it was ultimately a result of the School and Town working together to reach a solution.

## **II. 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 new 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 six of the findings in this report should be categorized as material weaknesses and are identified as such in the contact header.

### ***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.

This became readily apparent for fiscal year 2013 and into 2014, when the loss of key financial personnel to retirement or resignation within various Town departments resulted in many hurdles being created that led to significant challenges and inefficiencies in closing the Town’s financial records. This was exacerbated to the point that there was a need to bring in a short-term consultant to assist in closing the records for both fiscal year 2013 and 2014.

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.

### **Management Response:**

As noted by the Auditors above, the Town has been functioning under a decentralized set of policies and procedures. Over the past six months there has been a great deal of work done by the Finance Committee, in consultation with the Town Manager, to codify all currently existing and new financial policies into one comprehensive manual with the intention of



presenting the document to the Board of Selectmen for consideration and adoption. It is expected to be completed and voted prior to the end of fiscal year 2015.

### ***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 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.

**Management Response:**

In conjunction with the planned creation of an Audit Committee through a bylaw request at the 2015 Annual Town Meeting, as later referenced in this report, we will seek to institute the recommended limited internal audit process as recommended above.

***Student Activity Accounts***

Our firm performed an audit of the Student Activity Accounts as of June 30, 2012; this was a separately issued report and the various findings relative to the operation of these accounts identified can be reviewed in detail within that report. Under MGL c.71 s.47, the School Department is next required to have the independent audit of these accounts for the year ended June 30, 2015 (next fiscal year).

Additional, we would note that in fiscal year 2014, the Massachusetts Department of Elementary and Secondary Education (ESE) issued formal compliance guidelines under this MGL which now clearly requires not only the triennial independent audit, but that an annual documented internal review be performed by the School Department over these accounts at each school building location in accordance with the Student Activity Account compliance supplement published by the ESE. The ESE is requiring immediate compliance with these guidelines; accordingly, the School Department should plan on performing and documenting their internal review of these accounts during fiscal year 2015, relative to the activities for the year ended June 30, 2014 as reviewing this will compliance will be part of the 2015 audit process.

**Management Response:**

In conjunction with the planned creation of an Audit Committee through a bylaw request at the 2015 Annual Town Meeting, as later referenced in this report, we will seek to have the Committee work with the School Department to meet this new ESE requirement as recommended above.

***New Pension Accounting Standards***

In June 2012, the GASB issued Statements No. 67, and No. 68. Both statements will materially impact the Town's reporting of pension liabilities, effective fiscal year 2015. Because the calculations necessary to implement these statements will be generated by the Worcester County Regional Retirement System (the System), it is imperative that the Town work with the System to ensure that the information needed is available in sufficient time to be included in the Town's fiscal year 2015 Basic Financial Statements.

The following areas will be impacted materially:

- 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 in 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 disclosure relative to the pension plan will be required.
- 4) Enhanced and more detailed required supplementary information reporting relative to the pension plan will be required.

*In the event the information is not available, it will result in an adverse opinion to the financial statements, and potentially reduce the Town's credit rating. Therefore we urge the Town to contact the System and maintain an open line of communication regarding the timing of this information.*

**Management Response:**

We are working with Worcester Regional Retirement System on this matter.

***Other Postemployment Benefits***

Governmental Accounting Standards Board ("GASB") No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pension Plans* ("GASB 45") requires communities to recognize in their financial statements a liability that recognizes postemployment benefits as this benefit is earned by employees.

The Town's most recent valuation reflected a future actuarial-estimated liability of approximately \$24.8 million. While this is a future liability, its impact to current operations cannot be ignored. This is especially important in light of the average employment age for Winchendon employees, which is approaching fifty years old. This factor, among others, may make this an unmanageable liability in ten years as the latest actuarial report projects pay as you go costs of \$1.4 million by 2023 (an increase of 233% over current levels.).

The credit evaluation bureaus have begun to assign an allocation of the credit evaluation to the management of long-term liabilities. OPEB qualifies as such an item. This is a reminder to management that as part of its long-term planning, the Town should begin to reflect the effects of OPEB into its plan.

On a positive note, the Town has elected an OPEB trust under MGL c.32B s.20. The next step is to think about funding this Trust. While this can be a daunting endeavor for a town like Winchendon that finds itself with significant economic impasses, we would highly encourage the Town, to establish some level of consistent funding into the Trust as part of that process so that a new budget model will acknowledge the importance of establishing a mechanism for funding these very real employee benefit costs. The Town does not have to look to meet 100% of the actuarial suggested annual funding, but to more importantly demonstrate to impacted parties and other interested outside parties that the Town has a responsible plan in place and that such a plan is followed through on. *We understand that with the many financial challenges the Town is currently facing, that this would not be a priority item until the adverse financial situation begins to improve.*

**Management Response:**

We recognize the importance of the OPEB liability and not only created the statutory OPEB liability trust fund but also began to appropriate into it last year.

### **III. MATERIAL WEAKNESSES**

As previously discussed, the lack of fully functional integrated operating system has directly led to systemic flaws that have caused material weaknesses. These are included within this section of the Management Letter.

#### **Budget Management (Material Weakness)**

A Town's budgeting process is one of the most significant functions of internal control. Not only does it provide the cornerstone for the Town's strategic direction, but it is the guideline for departments and their managers to maintain their cost of operations within. These budgets are legally adopted, and subject to Massachusetts General Laws (MGL). Any violation of these mandates could lead to severe consequences, the minimum of which is the requirement to raise any deficits with the subsequent year tax rate. This could have a serious impact on the subsequent year budget.

Deficits in the Town's annual budget have been common place for a number of years however, up until and through fiscal year 2012 the Town adopted a practice of funding these deficits at the November Special Town Meeting and including them on the tax recap as part of the tax rate setting process. The practice was transparent since the deficits were authorized by Town Meeting, and acceptable by the DOR. Prior to 2013, these deficits were not significant and consisted mainly of snow and ice which is a legal deficit and other unpredictable items that are commonly difficult to target such as Veteran's, and benefits. For 2013, the Town attempted to raise deficits at its December Special Town Meeting but did not capture all deficits because the books had not been closed for the year thus the deficits were charged against free cash by the Department of Revenue.

Town Meeting authorizes its budget into functional categories instead of line items. Therefore individual departments within each category that incur deficits may be offset by other departments that end the year with surplus balances. While this provides the Town with more flexibility in the budget, the control aspects of the budget are diminished.

