

TOWN OF ROYALSTON, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2015

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Additional Offices:

Nashua, NH
Manchester, NH
Andover, MA
Ellsworth, ME

To the Selectboard
Town of Royalston, Massachusetts

In planning and performing our audit of the basic financial statements of the Town of Royalston as of and for the year ended June 30, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, significant deficiencies or material weaknesses may exist that have not been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

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. Material weaknesses are noted in the table of contents and comment headings.

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. Significant deficiencies are noted in the table of contents and comment headings.

During our audit we also became aware of other matters that we believe represent opportunities for strengthening internal controls and operating efficiency. The recommendations that accompany this letter summarize our comments and suggestions concerning those matters.

The Town's written responses to our comments and suggestions have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

The purpose of this communication, which is an integral part of our audit, is to describe for management and those charged with governance, including those overseeing the financial reporting process, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Melanson Heath

January 17, 2017

CURRENT YEAR ISSUES

1. IMPROVE CONTROLS OVER CASH (MATERIAL WEAKNESS)

During our review and testing of the Town's controls over cash, we found several areas where improvement is needed. Specifically:

- Cash balances between the Treasurer and general ledger have not been reconciled in years. Based on our audit testing, we found the Treasurer's balance was lower than the general ledger by approximately \$125,000. As a result, we were unable to opine on the Town's financial statements and our audit report disclaimed an opinion. We recommend the Town implement formal procedures requiring the monthly reconciliation of cash. This overall cash reconciliation should be in written form and signed by both the Treasurer and Town Accountant. Implementing formal procedures will help ensure that cash is properly reconciled on a regular basis and will reduce the likelihood of errors or irregularities occurring without being detected.
- The Treasurer does not file the June 30, 2016 Quarterly Report of Reconciliation of Treasurer's Cash with the Commonwealth of Massachusetts Department of Revenue. We recommend that this report be completed and filed on time.
- The Town maintains certain cash accounts within the general ledger for which the Treasurer also maintains separate bank accounts (e.g., stabilization and trust funds). The existence of trust funds dictates that the Town assumes a fiduciary responsibility over them. In addition, since many trust funds are restrictive in nature, their integrity must be maintained. This is typically accomplished through the physical separation and monitoring of trust fund cash. There are currently no procedures in place to reconcile these separate bank accounts to the general ledger. We recommend the Town establish a procedure whereby trust fund cash is reconciled separately between the general ledger and the Treasurer on a quarterly basis.

Town's Response:

We have hired a new accountant, and she and the Treasurer have reconciled our accounts through June 2016. Once we are totally caught up, they will sign off on a monthly reconciliation, and the Treasurer will resume filing her quarterly reports with the state. Regarding the separate bank accounts, we agree with your recommendation and will implement the changes suggested.

2. IMPROVE CONTROLS OVER RECEIVABLE COLLECTIONS AND BALANCES (MATERIAL WEAKNESSES)

During our review and testing of the Town's controls over receivables, we found several areas where improvement is needed. Specifically:

- In our testing of receipt procedures in the Tax Collector's Office, we noted that receipts in cash (currency) are not coded as such in the tax receipt system nor do the receipt stubs indicate those that were paid in cash. Because of the increased risks related to handling cash, it is very important that a clear audit trail exist from the time cash is accepted to the time it is deposited. We recommend the Tax Collector include a notation on the receipt stub of those payments that were made in cash and that the office make efforts to ensure currency transactions are coded as such when receipts are posted to taxpayer accounts in the receipt system. Also, the amount of currency deposited should be proven to the receipt stubs and daily receipt posting reports.
- The Town has not established and implemented formal reconciliation procedures between the Tax Collector and the Town Accountant for any receivable balances. Further, based on our review of the general ledger detail, the Town Accountant posted one adjustment at year end to make the general ledger balances agree with the Collector balances. We recommend the Accountant post activity based on the various source documents provided by other departments and that the resulting balances be reconciled to the Tax Collector on a monthly basis. All differences should be researched and corrected immediately.
- Community preservation fund receivables are not recorded in the general ledger. We recommend the Town record all activity related to community preservation receivables in the general ledger and reconcile the balances monthly to the Tax Collector.
- The Town maintains receivable balances for personal property dating back several years. If these receivables are not truly collectable, receivables and liabilities reported in the Town's financial statements are overstated. Only amounts that are considered to be collectible should be shown on the Town's financial records. We recommend that these old accounts receivable be reviewed to determine the likelihood of collection. If they are deemed uncollectable, we recommend that they be abated. This will ensure that the Town's receivables are fairly stated.
- The Town does not maintain accurate balances in the general ledger to track betterments and betterments not yet due. This increases the risk that billing and receivable information could be incomplete or inaccurate, which could result in lost revenue to the Town. We recommend the Town

