

TOWN OF IPSWICH, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2013



100 Quannapowitt Parkway
Suite 101
Wakefield, MA 01880
T. 781-914-1700
F. 781-914-1701
www.powersandsullivan.com

To the Honorable Board of Selectmen
Town of Ipswich, 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 Town of Ipswich, Massachusetts, as of and for the fiscal year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Town of Ipswich, Massachusetts' 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.

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 material weaknesses or significant deficiencies, and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

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.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

The Town's written response to the comments identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various Town personnel, and 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.

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

Powers & Sullivan LLC

December 9, 2013

TOWN OF IPSWICH, MASSACHUSETTS

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Previous Year Comments

Feoffees of the Grammar School in the Town of Ipswich Trust

Prior Comment

Pursuant to a court judgment in December, 2011, a new trust arrangement named “the Feoffees of the Grammar School in the Town of Ipswich Trust” becomes effective in fiscal year 2013. The new trust is defined as a “public body and an agency of the Town of Ipswich” and has several distribution, accounting and reporting requirements that will impact the Town and funds available to the Town’s school department. Given the significance of the activity and the new requirements of the trust, we recommend that the Town implement processes to monitor and ensure compliance.

Examples of areas where compliance should be monitored include the following:

- (1) The Town should implement a process to ensure that the Town receives the initial required distributions of funds:
 - \$2.4 million in “use and occupancy funds” plus interest is distributable to the Ipswich School Committee in fiscal year 2013 (1/3), 2014 (1/2 of remaining), and 2015 (remaining).
 - Monthly distributions of rental income during the “interim period” to the School Committee.
 - The establishment of a permanent endowment (initial principal) to provide annual distributions beginning in fiscal year 2016. The principal is required to remain intact.
- (2) The Town should implement a process to ensure that the Town receives the required audit reports and annual reports from the trust:
 - The trust is required to have an audit at the end of the interim period.
 - The trust is required to have an annual audit thereafter.
 - The trust is required to submit an annual report to the Town of Ipswich.
 - The trust is required to establish adequate controls and safeguards.
- (3) The Trust must be allowed to use Town of Ipswich buildings and Town Administrative functions such as posting minutes and meetings.
- (4) Based on the nature and significance of their relationship with the Town, the Town must consider and document the reasons whether or not the new Feoffees should be considered a component unit (blended or discretely presented) of the Town for financial reporting purposes. This documentation should include consideration as to whether or not there is a significant financial benefit/burden relationship and whether or not elected officials appoint a voting majority of the governing body of the new entity. Based on this determination, the Town must also coordinate the timing of audit and financial reporting between the Trust and the Town.
- (5) The Town must determine how funds received from the new trust should be treated and reported at the Town and how the funds may be expended.

We recommended that the Town consider all of the requirements of the new Feoffees Trust and implement an internal process for monitoring compliance with the requirements of the new trust.

Status – Resolved. The Town began receiving periodic reports and the required distributions from the Feoffees Trust during fiscal year 2013 and has reported the Feoffees Trust as a major governmental fund in the Town's fiscal year 2013 financial statements. Additionally, the School Committee formally approved a policy manual titled "Principle Elements for Future Feoffees' Distributions". It includes the process in how distributions to the School Committee will be allocated each year and also includes an excerpt governing the treatment of unexpended funds received from the permanent endowment, which will begin in fiscal year 2016.

Support for Payment of Invoices

Prior Comment

The Finance Department did not consistently receive complete bills with requests for payment or copies of all executed contracts from the Municipal Light Department. As a result, the Finance Department was unable to fulfill their statutory duty of determining if payments are fraudulent, illegal or excessive before they are paid as required by Massachusetts General Law Chapter 164, Section 56. The lack of sufficient supporting documentation can result in delayed payment processing and puts the Town at risk of processing payments that are potentially fraudulent, illegal or excessive.

We recommended that the Town adopt policies that will clarify the process for providing contracts and adequate supporting bills to the Town's Finance Department that will bridge the independence of the operation of the Municipal Light Department with the statutory responsibilities of the Town's Finance Department.