The following summarizes the appropriation deficits:

Department	2012	2013	2014
Administration, Finance and Benefits	\$ 95,173	\$ 57,762	\$ 114,779
Public Safety	-	29,911	125,882
Public Works	-	-	92,845
Snow and Ice	56,516	157,778	191,527
Health and Human Services	24,968	37,610	77,072
Education	-	869	559,578
	<u>\$ 176,657</u>	<u>\$ 283,930</u>	<u>\$ 1,161,683</u>

While it is expected that deficits in the snow and ice account are unavoidable due to unpredictable seasonal weather conditions, and deficits in Veteran's Benefits are not uncommon, it is unacceptable and contrary to MGL to incur deficits in other appropriation items.

One of the biggest issues we observed in 2013 and 2014 was the lack of a streamlined process able to produce accurate data to monitor departmental budgets on a monthly basis. This was evident through the observation of a substantial number of manual adjusting journal entries throughout the general ledger many of which were made in the final month or subsequent to year-end, which were primarily caused from the difficulties in the MUNIS operating system previously discussed.

Such adjustments are usually a sign of one or a combination of the following:

- The system's automated entries are not properly or accurately setup.
- A misunderstanding of the budget organization,
- Expenditure invoices are not being accurately assigned the correct, initial general ledger account number by departments for the Town Accountant to process the bill to.
- Transactions are not being properly entered into the system by the Treasurer and Accounting offices at time of input, and/or

It appears that the Town developed a philosophy over the years that when deficits occur they are funded in the Fall Special Town Meeting and raised on the tax recap or from other departments with surplus balances. In fact in the fiscal 2015 Annual Town Meeting the Town authorized a budget based on a Town bottom line and School bottom line to further expand the budget parameters. This false sense of disposition may have caused a more relaxed approach to the deficits as they surfaced and lessened in a critical manner the ability to monitor the appropriations.

A process should be developed for monthly monitoring of all budgets. This should be performed by the Town Accountant in conjunction with the department heads through a monthly reconciliation process. Results of the process should be communicated to the Town Manager, Board of Selectmen and Finance Committee. As department heads near their authorized budgets or exceed their monthly expectation, action plans should be in place to avoid the department being in deficit.

Ultimately, it is the Town Accountant who has the legal obligation and responsibility not to allow charges to appropriation lines that are in deficit.

Additionally, the bottom line budget should be abolished immediately and reverted to a line item budget. This will allow more micro-control of the operating budget.

#### **Management Response:**

While in no way trying to minimize the occurrence of fiscal year 2014 appropriation deficits in both the school and general government accounts, context is important to come to understand the fiscal year 2014 appropriation deficits of \$1,161,683. First, the total fiscal year 2014 appropriation deficit is split nearly equally between general government and school accounts.

The school budget appropriation deficit of \$559,578 is addressed by the Auditors later in this report therefore this response focuses on the general government side.

While the general government budget in fiscal year 2014 was voted in functional segments, or groupings based upon the type of service being provided (i.e. public safety, public works,

etc.), when reviewing the underlying deficit drivers within those segments we see that the aggregate general government deficit of \$602,105 resulted from the following: \$191,527- Snow and Ice which is usual and customary and \$77,072- Veterans Benefits which the Auditors note above is not uncommon. The need to fund deficits in both of these accounts was publicly discussed as early as last spring.

Accordingly, after factoring the effects of the \$268,599 of forecasted, customary and transparent deficits in Snow and Ice and Veterans Benefits, the remaining general government deficit requiring further analysis is \$333,506. This number reflects the truly unanticipated fiscal year 2014 deficit.

Of this remaining deficit, \$112,651 was due to the Town's response to a fiscal year 2013 Management Letter comment in which the Auditors cite that the Town had not recorded a proper payroll accrual. The prior Town Accountant had historically only reported the School payroll accrual, but the Department of Revenue in March 2011 issued Bulletin 2011-03B requiring municipalities to post all payroll accruals as of June 30 of each year. The Town's plan was to budget an extra week of payroll in 2013 but this did not materialize due to the accounting transition and thus a one-time charge in fiscal year 2014 was required resulting in an extra week of payroll that was not anticipated.

In addition, due to the issues in closing the Health Insurance Trust, not all charges were posted to the Health Insurance appropriation until subsequent to year-end after a complete analysis of the Health Insurance Trust had been conducted. This caused the June appropriation reports to reflect a surplus when in fact they should have reflected a deficit of \$299,800.

In summary, notwithstanding the customary Snow and Ice and Veterans' Benefits and the adjustments described above, the budget reports at the end of June reflected overall surplus balances of about \$80,000.

Also, as recommended by the DOR and the Auditors, the Town Meeting voted in November of 2014 to revert back to a salary and expense line budget for the general government accounts. The School Committee, however, has and retains the statutory flexibility to function with a bottom-line budget pursuant to the Education Reform Act of 1993.

#### **Accounts Receivable Reconciliation Process (Material Weakness)**

In our letter to management dated July 21, 2014 we indicated that we were unable to verify water and sewer user receivable balances because the Treasurer/Collector was unable to produce a receivable report out of the MUNIS collections module for the water and sewer user charge balances owed as of June 30, 2013. We reported this as a material weakness.

For the fiscal year ended June 30, 2014 we were able to obtain reports from the Treasurer/Collector and after reviewing the reports discovered material errors that required a restatement to the prior year financial statements. Water and Sewer user charges that had been lienied were properly reported as liens however the user charges outstanding were not reduced to reflect the liens, thus the receivable balances were double counted. This resulted in audit adjustments to reduce net position of the Water and Sewer activities by approximately \$300,000.

In addition, while reviewing receivable detail in the general ledger we determined that many entries to the receivable detail that pertained to items throughout the year were made in June or subsequent to year-end with a June effective date. We understand that the Town's billing and collection system is not integrated with MUNIS and requires journal entries to update. These entries were not made the top priority during the year due to other more urgent issues. As a result, receivable balances were not reconciled periodically through the year but only at the end of the year.

This increases the likelihood of errors and delays the completion of year-end close. We have reported this as a material weakness.

**Management Response:**

The new Town Accountant and the Town Treasurer/Collector are now performing the accounts receivable reconciliations on a quarterly basis.

**Cash Reconciliation Process (Material Weakness)**

The timely, complete, and accurate reconciliation of cash between the bank statements, Treasurer's cashbook, and Accountant's general ledger is probably the most important part of maintaining a reliable and valid set of financial records and is the biggest deterrent to preventing or detecting fraudulent acts relative to Town funds. We observed that while the Treasurer's office was able to reconcile their cashbook balance to the bank statements on a monthly basis throughout 2013 and fiscal year 2014, the reconciliation between the Treasurer and Town Accountant was not performed timely, in fact, in both years, the reconciliations for the entire year were not completed until after the year had closed.

