

**TOWN OF MILLBURY, MASSACHUSETTS**

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2015

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Board of Selectmen  
Town of Millbury  
Millbury, Massachusetts

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Town of Millbury, Massachusetts (the "Town"), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Town's basic financial statements, and have issued our report thereon dated November 17, 2015.

### **Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Town's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

## **Compliance and Other Matters**

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

## **Purpose of this Report**

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

*Roselli, Clark and Associates*

Roselli, Clark & Associates  
Certified Public Accountants  
Woburn, Massachusetts  
November 17, 2015

## **I. OVERVIEW**

Local, national and worldwide economies continued to strengthen in fiscal year 2015. The Town's economic demographics in terms of median household value and income as well as its unemployment rates as of June 30, 2015 were as follows:

|                         | <u>Town of<br/>Millbury</u> |         | <u>Worcester<br/>County</u> |         | <u>Commonwealth<br/>of Massachusetts</u> |         |
|-------------------------|-----------------------------|---------|-----------------------------|---------|--|---------|
| Median household income | \$                          | 67,105  | \$                          | 65,223  | \$                                       | 66,768  |
| Median household value  | \$                          | 249,847 | \$                          | 235,200 | \$                                       | 327,200 |
| Unemployment rate       |                             | 6.0%    |                             | 5.2%    |  | 5.6%    |

The Town has enjoyed modest new growth over the past several years and additional development opportunities for residential and commercial growth are available.

The Town's unassigned fund balance in its general fund increased 11.6% in 2015 to over \$2.7 million. This represented approximately 7.3% of total fiscal year 2015 general fund expenses, which is slightly better than both the prior year and the State-wide average. In fact the Town has been at or near the State average since at least 2007. In addition the Town has established free cash policies such that the reliance of free cash in future operating budgets is being phased out with the ultimate goal that free cash be used only for one time capital items.

This is the type of consistency that has allowed the Town to earn and maintain an AA-rating from the bond rating bureaus and we are encouraged by this effort.

The remainder of the report reflects informational items and findings and recommendations. We hope that Management will address comments in the current year report with the same motivation it has addressed comments in the prior years.

## **II. INFORMATIONAL ITEMS**

### ***Effect of Adoption of New Accounting Principal – Pensions***

In fiscal year 2015, the Town and virtually all municipalities in the Commonwealth adopted new pension accounting standards. The new pension accounting standards required, for the first time, that the Town present its portion of the unfunded pension liability owed to its current and former employees in the government-wide financial statements. At June 30, 2015, the net pension liability for the Town exceeded \$20.3 million.

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

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

### ***New Accounting Principal – OPEB***

The Governmental Accounting Standards Board, or GASB, has issued a new pronouncement related to other postemployment benefits, or OPEB, that is substantially similar to the pension standard described above. OPEB typically includes health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits. The Town presently contributes 75% of the cost of retirees' (50% for surviving spouses) comprehensive medical insurance offered through Tufts Health Plan and Fallon Community Health.

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

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

The Town established an OPEB trust fund in May 2013, however is hasn't yet funded it. Credit rating agencies like Standard and Poor's Financial Services LLC, or S&P, have begun to assign an allocation of the credit evaluation to the management of long-term liabilities, which includes OPEB.

As we have indicated in several previous letters to management, the Town should begin to include OPEB strategies in its long-term planning.

### ***Changes to Single Audit Requirements***

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

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

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

Adopting a formal internal control framework is new to municipalities and will likely require a good deal of evaluation, documentation, remediation and ongoing monitoring. We recommend that the Town commence this process by taking a common sense approach and tackle the areas in which the Town is most susceptible to an internal control deficiency. Over a period of time, the Town should complete the formal adoption of an internal control framework. We have attached the 17 principles of effective internal control issued by COSO on page 9 of this letter to management for your reference.

### ***Indirect Costs***

During fiscal 2015, the Massachusetts Department of Revenue (the “DOR”) completed a state-wide study regarding the manner in which indirect costs are applied in communities across Massachusetts. It was determined that indirect costs are applied using a variety of different non-standard methodologies. This made it very difficult to compare from community to community and very challenging to assess the reasonableness of these allocations.

As a result of this study, the DOR recommended that each Massachusetts municipality establish formal policies to formulate indirect cost allocations that reasonably and consistently assess indirect costs to an enterprise fund. These policies should be reviewed annually by all interested parties. The DOR also requested that during our audits we begin to identify if formal indirect cost policies have been established and if the indirect cost allocation is reasonable.

We determined the Town does not maintain a written internal policy regarding indirect cost allocation. The Town has used a spreadsheet to allocate indirect costs for many years in a consistent manner. However, the allocation methodology is unique and difficult to follow. We have historically evaluated the results of the Town’s calculation versus a more common allocation methodology and concluded that the Town’s results have been materially consistent with our expectations. However, many of the individual components such as pension expense vary greatly between the Town’s unique calculations and those derived from a more common allocation methodology. In connection with the Town’s adoption of GASB 68 in fiscal year 2015, this variance (while still immaterial) became more important and may possibly cause a material difference in the future.

We understand that the Town is currently drafting a *Sewer Indirect Cost Policy*. We recommend that the Town evaluate the manner in which it calculates indirect costs and strongly consider modifying its method to be more consistent with common practice. The Division of Local Services of the Massachusetts Department of Revenue has a March 2005 publication entitled *Costing Municipal Services: Workbook and Case Study* that provides a variety of methods and real-world examples that the Town can use in this endeavor.

### ***Municipal Data Breaches***

We continue to report to management the need to enhance network security. The incidents of data intrusions and theft through computer networks continue to rise. In fact, there have been several recent issues that have made headlines here in the Commonwealth of Massachusetts.

