

CITY OF MARLBOROUGH, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2017

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The Honorable Mayor and City Council
City of Marlborough
Marlborough, Massachusetts

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Marlborough, Massachusetts (the "City") as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances 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 City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Roselli, Clark & Associates

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
December 13, 2017

OVERVIEW

Throughout fiscal year 2017, the local, state-wide and national economies continued to strengthen. Unemployment rates are low and property values are rising. The City continues to experience new growth. A number of significant commercial and industrial building projects are underway, which will further strengthen the City's already impressive property tax base. Furthermore, several large corporations have relocated to the City, recognizing its affordable housing, vibrant restaurants, good location and proximity to many institutions of higher education.

The City's financial condition continues to be strong. The City has not increased its property tax rates (subject to Proposition 2 ½) in many years. Rather, property tax growth has come in the form of new growth within the City. Despite this, the City enjoys nearly \$33.6 million in unused levy capacity.

In its governmental funds financial statements, which most closely resembles the City's statutory accounting records, the City's unassigned fund balance in its general fund exceeded \$33.1 million at June 30, 2017. This is an approximate \$3.4 million increase from the prior year and is indicative of strong revenue growth. Included in the unassigned fund balance at June 30, 2017 and 2016 was approximately \$13.7 million and \$11.6 million in stabilization funds, respectively.

Liquidity in the general fund is often measured by comparing both the unassigned fund balance to the current year's total fund expenditures. Credit rating bureaus often refer to this as a "reserve ratio." At June 30, 2017, the unassigned fund balance in the general funds approximated 22% of total general fund expenditures. Furthermore, the total fund balance in the general fund approximated 27% of that same amount. The City's reserve ratio of 22% at June 30, 2017 is very strong and was consistent with the prior year's reserve ratio.

The City has been at the forefront in Massachusetts in establishing and funding an OPEB trust to assist the City in funding its future postemployment health benefits to its employees. At June 30, 2017, the City's OPEB trust totaled nearly \$7.8 million. The City contributed \$1.3 million to its OPEB trust in fiscal year 2017 and expects to continue making material future contributions to mitigate this future obligation. The monies in this trust are principally overseen and managed by a third party investment manager with significant experience with Massachusetts municipalities.

The City's budgetary flexibility, strong reserve ratio and planning/funding for its future obligations has undoubtedly been seen as positive factors to Standard & Poor's Financial Services LLC ("S&P"). S&P assigned the City an AA+ credit rating, which signifies that the City's general obligation bonds are of investment grade, high quality and very low credit risk. Furthermore, this is the second highest credit S&P issues on long-term debt; the highest being rated as AAA.

The remainder of the report reflects informational items and findings and recommendations. This discussion is intended to provide the City and its management with recommendations for improvement in accounting and financial operations. The City should review these recommendations and, if determined to be cost-effective, implement these improvements. Items that have been repeated from past letters to management are so indicated.

INFORMATIONAL ITEMS

New Financial Statement Disclosures – OPEB Part 1

The City adopted Governmental Accounting Standards Board, or GASB, issued Statement No. 74, *Financial reporting for Postemployment Benefit Plans Other Than Pensions*, in fiscal year 2017. Other postemployment benefits are commonly referred to as “OPEB” and includes health and welfare plans and other similar benefits provided to City retirees exclusive of pension benefits. The City’s current policy is to contribute 60% to 70% of the cost of retiree health insurance costs, which represents the largest component of OPEB.

The adoption of this accounting standard resulted in additional disclosures within the City’s financial statements and the inclusion of the effects of retiree benefits paid and received (both from the City and its retirees) in the City’s fiduciary funds financial statements.

FY 2018 New Accounting Principle – OPEB Part 2

As discussed in previous letters to management, the City will be required to report the full amount of its net OPEB *liability* in its government-wide and proprietary funds financial statements in fiscal year 2018. The City currently reports a net OPEB *obligation* in its government-wide financial statements calculated under GASB 45.

The City net OPEB *liability* is significantly greater than its net OPEB *obligation*. The City’s independent actuary determined that its net OPEB *liability* at June 30, 2017 was approximately \$114.5 million versus a net OPEB *obligation* of approximately \$48.7 million.

The City’s independent actuary will remeasure the City’s net OPEB liability at June 30, 2018. The City will present this figure in its fiscal year 2018 affected financial statements. This will result in a further deterioration in the City’s unrestricted net position.

The City established an OPEB trust fund several years ago and has made substantial contributions to it. As it stands at June 30, 2017, the OPEB trust fund is approximately 6% funded.

As we have indicated in several previous letters to management, the City should continue to include OPEB in its long-term planning.

Changes to Single Audit Requirements – Need for Internal Control Framework

In our previous two letters to management, we notified the City that there were a number of changes made to single audits. One of the requirements under the new Uniform Guidance (the successor to the OMB A-133 compliance supplement) is that all federal award recipients are required to establish an internal control system based on a recognized internal control framework such as the Green Book or COSO.