Status – Partially Resolved. During fiscal year 2013, the Finance Department has drafted a payment policy to clarify the process for providing contracts and adequate supporting documentation for the payment of bills. As of June 30, 2013, the Finance Department and the Municipal Light Department have yet to formally finalize this policy.

Current Year Comments

Indirect Cost Allocation

Comment

The Town's general fund provides services for its enterprise operations and allocates estimated indirect costs to each of the enterprise funds annually. The Town does not have a written internal policy regarding indirect cost allocations to the enterprise funds and the current methodology used to charge indirect costs to the enterprise funds is not adequately supported.

The Town has historically charged indirect costs by allocated a portion of the Finance Director, IT Director, Town Manager and Treasurer's salaries to the electric light enterprise fund and a portion of the Facilities Director's salary was allocated to the electric light, water and sewer enterprise funds. Beginning with the fiscal year 2014 budget, the process was updated to allocate a portion of each of the overhead departments to the electric light, water and sewer enterprise funds (the utilities). The new allocation included a brief description of the service provided to the utilities by each overhead department. However it did not provide justification for the percentages used or provide a complete cost allocation for each of the overhead departments.

Additionally, the Town's indirect charges are based on the budgeted amounts which are estimates. A final analysis of the actual expenses for the year is not reconciled, compared to the budgeted amounts and adjusted if necessary.

The current process puts both the Town's general fund and enterprise funds at risk that they are not being charged for their fair share of expenses and it prevents management from knowing the true cost of delivering services.

Indirect costs are the costs for services shared by many programs within an entity. Some activities such as finance, treasury, and facilities do not lend themselves to direct charging. These shared costs should be apportioned using a systematic and rational allocation methodology that is documented in a cost allocation plan and approved each year. Developing a sound cost allocation plan would provide assurance that the general fund and enterprise funds are being charged the appropriate share of costs and it would provide the Town with a sound policy that can be used in the development of future budgets.

Recommendation

We recommend the Town implement and document a formal cost allocation plan to allocate shared costs amongst departments. The plan should be reasonable and calculated on a fair and consistent basis. Officials should understand and agree on what indirect costs are appropriated as part of the general fund operating budget and what percentage of these costs should be allocated to the enterprise funds.

The cost allocation plan should:

- Identify which general fund costs can be directly tied to a specific department and allocate those costs accordingly. These would include costs such as health insurance, retirement liability insurance, etc.
- Document the services provided to each of the funds and obtain consensus from each of the departments.
- Identify each overhead cost to be allocated based on those providing significant services to other funds.

- Calculate the fully loaded cost of each position to be allocated
 - This would include the direct costs of the departments as well as the full cost of benefits, vacation time, facilities costs, and any other significant costs associated with the department providing the service.
- Document an equitable distribution method for allocating each of the costs based on the services provided.
- Allocate 100% of each of the fully loaded costs.
- Document a process for calculating the actual costs incurred and accounting for any significant differences to the amounts budgeted either through an annual adjustment or through the subsequent budget.

Services that the Town should consider in the Cost Allocation Plan (not all inclusive):

- General Town management and policymaking services provided by the Board of Selectmen and the Town Manager.
- Services of the Finance Director including budget development, budget monitoring, preparation of the Tax Rate package prepared for the Department of Revenue, accounting, general ledger maintenance, contract maintenance, financial statement preparation.
- Services of the Assistant Town Accountant include internal departmental reviews, budget maintenance, review and posting of transactions and journal entries, state reporting, general ledger maintenance, and grants management.
- Payroll processing, employee maintenance, and W-2 and 1099 processing.
- Accounts payable processing
- Human Resources
- Treasury and Collections
- Insurance claim management and management of Safety Programs and insurance credits.
- Purchasing
- Information Technology including computer set-up and maintenance, technical support, email services, computer backup services, internet and computer security.
- Facility services including repairs, maintenance and cleaning

Management's Response

The Finance Director will undertake this analysis during the FY 15 Budget preparation process, and implement for FY15.