This was a result of management turnover and the substantial challenges in closing and adjusting the MUNIS general ledger for fiscal years 2013 and 2014. Upon review of the cash reconciliation for June 30, 2014, we determined that there initially existed a cash variance of almost \$105,000.

The Town called upon its CPA consultant to reconcile the balances and as a result it was determined that the Treasurer was carrying a \$40,000 reconciling item for a void check and the Town Accountant reported a double entry to the Town's Teacher withholding liability in the amount of \$74,000. After reflecting these adjustments, the variance between the Treasurer and Town Accountant was \$9,000.

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

**Management Response:**

The new Town Accountant and the Treasurer/Collector are now performing the cash reconciliations on a quarterly basis. The noted \$9,000 variance between the Town Accountant and Treasurer/Collector ties back to a timing issue related to a void check. There is no longer such a variance.

**Circuit Breaker Overdraft (Material Weakness)**

The special education circuit breaker program (MGL Chapter 71B §5A) is intended to provide partial reimbursement to school districts for the cost of individual special education students. The reimbursement is based on a formula calculated by the Department of Elementary and Secondary Education (ESE), that assigns an adequate, but not excessive, spending level for each local and regional school district.

It essentially provides school districts a level of relief to offset their special education costs. Districts are allowed to accumulate available funds in the circuit breaker account and are allowed to spend from the account without further appropriation. Carryovers for up to a one year amount of circuit breaker reimbursements may be carried from one year to the next. For two successive years the Circuit Breaker account ended the year in a deficit position. In fiscal year 2013 the deficit was \$159,943 and in fiscal year 2014 the deficit was \$473,619. The fiscal year 2013 deficit appears to have arisen as a result of revenue received in July 2013 that, despite being posted as 2013 revenue was mistakenly identified as additional 2013 revenue because the date of wire and date of receipt were in different fiscal years. This was not discovered until we concluded our audit for the prior year in July of 2014 which resulted in the school being unaware of this deficit until fiscal year 2014 had concluded so this had the effect of compounding the fiscal 2014 deficit. In addition, in fiscal 2014, the MUNIS update carried forward incorrect balances on the reports the School used to monitor this account which further compounded the problem.

During fiscal 2014, the former School Business Manager charged \$825,056 of expenditures against this account against reimbursements of only \$511,380. These charges were made without authorization from the School Committee. When added to the existing deficit of \$159,943 this caused the overall deficit of \$473,619.

The Department of Revenue reviewed this account and determined that the over-expenditures were improper and required the Town Accountant to journalize \$595,203 back to the School Department budget. This caused the School Department budget to go into deficit by over \$500,000 (see above budget discussion) and left \$121,584 in the Circuit Breaker account to carryforward.

We believe a process between the School Department and the Accounting office is developed to ensure that all grant balances are reconciled prior to the close of the records for the year and to make sure that deficits are remedied prior to carrying balances into the next fiscal year.

**Management Response:**

The School District agrees with this finding and anticipates addressing the issue at the monthly finance team meetings as required by the DOR.

**Overdraft (Material Weakness)**

As we previously highlighted in this report and in our prior letter to management dated July 21, 2014, the Town's ability to meet its basic weekly obligations to vendors and employees has been under severe pressure due to the liquidity crunch the Town is experiencing. This directly led to the Town requiring a \$2 million emergency advance of State aid subsequent to year-end.



Massachusetts General Laws specifically prohibit the general fund from using cash restricted for other funds to satisfy general fund operating obligations. The only exception is the general fund is able to borrow from the stabilization fund.

At June 30, 2014, the financial statements presented negative cash of \$1,878,177 in the general fund; this was reflected as a due to other funds or a cash overdraft. Since the stabilization fund money is invested with an investment company in fixed income securities, it's not possible that the overdraft could have been funded from the stabilization fund therefore the overdraft was funded from other available cash in either special revenue, capital projects or the enterprise funds.

Subsequent to year-end, it was determined that the Town Treasurer had been using available cash from a BAN proceed intended to fund capital projects. Additionally, we determined that cash forecasts had never been prepared by the Treasurer's Office therefore it was difficult for the Town to understand its cash flow requirements.

The use of restricted cash to finance general fund operations contradicts Massachusetts General Laws; in addition, the use of proceeds intended for capital projects to finance general fund operations could impact the tax status of the borrowing, thus increasing the financing costs and create negative investment appeal for the Town's issued securities. In the most adverse situation, the debt could be called immediately on demand.

The Town needs to create a process that avoids such situations in the future; we suggest the following is undertaken:

1. All BAN and Bond proceeds, once received, should be placed in dedicated bank accounts segregated from the cash pool.
2. Cash forecasting should become part of the normal duty of the Treasurer.
3. In the instance that it is determined that a cash infusion is necessary, the Town should issue revenue anticipation notes rather borrow from restricted cash balances.

**Management Response:**

The Treasurer/Collector has appropriately segregated each fund such that they are segregated from the cash pool. The Treasurer/Collector has been performing more formalized monthly cash flow projections since last September.

**Health Insurance Trust Fund (Material Weakness)**

The Town's health insurance trust fund (the Trust) suffered another catastrophic year during fiscal 2014. Health claims and administrative costs exceeded \$5 million while employer and employee contributions were less than \$4 million. This caused an operating loss of \$1.1 million which, when added to the prior year deficit of \$0.7 million resulted in an accumulated fiscal year 2013 and 2014 deficit of over \$1.8 million.

The major cause for the adverse operating results was due to unanticipated catastrophic claims rising to a level that could not be supported by the rate structure in place. The following illustrates the trend with respect to average monthly claims data:

<b>Fiscal Year</b>	<b>Average Monthly Claim</b>
2012	\$ 220,626
2013	260,107
2014	317,311

Further review indicated that the initial spike in claims did not occur until the May 2013 payment which amounted to \$391,000 as compared to \$263,000 and \$220,000 the two months prior and began a 9 month period from May 2013 – January 2014 where claims were averaging an all-time high of \$360,000 per month.

The recording, reporting and accounting for the Trust has many constantly revolving components:

1. Withholdings from employees are reported as revenues to the Trust.
2. Matching contributions from the Town are reported as revenues to the Trust.
3. Reinsurance reimbursements are recorded as revenues to the Trust.
4. Medical claims are recorded as expenses of the Trust.
5. Administrative costs are recorded as expenses of the Trust.
6. Medical claims incurred but not reported (IBNR) are required to be accrued at the close of the year.
7. Payments for medical claims paid subsequent to year-end that relate to the target year are posted as accounts payable of the trust.
8. Reinsurance reimbursements received subsequent to year-end that relate to the target year are posted as accounts receivable of the trust.

