

**TOWN OF PHILLIPSTON, MASSACHUSETTS**

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2013



## TRANSMITTAL LETTER

Board of Selectmen  
Town of Phillipston  
Phillipston, 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 Phillipston, Massachusetts, (the "Town") as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal controls over financial reporting ("internal controls") 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 controls. Accordingly, we do not express an opinion on the effectiveness of the Town's internal controls.

A deficiency in internal controls 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 identified deficiencies that we have considered material weaknesses. Those are identified as such in the body of this report.**

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*

Roselli, Clark & Associates  
Certified Public Accountants  
Woburn, Massachusetts  
May 2, 2014

## **INTRODUCTION**

Fiscal year 2013 can be categorized as a year of significant breakdowns in internal controls. The vacancy and subsequent replacement of the Town Treasurer was met with many challenges, causing reports to be issued late, reconciliations to be incomplete and numerous other deficiencies that have been classified as material weaknesses. These are discussed in detail in the discussion that follows.

Despite this, the Town managed to maintain a sound financial position, as unassigned fund balances were still in excess of \$500,000 and thus well above the 10% goal thought of by many as a goal to maintain.

Subsequent to hiring the Treasurer, this individual resigned and another person was appointed to the position during fiscal 2014. With this appointment, many of these deficiencies were corrected, reports and reconciliations were completed and the functions were all brought up to date. It is critical, that the Town maintain this momentum so that effective internal control is not compromised.

## **CURRENT YEAR COMMENTS**

### **A. Bank Reconciliation Process – Material Weakness**

Arguably, the most important control in place as part of an effective internal control system is the timely reconciliation of bank statements to the cash book. Timely reconciliations will help detect if any errors have been made or if cash is unaccounted for or, even worse, stolen.

The Town's policy is to prepare bank reconciliations monthly however this policy was not followed from November 2012 to September 2013, so it went 10 months in arrears.

This is a very risky situation for the Town. Having no confidence that cash balances reconcile on a monthly basis sets up risks that the Town has to avoid. If an error occurred or money was stolen during this timeframe, there would be no way of knowing that without completing the reconciliations.

We suggest the Town establish as a priority the immediate completion of all bank reconciliations for every month.

*With the appointment of a third new Treasurer, bank reconciliations were finally brought up to date as of the date of our audit in April 2014.*

### **B. Treasurer to Town Accountant Cash Reconciliation – Material Weakness**

A sound system of internal control includes the process of a timely, cash reconciliation between the Treasurer and the Town Accountant. This is typically accomplished upon the completion of the Treasurer's internal bank reconciliations as discussed above. Because of the condition discussed in the previous comment, this step could not be completed from November 2012 to September 2013. Consequently, the Town was unable to complete the reconciliation required by the Department of Revenue annually.

This also is a very risky situation for the Town. Because the Town Accountant was unable to verify that the Treasurer's balances reconciled to the General Ledger for a prolonged period of time, it was unknown if any major errors were present, or more importantly if any cash had been stolen.

*With the appointment of a third new Treasurer, bank reconciliations were finally brought up to date as of the date of our audit in April 2014.*

### **C. Statement of Indebtedness**

The Statement of Indebtedness is a schedule that includes all of the Town's debt related activity for the fiscal year. It is required to be submitted annually to the Department of Revenue. The deficiencies within the Treasurer's office resulted in this schedule not being prepared or turned into the Department of Revenue, thus the Town was out of compliance with this reporting requirement for fiscal 2013.

It is important that a process in place to ensure that this schedule is prepared and submitted to the Department of Revenue annually. Any deficiency in this process will risk the certification of free cash.

*With the appointment of a third new Treasurer, the Statement of Indebtedness was completed and submitted to the Department of Revenue, thus the Town is currently in compliance with this requirement.*

### **D. School Construction**

The Town undertook a construction renovation project for the school building it owns. It was fortunate that it qualified for an MSBA reimbursement grant relative to this project. As discussed in the prior year management letter, the Town has had problems with the administration of this project and its reimbursement. In the prior year we discussed that the Town did not timely request reimbursements and allowed project deficits to increase, and in the current year it was discovered that the Town overdrew the project by \$57,000. This was due to a BAN being paid off instead of rolled over when it matured. As a result, the Town had to take a charge against its free cash for fiscal 2013 and subsequently raise the amount on the 2014 tax recap.