formalize policies and procedures for accounting and reconciling betterment receivables due, as well as future amounts not yet due. This will improve controls and oversight over betterment receivables and revenues.

- Due apparently to transfers of ownership in prior years, several properties are annually billed to owners unknown. Consequently, these bills are never paid and receivables are reported in the general ledger back to 1994. We recommend the Town research and resolve the true ownership of these properties and/or contact the Department of Revenue to request approval to write these balances off.
- The Treasurer's list of tax lien receivable balances due appears incomplete and could not be reconciled to the general ledger balance.
- The Town's tax title balance grew from approximately \$150,000 at June 30, 2014 to approximately \$555,000 at June 30, 2015. In addition, the Town's real estate receivables include over \$100,000 for levy years 2013 and prior, \$57,000 of which is from levy years prior to 2010. We recommend the Town establish a policy to be more aggressive in pursuing delinquent accounts. This could include collection efforts such as pursuing land court / foreclosure procedures, using an outside collection agency and/or executing payment plans in accordance with State laws.
- The Assessors' Office does not maintain a running balance of the overlay (allowance for abatements and exemptions) accounts. As a result, the balance in the general ledger cannot be reconciled. The lack of reconciliation increases the risk that abatements issued by the Assessors' Office are not recorded in the general ledger, thereby misstating the Town's receivable balances. We recommend the Assessors' Office maintain a running balance of all overlay accounts and that balances be reconciled monthly to the general ledger.

Town's Response:

Cash tax payments: Cash receipts are recorded as such in the Collector's system, and have been for years. We have instituted the other recommended changes. *Reconciliation procedures:* As noted above, we are working toward proper, monthly reconciliation. *Community Preservation funds:* We have implemented this recommendation. *Tax and lien receivables:* We have just bought into a Vadar tax title program and should in the near future be able to fully implement the recommendations. *Betterments, unknown owners, and overlay balances:* We agree with your recommendations and will implement the changes suggested.

3. ESTABLISH FORMAL GENERAL LEDGER RECONCILIATION PROCEDURES (MATERIAL WEAKNESS)

As noted in the first two comments, the Town's general ledger was not reconciled during the year for significant accounts such as cash and receivables. In addition, withholding accounts, capital projects, and grants were also not reviewed and reconciled. Monthly reconciliations are necessary to ensure the accuracy of the Town's financial records as well as to provide a means of checks and balances between the financial departments.

We recommend the Town Accountant establish formal procedures to reconcile all critical general ledger balances on a regular monthly basis. This will provide additional assurance that the Town's internal financial reports, including monthly departmental budget reports, the balance sheet used for free cash certification, and the annual Schedule A report are accurate. It will also provide the necessary checks and balances over the Treasurer and Tax Collector Offices to help ensure that errors or irregularities, if any, are identified and corrected in a timely manner.

Town's Response:

We agree with your recommendation and will implement the changes suggested.

4. IMPROVE INTERNAL CONTROLS OVER PAYROLL DISBURSEMENTS (MATERIAL WEAKNESS)

During our testing of internal controls over 25 payroll disbursements, we noted 13 instances where the documentation to support the rate of pay was lacking. While the timesheets themselves included a pay rate, there was no documentation that the pay rates on the timesheets were authorized. This increases the risk of inappropriate salaries and wages being paid.

We recommend that procedures be established to maintain up-to-date documentation of pay rates in all employee files. This could be achieved by annually compiling a list of all employees with their step / grade level as of July 1st to be approved by the Board of Selectmen for the upcoming fiscal year. This will help assure that proper wages are paid for all employees and provide clear authorization for all pay rates.

