

TOWN OF SOUTHAMPTON, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2014

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTORY LETTER	1
CURRENT YEAR ISSUES	
1. Improve Internal Controls Over Payroll Disbursements (Material Weakness)	3
2. Ensure Compliance with Massachusetts Procurement Laws (Compliance Finding)	3
3. Monitor Transfer Station Fund Budget	4
4. Report All Bank Accounts in the Treasurer and General Ledger Records	5
5. Improve Internal Controls Over Budget Process	6
6. Other Issues	7
PRIOR YEAR ISSUES	
7. Improve Internal Controls and Reconciliation of Water Receivables (Significant Deficiency)	8
8. Improve Procedures Over Ambulance Receivables (Significant Deficiency)	9
9. Improve Departmental Receipt Procedures	10
10. Develop a More Formal Risk Assessment Process	10

Additional Offices:

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

To the Board of Selectmen
Town of Southamptton, Massachusetts

In planning and performing our audit of the basic financial statements of the Town of Southamptton as of and for the year ended June 30, 2014, 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.

This communication is intended solely for the information and use of management, the Board of Selectmen, others within the Town, and is not intended to be, and should not be, used by anyone other than these specified parties.

Melanson Heath

May 12, 2015

CURRENT YEAR ISSUES:

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

As noted in prior years during our testing of internal controls over 25 payroll disbursements, we noted the following exceptions:

- For a majority of the non-school employees tested, documentation to support the rate of pay was lacking. While the timesheets themselves included a pay rate and several of the employees tested were covered by a union contract, there was no documentation that the pay rates on the timesheet were authorized or that the union scale paid accurately reflected the employee's authorized step and grade. This increases the risk of inappropriate salaries and wages being paid.
- In addition, we found one instance where a timesheet contained no documented approval.

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.

We also recommend that employee timesheets be signed before processing.

Town's Response:

For fiscal year 2016 the Town plans on compiling a list of all town employees, their pay rates, and step/grade level to be approved by the Board of Selectmen. The Town is also working on procedures (as part of our financial management procedure and policy manual) to establish and maintain an up-to-date documentation of pay rates going forward.

2. ENSURE COMPLIANCE WITH MASSACHUSETTS PROCUREMENT LAWS (COMPLIANCE FINDING)

In our review and testing of the internal controls over compliance with Massachusetts procurement laws (Massachusetts General Laws [MGL] Chapter 30B) we noted the following issues:

- We found one instance where expenditures for services were in excess of \$25,000 and therefore should have been subject to a formal bidding process. The Town could supply documentation for the company who was

awarded the bid, but no other documents evidencing compliance with this requirement of Chapter 30B.

We recommend the Town retain all documents supporting the bid process, including all bids submitted.

- We also found one instance where the Town participated in a bid orchestrated by an outside agency, but could not locate supporting documentation for the cost of the goods submitted per the contract.

We recommend in the future that the Town maintain documentation to evidence that the prices paid agree with those contained in the awarded bid.

- Invoices submitted to the Town Accountant for payment do not contain a certification that the applicable bid requirements have been met in accordance with MGL.

We recommend departments attach documented evidence of vendor quotes/bids to invoices when submitting to the Town Accountant for disbursement processing. This will streamline the disbursement process and provide assurance that procurement procedures were properly followed.

In addition, we also recommend the Town consider holding a departmental training to help familiarize department heads with the rules and regulations of the Massachusetts procurement laws.

Town's Response:

The Town Administrator, as the CPO, will work on completing a financial policy guide that includes Procurement Procedures for the Town. The CPO will request that documentation of bidding and all requirements under 30B be submitted to CPO prior to issuance of a purchase order. In the issuance of the purchase order, CPO will include compliance with 30B so the Town Accountant is aware that the law has been followed. Department Heads have also been given current copies of 30B requirements and the requirements have been reviewed.

3. MONITOR TRANSFER STATION FUND BUDGET

The Town's fiscal year 2014 transfer station charges revenue fell short of budget projections by approximately \$(31,000). Since the charges in fiscal year 2014 were comparable to the previous year's revenue, the budget shortfall appears to be due to an overestimation of anticipated collections. In addition, expenditures were only under budget by approximately \$(11,000).

The transfer station fund operations reported a net loss of approximately \$(20,000) in fiscal year 2014, leaving retained earnings in a deficit of approximately \$(7,000). This deficit was required to be raised on the fiscal year 2015 recap. In addition, per the fiscal year 2015 tax recap, revenue was budgeted at approximately \$227,000, which is approximately \$45,000 more than the prior year's actual receipts. Even with an increase in rates, it appears unlikely that the budgeted revenue is attainable; as of audit fieldwork in March 2015, actual revenue was under budget by approximately \$122,000 (46%).

We recommend the Town carefully monitor future revenue projections to avoid basing the budget on unrealistic or unattainable estimates. This will help ensure the positive financial position of the Town's transfer station fund and enable the Town to make sound decisions in regard to future rate setting and expenditure decisions.