The Town, together with its outside IT management provider, takes a proactive approach to IT security. We recommend that the Town continue to place an emphasis on IT



security and continually update its IT security appliances and software as well as its policies and procedures regarding IT security.

Recently, a select number of highly qualified companies have emerged that conduct “Data Security Audits” for municipal entities. The audit is a comprehensive examination of the administrative, technical and physical security controls that a municipality has implemented to protect personal information. The resulting audit report identifies each condition that exposes the municipality to potential unauthorized access and offers practical recommendations to remediate these conditions.

### **III. FINDINGS AND RECOMMENDATIONS**

#### *Cash Receipts Processing*

The Town's accounting records reflected a deficit in its federally-funded special education special revenue fund of \$83,121 at June 30, 2015. Shortly after year end, the Town received \$65,955 as a final payment on the 2015 award, which does not eliminate the deficit fund balance.

In connection with our audit, we determined that the Town improperly recorded a July 30, 2014 receipt in the amount of \$35,670. These funds were improperly recorded in the federally-funded Title I special revenue account versus the federally-funded Special Education special revenue account.

While the Town identified the initial large deficit balance and worked with its School Business Office, this incorrect posting was not corrected and the federally-funded Special Education special revenue account maintained a deficit fund balance at year end.

We recommend that the Town perform an analysis of all deficit fund balances at year end, particularly those involving federal awards, to determine how and when these deficits are cured to better ensure that the accounting records are accurate.

**Management's Response** – A reconciliation process was in place, however this incorrect posting is believed to be an isolated incident that occurred during the transition between fiscal years. We intend to monitor our fiscal year 2016 account balances more closely.

#### *Capital Assets Included in Purchases of Services Accounts*

The Town maintains a fixed asset database which it updates annually for capital asset transactions. This system is not integrated into the statutory accounting records, which is appropriate.

At times, a department will procure a capital asset in a "purchases of services" budgetary account versus in a "capital outlay" account. In fiscal year 2015, there were two significant capital transactions recorded in these purchases of services accounts that were not initially recorded by the Town in its fixed asset database – land improvements in a special revenue account totaling \$114,725 and infrastructure assets in the sewer enterprise fund totaling \$38,500. Upon discovery, these amounts were imported into the fixed asset database and the government-wide and proprietary fund financial statements were updated accordingly.

We recommend that the Town perform an analysis on all purchases of services accounts each year to better ensure the completeness of its capital assets.

**Management's Response** – While performing our internal analysis of capital asset additions, we did not identify the \$114,725 land improvement and believe this to be an isolated incident. With respect to the \$38,500 infrastructure asset, we identified this as a repair and therefore did not capitalize it; however, upon further analysis, we concur with our auditors' judgment that this should have been a capital asset addition.

*Student Activity Agency Accounts (repeated from prior year)*

The Town maintains an agency liability account for monies it holds on behalf of students for various student activities. By law, the Town Treasurer must hold and control the interest-bearing depository accounts for student activities. At June 30, 2015, the Town maintained three interest-bearing depository accounts for student activities with an aggregate bank balance of \$229,260. However, the recorded agency liability account for its student activities totals \$59,143 at June 30, 2015. This difference is the result of bank transfers not being made to match agency account activity.

It's important to note that the Town pools all its banking and investment accounts and recorded cash and related accounts are properly reflected in the base accounting records. However, this large difference between the bank balances and the agency liability accounts may have the following effects:

- Interest income that rightly belongs to the Town is being unjustly applied to student activities; and
- The difference in cash accounts and the recorded agency liability balances may result in students, class/club advisors questioning the accounting practices of the Town in relation to student activities.

We recommend that the Town Treasurer make the appropriate transfers between accounts to balance the student activities bank accounts with the recorded agency liabilities. Furthermore, we recommend that these accounts be evaluated on at least a semi-annual basis to ensure that the recorded agency liabilities are consistent with reconciled bank balances.

**Management's Response** – We are currently working on this reconciliation process.

\* \* \* \* \*

#### **IV. PRINCIPLES OF EFFECTIVE INTERNAL CONTROL**

The following 17 principles of effective internal control were extracted from the publication by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, *Internal Control – Integrated Framework*. The entire internal control framework and implementation guides can be found online. We've included the COSO principles in this letter to management as the COSO framework is the most widely used internal control framework in the United States of America.

| <b>Internal Control Component</b> | <b>Principles</b>  |
|-----------------------------------|--|
| Control environment               | <ol style="list-style-type: none"><li>1. Demonstrate commitment to integrity and ethical values</li><li>2. Ensure that board exercises oversight responsibility</li><li>3. Establish structures, reporting lines, authorities and responsibilities</li><li>4. Demonstrate commitment to a competent workforce</li><li>5. Hold people accountable</li></ol> |
| Risk assessment                   | <ol style="list-style-type: none"><li>6. Specify appropriate objectives</li><li>7. Identify and analyze risks</li><li>8. Evaluate fraud risks</li><li>9. Identify and analyze changes that could significantly affect internal controls</li></ol>  |
| Control activities                | <ol style="list-style-type: none"><li>10. Select and develop control activities that mitigate risks</li><li>11. Select and develop technology controls</li><li>12. Deploy control activities through policies and procedures</li></ol>   |
| Information and communication     | <ol style="list-style-type: none"><li>13. Use relevant, quality information to support the internal control function</li><li>14. Communicate internal control information internally</li><li>15. Communicate internal control information externally</li></ol>   |
| Monitoring                        | <ol style="list-style-type: none"><li>16. Perform ongoing or periodic evaluations of internal controls (or a combination of the two)</li><li>17. Communicate internal control deficiencies</li></ol>   |