The following illustration reflects the above components in accounting terms:

<b>Health Insurance Trust Fund</b>	
<b>Debits</b>	<b>Credits</b>
4 Processed claims	1 Employee withholdings
5 Administrative costs	2 Town Contribution
6 Claims incurred but not reported (IBNR)	3 Reinsurance receipts
7 Subsequent year processed claims	8 Subsequent year reinsurance receipts

If debits exceed credits, the fund is in deficit; if credits exceed debits, the fund is in surplus. This is an analysis that should be conducted every month or at least quarterly.

The process as described above is complicated, specialized and generally benefits from the assistance of qualified consultants to complete. If any of the above steps are not performed or conducted in a timely, accurate manner it could lead to the Town's inability to properly

monitor the fund and make appropriate decisions necessary when spikes as those discussed occur.

Compounding the complexity of this issue is the GAAP procedure described above which is hardcoded into the MGL statute for internal self-insurance funds is seldom mandated by the Department of Revenue as normally, 12 months cash in, 12 months cash out and an adequate IBNR is a standard that is acceptable and is the practice the Town had followed since 2005 when the Trust was first set up.

We determined the Town does not conduct a monthly analysis as described above, in addition, the Town does not utilize the services of an insurance committee to oversee the process and no single individual was responsible for the results of the entire process since the departure of the prior Town Accountant. This directly led to the Town's inability to conclude that the fund was in distress beginning at the end of fiscal year 2013 and continuing into 2014.

In our audit we determined that the following are the key roles as they were being performed in fiscal year 2014:

**Town Manager's role** – per discussion with the Town Manager, his monitoring of the fund was limited to reviewing the contribution from the general fund into the trust and comparing this to the appropriation.

**Treasurer's role** - the Treasurer's role is to submit the health claims to the Town Accountant for payment and to report the employee and employer contributions.

**Town Accountant's role** - the Town Accountant's role is to post the entries to the general ledger once those are communicated to the office.

**Carrier/Consultant's role** – the role of the consultant is to calculate the IBNR, manage reinsurance claims and advise the Town Manager regarding employee and employer contribution rates.

The unanticipated claims to the Trust could not have been avoided, since catastrophic medical claims are not optional, however, this segregated process, deficiencies in the process, and external events outside of the Town's control directly led to the Town's inability to identify the trust deficits in a timely manner.

The deficiencies in the process are as follows:

1. In November 2012, the Town terminated its relationship with its insurance consultant. Since that time, through the end of fiscal year 2014, the Town relied solely on Blue Cross Blue Shield, its claims processing agent, to provide it with insurance claim data and administrative guidance as requested. However these duties reduced the oversight that a dedicated and qualified independent insurance consultant can provide.

While there is a cost for these services which the Trust has borne in the past, there is likely a positive cost/benefit of engaging such a consultant. In addition, since Blue Cross Blue Shield is the Town's insurer and reinsurer, it eliminates any possible conflict in claims processing.

The lack of such a consultant may have contributed, in some proportion, to the inability for the Town to detect the issues with the Trust more timely.

2. The Town Manager's oversight of the Town's actual contribution versus the appropriation is an incomplete review of the process. There are numerous other components, as listed previously, to the process that all contribute to the end result and if these other components are not reviewed then this oversight is flawed. An individual or committee should be designated to be responsible for reviewing the overall results of the Trust and report those results to the Town Manager.
3. The Treasurer does not direct the Town Accountant to post employee and employer contribution detail to the Trust in a timely manner. For fiscal 2014 the employee withholdings for the entire fiscal year were recorded to the Trust as revenue on September 14, 2014 almost 3 months after the year ended. Also, when we were conducting our audit in October, and asked for detail of the Trust for fiscal 2015 to date we discovered that none of the revenue for the first 3 months had been posted. Essentially \$1.5 million was not posted to the Trust for the entire fiscal year. As a result, there was no meaningful way to review the true results of the Trust on a periodic basis during the fiscal year.
4. While MGL 32B states it is ultimately the Treasurer's responsibility to insure that there are sufficient funds in the Health Trust to cover claims, this is not standard operating procedure in Massachusetts. In fact, as had been the case with the prior Town Accountant, the Town Accountant is the most logical individual to review the results of the Trust since all the components ultimately end up in the general ledger and the end result is accounting intensive. However, the current Town Accountant had no previous experience in this complex accounting area and for reasons outside of the Town's control was not afforded the transition training that was anticipated at the time of appointment. When questioned about the lack of revenues posted to the Trust during the year, the Town Accountant rightly felt it was the Treasurer's responsibility to report this under MGL, while the Treasurer indicated that the previous Town Accountant made the entries from the system without a prompt, so there was confusion as to responsibility in this area which led to an incomplete process during the year.

Notwithstanding the fact that the prior Town Accountant served as the de-facto point person, the responsibilities of an operational area of this magnitude that impacts all of the Town's operations and is the second largest expense are generally assigned to a specific individual or commission to monitor. The desegregated manner in which this was managed and confusion in responsibilities directly led to the Town's inability to detect the deficits in a timely manner.

In addition, the significance of the Town's catastrophic medical claims lends itself to the assertion that the Town's reinsurance claims (stop loss reimbursements) should also be significant. When we requested reinsurance reimbursement amounts for fiscal year 2014 we were informed these showed as deducts on the monthly claims bill and were not reported directly and difficult to calculate. Consequently, nobody was able to provide us with this information. We conducted our own calculation of these reimbursements and determined that approximately \$500,000 was received between December 2013 and October 2014. Despite this calculation, we were unable to determine if these were the complete amounts the Town was entitled to as this was beyond the scope of this audit. We suggest that the Town engage an independent specialist to review the catastrophic medical claims and determine if claims were processed correctly and if the Town is owed further reimbursements as a result.

In summary, the costs to the Trust could not have been avoided, however had the deficits been acknowledged in a more timely manner, the Town could have acted more swiftly in addressing these deficits through increased participation rates or some other manner and possibly avoided the size of the ultimate deficit.

**Management Response:**

As the Auditor appropriately noted above, the position of Town Accountant is the most logical position to monitor all of the pieces of the trust and that this was the case here in Winchendon until the departure of the prior Town Accountant. What is most unfortunate is that this fact was never conveyed by the prior Town Accountant to the incoming Town Accountant due to the serious illness of the prior Town Accountant and the resulting inability to provide a proper transition as the Auditor also previously addressed.