Documentation of Payroll Information

Comment

The Town's personnel files do not always contain source documentation to support rates of pay for each employee. In the past, the Town has accepted a memo from management as support to increase non-union personnel pay rates. However, the supporting memos were not included in the employee's personnel file or in a central location to support changes in non-union pay rates. The lack of such support increases the Town's risk that employees' pay rates may be inaccurate and it does not provide adequate support for changes in pay rates.

Recommendation

We recommend the Town establish a list of documents to be included in each personnel file and that support to justify all pay changes either be included in each personnel file or within a separate payroll file, by employee that will allow all pay rates to be traced back to the original authorization.

Management's Responses

The Human Resources Director is currently working on implementing a standard list of documents that should be included in each personnel file.

The Documentation and Adoption of Key Financial Policies

Comment

During fiscal year 2013, the Town adopted several new financial policies including a Stabilization Fund Policy, Capital Planning Policy and a Free Cash Policy. The Town has not yet finalized other key financial policies including a Debt Policy and a policy for funding long-term liabilities such as OPEB.

A well designed and documented system of financial policies can be a key component in the Town's planning and decision-making with regard to the use of available resources and can provide guidance throughout the budget process. The formal acceptance of financial policies can solidify a community's financial goals and can limit inconsistencies regarding financial decisions. Furthermore, the establishment of formal financial policies is widely recommended by the major bond rating agencies, as they presume that formal policies are most likely to be continued into the future and to transcend changes in the operating environment or personnel.

Recommendation

We recommend that the Town continue the process of establishing and formally adopting a complete set of financial policies that will document the Town's financial goals by completing and adopting a Debt Policy and OPEB funding policy.

Management's Responses

The Finance Director has been in the process of preparing a debt policy. This process will be completed by the end of December for presentation to the Board of Selectmen for adoption. Management will be preparing an OPEB policy by the end of December for presentation to the Board of Selectmen for adoption.

Informational Comments

Future Government Accounting Standards Board (GASB) Statements for Pensions and OPEB

Comment

The GASB has issued new pronouncements that will significantly affect the accounting and reporting requirements for Pensions and Other Postemployment Benefits (OPEB). These new standards will start to phase in during fiscal year 2014 and will substantially impact your financial statements and will also affect the requirements for accumulating the necessary data to meet the reporting requirements.

The new standards that have been issued and their effective dates are as follows:

- The GASB issued Statement #65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented in fiscal year 2014.
- The GASB issued Statement #67, *Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25*, which is required to be implemented in fiscal year 2014.
- The GASB issued Statement #68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*, which is required to be implemented in fiscal year 2015.

The GASB is expected to issue additional standards following #67 & #68 for Pensions, which will similarly affect accounting and financial reporting for OPEB Plans. The GASB is encouraging earlier application of these standards. To briefly summarize these new standards –

- GASB #65 will require reporting each of the financial position elements in a separate section in the statements of financial position. These elements are Assets, Deferred Outflows, Liabilities, Deferred Inflows, and Net Position; where assets + deferred outflows – liabilities – deferred inflows = net position. This new requirement will affect certain aspects of the financial statements currently and they will pave the way for the new reporting requirements of the new Pension and OPEB standards.
- GASB #67 and #68 will substantially change the reporting for pension liabilities and expenses. Changes in pension liability will be immediately recognized as pension expense or reported as deferred outflows/inflows of resources depending on the nature of the changes. Substantial changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes will be required. Current actuarial methods may continue to be used to determine funding amounts. Employers will report in their financial statements a *net pension liability (asset)* determined annually as of the fiscal year end. *Net pension liability (asset)* equals the total pension liability for the plan net of the plan net position. Pension liability is the actuarial present value of projected benefits attributed to past service, and plan net position is the accumulated plan assets net of any financial statement liabilities of the plan.

The Town should expect to record significant pension and OPEB liabilities in the future.

Recommendation

We recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes, and to formulate plans to meet with your actuaries and financial advisers as more information becomes available. You may also want to consider how and when this information should be communicated to your constituents and other financial statement users.