

TOWN OF SWAMPSCOTT, MASSACHUSETTS
MANAGEMENT LETTER
YEAR ENDED JUNE 30, 2018



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Management
Town of Swampscott, Massachusetts

In planning and performing our audit of the financial statements of the Town of Swampscott, Massachusetts (Town) as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, 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 Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

However, during our audit we became aware of deficiencies in internal control (other than significant deficiencies and material weaknesses) that are opportunities to strengthen your internal control and improve the efficiency of your operations. The memorandum that accompanies this letter summarizes our comments and recommendations regarding those matters. This letter does not affect our report dated March 27, 2019, on the financial statements of the Town.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and recommendations with Town personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

The Town's written responses to the matters identified in our audit have not been subjected to the audit 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 and others within the Town, and is not intended to be, and should not be, used by anyone other than these specified parties.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Boston, Massachusetts
March 27, 2019

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TOWN OF SWAMPSCOTT, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2018

TABLE OF CONTENTS

	Page
Comments and Recommendations	1
Bank and Cash Reconciliations	1
Bond Anticipation Note Pay-Downs	2
Water and Sewer Billing	3
Information Technology	4
State and Federal Grants	6
Bank Transfers and Certain Bank Reconciliations	7
Procurement Policy	8
Accounts Receivable – Parking Tickets and Police Detail	9
Risk Assessment and Monitoring	10
Financial Policies and Procedures Manual	12

Comments and Recommendations

Bank and Cash Reconciliations

Comment

During fiscal year 2018, there were significant delays in recording all transactions in the Treasurer's cashbook, the performance of individual bank reconciliations and the reconciliation of cash between the Treasurer and general ledger (maintained by the Town Accountant). For context, as of March 2018, the Treasurer's cashbook had not been updated for certain transactions (e.g., receipts, payroll and vendor warrants) dating back to July 2017, approximately 80 individual bank reconciliations had not been performed for months ranging from July 2017 through February 2018, and cash had not been reconciled between the Treasurer and general ledger since June 2017.

The fiscal year 2018 cashbook and related reconciliations were not completed until September 2018, and included outstanding reconciling items totaling approximately \$69,000. As part of the reconciliation process, the Treasurer identified that the April 2018 payroll withholdings/taxes were underpaid to the Internal Revenue Service and the Massachusetts Department of Revenue by \$10,064.60 and 42,302.60, respectively. This error was not discovered and corrected until August 2018.

We also identified that checks issued in July 2019 (related to a fiscal year 2018 vendor warrant) were dated June 30, 2018 and were included as part outstanding checks at June 30, 2018. This does not represent a proper cash "cut off" at year-end and understates cash and warrants payable. The financial statements have been properly adjusted to reflect this activity.

The conditions identified above present the risk that errors or irregularities could occur and go undetected. Furthermore, these conditions inhibit accurate financial reporting and financial decisions made by the Town.

Recommendation

We recommend the Treasurer's cashbook be updated as activity occurs.

We recommend all individual bank accounts and the reconciliation of Treasurer's cash to the general ledger be performed no later than 30 days after month end.

We recommend checks be dated the actual date of issuance and only be included in outstanding checks when the actual checks are issued, no matter what period the disbursements relate to.

Management's Response

The delays were due in large part to organizational changes that have been taking place, including the Treasurer's promotion to the role of Assistant Town Administrator, along with various other organizational changes that impeded the Treasurer's ability to accomplish all the tasks expected of him. In order to accomplish the goal of full reconciliation within 30 days of the end of each month, additional staff resources have been hired and/or re-assigned to make sure this task occurs on a monthly basis going forward, and in FY2019 monthly cash reconciliations have been occurring on schedule.

Bond Anticipation Note Pay-Downs

Comment

On January 25, 2018, the Town had outstanding bond anticipation notes (BANs) totaling \$283,409. We identified that management paid the BANs off permanently from the general fund without an appropriation and without a plan to permanently fund the capital projects. As a result, the capital projects funds related to the BANs are in deficit with no permanent funding source at June 30, 2018.

Recommendation

We recommend the Town appropriate a transfer from the general fund to the capital projects funds at a future town meeting to permanently fund the deficits identified above.