Town's Response:

We intend to do a thorough salary review for the upcoming fiscal year 2018 budget and will incorporate this recommendation as part of that work.

5. IMPROVE BUDGETING PROCEDURES (SIGNIFICANT DEFICIENCY)

During our review of the Town's procedures related to the annual budget process we noted the following issues:

- At the Town's May 2014 Annual Town Meeting, \$75,000 was appropriated from the stabilization fund and \$35,000 from the storm account to cover a snow and ice deficit. These amounts were not included on the Town's fiscal year 2015 tax recap. Although this meeting had no impact on the Town's tax rate, a good internal control system, as well as State regulations, require all town meeting appropriations to appear on the Town's tax recap. We recommend the Town ensure that all future town meetings involving the appropriation of funds be included on the tax recap.
- During fiscal year 2015, the Town voted to transfer \$3,179 from the sale of highway equipment (a current year revenue line item). Current year revenues are not allowable funding sources once the tax rate is set. We recommend the Town establish a procedure to determine an allowable funding source while the appropriation article is being formed. This will result in compliance with State statutes and minimize the risk of unfunded appropriations.
- Budget amounts for property tax revenue recorded in the general ledger were at variance with the tax recap by approximately \$90,000. We recommend that all revenue budgets be entered into the general ledger and reconciled to the tax recap in order to properly monitor actual results versus budget.
- Budgetary adjustments to general fund appropriations were incorrectly made to actual expenses, resulting in materially misstating individual expense line items by approximately \$170,000. Budgetary adjustments should never be made to actual expenses, only to the amounts appropriated through the software's budget module.
- The intent of one the adjustments noted above (totaling approximately \$80,000) was to move excess budgeted amounts to the stabilization fund; however, this included \$20,000 unspent from the reserve fund. Per Massachusetts General Laws, amounts appropriated for the reserve fund can only be used for extraordinary and unforeseen expenditures, and the excess balance in this account cannot be transferred to the stabilization fund. We recommend any future budgetary transfers comply with State guidelines.

Town's Response:

We agree with your recommendations and will implement the changes suggested.

6. SUBMIT TIMELY REQUESTS FOR STATE CHAPTER 90 REIMBURSEMENT

In fiscal year 2015, the Town incurred approximately \$370,000 in highway improvement costs which were reimbursable under the State Chapter 90 program. While some requests for reimbursement were done during fiscal year 2015, the Town did not submit a request for reimbursement for approximately \$43,000 of the costs until May 2016. In addition, it appears that additional requests for reimbursement may still need to be submitted, given that the Town's Chapter 90 fund was still in deficit by approximately (\$66,000).

Timely reimbursement of expenditures is essential to ensure an adequate cash flow. Late requests for reimbursement place a burden on the financial resources of the Town and increase its potential need to incur short-term borrowing costs. In addition, the Commonwealth reimburses on a first come/first served basis, which could result in significant delays in receiving reimbursements.

We recommend requests for Chapter 90 reimbursement be submitted in a timely manner to ensure prompt payment by the Commonwealth, improve the Town's cash flow, and reduce its potential short-term borrowing costs.

Town's Response:

We were aware of this problem at the time, but certain personnel issues made resolution difficult. In fiscal year 2017 we hired a part-time clerk for the DPW, and our Chapter 90 documentation is already proceeding more smoothly.

7. OTHER ISSUES

The following section of the management letter identifies several other recommendations for improvements. We report these issues here in a summarized manner and are available to discuss their status with the Town in more detail if desired.

- Bank statements for the Deputy Tax Collector account are mailed to the Deputy Collector instead of to the Town Collector's office. Since these funds belong to the Town, the Town Collector should be the primary / direct recipient of these statements.
- Fees earned by the Deputy Tax Collector are paid directly from the Deputy Tax Collector's checking account and therefore bypass the normal warrant approval process. While this is allowable under Massachusetts General Laws, controls would be strengthened if the fee were processed through a Town warrant.

