

TOWN OF MILLBURY, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2010

MANAGEMENT LETTER

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Board of Selectmen
Town of Millbury
Millbury, 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 Millbury, Massachusetts, (the "Town") as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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.

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Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
December 1, 2010

ECONOMIC DISCUSSION

The Town has done an extremely efficient job of managing its reserves. While many communities have begun to succumb to the economic pressures prevalent both nationally and at the local level the Town managed to maintain the majority of its reserve position during fiscal 2010. In fact, the Town's reserves (Undesignated Fund Balance and Stabilization) approximate \$3.2 million as compared to the Town's 2010 overall budget of approximately \$33.1 million. This is over the 10% metric that the bond rating agencies seek when considering a positive bond rating evaluation for a community. This when combined with the Town's Sewer Stabilization Fund (see below) has placed the Town in a comfortable position financially.

The period from July 1, 2008 through June 30, 2010 can be characterized as one of the most difficult periods in recent memory. A banking crisis that froze the credit markets brought the economy to a complete standstill and adversely impacted local revenues and State Aid. The Town responded well in fiscal years 2010 and 2011 to these reductions in State Aid and other local non-property tax receipts and showed the ability to strategically budget appropriations in ways that preserved local service levels. In addition, the Town was able to accomplish this while increasing its Stabilization Fund balance. As a result, the Town was able to maintain a fairly healthy undesignated fund balance at year-end of approximately \$2.1 million. However, possible revenue deficits, including further cuts by the Commonwealth to State Aid, inflationary pressures and other collateral challenges will require the Town to attempt to incorporate a program of expenditure reductions reflecting lower appropriations to meet realistic revenue estimates in fiscal year 2011. If the Town is successful in implementing this plan, the Town's overall reserve position will be preserved at the desired 10% level though at least 2011.

We applaud management for being vigilant during this process and caution them to continue to be conservative as the economy attempts to stabilize. The following summarizes the Town's strategic reserves:

- Undesignated Fund Balance - \$2.1 million, this resulted in positive free cash and allowed the Town to continue its numerous consecutive years of positive free cash balances.
- Stabilization Fund – nearly \$1.1 million is maintained in the Town's rainy day fund. This ideally, should only be used in emergency situations. The Town has strategically built this fund through appropriations from free cash.
- Sewer Stabilization Fund – nearly \$4.6 million, this amount is held mostly for the specific purpose of funding future debt service related to the most recent expansion project, with \$100,000 held for the maintenance of the currently constructed sanitary system.
- Allowance for Abatements - \$0.6 million, these are amounts reserved against future adverse decisions of the Appellate Tax Board. Towns in Massachusetts are presently still defending claims of personnel property valuations by certain telecom companies. The amount in question for the Town is approximately \$0.7 million. Recently, the courts resolved in favor of the towns. The decision has been appealed; however, the towns are awaiting the outcome of the appeal. Should the court ruling be upheld, the Town will be able to free a substantial portion of this balance and; (1) make further transfers to the stabilization fund; (2) increase its free cash; or (3) supplement its budget.

The Town should review the items in this report and put in place a plan to correct the items noted. Given the continued challenges management is confronting with respect to the economy, we understand that certain of these items would not be given the highest priority.

INFORMATIONAL ITEMS**Statement on Auditing Standards No. 115 – Audit Communications**

The American Institute of Certified Public Accountants (“AICPA”) recently issued Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (“SAS 115”). SAS 115 establishes 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 did not deem any of the findings in this report to be categorized as (2) or (3) above.

GASB 45

In June 2004, the Governmental Accounting Standards Board (“GASB”) issued GASB No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefit Plans Other Than Pension Plans* (“GASB 45”). GASB 45 establishes standards for the measurement, recognition and display of “other post-employment benefits” expenses/expenditures and related liabilities and/or assets, note disclosures and, if applicable, required supplementary information in the Town’s financial reports. Other post-employment benefits typically include health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits.

Based on the size of Town’s annual revenues, GASB 45 became effective for the Town during the fiscal year ended June 30, 2009. The Town was able to implement GASB 45 with success and should be commended for doing so. The Town’s latest actuarial report becomes stale in fiscal year 2011 and would next need to be updated for its audit reporting as of June 30, 2011. *To that end, the Town has engaged an actuary that is in the process of updating the actuarial valuation and is confident that this updated calculation will be completed in time for inclusion in the 2011 operating results.*

The issuance of GASB 45 is a financial reporting requirement. However, its issuance reminds towns like Millbury that it has future obligations that may materially affect the Town. During 2010, the Town took some initial steps to address this issue by voting to establish a trust fund under MGL 32B Section 20. This will allow the Town to appropriate funds into this trust fund for the express purpose of reducing the unfunded liability. The funding requirements however are significant and given the current economic climate impossible to meet.

We suggest the Town form a committee that would be charged with exploring funding options for the actuarial-determined unfunded liability. The absence of a funding strategy for other post-employment benefits may materially and adversely affect the Town’s future operations as it may not have appropriate funds set aside for its retiring workforce’s other post-employment benefits. We encourage the formation of such a committee to explore future funding strategies.

GASB 54

In March 2009, the GASB issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement 54 is intended to improve the usefulness of information provided to financial report users about fund balance by providing clearer, more structured fund balance classifications, and by clarifying the definitions of existing governmental fund types.

