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Bill Fraher, CPA

TOWN OF MERRIMAC, MASSACHUSETTS

Management Letter

June 30, 2009



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Board of Selectmen
Town of Merrimac
Merrimac, Massachusetts

Dear Board Members:

In planning and performing my audit of the general purpose financial statements of the Town of Merrimac for the year ended June 30, 2009, I considered its internal control structure in order to determine my auditing procedures for the purpose of expressing an opinion on the general purpose financial statements and not to provide assurance on the internal control structure. However, during my audit, I noted certain matters involving the internal control structure and other operational matters that I am presenting for your consideration.

My consideration of the internal control structure was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that would be considered reportable conditions under standards established by the American Institute of Certified Public Accountants. In addition, because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected by such control structure.

The matters involving the internal control structure and other operational matters are presented in the attached report. These matters were considered in determining the nature, timing and extent of the audit tests applied in my audit of the general purpose financial statements, and this report does not affect my report on those general purpose financial statements dated March 1, 2010. I have not considered the internal control structure since the date of my report.

This report is intended solely for the use of the Board of Selectmen and Town management.

Overview

[Please note that the discussion of the Town's financial results is based on amounts in the Town's fund financial statements, presented in accordance with Generally Accepted Accounting Principles (GAAP).]

At June 30, 2009, the Town's general fund undesignated fund balance in its financial statements was \$186,542, down significantly from \$294,457 at June 30, 2008. Although the Town utilized all prior year free cash during fiscal year 2009 (eliminating the free cash that was certified at June 30, 2008), the Town generated some new free cash from the net 2009 budgetary results. This was the result of unexpended appropriations in excess of the revenue deficit (which resulted primarily from state aid cuts). Since the Town did not use any free cash for the 2010 budget before June 30, 2009, the Town was left with some undesignated fund balance at June 30, 2009.

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Overview (continued)

[Since the GAAP based undesignated fund balance includes a sixty day accrual of approximately \$96,000, certified free cash will be significantly less than undesignated fund balance at June 30, 2009.] The Town also ended the year with \$633,413 in its stabilization fund, up from the prior year amount of \$542,387.

When combined, the Town's undesignated fund balance and stabilization fund make up approximately 7% of the Town's annual budget, about the same as last year. The Town should attempt to build up its free cash and stabilization funds as budgetary circumstances allow. While there are no definitive guidelines as to how much the Town should have in these reserves, a general rule is from 5% to 20% of the annual operating budget. As shown, the Town is on the lower end of this range.

The Town worked hard to maintain a positive financial position during the recent economic slow down and state budget reductions of the past few years. If the economy continues to struggle and local aid continues to be cut, it will be difficult to balance the annual budget and maintain current levels of free cash and stabilization fund balances. The Town should monitor the trend of tax revenues, local aid and other receipts and ensure that annual operating budgets are kept within available revenue and other funding sources. The Town should also attempt to maintain a healthy level of operating reserves to guard against unforeseen budget issues.

Specific management letter comments are presented below.

Control Deficiencies and Other Matters for Management Consideration

Under auditing standards, there are three categories of internal control deficiencies and other matters that can be identified during an audit. These three categories are material weaknesses, significant deficiencies and control deficiencies. Any items that are identified as material weaknesses or significant deficiencies require that the auditor's report on internal control and compliance (which is presented in the report on the financial statements) be modified. None of the issues identified in this letter represent material weaknesses or significant deficiencies and are therefore considered control deficiencies (the least serious category). These comments do not require any modification to the auditor's report.

1. GASB 34

In 2003, the Town implemented GASB Statement Number 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Town worked diligently to perform the required major steps to implement GASB 34 and other new accounting

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1. GASB 34 (continued)

requirements for the 2003 financial statements. Going forward, a few refinements to the Town's systems are necessary to ensure that all required information is properly captured in future years.

These refinements include:

- Tracking items such as accrued interest on debt, compensated absences and bond premiums.
- Recording employee benefits by expense function.
- Tracking revenues on both a fund and entity wide basis.

2. Personnel Records

The Town continued to make improvements in obtaining documentation to establish centralized personnel files. Still, further work needs to be performed in this area.

All personnel should have an active file which documents current pay rates, tax withholdings and authorizations for deductions. The Board should ensure that all Town Departments cooperate with this effort and provide the required information to the Treasurer. The Town should also ensure that all employees submit signed time sheets so that hours worked as well as sick and vacation time can be documented and verified by department managers.

3. Cash Receipts Documentation

The Town's cash receipts system for miscellaneous departmental cash receipts (i.e. building permits, fire alarm fees, etc.) does not provide for optimum control. Many receipts involve high annual dollar levels and a large volume of transactions, which increases the chance for misappropriation of funds. In addition, there is a wide range of supporting information provided by various Town departments when cash is turned over to the Treasurer.

There is a trade off between the time, money and effort that would be required to enhance controls in this area vs. the added security of a tighter system. The Town should monitor this area for any possibility of increased controls. One possible alternative would be to have the Town Accountant perform an internal audit of selected receipts each year, matching amounts reported to the Treasurer to the underlying documentation at the department level. In addition, Town departments should provide adequate supporting detail to the Treasurer with their cash turnovers. This information should list (at a minimum) the type of receipt and source of funds.

