

TOWN OF OXFORD, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2017

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Board of Selectmen
Town of Oxford
Oxford, Massachusetts

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Town of Oxford, Massachusetts (the "Town") as of and for the year ended June 30, 2017, 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 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. 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.

This communication is intended solely for the information and use of management, the Board of Selectmen, and others within the Town, 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
February 2, 2018

OVERVIEW

Throughout fiscal year 2017, the local, statewide and national economies continued to strengthen. The Town has been slowly seeing signs of this recovery. The Town's total property valuations increased approximately \$20 million to just over \$1.3 billion in the 2018 tax rate recapitulation from the 2014 tax rate recapitulation, or only 1.6% over this 5-year period.

In its governmental funds financial statements, which most closely resembles the Town's statutory accounting records, the Town's unassigned fund balance in its general fund approached \$2.4 million at June 30, 2017 and its total fund balance was nearly \$4.6. Overall, the total fund balance in the general fund increased approximately \$457,000 in fiscal year 2017, which is mostly indicative of strong cost controls. Included in the unassigned fund balance at June 30, 2017 was approximately \$297,000 in stabilization funds.

Liquidity in the general fund is often measured by comparing both the unassigned fund balance and the assigned fund balance to the current year's total fund expenditures. Credit rating bureaus often refer to this as a "reserve ratio." At June 30, 2017, the reserve ratio was approximately 8.2%. Furthermore, the total fund balance in the general fund approximated 11.1% of that same amount.

The Town has a relatively low debt burden in its general governmental services relative to its normal revenues and expenditures, which affords it flexibility should its needs require.

The Town has undergone a number of cost savings initiatives and continues to seek additional revenue sources to assist it in planning for its future. The Town past funding of its OPEB trust fund puts its OPEB trust fund in a relatively strong position versus other Massachusetts municipalities. The Town intends to dedicate excess resources to its general stabilization fund in greater proportion than its OPEB trust fund for the foreseeable future to build up this reserve balance, which has less than \$300,000 in assets at June 30, 2017.

The remainder of the report reflects informational items and findings and recommendations. This discussion is intended to provide the Town and its management with recommendations for improvement in accounting and financial operations. The Town should review these recommendations and, if determined to be cost-effective, implement these improvements.

INFORMATIONAL ITEMS

New Financial Statement Disclosures – OPEB Part 1

The Town adopted Governmental Accounting Standards Board, or GASB, issued Statement No. 74, *Financial reporting for Postemployment Benefit Plans Other Than Pensions*, in fiscal year 2017.

Other postemployment benefits are commonly referred to as “OPEB” and includes health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits. The Town’s current policy is to contribute one-half of monthly health, dental and life insurance premiums for retirees.

The adoption of this accounting standard resulted in additional disclosures within the Town’s financial statements and the inclusion of the effects of retiree benefits paid and received (both from the Town and its retirees) in the Town’s fiduciary funds financial statements.

FY 2018 New Accounting Principle – OPEB Part 2

The Town will be required to report the full amount of its net OPEB *liability* in its government-wide and proprietary funds financial statements in fiscal year 2018. The Town currently reports a net OPEB *obligation* in its government-wide financial statements calculated under GASB 45.

The Town’s net OPEB *liability* is significantly greater than its net OPEB *obligation*. The Town’s independent actuary determined that the Town’s net OPEB *liability* at June 30, 2017 was approximately \$46.2 million versus a net OPEB *obligation* of approximately \$19.1 million.

The Town’s independent actuary will remeasure the Town’s net OPEB liability at June 30, 2018. The Town will present this figure in its fiscal year 2018 affected financial statements. This will result in a further deterioration in the Town’s unrestricted net position.

The Town established an OPEB trust fund several years ago and made sizable initial contributions to this trust fund. The OPEB trust fund had a balance of approximately \$3.7 million at June 30, 2017, which the Town’s independent actuary estimated to be approximately 7.4% funded at that time.

The Town has not committed to funding its OPEB trust in the future, which adversely affects actuarial calculations of the net OPEB liability. Provided the Town’s financial projections improve, the Town should strongly consider establishing a minimum annual OPEB funding policy to assist it in meeting its future obligations.

Fraud Prevention Measures

There has been an alarming increase in municipal fraud throughout the United States. Many Massachusetts municipalities have been victims of fraud. Although “red flags” of fraud are not clearly visible within the Town, the Town should have a heightened awareness of fraud risks. The three most common ways to commit fraud in municipalities are as follows:

- 1. *Unauthorized Issuance of Vendor Checks*** – According to the Association of Certified Fraud Examiners, this type of fraud presents the greatest risk of theft of **material** amounts of municipal funds. Payments are made from municipal bank accounts to either fictitious vendors or to valid vendors for unauthorized or phantom goods or services. This type of fraud is generally perpetuated at higher levels within a municipality (i.e., department heads with purchasing capabilities, Accounting or Treasury personnel).