We recommend management implement procedures to have an established plan and appropriation (where applicable) to fund all BAN pay-downs via renewals, permanent financing or available funds.

Management's Response

Management will continue to ensure a proper funding source has been identified for future pay-downs before they occur. Management has a long-range debt service plan that the Town follows and adheres to. Pay-downs will not be authorized by the Management Team or occur until the requisite journal entries have been made by the Town Accountant moving the money from the appropriation line to the capital fund.

Water and Sewer Billing

Comment

During fiscal year 2018, the Town identified numerous billing errors related to water and sewer readings, which resulted in approximately \$785,000 of billing adjustments and refunds processed to customers. This condition indicates that controls have not been established to ensure the consistent accuracy of meter readings and the related bills.

Recommendation

We recommend management implement controls to ensure meter readings and the related billings are accurate at the time the customer is billed.

Management's Response

The standard practice for the water and sewer department when they are unable to obtain accurate quarterly meter readings via the mobile readers is to send a letter to the homeowner to request an appointment to make a visual read. Following the appointment, the water and sewer department then makes an adjustment to the estimated bill to reflect the current amount of usage. If the homeowner does not respond, then the water and sewer department will send a bill with an estimate of 40,000 cubic feet of usage. There are times when it might be 3 to 4 billing cycles before the resident can make an appointment, which can result in a sizable abatement. The water and sewer department make every attempt to obtain an accurate reading to ensure the most accurate billing is sent to the customer.

In FY18 there was a clerical error where three large inaccurate readings made it on to the billing reports. Going forward the water and sewer department has implemented a quality check process to help mitigate this from re-occurring.

Information Technology

Comment

We evaluated the computer processing environment and general controls that help ensure the reliability of the business and financial systems that support business objectives and identified the following:

1. An External Penetration Test has never been performed by an independent third party.
2. There are no formal IT policies in place.
3. The password policies in place do not currently meet best practice.
4. Functions are not disabled on workstations that allow peripheral devices (i.e., USB ports) to be used to download data and information.

Recommendation

1. We understand that an External Penetration Test is scheduled to be performed in calendar year 2019. We recommend that management follow through with the test and take corrective actions to resolve any deficiencies.
2. We understand that formal policies are being developed to govern the IT department including, but not limited to, the following areas:
 - a. Vendor management
 - b. Physical and logical access
 - c. Change management
 - d. Data backup & storage
 - e. Information security incident response
 - f. Applications
 - g. Servers, workstations and network

We recommend management follow through with the completion of the formal policies during fiscal year 2019. We also recommend the policies be documented to reflect current practices, are reviewed and updated by management annually, and communicated to Town personnel.

3. We recommend the implementation of stronger and more complex password parameters. Password settings should be to the following:
 - a. Password length of 8 characters
 - b. Complexity enforced (Upper case, lower case, alpha numeric, special character)
 - c. Change frequency of 90 days enforced
 - d. Password history of 12-24
 - e. Minimum password age of 1 day
 - f. Invalid login attempts set to 5
 - g. Users be required to change their passwords based on the above parameters and the IT Director only be able to provide temporary reset passwords
4. We recommend enforcing restrictions on user workstations that allow only the use of IT-provisioned, encrypted peripheral devices. Such restrictions would prevent the use of peripheral storage devices that are not purchased and administered by IT.

Management's Response

- 1) The Town's outside IT consulting firm will be performing an external penetration test, the test and report will be presented by the end of June 2019.
- 2) IT policies are being developed and the goal is to have them complete by the end of June 2019.
- 3) The Town intends to implement a more complex password policy as recommended by the end of June 2019.
- 4) This is not recommended by the Town's outside IT firm.

State and Federal Grants

Comment

The Town applies for and receives various state and federal grants annually that are accounted for in separate Special Revenue Funds, which are used to account for and report proceeds of specific revenue sources that are legally restricted to expenditure for a specific purpose. The legal and contractual obligations as well as the accounting and reporting responsibilities which a grant may impose can be burdensome.