It is also worthy of noting that the nine month surge in catastrophic claims expense referenced by the Auditor (May 2013 to January 2014) began right as the prior Town Accountant was preparing to retire, went on vacation and unfortunately never returned; and then continued until January 2014.

In September, when the new Town Accountant began her employment with the Town, she quickly realized the depth of the work ahead of her including the urgent need to close fiscal year 2013, determine how to operate in MUNIS, and understand the intricacies of the Health Insurance Trust which was new to her. It was determined that outside help would be needed from the CPA community and in December 2013, the Town engaged a CPA with both MUNIS and Health Insurance Trust experience. From there, in the late spring of 2014, the Town Accountant, the CPA and the DOR concurred with one another regarding the fiscal year 2013 Health Trust Fund deficit of \$735,000. As detailed by the Auditor above, this determination wasn't made until the last month in fiscal year 2014 which effectively precluded the Town from addressing the matter at all during fiscal year 2014 and thus the full impact of the \$1.8 million cumulative deficit for fiscal years 2013 and 2014 wasn't realized until the late fall of 2014.

It is also important to note that \$700,000 of the \$1.8 million dollar health trust deficit resulted from a change in accounting standard instituted by the new Town Accountant in which two additional months of liabilities (14 months instead of the earlier employed standard of just 12 months) were recognized in fiscal year 2013. In the past, the former Town Accountant mitigated this by reporting a higher IBNR, and/or not reflecting the third party deposit to the Department of Revenue. While both practices are accepted, it caused the expenses in fiscal year 2013 to be higher.

Since then, however, the Town has move swiftly to solicit competitive bids from the municipal insurance marketplace (Tufts, Harvard Pilgrim, Fallon and Blue Cross Blue Shield) all toward the end goal of moving away from being self-insured and reverting to a fully insured premium based program. Once the bids were in hand the Town negotiated with the appropriate union bodies and much to the credit of the employee groups with just one meeting received a unanimous vote to make the plan change over. Effective right now the Town is a fully insured premium based program. While the premium expense is higher to be fully insured, that increase is offset by the decrease in exposure to occurrences such as the recent spate of catastrophic claims.

The Auditor asserts that “The lack of such a consultant may have contributed, in some proportion, to the inability for the Town to detect the issues with the Trust more timely.” We agree with this statement philosophically but not practically because even if the Town had discovered the issues with the Trust sooner we still would not have avoided the financial impacts of the catastrophic claims.

If the Town had discovered the deficit in the Trust earlier, and more quickly transitioned from a self-insured plan to a fully insured premium plan, the Town would have incurred the significantly higher premium expense that comes with such a transition. This 30% increase, which the Town just realized in FY15, would just have hit a full fiscal year and one half sooner.

To point, a 30% increase on our roughly \$2.2 million dollar annual health insurance budget would have been \$990,000 for the year and one half. So even if the Town had discovered the issues earlier and transitioned sooner we would still have incurred this roughly \$1 million additional health insurance expense.

Lastly, while on the discussion of the value of consultants as it relates to health trusts, it is noteworthy that even with the best of consultants and advisory committees that there is still no guarantee against significant self-insurance health trust deficits such as the one the Town incurred. For example, the Commonwealth’s Group Insurance Commission (GIC) has some of the best and brightest consultants and a very active advisory board and its self-insurance fund is currently sitting with a \$190 million dollar deficit. This is not intended to justify a deficit it is merely intended to provide appropriate context.

#### **IV. FINDINGS AND RECOMMENDATIONS: GENERAL OPERATIONS**

##### **Cash**

##### **Trust Accounts**

The Town invests approximately \$4.8 million under the oversight of a municipal money manager. The money manager provides a detailed schedule of the breakout of what the \$4.8 million consists of; for example Cemetery Perpetual Care, Library, Scholarships, Stabilization, etc.

Under MGL, Trust Funds carry with them extra investment privileges beyond operating cash and thus it is important not to commingle the two in the records.

We determined that the Trust Fund balances are not reconciled specifically to the Trust Fund balances carried by the Town Accountant in the general ledger. Upon further review we discovered numerous discrepancies between the two records.

Those of significance are a balance for the Murdock Trust of \$245,055 when only \$40,000 exists on the general ledger and a balance of \$153,937 in the Health Insurance Trust when the balance has been negative on the Town's general ledger for two years.

The overall variance between the general ledger and the money manager's is \$322,989, most of which is in the two accounts discussed with the remaining variances most likely between trust accounts themselves.

We suggest the Treasurer and Town Accountant endeavor to correct the records and transfer any excess cash to the operating bank account. This is particularly important in light of the liquidity stress the Town is currently under.

##### **Management Response:**

The Treasurer and the Town Accountant are working to correct these records per the recommendation of the Auditors.

##### **Fair Value Reporting (repeated from prior year)**

GASB 31 which became effective for fiscal year 1998 required that cash and investments be reported within financial statements at their fair values (which are more generally referred to and in-line with market values); historically this was recorded as part of the annual audit adjustments for GASB reporting purposes only. However, within the last few years, the Massachusetts Department of Revenue revised its policy on investment reporting and as delineated in their Year End Letter to Accountants, required the reporting of such amounts at fair value; thereby making it a requirement under UMAS reporting that the Town follows.

Presently, the Town records their investments at an amount that does not represent the fair value due to a lag in when the statements are received at year-end; the difference for fiscal year 2014 was not material (about \$28,000) and did not require audit adjustment. However, we would encourage the Town to implement a policy to record its investments at fair value by June 30, 2015.

**Management Response:**

The Town Accountant is recommending that this matter be considered by the Finance Committee and the Town Manager in the creation of the comprehensive policy manual.

**Revolving Funds**

The Town maintains several revolving funds or special revenue accounts that are either not proper revolving funds under MGL or have not been authorized by Town Meeting; these are as follows:

<u>Name</u>	<u>Balance</u>	<u>Proper classification</u>
College Board Testing	(225)	Student Activity Account
PSAT Proceeds Revenue	131	Student Activity Account
AP Proctor Services	525	Student Activity Account
Library Copy fees	7,232	General Fund
Library Fines	4,916	General Fund
Dog License fees	34,282	General Fund

The Student Activity accounts should be transferred to those accounts and the remaining funds should either be authorized or closed out to general fund.

**Management Response:**

These funds will either be closed to the general fund or authorized at town meeting for revolving fund status if appropriate.

**School Rental**

Presently the School has arrangements in which it rents out School facilities that result in approximately \$10,000 in annual rentals.

Such arrangements fall under MGL Chapter 40 Section 3 which stipulates that the rentals received from this arrangement are to be used for the upkeep of the rented facility or space, including custodial costs, utilities, ordinary repairs and maintenance.