There are a number of prevention methods that can be used to prevent or timely detect this type of fraud including:

- a. Timely review of budget to actual results by department heads, the Town Accountant and the Town Manager;
- b. Regular periodic review of vendor master files within the Town’s accounting system and the deactivation of vendors who haven’t served the Town for several years; and
- c. Timely reconciliation of bank accounts.

We are pleased to report that budget to actual reviews are available for review by all department heads on a timely manner. In addition, the Town Treasurer ensures that all bank accounts are reconciled with the underlying accounting records each month.

The Town does not have a formal schedule to periodically review (i.e., quarterly or semiannually) its vendor master files within GEMS, its accounting system. We recommend that the Town Accountant or their designee review these vendor files for relevancy and validity and, if necessary, deactivate inactive vendors as needed.

- 2. *Theft of Cash Receipts*** – According to the Association of Certified Fraud Examiners, this type of fraud is the **most frequent** type of fraud municipalities become victim to. Fraudulent schemes to steal municipal receipts prior to their recording in the accounting records represents the largest risk to a municipality and is the most common form of cash receipts fraud committed. For example, cash received at a departmental level are simply not turned over to the Town Treasurer. Generally, this type of fraud starts small and grows over time.

There are a number of prevention methods that can be used to prevent or timely detect this type of fraud including:

- a. Trend analysis of departmental revenues for multiple accounting periods by the Town Accountant and Town Manager; and
- b. Performing periodic “audits” or business reviews of departmental turnover procedures.

The Town does not perform either of these activities. Trend analysis of departmental revenues tracks monthly recorded revenues by department by revenue type (i.e., permits, user fees, fines, licenses) over several years. In doing so, patterns can generally be observed and deviations from these patterns may identify abnormalities, including the possibility of fraud. We recommend that the Town develop these reports and implement them beginning in fiscal year 2019.

Periodic “audits” or business reviews at departments by the Town Accountant can provide insights into a department’s operations that cannot be obtained by simply reviewing its periodic cash receipt turnovers to the Town Treasurer. We recommend that the Town Accountant adopt a schedule for these business reviews and perform these reviews on two to three departments each year.

3. **Payroll Frauds** – According to the Association of Certified Fraud Examiners, this type of fraud was present in a similar frequency as cash receipts fraud and its average loss was also comparable to cash receipts fraud. The most common types of payroll fraud applicable to municipalities pertains to (i) expense reimbursement and (ii) payments to “ghost” employees.

Due to the nature of the Town’s operations, expense reimbursements are infrequent and generally carry a high degree of scrutiny. The Town’s timely review of budget to actual performance serves as a key detective control with respect to this fraud risk area. Furthermore, there are multiple levels of review of payroll submissions to further prevent this type of fraud.

We recommend that the Town perform regular periodic reviews of the payroll database and deactivate terminated/retired employees from the active payroll master database.

Changes to Single Audit Requirements – Need for Internal Control Framework

A number of significant changes were made in the audit requirements for federal grant awards in the past several years. One of the requirements under the new Uniform Guidance (the successor to the OMB A-133 compliance supplement) is that all federal award recipients are required to establish an internal control system based on a recognized internal control framework such as the Green Book.

We are pleased to report that the Town is among a relative few that has taken this requirement seriously. The Town’s school district implemented a formal, documented internal control system in accordance with the Green Book in January 2018.

Student Activities in the News

On November 27, 2017, the *Boston Globe* reported on the Boston Public Schools’ use of student activity accounts to pay employees “under the table” and for purposes unrelated to student activities. These violations of federal and state tax law and Massachusetts General Laws were uncovered by an IRS audit. The *Boston Globe* article spotlights the need for continued oversight of the operation of a school district’s use of student activity accounts as well as the risks associated with their misuse. Furthermore, as these matters were made public in the State’s most widely circulated daily newspaper, this may lead to additional rules and regulations being issued by the Commonwealth related to student activity accounts.

We are pleased to report that the Town's schools undergo independent reviews of their student activity accounts in accordance with recommendations set forth by the Massachusetts Department of Elementary and Secondary Education ("DESE") and the Massachusetts Association of School Business Officials. The School district last performed an independent audit of its student activity funds in fiscal year 2015 and intends to undergo the required triennial independent audit in fiscal year 2018. Additionally, the School district recently received feedback from DESE regarding its student activity funds.

We recommend that the School district revisit these reports and review the DESE's most recent audit guidelines for student activities. Furthermore, we recommend that the Town provide a copy of this article to all school principals as a training tool and to continue its diligence in managing this fiduciary activity.