Town's Response:

The Highway Superintendent has created a more detailed budget for fiscal year 2016. He has documentation for his revenue and expense projections which had not been documented previously. This will allow him to keep better track of where the fund is during the year. To help him do this, the Town Accountant will provide a quarterly budget report to highlight revenue deficits or overspending in expenditures.

4. REPORT ALL BANK ACCOUNTS IN THE TREASURER AND GENERAL LEDGER RECORDS

Periodically the Town receives monies from various contractors, developers, etc. as deposits to be held in escrow until the completion of a project. These funds should be turned over to the Treasurer and deposited into a bank account under the Town's Federal identification number, as the Town acts as an agent for those funds. During our testing of cash in fiscal year 2014, we noted two instances where such deposits were not reported in the Town's general ledger or Treasurer's cash. In one case, the bank account was established in the business's identification number instead of the Town's.

The existence of escrow monies requires the Town to assume a custodial responsibility over them. This responsibility would be fulfilled by the accurate maintenance of these balances by both the general ledger and Treasurer's Office and the reconciliation of these funds between the Accountant and Treasurer. In addition, since these monies are required to be held in the Town's name, they should be part of the Treasurer's cash even though they will be returned at the successful conclusion of a particular project.

We recommend the Town determine the current balance for all Town-owned escrow accounts and adjust the general ledger and Treasurer's balances ac-

cordingly. Furthermore, going forward, all such funds should be deposited in an account that is under Town's control. We also recommend that routine reconciliation procedures be established between the department who initiated the deposit and the general ledger.

Town's Response:

In fiscal year 2015 the Town Accountant created and recorded any monies received by the Town in relation to escrow accounts. Since these are now recorded and maintained on the balance sheet, the accounts will be reviewed and reconciled with the appropriate departments, as well as the Treasurer on an annual basis or sooner if needed.

5. IMPROVE INTERNAL CONTROLS OVER BUDGET PROCESS

In our review of the Town's budget process, including documentation, vote authorizations and the tax recap, we noted the following issues:

- Sources and uses of funds voted at Town Meeting should be more clearly defined. Specifically, we found at Annual Town Meeting there are some instances where articles are voted as additional appropriations to the operating budget (Article 1) and other instances where the articles are meant to serve as the funding source for expenses already raised in the operating budget. Since the articles do not specify the intended purpose, it can be confusing and open to interpretation. As a result of the lack of specificity, the fiscal year 2015 recap did not raise and appropriate enough to cover the expenditures voted by Town Meeting, resulting in unbudgeted appropriations of \$10,000.

We recommend the Town clearly authorize the source and use of all budgeted funds and ensure that Town Meeting articles reflect these authorizations. This will improve the clarity of the budget process and will reduce the risk that unauthorized or duplicate appropriations occur.

- Per review of the budget recorded in the Town's general ledger, we noted a few instances where revenue or expenditure line items were increased without Town Meeting appropriation.

We recommend in the future, that the budgeted amounts entered in the general ledger reflect only the amounts voted by Town Meeting.

Town's Response:

Admittedly, the budget process has been unclear and fragmented in years past and changes were made when preparing the fiscal year 2016 budget. In part, these changes came as a result of recommendations set forth by the Massachusetts Department of Local Services. The Town now has a finance

team made up of members from the following offices/departments: Town Administrator, Town Accountant, Treasurer, Town Finance Committee, School Department and Assessors. The Town now has a better understanding of the actual budget and the warrants for the Annual Town Meeting. Finally, the Town has documented its new processes and expects future concerns in this area to be alleviated.

6. OTHER ISSUES

The following section of the management letter identifies several other current and prior year recommendations for improvements which are reported in a summarized manner. Some of these issues were also noted in the prior year. We will be available to discuss these with the Board of Selectmen in more detail to assure that there is a clear understanding of the issues and recommendations.

Current Year:

Document policy for indirect costs

The Town annually calculates indirect costs to be allocated to the two enterprise funds. While backup was provided to support the costs allocated, there is no documented policy for the calculation.

We recommend the Town develop and document a policy for allocating indirect costs to the enterprise funds. This will help ensure that the costs charged are reasonable and eligible.

Town's Response:

The fiscal year 2016 Indirect Cost policy for Enterprise Funds has been written, sent, and approved by the department heads/boards in charge of the Enterprise Funds. This document will stay on file with the Town Accountant, and will be reviewed each budget season to ensure the amounts calculated are reasonable and eligible.

Prior Year:

Formalize procedures over water abatements

During our inquiry we found that there are no formalized policies and procedures over the issuance of water abatements.

We recommend the Town establish procedures outlining the situations where abatements will/will not be granted. This will help ensure that all users receive consistent treatment.

Town's Response:

The Town is currently seeking information from other towns regarding their water abatement policies. This information will be reviewed with the Water Commissioners and members of the finance team to see if the information received can be adapted into the Town's policy.