We identified instances where certain grant expenditures (related to SPED, Teacher Quality and METCO, totaling \$718.83, \$496.00 and \$32,765.67, respectively) were recorded in incorrect accounts related to grant years that have already been closed. This negatively impacts the accuracy of financial reporting, including financial reporting required by the grant awarding agency.

Recommendation

We recommend procedures be implemented to have grant administrators review and approve activity posted to their respective grant(s) monthly.

Management's Response

The School Department will implement procedures to have grant administrators review and approve activity posted to the general ledger on a monthly basis. Further, we will have accounts related to grant years that have been closed inactivated in MUNIS to prevent grant expenditures from being charged to incorrect accounts.

Bank Transfers and Certain Bank Reconciliations

Comment

During 2018, \$250,000 was voted at Town Meeting to be transferred from the General Fund to the Other Postemployment Benefits (OPEB) Trust. This transaction was recorded on the general ledger but the cash was not transferred to the separate OPEB Trust bank account at year-end. As a result, investment income was not distributed appropriately.

Recommendation

For funds that require (via law, trust, endowment, etc.) separate bank accounts, we recommend monthly reconciliations of bank balances to the general ledger to ensure all activity has been accounted for in both the accounting system and bank account(s).

Management's Response

Management has instituted a process where the journal entries are not completed until the Treasurer has provided the supporting documentation for the completed transfer to mitigate the risk and provide a check and balance.

Procurement Policy

Comment

Title 2 of the Code of Federal Regulations states that the non-federal entities receiving federal funds must have written procedures for procurement transactions. §200.318 states that the non-Federal entity must use its own documented procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards. §200.318 describes the methods of procurement to be followed:

- a) Procurement by Micro-purchases. Aggregate dollar amount of which does not exceed \$3,000. To the extent practicable, the non-Federal entity must distribute micro-purchases equitably among qualified suppliers. Micro-purchases may be awarded without soliciting competitive quotations if the non-Federal entity considers the price to be reasonable.
- b) Procurement by small purchases. Small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than the Simplified Acquisition Threshold (currently \$150,000). If small purchase procedures are used, price or rate quotations must be obtained from an adequate number of qualified sources.
- c) Procurement by sealed bids and competitive proposals. Bids are publicly solicited and awarded for amounts in excess of Simplified Acquisition Threshold (currently \$150,000).
- d) Procurement by noncompetitive proposals (Sole Source). Procurement by non-competitive proposals is procurement through solicitation of a proposal from only one source when this source meets all the circumstances in §200.320 paragraph (f)(1-4).

The Town's procurement policy does not address the criteria outlined by Title 2 of the Code of Federal Regulations §200.320.

Recommendation

We recommend the Town update its procurement policy to include the requirements of Title 2 of the Code of Federal Regulations §200.320.

Management's Response

It is our goal to have the purchasing policy updated by the end of FY2019 and to institute updated procurement processes and contract administration processes in FY2020.

Accounts Receivable – Parking Tickets and Police Detail

Comment

Consistent with prior years, procedures have not been developed and implemented to record (on the general ledger) the monthly amounts billed as accounts receivable (and the corresponding deferred revenue) related to parking tickets and police detail. As a result, monthly reconciliations of outstanding accounts receivable cannot be performed. Proper internal controls require all transactions related to accounts receivable to be accounted for and recorded on the general ledger.

In addition, an accounts receivable aging report is not maintained for the police detail receivables.

Recommendation

We recommend procedures be implemented where all billings for parking tickets and police detail be provided to the accounting office to enable the recording of the applicable accounts receivable on the general ledger. We recommend that all subsequent transactions related to the billings (cash receipts, write-offs and other adjustments) also be recorded (in summary) by the accounting office on the general ledger. The general ledger should serve as a control account for the parking tickets and police detail accounts receivable balances.

We also recommend the maintenance of a police detail aging report.

Management's Response

Management recognizes the importance of this finding and it is our goal to have a plan to implement the billing functionality in Munis over the next 12 months for police details, to track the receivables and will utilize reports from our outside vendor to record the receivables in Munis for parking tickets.

