

TOWN OF SHARON, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2016

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Additional Offices:

Nashua, NH
Manchester, NH
Greenfield, MA
Ellsworth, ME

To the Board of Selectmen
Sharon, Massachusetts

In planning and performing our audit of the basic financial statements of the Town of Sharon, Massachusetts as of and for the year ended June 30, 2016, 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.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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 response to our comments and suggestions has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

Melanson Heath

July 5, 2017

CURRENT YEAR RECOMMENDATIONS:

1. Perform Cash Reconciliations in a Timely Manner (Significant Deficiency)

Cash reconciliations for the period of May and June of 2016 were not formally completed by the Town until May 2017. Performing bank reconciliations is a key function of the Town and should be performed and completed in a timely manner.

We recommend that cash reconciliations be completed on a monthly basis. We further recommend that the bank reconciliations be documented on a single form/spreadsheet that is approved by the Finance Director and Treasurer. This will result in improved control and documented oversight over the Town's bank balances, will help minimize the risk of errors or irregularities occurring and going undetected, and will improve the timeliness of completing the annual audit.

Town's Response:

As of July 13, 2017, cash is reconciled monthly through May 31, 2017. We await monthly bank statements for June 2017. The recommendation to create a spreadsheet approved by the Finance Director and Treasurer/Collector has been implemented.

2. Complete Documentation for Compensated Absences (Significant Deficiency)

In fiscal year 2016, the Town did not compute the liability associated with employee compensated absences (i.e., accrued sick and vacation time). As a result, the amount reported in the Town's financial statements was estimated based on prior year amounts. The reporting of this liability is necessary to comply with generally accepted account principles (GAAP).

We recommend the Town compute the compensated absence liability annually for inclusion in the financial statements. This will allow the Town to properly report financial statements in accordance with the requirements of GAAP and will provide the Town with improved information regarding the amount of this unfunded liability.

Town's Response:

Accrued vacation leave and sick leave is integrated into the MUNIS payroll system. Vacation leave is payable at the current rate of pay at the date of resignation, retirement or death of an employee. Distribution of accumulated sick leave is restricted to those employees who meet the definition of retirement under Mass General Law (age 55 with at least 10 years of service), with the benefit capped at not more than 25 days at the current rate of pay at the date of retirement or death. During FY2017, the Treasurer's office began tracking

compensatory time through the MUNIS payroll system. The Treasurer and Finance Director will provide a spreadsheet listing employees eligible for payments for each of these types of compensated absences for the FY2017 audit.

3. Prepare for New Single Audit Guidelines Over Procurement

In fiscal year 2016, there were new requirements related to the Single Audit Act as a result of OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (UG). Included in these new requirements were new procurement rules over purchases made with federal grant funds, which differ in certain respects from Massachusetts procurement laws (MGL Ch.30B, et al). The OMB provided a grace period of two full fiscal years after the effective date of the Uniform Guidance to allow entities to comply with the new procurement standards. Consequently, the new procurement standards will be effective as of July 1, 2018. Under the new requirements, Federal award recipients must:

- Establish written policies and procedures for the following:
 - Procurement in compliance with new procurement standards
 - Standards of conduct covering conflicts of interest
 - Process for conducting proposal evaluations
- Maintain certain records to detail the history of procurement
- Implement oversight procedures to ensure contractors perform in accordance with terms.

Differences to MGL Ch. 30B include:

- Under the new rules, purchases of \$3,000 - \$10,000 must have evidence of obtaining/evaluating prices from more than one source; MGL Ch. 30B does not contain any requirements for purchases under \$10,000.
- There are no exemptions allowed under the new procurement standards; MGL includes exemptions for certain types of purchases such as Special Education services and supplies.
- Sole-source/no-competition purchases are only allowed in certain situations and are not dependent on the purchase amount; MGL sole-source requirements are less specific.

We recommend the Town review the new requirements and modify their own procurement policy to ensure compliance with Uniform Guidance.

Town's Response:

During FY2018, the Town will develop, approve, and implement procurement guidelines and standards in keeping with the new OMB circular relative to audit requirements for purchases using Federal grant award funds.

4. Prepare to Implement GASB 74 and 75 for OPEB

Beginning in fiscal year 2017, the Town will be required to implement the Governmental Accounting Standards Board (GASB) Statement 74 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (OPEB)*, and in fiscal year 2018 GASB Statement 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. GASB 74 applies if a trust fund has been established to fund future OPEB costs, and GASB 75 applies whenever OPEB benefits are offered. GASB has taken the position that OPEB is a form of compensation and the liability/expense should be recognized while the employee provides service to the government. GASB Statements 74 and 75 replace Statements 43 and 45, and require the full net OPEB liability and related expenses to be presented on the government's accrual basis financial statements. Previously, the liability was recorded incrementally, generally increasing based on the degree to which a government funded the annual required contribution. It is expected that the implementation of these accounting standards will have a material impact on the Town's financial statements, including the recording of a larger net OPEB liability and substantial new disclosures.

We recommend the Town begin planning for the implementation of GASB 74 and 75, which includes gaining an understanding of the new requirements, educating applicable financial statement users, and ensuring that actuarial valuations are performed in a timely manner and in compliance with the new requirements. More specifically, since the Town has established an OPEB Trust Fund, GASB 74 will require additional required supplementary information in the fiscal 2017 audited financial statements; however, the Town will also need a valuation prepared under GASB 45 in order to record the Town's liability on its government-wide financial statements. Therefore, it is critical that the Town coordinate with its actuary to discuss the need for two valuation reports, one prepared under GASB 74 and one under GASB 45. It will be also important for the Town to maintain an adequate system of documentation to support the employee census data information provided to the actuary, since this information will now be subject to annual audit testing.

Town's Response:

The Town will engage a consulting actuary to prepare an updated actuarial study that complies with GASB 74 and 75 reporting requirements. The Town has established an OPEB trust fund, but has not formalized an investment policy or placed the funds in a diversified portfolio. Our policy calls for increasing annual contributions to the trust to address the growing liability. We note that state law has placed a moratorium through FY2018 precluding municipalities from increasing the premium contribution share paid by retired employees and dependents.

PRIOR YEAR RECOMMENDATIONS:

5. 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 to respond to the risks.

We continue to 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 continue to 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 vacancy in the Finance Director position during much of FY2017 delayed the completion of the risk assessment procedure and standards. We expect to address this recommendation prior to the completion of the FY2017 audit.

6. Establish Fiscal Policy Goals

The Town currently does not have formal policies establishing financial guideline levels and spending criteria for the general fund, enterprise funds, and stabilization fund. As a result, there is a risk that fund balance levels could fall below the levels recommended by financial advisors, thereby risking a reduction in the Town's bond rating.

We continue to recommend the Town establish long-term fiscal policy goals, including issues such as established thresholds for general stabilization, and enterprise fund unassigned fund balance levels, as well as plans to stabilize future tax and utility rates. This will help ensure adequate resources exist for funding unexpected costs, minimize future interest costs through continued strong bond ratings, and provide resources to deal with the effects of future downturns in the regional economy.

Town's Response:

The Finance Committee and Board of Selectmen have approved guidelines and practices related to a ceiling on the percentage of non-exempt debt service for capital projects equal to 6% of the ensuing year's estimated appropriations; initiated a practice of funding at increasing annual levels capital purchases funded within annual appropriations rather than issuance of debt; and set a goal of increasing undesignated general fund balance and stabilization funds to an amount between 5% and 8% of appropriations. We will formalize these guidelines and practices as policies by December 2017.