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4. Ambulance Billing and Receivable Processes

During the audit, we reviewed the processes related to the billing, collection and tracking of ambulance accounts. A number of issues were noted:

- Many ambulance accounts receivable are over a year old. Of the \$281,000 in outstanding ambulance accounts receivable at June 30, 2009, approximately half relate to services rendered in fiscal years 2007 and 2008. Most of this balance is likely uncollectible. The Town should revise its method of monitoring ambulance accounts receivable. The Town should ensure that these accounts are collected within a timely basis and, for those not collectable, reasons should be documented and the accounts should be abated.
- The person responsible for performing ambulance billing is already a Town employee (for other purposes) and does not perform this billing service for any other entity. Based on IRS regulations, it appears that this individual should be paid as an employee and not a contractor.
- Payments received by the Fire Department are currently forwarded to the billing person who enters the payments into the billing system and turns the funds over to the Treasurer once a month. Payments should be forwarded to the Treasurer by the Fire Department on a more regular basis, with copies given to the billing person for entry into the billing system.
- Abatements/write offs of uncollectible should be approved by Town management on a periodic basis.
- Most billing is done manually. Typically, billing for these services is done electronically to minimize billing errors and maximize collections.
- The Town should review the ambulance billing processes to ensure that the Town is collecting the maximum amount possible for ambulance services. Amounts written off for contractual allowance purposes should be evaluated separate from amounts deemed uncollectible.

5. Tracking of Miscellaneous Accounts

The Town should improve its tracking of certain accounts. During the audit, we noted that the Town does not have a detailed listing of tax possessions. The Town also does not have a summarized list of third party invoices for police details.

The Town finance offices should work with the applicable Town departments to improve tracking of these accounts by implementing more formal documentation on these items. For police details, the Town Accountant should receive third party police detail invoices so that better tracking and reconciling can be performed.

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6. GASB 40

In 2003, GASB issued Statement Number 40, *Deposit and Investment Risk Disclosures*, which was effective for the 2009 financial statements. In addition to changing the required financial statement disclosures for the Town's cash and investments, this statement outlines the risks the Town undertakes when making investment allocation decisions and when placing funds into the hands of various third parties (such as banks and investment brokers). The Statement recommends that the identified risks be included in the Town's investment policy.

The Town should familiarize itself with the requirements of GASB 40 and ensure that the outlined risks (which include interest rate risk, custodial credit risk and concentration of credit risk) are addressed in its investment policy. The Town should also ensure that the required financial statement disclosures are available for the annual audit.

7. GASB 45

For the 2009 financial statements, the Town implemented GASB Statement Number 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The implementation of this statement resulted in the recording (on the entity wide statements) of a long-term liability of \$283,051. This includes the current year's estimated cost (not currently funded) plus the first year of a thirty year amortization of the unfunded actuarial accrued liability of \$3,596,597.

The Town has fulfilled its obligation under GASB 45 for its 2009 financial statements. In future years, as this liability grows with the amortization of the unfunded actuarial accrued liability, the Town should consider addressing a possible long-term funding strategy. The size of the unfunded liability and the existence of a funding plan could have an impact on future bond ratings. The Town needs to update the OPEB calculation every three years and should plan for this in future Town budgets.

8. Statements of Auditing Standards on Fraud & Risk Assessment

The Auditing Standards Board has issued numerous Statements on Auditing Standards (SAS) related to fraud and risk assessment.

One such statement, SAS 99 - *Consideration of Fraud in a Financial Statement Audit*, outlines an auditor's responsibility as it relates to the possibility of fraud. One area where most communities are exposed to fraud risk is in the area of miscellaneous cash receipts. Due to the

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8. Statements of Auditing Standards on Fraud & Risk Assessment (continued)

nature of Town operations, it is necessary that certain miscellaneous cash receipts be decentralized at various Town departments. Although the dollars involved are often not material to the financial statements, this situation creates an internal control concern.

The Town should monitor this area for possible internal control improvements. One possible internal control enhancement is to have periodic internal audits of selected departmental cash receipts, where departmental turnovers are matched to underlying documentation. While other steps could be implemented, the cost of a more tightly controlled system for miscellaneous departmental receipts must be weighed against the related internal control benefits.

The Auditing Standards Board also recently issued several new SAS that are collectively called the "Risk Assessment Standards". These standards change and expand an auditor's responsibility in reviewing, identifying and assessing risks faced during a financial statement audit. These standards also affect management's responsibilities in this area.

One of the elements of an organization's internal control is risk assessment. Therefore, it is important that the Town periodically perform a risk assessment process to analyze, identify and evaluate areas where the Town may be exposed to various financial risks. As part of this process, the Town should review its systems, procedures and internal controls in all material financial and operational areas to determine if any modifications are required to minimize such risk. The Town should also ensure that it has an ongoing monitoring program in place to periodically test the effectiveness of any related policies and procedures that are in place.

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I hope that the Town has found these comments constructive and that these areas can be addressed in the coming year. Finally, I would like to thank Town personnel for their assistance and courtesy during the course of the audit.



Bill Fraher, CPA
March 1, 2010