Risk Assessment and Monitoring

Comment

When internal controls are *initially* implemented, they are usually designed to adequately safeguard assets. However, over time, these controls can become ineffective due to changes in technology, operations, etc. In addition, changes in personnel and structure, as well as the addition of new programs and services, can add risks that previously did not exist. As a result, all municipalities must periodically perform a risk assessment to anticipate, identify, analyze and manage the risk of asset misappropriation. Risk assessment (which includes fraud risk assessment), is one element of internal control.

The risk assessment should be performed by management-level employees who have extensive knowledge of the Town's operations. Ordinarily, the management-level employees would conduct interviews or lead group discussions with personnel who have knowledge of the Town's operations, its environment, and its processes. The risk assessment process should consider the Town's vulnerability to misappropriation of assets. It should also address operations that involve heightened levels of risk. When conducting the assessment, the following questions should be considered:

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- What operations are the most complex?
- How could assets be stolen?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could potential misappropriation of assets be concealed?
- What prior internal control issues could still continue to be problematic?

Once the areas vulnerable to risks have been identified, a review of the Town's systems, procedures, and existing controls related to these areas should be conducted. The Town should consider what additional controls (if any) need to be implemented to reduce risk.

After risk has been assessed, periodic monitoring of the identified risk areas must be performed in order to evaluate the controls that have been implemented to mitigate the risks. Since control-related policies and procedures tend to deteriorate over time, the monitoring process ensures that controls are fully operational and effective.

Recommendation

We recommend management develop and implement a risk assessment program to periodically anticipate, identify, analyze, and manage the risk of asset misappropriation. The risk assessment program should be formally documented and become part of the Town's financial policies and procedures manual.

We further recommend management develop and implement a monitoring program to periodically evaluate the operational effectiveness of internal controls. The monitoring process should be documented in order to facilitate the evaluation of controls and to identify improvements that need to be made.

Management's Response

Management has included in their draft financial policies a section on risk management and assessment. As part of management's on-going fiscal responsibilities, the team is consistently monitoring and identifying where risks might be present and developing action plans where appropriate. The management team includes two individuals with backgrounds in risk/audit and as potential risks are identified, the HR Director or the Town Accountant, investigate the potential risks and provide corrective action plans as need be. Management continues to be dedicated and focused on continuing to make enhancements, adjustment and changes. We will continue to develop our risk assessment model and mitigate risks where possible. The Financial team will continue meet regularly and identify risks and discuss mitigation plans. The management team over the past year have included this as an item of discussion in their regular meetings.

Financial Policies and Procedures Manual

Comment

In fiscal year 2018, the Town drafted formal policies and procedures that address the following financial activities:

- General ledger maintenance
- Year-end closing
- Processing invoices
- Vendor cash disbursements
- Voided and reissued checks
- Enterprise risk management
- Employee expense reimbursement
- Credit cards

The drafted policies also define the objectives, responsibilities and authorizations for employees/job positions in the accounting department. However, the policies and procedures drafted by the Town do not define the objectives, responsibilities and authorizations for **all** employees/job positions, and they do not address the following financial activities:

- Cash receipts
- Purchase orders
- Payroll cash disbursements
- Administration of grants
- Administration of student activity funds
- Personnel (i.e., hiring, payroll and related changes, etc.)
- Month-end closing procedures

We believe that formal policies and procedures addressing the financial activities identified above would improve and standardize the Town's financial policies and procedures. Inherent in any organization that operates without formalized written procedures are inconsistencies in everyday policies and procedures. The number of such inconsistencies can be minimized by the written codification of policies and procedures and insistence on adherence to them.

Recommendation

We recommend management formally adopt the drafted policies and procedures identified above.

We recommend management continue to develop its formal financial policies and procedures to address the financial activities identified above.

Management's Response

Management recognizes the importance of a strong financial policy. A substantial draft has been created and review by the Management team. We continue to make additional adjustments and enhancements to the financial policies. Our goal is to have the Board of Selectmen thoroughly review the enhanced policies and adopt them in FY19. We will continue to refine and add to the policies to address the areas highlighted above. As part of our on-going fiscal policies Management produces quarterly expense and revenue reports and discusses the analysis with the Board of Selectmen and Finance Committee and project out to end of year to ensure that the Town is remaining fiscally responsible.

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