Inactive Special Revenue Accounts

The Town maintains approximately 160 special revenue accounts in its accounting records, many of which likely have had no activity in several years. In our initial audit, we determined that there were fifty-three special revenue accounts with fund balances totaling \$194,879 that had no activity in fiscal year 2017. Additionally, based on the description of these special revenue accounts, there are a number of state/federal award funds that are quite old that have residual balances. For example, there are four FEMA grants for storm assistance dating as far back as 2009 with an aggregate fund balance of \$51,936.

As there has been turnover in the accounting function, the genesis and intent of many of these funds will need to be investigated. We recommend that the newly hired Town Accountant evaluate all special revenue/revolving funds, particularly those without activity in the past two fiscal years, for relevancy. Inactive funds should be transferred to an appropriate active fund or the general fund based on the nature of the inactive funds.

Trust Fund Review

The Town has a significant number and dollar value of trust funds whose principal is restricted (in many cases permanently) for various purposes. We recommend that the Town investigate all its trust funds and determine the specified use of the funds and the restricted amounts of each fund.

Capital Asset Management

The Town historically maintained an Excel-based capital asset register to account for its investments in capital assets. This register was overly complicated and required significant resources to manage it. Its complexity prevented an accurate and thorough review of its components due to its voluminous nature. For example, construction in-process was being maintained for capital projects completed several fiscal years ago. Additionally, there were dozens of vehicles aged over twenty years and no longer in service that were still being maintained in the register. Corrections were made to the register and the current year's audited financial statements to reflect these capital asset movements.

In connection with our audit, a more simplified capital asset register was adopted by the Town and we hope that it will be much more efficient and save valuable accounting resources. This new capital asset register should be reviewed annually, at a minimum, to evaluate relevancy particularly with older assets that are most susceptible to disposal or impairment.

Volume of Bank and Investments Accounts

The Town Treasurer maintains forty-five individual bank and investment accounts with fifteen separate financial institutions. Diversifying the custody of the Town's cash and investments is a prudent investment principle. However, for the types of accounts and dollar amounts maintained by the Town, the maintenance of this many accounts and financial institutions can become burdensome and slow down the periodic closing process.

Many local financial institutions have strong financial positions and provide depositors with additional depository insurance to fully cover a depositor in the event of a bank failure. Consolidation of some accounts, particularly with banks in which the Town maintains a single money market or savings account may provide efficiencies within the Town's treasury function without greatly increasing custodial credit risk.

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Absence of Accounting and Financial Operations Policies and Procedures Manual

The Town has a draft accounting and financial operations policies and procedures manual, which encompasses Town and School financial and accounting matters. This manual requires a number of enhancements and modifications, particularly as the School district adopted a policies and procedures manual in January 2018 which may have conflicting processes to the existing draft Town manual. Additionally, disaster recovery and other technology processes are not included in the draft manual and should be included in any comprehensive accounting and financial operations manual.

Formal policies and procedures play a critical role in any internal control system. Furthermore, in periods of personnel transition such policies and procedures can prove invaluable and assist in these often-difficult transitions.

We noted that the Town has very good financial and technology processes. We recommend that the Town's newly hired finance director endeavor to complete this draft manual and tailor it to meet the Town's current needs.

Accounting for Health Insurance Withholdings

Like many Massachusetts municipalities, the Town records employee health insurance deductions and retiree contributions towards health insurance in an agency fund. Employee and retiree withholdings in one month are applied against the following month's premiums as the Town collects these withholdings in advance (i.e., January's withholdings apply to February's health insurance). As premium invoices from insurers are presented for payment, the Town applies these deductions against these premium invoices. Accordingly, the amount of employee and retiree withholdings maintained in their respective agency funds should approximate one-month's health insurance premiums (adjusted for seasonal and one-time items).

In connection with our audit procedures, we determined that the recorded June 30, 2017 employee and retiree health insurance withholding figures included in the Town's agency funds were incorrect. We reviewed prior year accounting records for these two withholding accounts noting the following:

- In January 2013 (fiscal year 2013), an erroneous credit was applied against the employee withholding account of approximately \$183,000.
- In September 2013 (fiscal year 2014), the Town did not apply approximately \$120,000 in insurance premium invoices from Tufts against the employee withholding account.
- In fiscal year 2017, there were a number of mispostings to retiree health insurance contributions, which resulted in a net receivable in the amount of approximately \$13,000. The Town Treasurer maintains collection reports for retiree health insurance contributions separate from the accounting system which indicates that the Town collected approximately \$60,000 in June 2017, which relate to July 2017 health insurance premiums. Accordingly, this account is approximately \$73,000 understated.

In total, these errors result in an overstatement of approximately \$230,000 in employee and retiree health insurance withholdings. Fortunately for the Town, the correction of these erroneous balances results in a positive inflow of resources available to the Town. However, these variances are indicative of a lack of periodic reconciliation and review of these withholding accounts. The audited financial statements reflect an adjustment to these accounts.