It may also be used for upkeep of *any* school facility if the city/town has accepted provisions so permitting.

Any available balance closes to the general fund at the end of the fiscal year, unless the city/town has accepted provisions permitting carry over to the next fiscal year.

The amounts charged to this fund were \$1,599 in 2012; \$7,246 in 2013 and \$46,237 in 2014 and the carryover from 2013 to 2014 was \$35,126.

We discovered that the increased costs for 2014 were to fund a custodian whose obligations related to more than the facility from which the rental occurred, however we were not provided any Town authorization to allow this or to carryover the \$35,126 balance from 2013 to 2014.



We suggest the Town receive the proper authorizations in future years if the School wishes to carryover this activity and use this for upkeep outside of the facility itself.

**Management Response:**

The School District agrees with this finding and will insure appropriate use of the building rental fees.

**School Special Revenue Funds**

Like many districts, the School has used special revenue revolving and other funds to supplement its operating budget on an annual basis. In fiscal year 2013 and fiscal year 2014, the School charged such funds over \$1.7 million. The available amounts in these funds have diminished greatly over the past couple of years; \$1.6 million was available at the end of 2012, \$1.1 million at the end of 2013 and \$250,000 at the end of 2014 so reliance on these funds is no longer a major option in strategizing the budget process. This is a reminder to the Town and the School to understand this situation going into 2016 budget development.

**Management Response:**

The School District has taken this into account for fiscal year 2015 and fiscal year 2016.

**Revenue Postings**

In order for a community to strategically, adequately and timely analyze its financial operations it is critical that all transactions are accurately reported and timely posted. In a previous section we discussed the need for the Town Accountant and department heads to reconcile their respective information relative to expenditures. In this section we highlight the urgency for the Treasurer to timely report revenues to the Town Accountant.

We discovered in many situations that revenues lag up to 3 or 4 months and in the case of the Health Insurance Trust there was a 15 month lag between when revenue was received and when it ultimately got posted to the Trust.

The following two items were brought to our attention that is inhibiting this process:

- Presently, the Town Accountant uses the MUNIS system for the general ledger and the Treasurer/Collector uses the Point system for most of their collections processing. These two systems do not have a “bridge” to automatically/electronically share transaction data between them; accordingly, the same transaction data must be manually entered by the Treasurer/Collector’s Office personnel no less than 4 separate times. This impedes the timeliness, consistency, and accuracy of sharing data throughout the Town.
- The Treasurer/Collector’s Office posts receipts transactions to the MUNIS general ledger system which are then later verified by the Town Accountant. It was identified by Town representatives that the MUNIS system has never been set up properly so that receipt postings can automatically be made to all necessary general ledger accounts during the entry process; some of the automated journal entry links are not completely programmed. Accordingly, even though the Treasurer/Collector’s Office has been entering the receipts to assist in the general ledger posting process, the Town Accountant is forced to go into the system and make manual journals to fully and properly record receipt transactions as

required under UMAS and GAAP accounting. Specifically, one of these manual journal entries is the actual recording of revenue; therefore, revenue reporting is not as efficient or timely as could be if the system was properly setup. A revision to the account linkages would not result in any additional input time by the Treasurer/Collector's Office once established in the system.

It is important that the Town get this under control immediately. The inability to have all timely information from which to make decisions will continue to create challenges for the Town if not addressed.

**Management Response:**

As a short term solution the Town Accountant and Treasurer/ Collector have worked to increase the frequency of the revenue postings and they now have it down to 30-45 days. The more long term solution will dovetail with the planned overhaul or replacement of the Town's MUNIS financial operating system.

**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 it 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 has now increased to over 60% and receivables in general have increased over to almost \$500,000 at the end of the year.

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:**

The Fire Chief is working with the Town's outside collection vendor to tease out what amount of this receivable is likely uncollectable and the Chief will come before the Board of Selectmen, as has occurred in the past, to recommend abatements. Additionally, the Chief will be proposing a revised collection policy for the Board's consideration.

**Compensated Absences Calculation Procedures (repeated from prior year)**

Both the Town and School did not have a well-documented procedures or calculation schedules readily in place with which to efficiently determine and calculate the dollar value of the compensated absence accounting liability for unused sick and vacation time as of June 30, 2014. Previous documents and institutional knowledge of the processes were lost in the transition of the Town Accountant and School Payroll Clerk personnel. While the information was ultimately compiled by Town and School personnel for fiscal year 2014, we would strongly suggest that more formal and documented processes be developed and implemented for annual financial statement reporting purposes that also ensures that Town and School policies and union agreements which define vesting and accumulated time limits are fully incorporated within the year-end financial statement calculation schedules.

**Management Response:**

The Town Accountant reports she expects that this matter should be addressed by the Town having transitioned to an outside payroll processing company.

**Indirect Cost Accounting (repeated from prior year)**

Water, sewer, and transfer station indirect costs are approved at Town Meeting and transfers are made into the General Fund on the general ledger; however, they are not reflected as transfers on the tax recap, but instead as revenues and expenses. The more proper accounting methodology is to show these as transfers between funds and not as revenues and expenses.

It is also suggested that every few years, a formal evaluation of the indirect cost calculations be performed so as to ascertain that the amounts being allocated as such are valid.

**Management Response:**

While allowed by the DOR, this style of accounting for enterprise fund indirect costs is a holdover from the late 1990's and the new Town Accountant is working with the Public Works Director to address the issue using newer DOR indirect cost accounting templates.

**Murdock Education Trust**

The Murdock Education Trust (MET) is a large benefactor of the Town. Amounts are received annually and restricted for educational purposes. The MET fund began 2014 with a balance of \$277,742 and received \$160,430 in grants. During the year the School charged \$617,832 to the account resulting in a year-end deficit of \$179,660. Like many of the deficits previously discussed, it is contrary to MGL to overspend grant accounts unless an award or other commitment is in place.

We discussed this issue with the School Department who provided us with reports that reflected a beginning balance over \$459,479 which caused the School Department to believe that there was more available in the fund than the actual amount. In a previous discussion, we indicated that a MUNIS update in fiscal 2013 caused multi-year funds such as the MET to carry balances in excess of those truly available. This is apparently what happened in this situation.

The Department of Revenue reviewed this and determined that the over expenditures were improper and a journal entry to move expenditures to the School operating budget was required, leaving a positive balance of \$40,000 in the MET. As a result, the Town Accountant journalized \$217,216 to the School operating budget which contributed to the overall deficit in the School budget as previously discussed.