PRIOR YEAR ISSUES:

7. **IMPROVE INTERNAL CONTROLS AND RECONCILIATION OF WATER RECEIVABLES (SIGNIFICANT DEFICIENCY)**

As also noted in prior years, unlike most other Town receivables, water services are maintained through a unique software program provided to the Town by a consultant. The system is a combination of a meter reading / usage tracking software, Best Water System (BWS), which is downloaded to a QuickBooks (QB) database that tracks billings, collections, and outstanding balances.

While we did not find any errors in the reports generated from this system, we continue to find procedural and reconciliation issues that should be addressed. While the Accountant began posting receivable activity (commitments, receipts, etc.) in the general ledger in fiscal year 2014, an annual adjustment was still needed to the general ledger receivable balance in order for it to agree with a report generated from QB. Part of the reason this adjustment is needed is due to the lack of detail on the reports generated from QB. When fees are collected along with the user charges, there is no simple way to identify these amounts on the turnover form. These fees should not be posted against the receivable account, but currently are, which results in a variance in the receivable balance at year-end. In addition to the difference in receipts, maintaining these balances in QB makes posting to customer accounts time consuming.

We recommend the Town look into tracking water receivables in Point software (the system used by the Collector to track all other receivables) to obtain consistency among all receivable accounts.

Town's Response:

The Town Treasurer/Collector is currently reviewing the Town's best options for software to more effectively handle the collection of water receivables. The options will be discussed with the Water Commissioners, and once determined, the Town will move forward with implementing the new software that it feels is the best fit. The Town will continue with its current process, with the Town Accountant and Collectors' offices reconciling and resolving discrepancies sooner.

8. IMPROVE PROCEDURES OVER AMBULANCE RECEIVABLES (SIGNIFICANT DEFICIENCY)

As also noted in prior years, the Town contracts with an outside company to bill and collect for ambulance services provided by the Town's Fire Department. The outside company also maintains the database and reports amounts billed, collected and owed to the Town. Most payments for ambulance services are received by the company who periodically wires the funds collected directly into a Town bank account. Occasionally checks are received by the Fire Department and direct Medicare payments are received by the Treasurer.

To enhance internal controls, we recommend:

- The Fire Department reconcile the service call information supplied to the company for billing purposes to the call detail / billing report generated by the company to ensure that all ambulance services provided were billed.
- The Accountant and/or Fire Chief compare receipts between the general ledger / Treasurer and company reports to ensure that receipts were remitted and posted timely and intact.
- The Accountant annually reconcile the general ledger receivable balance to agree with a balance due report generated by the outside company.

In addition, as of June 30, 2014, approximately \$70,000 of the total receivable balance of \$109,000 was over 90 days old. Upon inquiry, we found there are no formal procedures for recognizing an ambulance receivable account as uncollectible and the subsequent "write off" of the delinquent account.

We recommend the Town formalize a policy for abating uncollectible ambulance receivables. This may be accomplished by requiring the outside billing company and the Town Administrator to provide a list of uncollectible accounts to the Board of Selectmen with a recommendation to abate. The Board could then formally vote to abate the receivables.

Implementation of these recommendations will improve internal controls as applied to ambulance service receipts as well as ensure the accuracy of revenue and collectability of accounts receivable reported in the Town's general ledger.

Town's Response:

The Town will take the recommendations from the management letter and will implement them for the new fiscal year 2016.

9. 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 now 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. However, our review of procedures found that while a comparison is being performed in total, 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 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:

With the beginning of fiscal year 2015 the Town Accountant has been reconciling the delineation of cash and checks from her turnovers to the Treasurer's bank deposit slip. The Town Accountant's office also sends out revenue reports bi-monthly to all departments, committee and commissions with the most current activity. The internal audit function discussed in the recommendations from the management letter will be implemented in the new 2016 fiscal year. In relation to this area the Finance Team (Town Administrator, Town Accountant, Treasurer and Finance Committee) are working on a town-wide Financial Management Policy and Procedure Manual in hopes to streamline our policies and document them to avoid any risk of errors in the future.

10. 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. Risk assessment is a management function designed to identify where an organiza-

tion 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 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 written identification of areas where potential fraud or material misstatements to the financial statements may occur. Regular meetings with financial team staff 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 responsibilities, since this could create opportunities for fraud to occur and go undetected. If staffing levels do not permit an adequate segregation of duties, the Board of Selectmen should provide additional oversight, which should include review and documented sign-off.

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

Town's Response:

The Town Administrator will work with relevant bodies to develop a formal employee fraud policy and work with the Town Accountant to identify risk areas and set up meetings to evaluate possible risk within departments.

The Town Accountant along with the Treasurer and Town Administrator will work with examples given to them by the auditors to develop a policy and procedure that will work best for the Town for collecting and remitting departmental receipts. The Town Accountant has verified deposits made by the Treasurer who is committed to make better notes of checking the delineation of the checks and cash that are deposited. With the recommendations and examples given to the Town by the auditors the Town Accountant will develop an internal audit function for the fiscal year 2015 departmental receipts.

* * *

All other prior year issues have been satisfactorily resolved or modified and repeated as current year issues.