We recommend that the Town perform semi-annual reviews and reconciliations of these withholding accounts (September 30th and March 31st of each year are best as these months generally exclude seasonal and one-off transactions).

Old Encumbrance Carryforwards

The Town's general fund reported encumbrances of \$520,389 at June 30, 2017. Of this total, \$180,326 was carried forward from June 30, 2016 encumbrances. Furthermore, portions of the carried forward encumbrance amounts date as far back as 2011.

Encumbrances are, for the most part, used for normal goods and services consumed by a government in its day-to-day activities. In contrast, articles may have extended life cycles based on their very nature. The maintenance of encumbrances in excess of one year essentially creates a cookie jar reserve for departments and it not only unnecessary but increases the risk of budgetary abuse.

We recommend that the Town evaluate all encumbrance carryforwards and close out unnecessary balances to unrestricted fund balances as part of its next year-end close.

Community Center as an Enterprise Fund

The Town's Community Center operates as an enterprise fund. At June 30, 2017, the Community Center maintained a statutory retained earnings deficit of \$6,539. Massachusetts General Laws require that the Town raise from its tax levy as a general fund subsidy this retained earnings deficit.

Enterprise funds, for the most part, operate as self-sustaining business within a community. Revenues should equal or exceed expenditures. In the event revenues cannot meet expenditures, retained earnings may be used or a general fund subsidy may be provided.

We reviewed the audited financial reports of the Community Center for the past five fiscal years noting that the revenues are not keeping up with expenses on a full accrual basis. On a statutory basis, fiscal year 2017 revenues were approximately \$234,000 while expenditures exceeded \$287,000. Additionally, the Town's general fund paid over \$60,000 in debt service on behalf of the Community Center, which is not included in the \$287,000 figure above.

We recommend that the Town perform a business review of the Community Center's current operations and forecast its financial condition and results of operations for the next five years. Should the results of these analysis indicate that the Community Center remains indebted to the general fund, the Town should consider terminating its enterprise fund status and begin accounting and budgeted for the Community Center within the Town's general and revolving funds.

Accounting for Water Betterments

There are three commercial/industrial water users who are paying water betterments over twenty years. The Town has historically recorded the activity in its betterments in a special revenue fund outside the water enterprise fund. The Town would annually transfer monies from the special revenue fund to the water enterprise fund. However, these transfers did not take place in fiscal years 2017 or 2016.

The fiscal year 2017 audited financial statements reflect the activity in this special revenue fund within the water enterprise. We recommend that the Town begin accounting for water betterments in the water enterprise fund.

Nonroutine Receivables

The Town records certain nonroutine receivables that are typically unrecorded in most Massachusetts municipalities' underlying accounting records. Such receivables include over \$2 million for future payments receivable from the MSBA for school building construction and approximately \$120,000 in the water enterprise for future payments receivable for the water tower lease.

In the case of the MSBA receivable, the recorded amount represents 100% of the future collections due the Town from the MSBA. As this receivable was initiated many years ago and was receivable in equal annual installments, the correct accounting for this would be to have recorded the net present value of the future expected payments under this arrangement at the onset. Accordingly, the recorded balance is overstated. A prior period restatement adjustment was recorded in connection with the 2017 financial statement audit relative to this matter.

With respect to the water tower lease receivable, both the accounting for this as a receivable and the value of the receivable are incorrect. Revenue should be recorded as earned for both GAAP and UMAS purposes.

We recommend that the Town eliminate both of these receivables and their corresponding deferred revenue amounts in its underlying accounting records.

Uncovered Deficit in Middle School Renovations Capital Project Fund

There is a \$359,730 deficit in a middle school renovation capital project initiated in a prior period that was not covered by short-term borrowings. This resulted in a decrease to free cash that could have been avoided with short-term borrowing. We recommend that the Town take the appropriate steps to fund this deficit with short-term and/or permanent borrowings.

Impermissible Investments

In October 2014, the Massachusetts legislature and the governor of the Commonwealth of Massachusetts amended municipal finance laws regarding the investment of municipal trust funds and the safe deposit of municipal funds with chapter 343 of the Acts of 2014. Among other things, this law limits the investments a municipality may make. The Town's investments must comply with a List of Legal Investments (the "List") published annually by the Office of the Commissioner of Banks of the Commonwealth.

While this legislation has been out for over three years, it is only now beginning to gain traction as many Towns were invested in securities that were previously allowed under the old legislation but are no longer permissible and are needing time to wind out of positions.

Many of the investments maintained by the Town are not contained in the List. We recommend that the Town review its investment portfolio with its investment advisors and identify all now-impermissible investments. In addition, the Town and its investment advisor should develop a liquidation strategy for these investments that can be executed in a reasonable timeframe.

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