Whenever the Town is awarded unique grants, Town personnel should become intimately familiar with the management and requirements of these grants. By doing so, it can avoid the serious issues that have plagued the Town the past two years regarding administration of grant activity.

### **E. Retirement System Annual Assessment**

1. The Town pays its annual appropriation to the Worcester Regional Retirement System (the "Retirement System") in two equal semi-annual installments, which is permitted by the Retirement System. The Town has historically utilized this

installment method to manage its cash flows, particularly in the past when its financial condition was not as strong as it is today.

The Retirement System provides a financial incentive of nearly 2% should a municipal member pay their entire annual appropriation on July 1<sup>st</sup> of the fiscal year. This return is significantly greater than most of the money market yields the Town is receiving on its excess cash balances.

As stated above, the Town's decision to use semi-annual installments was born during a time in which the Town's financial position was not as strong as it is today. The Town's improved financial condition coupled with a recent change in the manner in which the Commonwealth of Massachusetts is paying state aid (monthly versus quarterly) suggest that the Town is in a position to benefit from the financial incentive offered by the Retirement System.

We recommend that during the Town's preparation of its fiscal year 2015 budget, the Town evaluate the effect that this advanced payment will have on its financial condition and, if found to be positive, begin advance paying its annual retirement appropriation in fiscal year 2015.

2. Regarding the above, the Town attempted to pay this amount completely on July 1 to save the funds of paying semi-annually; there were many issues that occurred throughout the process of attempting to pay this amount by the Treasurer:
  - The check was sent after the incentive period had expired, thus it was returned by the Regional Retirement System.
  - An 8% penalty was assessed, thus not leaving enough in the Retirement budget.
  - Therefore only half was paid at that time.
  - The second payment became due and a check was sent, but was lost.
  - Requests for payment sent by the Regional Retirement System were ignored.
  - The second payment was made, 13 months after it was due, and it cost the Town 8% in additional interest.

The Town needs to be much more responsive when dealing with the Retirement Assessment, as penalties for delayed payments are quite severe.

#### **F. Single Audit Act**

An additional audit is required for communities who expend more than \$500,000 in Federal Grants annually. The Town has never been subject to such requirements since it has never been active in grant activity. However, we understand that the Town will be disbursing more than \$500,000 in Federal Funds due to its involvement in the Community Development Program during fiscal 2014. Therefore, this is a reminder that the Town will have to undergo a Single Audit for fiscal 2014, thus it will need additional funds to pay for this audit and the audit will have strict deadline requirements attached to it for submission to the Federal Government.

## **G. Tailings**

The Town maintains details of old outstanding checks issued to taxpayers for refunds, employees and vendors. MGL classifies checks outstanding more than one year as abandoned property. The Town has the ability under MGL 200A to turn over these checks over to the State Treasurer or advertise the unclaimed checks. Once the Town has complied with all legal requirements under MGL, any remaining unclaimed monies can be credited to the Town's Treasury and ultimately increase free cash. We recommend that the Town investigate this process and determine the appropriate course of action to take relative to its old outstanding checks.

## **H. Town Clerk Bank Account**

The Town Clerk, along with the Town Collector is the only municipal employee who may have a bank account that is not controlled by the Treasurer. In Phillipston both these officers maintain such accounts. We suggest that periodically, as part of risk assessment that these accounts are independently audited by the Treasurer or Town Accountant since no other oversight exists over these bank accounts.

## **I. Tax Titles**

The Town's tax title issues have been well documented over the years. Presently, the Town maintains over \$100,000 in tax title balances which represents over 3% of the annual tax levy and is approaching an unacceptable level as it increases each year.