Situations such as this highlight more than ever the need for departments, especially the School to communicate with the Accounting office on a monthly basis. Prior to the close of the fiscal year all grant and other special revenue fund balances should be reconciled between the two such that all parties are aware of the balances that are available in all accounts; for Federal funds, this is required by statute.

We urge the School and the Accounting office to create a procedure that accommodates such a process.

**Management Response:**

With current knowledge of the parties regarding the difficulties with multi-year fund balances in MUNIS, the parties fully expect that such an issue will not occur again. Furthermore, it is expected that this will become moot with the revision to or replacement of the MUNIS system.

It is very important to note that at no time did any department other than the School Department spend Murdock Trust fund revenues.

**Transfer Station**

The Town's Transfer Station has operated at a deficit for at least the last three years. In fact in spite of adjusting rates, the deficit has gotten larger each year. The operation of the Transfer Station 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:**

The Public Works Director is assessing the revenues and expenses tied to the Transfer Station Enterprise fund and will be making recommendations, through his submitted budgets, for fiscal year 2016.

**Police Details**

Presently, police details are administered by the Police Department. Like many other communities, the year-end balances are in a deficit situation. This is normal since police detail payrolls are generally paid out prior to receiving revenue from the customer for the detail. Deficit balances have doubled to \$31,000 from \$15,000 in the prior year. In theory, the amount of detail outstanding should be equal or greater than the amount of detail in deficit.

We determined that the amount on the general ledger is never reconciled to the amount maintained on the listing in the Police Department. We suggest the Town Accountant adopt such a process as part of a quarterly procedure and at a minimum conduct this prior to the closing of the books at year-end.

**Management Response:**

The Police Chief is increasing collection efforts and is working on a revised detail policy that will require any outside third party vendor seeking a detail officer to have paid any outstanding balance prior to being provided an officer.

### **Accrued Payroll**

In our report to management dated July 21, 2014 we reported that the Town did not properly budget and charge payroll in accordance with recently required DOR guidelines which states that a payroll period that crosses between fiscal years is to be allocated to the applicable fiscal years in which it is earned. In prior years, the Town posted accruals for School payroll only, with the understanding it would need to post a 53<sup>rd</sup> week for the Town in 2013 or 2014, which never materialized. The Town should begin a process of either a split payroll warrant, which MUNIS can do automatically, for the first payroll warrant of the subsequent fiscal year, or the Town should manually calculate an accrued payroll liability and book the amount to the applicable expenditure and liability accounts. The Town implemented this process in an adequate manner for the first time in the year ending June 30, 2014 but because the amount was not budgeted it caused many payroll accounts to go into deficit at the end of the fiscal year.

### **Management Response:**

We recognizes the need to have incurred this one-time charge of \$112,651 in response to an accounting change mandated by the DOR, related to how split payrolls are accounted for between fiscal years and we will be budgeting a rolling 52.2 weeks each year to cover for this issue moving forward. As earlier highlighted in this report, this contributed to the overall accounting deficit by \$112,651.

### **Agency Accounts**

The following observations were made as a result of our review of the Town's Agency accounts and other liabilities:

- In the prior year we reported that the Town's Fire Arm License that was due the Commonwealth had not been paid since 2011. This has still not been paid and the amount has arisen from \$38,075 to \$54,250 as of June 30, 2014. The Commonwealth has yet to bill the Town for these fees. We suggest the Town follow-up with the Commonwealth and determine where this process stands. The amounts are properly encumbered and funds are available so this will not pose any further financial burden on the Town.
- A performance bond account has maintained a deficit balance of \$2,850 over multiple years; this is not possible, as these are deposits which when returned should never exceed the account balance. We suggest the Town Accountant reconcile performance bond deposits with the departments who oversee the activities relative thereto.
- The Fire Department Special Agency account was put into a deficit position of \$1,300 in fiscal year 2013 and this has risen to \$1,525. While this is not significant, the process should be reviewed.
- There were several errors related to recording duplicate deposits of withholdings that also impacted the cash reconciliations. These were greater than \$100,000. Also see cash reconciliation comments previously discussed in the material weakness section. These were adjusted prior to presenting the amounts on the financial statements.

**Management Response:**

The Commonwealth has only recently begun submitting electronic invoices for Firearms License fees. The Police Department continues to reach out to the Commonwealth regarding this issue requesting that a bill be issued to allow the Town to pay these past due amounts. The Police Department was advised to hold off on trying to pay the past due bills until the Commonwealth could properly invoice. The Police Department has this communication from September 23, 2014 in writing.

The performance bond issue is being researched by the Planning Office.

The Fire Department \$1,525 deficit is under review as well.

The matter of duplicate deposits of withholding amounts has been corrected.

**Special Revenue Funds and Other Deficits**

The following deficits existed relative to fund balance accounts and activities external of those previously addressed with regards to General Fund and the Health Insurance Trust Fund:

CDBG CDFI '10	\$ (14,984)
Coord. Fam. & Comm. Engage - 2012	(29)
Coord. Fam. & Comm. Engage - 2013	(279)
Coord. Fam. & Comm. Engage - 2014	(5,711)
Early Childhood - 2014	(94)
District & School Assistance - 2014	(5,773)
Inclusive Preschool Grant - 2014	(18,480)
Race to the Top Early Literacy - 2014	(39)
School Lunch Program	(37,487)
Chapter 90 Highway Funds	(3,264)
SETB Training	(165)
911 Dept Support & Incentive	(132,543)
USDA Police Cruiser	(15,226)
Police Bullet Proof Vest	(799)
Mass CEC Wind Grant	(11,309)
Urban Self-Help Grant	(23,980)
Sr. Center Renovations	(1,710)
Town Hall Roof	(4,316)
Sr. Center Director Wages	(4,346)
Total Special Revenue Fund Deficits	<u>\$ (280,534)</u>

As a result of our audit procedures we would strongly encourage the Town to adopt strict policies preventing the expenditure of monies out of Special Revenue Funds when adequate funding is not presently available within the fund or guaranteed through the receipt of a grant award letter or in-hand donation. Some of these deficits have extended over multiple years. The 911 fund is the only deficit of those listed that will not be funded as part of the special legislation since a commitment from the Commonwealth exists but the reimbursement

process is slow. In addition, the USDA and Mass CEC Wind Grant have been received subsequent to year-end.

**Management Response:**

The above listed Special Revenue fund deficits, while some go back five years and may have been known to the prior Town Accountant, were first reported out by DOR to the new Town Accountant this past spring. As the Auditors note, since that time a number of these have been addressed. When removing the 911 Grant of \$132,543, the USDA Police Cruiser Grant of \$15,226 and the Mass CEC Wind Grant of \$11,309, for which funds are either committed or have been received, this deficit actually is \$121,456.