Fund balance—the difference between assets and liabilities in the governmental fund financial statements—is among the most widely and frequently used information in state and local government financial reports. The GASB developed Statement 54 to address the diversity of practice and the resulting lack of consistency that had evolved in fund balance reporting. To reduce confusion, the new standards establish a hierarchy of fund balance classifications based primarily on the extent to which a government is bound to observe spending constraints imposed upon how resources reported in governmental funds may be used.

Statement 54 distinguishes fund balance between amounts that are considered *nonspendable*, such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. Beginning with the most binding constraints, fund balance amounts will be reported in the following classifications:

- *Restricted*—amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed*—amounts constrained by a government using its highest level of decision-making authority
- *Assigned*—amounts a government intends to use for a particular purpose
- *Unassigned*—amounts that are not constrained at all will be reported in the general fund.

The new standards also clarify the definitions of individual governmental fund types. It interprets certain terms within the definition of special revenue fund types, while further clarifying the debt service and capital projects fund type definitions. The final standard also specifies how economic stabilization or “rainy-day” amounts should be reported.

GASB Statement 54 is effective for financial statements for periods beginning after June 15, 2010 (fiscal year 2011). It is not required by the Bureau of Accounts for the Town’s internal financial statements but will be required for any financial statements prepared in accordance with generally accepted accounting principles. *We understand that although the Bureau of Accounts has not issued a pronouncement indicating that Municipalities in Massachusetts are required to follow this GASB statement. The Town’s intent is to provide the auditors the necessary information, and the required journal entry to ensure that the Town’s financial statements are in compliance with GASB 54.*

ENTERPRISE FUND

Enterprise funds are designed for activities that more closely approximate commercial activities. It allows the costs for such an activity to be captured by the user rate and thus provides management the ability to determine if rates need to be adjusted more easily than if the activity were treated as a governmental fund. In 1995, the Town elected to treat its sewer activities as an enterprise fund. However, unlike most enterprise funds that cover their own costs, the Town elected to subsidize a significant portion of the debt by the taxpayer via the general fund.

This gave the Town two options with respect to the presentation of the sewer fund on the financial statements. It could be treated as either an enterprise fund or a governmental fund. In prior years, the Town elected to present the funds as governmental funds. However, in light of the fact that the debt commitment from the general fund will be diminishing over the next several years, we advised the Town, that in the current year and in future years, presenting the activity as an enterprise activity is a more appropriate presentation for the user of a financial statement. The Town agreed and for fiscal year 2010, the Town began to present this activity as an Enterprise activity.

While reviewing this activity, the following item was noted that could be accomplished in a different manner by the town to facilitate a more efficient conversion.

The Town presently accounts for the enterprise fund under a modified accrual basis in its internal financial statements. We suggest that if it is feasible, the Town begin to account for the enterprise funds on a full accrual basis, through a period 13 transaction. Activity could be reversed back for budget purposes beginning with period 1 of the following year. *The Finance Director made us aware that the current accounting software does not allow for period 13 journal entries. However in the future, the Finance Director will provide us with the documentation, and the journal entry to bring the Enterprise fund from the modified accrual basis to the full accrual basis for accurate presentation in the financial statements.*

In addition, we noted that the sewer billing cycle has a significant lag. Consumption for the period January 1, 2010 through June 30, 2010 had yet to be billed as of the date of field work in late September. This essentially means that services used in January would not be collected until sometime in November at the earliest. We understand that the Town is tied into the water company billing process however we also understand that the Town may bill more than twice per year. Even though the sewer fund is not suffering any liquidity issues, we suggest as a matter of good business practice that the billing process be reviewed.

We understand that the Sewer Department recently experienced turnover in the office that does the billing. The primary person responsible for the billing has been trained not only on the accounting software in house, but also on the water company software. The billings will be now sent out in February, and August. It is the Town's intention to begin the exploration of moving to a quarterly billing cycle.

INSURANCE WITHHOLDINGS

The Town presently carries a health insurance liability on its books for approximately \$385,000. Reasonable estimates suggest the amount is more likely between \$120,000 and \$150,000. This balance has been carried on the books for a number of years and is one of the remaining items the Town is in the process of analyzing and adjusting.

We suggest this analysis be a priority and the books adjusted accordingly as a result of this analysis.

Management Response

A full analysis of the account has been completed, and is being reviewed. Upon completion of the review of the account analysis the appropriate adjustments will be made to bring the account to the appropriate balance.

FRAUD POLICY

The Finance Director has primary responsibility for the investigation of all suspected fraudulent acts as defined in the Town's *Policy on Fraud Protection and Anti-Fraud Response Program*. This policy contains a reporting hierarchy that directs employees to the Police Chief or Town Manager in instances where an employee believes the Finance Director may be involved. However, incidents of material financial fraud are most likely to take place in departments that have direct reporting responsibility to the Finance Director. Therefore, providing the Finance Director the ability in the policy to field complaints of suspicions of fraud and then being responsible for the investigation are incompatible duties. We recommend that the Finance Director be removed from this policy in his current capacities.

Management Response

The Town of Millbury has implemented this recommendation. The change to the Policy was made at the October 26, 2010 Board of Selectmen's meeting.

BLANK CHECK STOCK

There is no log that allows for the monitoring of blank check stock used in the processing of vendor payments and payroll. While there are other mitigating controls in place, this would serve as a control mechanism regarding the sequence of checks and the accounting of check stock.

Management Response

The Town of Millbury has implemented this recommendation.