- All of the Town's general ledger withholding accounts are in deficit at year end. We recommend the Town review the accounts and determine accurate withholding balances and adjust the general ledger accordingly. After an adjustment is made, these accounts should be reconciled monthly.
- The Town has numerous special revenue funds that have been inactive for at least the past few years. We recommend the Town investigate these funds and take the appropriate action to resolve and/or close these funds.
- The Town's individual bond coverage amounts for the Treasurer and Collector do not appear adequate. The coverage for the Treasurer is only \$44,000 and the Collector's coverage is \$41,000. We recommend the Town re-evaluate the individual bonds for the Treasurer and Collector and correlate them to the level of funds each office is responsible for. This will provide the Town with additional safeguards in case irregularities occur.
- The amount reported on payroll warrants and approved by the Select Board is the net payroll amount. We recommend gross payroll be reported and approved on payroll warrants, as that is the amount that is actually expended by the Town.
- During our evaluation of the Town's internal controls over information technology, we found that the Town should make improvements over offsite server backups, implementing procedures for server recovery and managing access to the system by terminated employees.
- Expenditure line items are not set up for projects voted from community preservation funds and as a result, the voted budget and expenditures that occur for a project cannot be monitored.
- The Post Office revolving fund has a voted spending limit of \$12,500. In fiscal year 2015, the Town Accountant moved approximately \$6,100 of expenditures out of this fund in order to stay under the \$12,500 limit. The Town should review the actual expenditures paid from this fund over the past fiscal year and consider raising the annual approved spending limit.

Town's Response:

Deputy tax collector, withholding accounts, special revenue funds, bond coverage, and post office: We agree with your recommendations and will implement the changes suggested. *Net vs. gross payroll, Community Preservation and IT:* These recommendations have already been implemented.

8. IMPROVE DEPARTMENTAL RECEIPT PROCEDURES

The Town currently does not have formal written policies and procedures for departments to follow for collecting and remitting departmental receipts. The

lack of formal policies and procedures increases the risk that errors or omissions could occur and go undetected.

In addition, the Accounting office usually receives one copy of the departmental turnover form from the remitting department, and a separate notification from the Treasurer's office, after the receipt has been processed. By comparing the two, the Accounting office can ensure that all departmental receipts have been processed intact by the Treasurer's office. Our review of procedures found that the Accountant is not comparing the delineation of cash versus check to the bank deposit slip prepared by the Treasurer's office. We recommend the Accounting office require departments to submit a copy of the turnover form for review and periodically compare the cash/check breakdown per the turnover forms to the respective bank deposit slip prepared by the Treasurer's office.

The Town should also consider establishing an internal audit function to properly monitor operations and assess the risk of misstatement caused by errors, irregularities or omissions. In addition, departments should be supplied with a report of their revenues on a monthly basis so they can verify that their receipts were recorded accurately in the general ledger.

Implementation of these recommendations will result in improved oversight and could reduce the risk of errors or irregularities from occurring and going undetected.

Town's Response:

We agree with your recommendations and will implement the changes suggested.

9. DEVELOP A MORE FORMAL RISK ASSESSMENT PROCESS

The Town informally performs its own risk assessment for possible fraud or material misstatement through various policies and procedures and regular reviews of trends in the financial statements. Risk assessment is a management function designed to identify where an organization may be vulnerable to errors and/or irregularities. A complete risk assessment process involves a written description of risk areas identified by those charged with governance (management and elected officials) and a description of how the organization intends on responding to the risks.

We recommend that the Town implement a more formal risk assessment process that includes internal audits and written identification of areas where potential fraud or material misstatements to the basic financial statements may occur. Regular department head meetings could be used as a starting point for documenting risk assessment discussions and assessments.

In evaluating risk areas, particular consideration should be given to situations where a single employee is responsible for performing most or all accounting responsibilities, since this could create opportunities for fraud to occur and go undetected. The Town should evaluate major transactional cycles in all applicable departments to ensure an adequate segregation of duties exists. If staffing levels do not permit an adequate segregation of duties, the Town should provide additional oversight, which should include review and documented sign-off of the key accounting records.

We also recommend the Town establish a formal employee fraud policy or consider establishing a fraud hotline to provide staff with guidance in the event they observe or suspect fraud in the work place.

Town's Response:

We would ask Melanson Heath to provide guidance on how we would do this, given the very part-time schedules of our town officials.