This aggregate deficit balance was further reduced subsequent to year-end by the discovery of coding errors; in the Senior Center Renovations account of \$1,710, the Town Hall Roof account of \$4,316 and the Senior Center Director Wages account of \$4,346, and have since been corrected.

The remaining deficit in these special revenue funds is \$111,084 which is equally split between school and general government accounts.

The recommended Special Revenue Fund policy will be proposed to be included in the consolidated financial policy manual that is currently being worked on by the Finance Committee in consultation with the Town Manager.

**Tax Collection Process**

In our report to management dated July 21, 2014 we described the collection process for real estate, personal property and other taxes and also communicated to management that the Town had not committed outstanding balances to tax title in either fiscal year 2012 or fiscal year 2013. Further we suggested the Town address this immediately since the tax title process is subject to a statute of limitations of 42 months and some of the outstanding balances were in danger of falling out of the statute of limitations. Since the prior audit report was delayed, the communication was not made until after fiscal 2014 had concluded; thus no improvements occurred during the fiscal year ended June 30, 2014 as real estate tax collections were \$154,000 under budget. This contributed to the Town's year-end liquidity issues.

We made a few suggestions in the prior year which included sending demand letters at the earliest possible point (May 15) such that the impact of the demand letters would be felt before June 30, and the Town could recognize the revenue in the current fiscal year. This did not happen in fiscal 2013 and 2014 as demand letters were sent in June. We also recommended 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.

We were informed by the Collector that she requested money for tax title in fiscal year 2013 and was not given any money for her budget thus could not conduct the process. This was essentially penny wise/pound foolish philosophy as in retrospect, given the financial crisis the Town is under every dollar in the door could have gone a long way.

We understand that subsequent to June 30, 2014 in response to the Town's financial crisis, that Town is investigating all methods of collecting taxes including tax title, installment payments, and assignments and has been very successful in their approach. We have not audited this process in fiscal 2015 and can't render an opinion on this however if the assertions made are true, they will be reviewed as part of the Town's fiscal year 2015 audit.

In summary, positive cash flow is critical, which means take the most aggressive approach to get taxes collected which includes sending demands for all taxes and excise at the earliest possible date and getting commitments out the door at the earliest possible date, especially the last motor vehicle commitments of the year.

### **Management Response:**

The issue of tax receivables was an issue that gathered a great deal of attention last fall and much was made of incomplete information that was put out publicly without the benefit of either context or up to date numbers.

Here in Winchendon we have historically and very publicly chosen to employ a more "small town" and "neighborly" policy regarding tax collection where personal circumstances were factored into decisions and grace was more readily offered in the form of payment plans for delinquent taxpayers.

In response to our financial crisis, we have very publicly revisited that strategy since last fall. That has all changed now as we have implemented new and more stringent tax and tax title receivable policies to strengthen our revenue receipts to include demands being issued as soon as allowed by law, funding tax title processing, more aggressive tax title filing and court takings, auction of tax title possession properties, and auction/sale of the existing tax receivable to an outside collection agent. We are moving forward with a tax title auction planned for early spring.

As this relates specifically to the outstanding receivables so much discussed last fall it is worth reporting that since the close of fiscal year 2013, as a direct result of the efforts of the Collector, we have seen the previously reported fiscal year 2013 cumulative real estate and personal property tax receivable reduced by 66% (from \$1,001,073 down to \$339,609) and the previously reported fiscal year 2013 cumulative motor vehicle excise tax receivable reduced by 72% (from \$269,072 down to \$75,202). Even more, we have realized the same positive effects in fiscal year 2014.

### **Audit Committee**

As can be reviewed throughout this document, the Town has experienced significant financial issues in each of the last two years and now is faced with incredibly difficult challenges to overcome.

Presently, the Town Charter requires the Town Accountant to report to the Board of Selectmen and the Town Treasurer to report to the Town Manager. Additionally, the School Business Manager reports to the Superintendent of Schools. Essentially the three key financial individuals in Town all report to different bodies. This desegregation of reporting responsibilities has created ineffective and at times confusing leadership of the entire financial function which has led to a lack of cogent communication between reporting bodies



and departments. Contributing to this are the inefficiencies with the MUNIS operating system and significant turnover in key positions as previously discussed.

Many communities throughout Massachusetts have developed formal audit committees to mitigate these risks. These committees are made up of selected members from the various boards. All accounting and audit related matters are vetted through such a committee which then prepares periodic reports for the administrative boards in Town. Such an audit committee would also be responsible for selecting the Town's independent auditor and providing oversight over the annual management letter and the progress of any recommendations made by the independent auditor.

The audit committee ideally would be made up of one member each of the Board of Selectmen, School Committee and Finance Committee with the representative member voted in by their respective board/committee. In addition, if the Town wished to extend the committee to five members, two volunteer citizens with background in finance/auditing could be added and appointed by the other three members.

Given the significant mandates placed on the Town by the Department of Revenue with respect to the deficit legislation and the significant issues brought to light in this management letter, we suggest such a committee is created immediately. The Department of Revenue can provide many samples of bylaws and templates to assist the Town in creating such a committee.

#### **Management Response:**

As previously referenced by the Auditors, the two most significant contributors to the deficit situation facing the Town, were the difficulties experienced with the MUNIS software system, and the institutional knowledge lost as a result of significant turnover in every financial team position, both school and general government. Most specifically, with the loss of the prior Town Accountant, any institutional systems that had been employed to overcome these structural deficiencies were lost. This was only made worse by having lost the opportunity for the planned two-month overlapping transition with the prior and incoming Town Accountants.

As the Auditors further assert, the entire structure of the Town's financial offices, to include by whom each position is appointed and to whom each position is responsible to report, also greatly contributed to the breakdown that led to our current crisis.

The structural deficiencies in the town's organizational chart referenced by the Auditors are established by the Town Charter whereby the Town Account is appointed by and reported to the Board of Selectmen leaving the Town Manager no ability to direct or supervise the work of that position. This matter has been at least temporarily rectified as a result of language included at the insistence of the DOR in the approved deficit legislation whereby the Town Manager now has direct authority over and responsibility for the Town Accountant and the functions of that office.

In an effort at conforming to the DOR expressed wishes regarding the relationship between the Town Manager and the Town Accountant, the Board of Selectmen will be voting the consideration of formally delegating the Board's authority vis-à-vis the supervision of the Town Accountant to the Town Manager.

The Town will continue to pursue the lines of reporting and accountability in the financial offices to include the potential for Charter changes to the Town Manager and Town Accountant interplay and potentially to include consideration of a the creation of a Finance Director position.