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Bill Fraher, CPA

TOWN OF MERRIMAC

MANAGEMENT LETTER

June 30, 2019



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The Board of Selectmen
Town of Merrimac, Massachusetts

Dear Board Members:

In planning and performing my audit of the financial statements of the Town of Merrimac for the year ended June 30, 2019, I considered its internal control structure in order to determine my auditing procedures for the purpose of expressing an opinion on the 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.

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 misstatements on a timely basis. A *material weakness* is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the Town of Merrimac, Massachusetts' financial statements will not be prevented or detected and corrected on a timely basis. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses.

Other matters involving the internal control structure and other operational matters are presented in the following report. These matters were considered in determining the nature, timing and extent of the audit tests applied in my audit of the financial statements, and this report does not affect my report on those financial statements dated July 13, 2020. 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 and is not intended and should not be used by anyone other than these specified parties.

Bill Fraher, CPA
July 13, 2020

**TOWN OF MERRIMAC, MASSACHUSETTS
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Section I - Overview of Operating Results

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

At June 30, 2019, the Town's general fund unassigned (undesignated) fund balance in the financial statements was \$1,852,688, down from the amount at June 30, 2018 of \$2,125,565. Although the Town utilized all prior year free cash during fiscal year 2019 (eliminating the free cash that was certified at June 30, 2018), the Town generated additional free cash from 2019 budgetary results. This came from unexpended appropriations, which totaled \$401,125 (more than the prior year amount of \$194,942) and excess revenues over budget of \$95,450 (less than the prior year amount of \$259,676). Of the unassigned fund balance at June 30, 2019, \$563,493 relates to the Town's operating (general) fund (compared to \$1,058,586 last year) while \$1,0289,195 relates to its stabilization funds (compared to \$1,066,979 last year). The Town also continued funding an OPEB trust fund in fiscal year 2019, contributing \$85,000 from the general fund, \$0 from the water fund, \$31,000 from the sewer fund and \$15,000 from the electric light fund into this fund. The Town has now funded 40% of its total OPEB liability.

When combined, the Town's unassigned fund balance (general and stabilization) equates to approximately 11% of the Town's annual budget, down from 14% last year. The Town should attempt to build up 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 at least 5% to 15% of the annual operating budget. As shown, the Town is in the higher part of this range, an improvement from prior years' amounts.

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.

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Section II - Control Deficiencies

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 modification of the auditor's report on internal control and compliance (which is presented in the report on the financial statements).

II-A. Material Weaknesses

There were no material weaknesses noted during this year's audit.

II-B. Significant Deficiencies

There were no significant deficiencies noted during this year's audit.

II-C. Control Deficiencies

II-C-1. GASB 34

In 2005, the Town implemented GASB Statement Number 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Town still has some GASB 34 compliance issues that should be addressed. These include:

- Recording accrued interest on long term debt and compensated absences.
- Recording employee benefits by expense function.
- Converting revenues to the categories required for entity wide statements.

The Town should work on eliminating some or all items in the coming year.

II-C-2. 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 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.

Section II - Control Deficiencies (continued)

II-C-2. Statements of Auditing Standards on Fraud & Risk Assessment (continued)

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.

II-C-3. Tracking of Foreclosure Properties

The Town should improve its tracking of foreclosure properties. During the audit, we noted that the Town does not have a detailed listing of tax possessions with applicable foreclosure amounts that agrees to the general ledger.

The Town should research Town records for foreclosed properties and compile a detail listing to support any amounts in the general ledger foreclosure account.

II-C-4 Documentation of Contracts

In order to properly approve payments for invoices submitted by Town departments, the Town Accountant must have any underlying contracts on file. This is necessary to determine that invoices adhere to the scope of the contract and can be approved for payment. We noted that some contracts were not on file in the Accountant’s office. The Accountant stated that there are difficulties getting contracts from some Town departments.

The Town should require all departments to cooperate in providing all contracts to the Accountant. Invoices submitted for payment in absence of a required contract should not be approved for payment.

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Section II - Control Deficiencies (continued)

II-C-5 Cemetery Recordkeeping

During our review of cemetery procedures, it was noted that many records are maintained on old paper cards, rather than on an automated system. This increases the likelihood of errors and does not represent the best internal controls.

The Town should consider automating these cemetery records.

Section III - Informational Matters/New Accounting & Auditing Standards

III-1. GASB 45, 74 and 75 - Other Postemployment Benefits (OPEB)

In fiscal year 2018, the Town implemented GASB Statement #74 – *Financial Reporting for Postemployment Benefits Plans Other than Pension Plans*. In fiscal 2019, the Town implemented GASB Statement #75 – *Accounting and Financial Reporting for Postemployment Benefits Plans Other than Pensions*. Together, these GASB statements had a significant impact on the Town’s financial statements.

At June 30, 2019, the OPEB liability on the Town’s financial statements is \$2,435,134, a decrease from the prior year liability amount of \$2,597,288. This liability on the statement of net position is made up of \$2,007,787 for governmental activities and \$214,683 for the water and sewer enterprise funds as of June 30, 2019, and \$212,664 for the light enterprise fund as of December 31, 2018. The Town also is showing deferred outflows related to OPEB of \$30,751 and deferred inflows of \$201,253. The Town also shows in its footnotes and Required Supplementary Information a total Town net OPEB liability as of June 30, 2019 of \$2,389,379 for all Town activities.

The Town began funding its OPEB liability by establishing an OPEB trust fund in 2014. This trust fund has a balance at June 30, 2019 of \$1,601,667. The Town should continue its funding effort in the coming years and, as funds allow, consider increasing the amounts transferred to the OPEB trust fund.