One option that an increasing number of municipalities are now pursuing with enormous success is the selling, or assigning, of tax titles under Massachusetts General Law Chapter 60, Sections 2C and 52. Under this MGL, the Town is essentially transferring its interest to a private entity through an auction or bid process, with the amount outstanding as the minimum bid. The law gives the Town the flexibility to assign or keep whichever tax title accounts it chooses and may assign single tax titles or groups of tax titles. Assigning tax title accounts gives the Town the ability to immediately recover the taxes owed, avoid the cost and delay of collections and foreclosure actions; increase its property tax collection rates and return delinquent accounts to the current roles. We recommend the Town evaluate this tool for managing tax title collections and highly encourage Town financial management to contact other Town's that have administered tax titles utilizing this process.

## **PRIOR YEAR COMMENTS NOT RESOLVED**

The following items were discussed in previous letters to Management. The completion of these items along with current comments will be a significant step in improving internal controls and are summarized below:

### **A. Recommendation to Improve General Internal Controls**

Internal controls consist of several interrelated components that, when operating effectively, provide the Town and the tax payers of Phillipston reasonable assurance that the strategic and operational objectives of the Town's finances are met. Policies and procedures should be established that:

1. pertain to the maintenance of accounting and financial records that accurately and fairly reflect the transactions and disposition of the Town's assets;
2. provide reasonable assurance that the Town's financial transactions are recorded as necessary to permit the preparation of periodic financial statements in accordance with accounting principles generally accepted in the United States of America; and
3. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Town funds.

Due to the nature of the Town's operations, we recommend that the Town focus its efforts in developing policies and procedures surrounding:

- cash receipts, department turnovers, cash disbursements and the warrant process;
- reconciliation processes for cash and accounts receivable;
- employee reimbursement for out-of-pocket expenses such as travel;
- investments;
- procurement compliance; and
- a fraud policy

### **B. Withholdings**

In the prior year, we determined that the Health Insurance Withholdings were out of balance by approximately \$6,000 and consequently had an adverse impact on free cash. We suggested that corrections be made to this account and, furthermore, a reconciliation process be implemented to assure that the account remains in balance during the year.

Efforts were made to address this, and, subsequently, the AFLAC withholding variance was reduced to \$50 however a variance still exists in other related withholdings of about \$5,600 at June 30, 2013.

This should be addressed by the Treasurer as a priority item to correct during 2014.

### **C. De minimus Property Tax Assessments**

The Town assessed property taxes for each tax entity for which the Town has reported taxable personal property. A large number of personal property tax accounts have valuations less than

\$2,000. At the current enacted property tax rates, these personal property tax accounts have annual assessments of approximately \$27. In many instances, the cost to assess, collect and follow-up on these deminimus accounts can exceed the actual property tax assessment itself.

We recommend that the Town consider including an article at the next Town Meeting asking voters to exempt property up to \$2,000 from being taxed. There are over 100 communities currently employing this practice, some for personal property as high as \$10,000. It is important to note that the elimination of these assessment would not reduce the amount of personal property tax assessments in any given tax year; the remaining property tax accounts would absorb these deminimus accounts, which will likely amount to an insignificant additional amount to these tax payers.

**D. Title V Receivables**

The Town participates in the Commonwealth's Title V septic program. This benefits its citizens who need to make repairs to their septic systems by providing qualified residences with no interest loans.

The Town is obligated to pay back the Commonwealth for the "seed" money received to begin the program. This is paid back from the loan proceeds received from the borrowers.

It is important that at all times, the amounts in the Title V Fund, when added to the receivable balance equal the total amount the Town owes to the Commonwealth.

Presently, the Assessor's administer balances that total approximately \$54,000. This balance does not agree to the general ledger and varies by about \$4,000. In addition, \$18,641 is not supported by any backup and is listed as unknown. It has been unchanged for several years.

The Town Accountant should adjust the general ledger to the Assessor's balance for the active loans and a determination should be made on the outstanding balance that has no support and no activity. If exhaustive research efforts have been made, the Town could consider writing these off.

**E. Collection Activity to be reviewed by Collector**

We determined that tax collection activity slowed down considerably in 2013 and 2012 when compared to prior years. We also discovered evidence of lower enforcement activity, such as none of the amounts budgeted for tax title costs had been used during the year. While the Town is in good financial condition as indicated above, efficient collection practices are still good habits to participate in, especially in light of the sluggish economy.