To date, the City has made little progress in this area. We continue to recommend that the City’s finance team, inclusive of the School Business Manager, prioritize this matter to properly establish and document their internal control system this year.

Student Activities in the News

On November 27, 2017, the *Boston Globe* reported on the Boston Public Schools' use of student activity accounts to pay employees "under the table" and for purposes unrelated to student activities. These violations of federal and state tax law and Massachusetts General Laws were uncovered by an IRS audit. The *Boston Globe* article spotlights the need for continued oversight of the operation of a school district's use of student activity accounts as well as the risks associated with their misuse. Furthermore, as these matters were made public in the state's most widely circulated daily newspaper, this may lead to additional rules and regulations being issued by the Commonwealth related to student activity accounts. We recommend that the City provide a copy of this article to all school principals as a training tool and to continue its diligence in managing this fiduciary activity.

We are pleased to report that the City's schools undergo independent reviews of their student activity accounts on a rotational basis in accordance with recommendations set forth by the Massachusetts Department of Elementary and Secondary Education and MASBO. In our reports on the City's student activities for its elementary schools and its middle and high schools dated June 17, 2015 and November 15, 2015, respectively, there were a number of areas in need of improvement district wide and at the individual school level. The next scheduled period of independent review of the City's schools will be for fiscal year 2017 at the elementary schools. We recommend that the City and its school district revisit our previously issued reports on its student activity funds and ensure that progress has been made in areas in need for improvement.

Fraud Prevention Measures

As previously reported to management, the City needs to take a number of steps to address fraud risk including (i) performing risk assessments, (ii) developing a written fraud policy and (iii) performing periodic internal reviews and "audits" within its departments. These recommendations are discussed in greater detail in our January 9, 2015 letter to management.

There have been several very public instances of municipal fraud in area communities that heighten the public's awareness of this risk. We continue to stress the need for increased diligence in risk assessment, particularly in departments that accept cash from residents and businesses that are outside the reach of the City Collector. Furthermore, we continue to stress the need to perform period spot internal reviews or "audits" of departments by the City Auditor.

Improvements Since our Previous Letter to Management

The City has addressed many of the matters discussed in our previous letter to management, most notably:

- In October 2017, the City Council approved an order to adopt an abbreviated budget authorization format for all departments effective fiscal year 2018. This change is expected to afford more budgetary flexibility and efficiencies.
- Custody of student activity depository accounts was transferred from the City's schools to the City Treasurer in accordance with Massachusetts General Law.
- The City Auditor conducted an analysis of the City's capital projects funds and corrected prior year account processing errors, which resulted in the elimination of many deficits. This also resulted in the restatement of the City's June 30, 2016 capital projects' balances between City, water and sewer funds.

- The City implemented a fixed asset database in fiscal year 2017 and is now accounting for capital assets and their associated depreciation.

Items We Continue to Highlight

The following summarizes findings and recommendations we made in our previous three letters to management that have not yet been addressed by the City. You should refer to those letters for specific details.

- The City's water and sewer departments function as enterprise funds. However, enterprise fund legislation has never been sought for these operations. Adopting such legislation would permit the City to better insulate its general fund from shortfalls resulting from these operations, which negatively impact the City's free cash calculation and general fund operations.
- The City has not yet formalized its policies and procedures into a comprehensive manual. We recognize that such a program, without outside assistance, is potentially a multi-year endeavor. However, the development of formal policies and procedures for key financial processes is not only a key element in any internal control system, but an invaluable tool in the event of personnel turnover.
- The City's allocation of pension benefits to its water and sewer operations is not based on common allocation methodologies. As a result, these operations are assessed larger percentages than would typically be assessed. We've recommended that the City revalue its pension allocation methodology to employ a system based on actual payroll paid.
- The Marlborough Community Development Authority ("CDA") and Marlborough Housing Authority share a number of resources. Recently, the Marlborough Housing Authority has been invoicing the CDA for its share of these costs using a formula it developed with the assistance of an outside accounting firm. However, a formal cost sharing agreement between these two entities does not exist. We recommended that a simple, yet formal cost sharing agreement be executed between the two entities.

FINDINGS AND RECOMMENDATIONS

Capital Asset Maintenance

As discussed in the *Improvements Since our Previous Letter to Management* portion of this letter to management, the City recently implemented a fixed asset database to account for its capital assets. Upon review of the details included in this fixed asset database, there are numerous fully-depreciated capital assets (particularly vehicles) that have likely been disposed in previous years. The inclusion of these fully-depreciated capital assets in the City's financial statements does not have an impact on the City's reported net position or its net investment in capital assets. However, the reported gross value of capital assets and associated accumulated depreciation are overstated as a result of the inclusion of these fully-depreciated capital assets, which are no longer in operation.

We recommend that the City evaluate its capital asset registers and identify capital assets that are no longer in operation and take the necessary actions to dispose of these assets in the City's fixed asset database.

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