

TOWN OF SAUGUS, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2011

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MELANSON HEATH & COMPANY, PC

CERTIFIED PUBLIC ACCOUNTANTS
MANAGEMENT ADVISORS

10 New England Business Center Drive • Suite 107

Andover, MA 01810-1096

(978) 749-0005 • Fax (978) 749-0006

www.melansonheath.com

To the Board of Selectmen
Town of Saugus, Massachusetts

In planning and performing our audit of the financial statements of the Town of Saugus, Massachusetts as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Town of Saugus, Massachusetts' internal accounting control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion 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 significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of the inherent limitations in internal control, including the possibility of management's override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 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. Material weaknesses are noted in the table of contents and comment headings.

Additional Offices:

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

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 responses to our comments and suggestions have 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 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.

After you have had an opportunity to consider our comments and recommendations, we would be pleased to discuss them with you.

Melanson, Heath + Company P.C.

Andover, Massachusetts
December 12, 2011

CURRENT YEAR ISSUES:

1. Improve Internal Controls in the Library (Material Weakness)

During fiscal year 2011, it was discovered that an employee in the Library had been misappropriating Town funds going back to 2004. Library receipts had not been turned over to the Town within that timeframe and internal controls in the Library were not being followed.

Massachusetts General Laws allow for the custody of Library property to be held by the Trustees. The Trustees established a bank account in the name of the Library. The account was not in the Town's accounting records nor was it held by the Town's Treasurer. As such, it was not under the same control structure as other Town funds.

We recommend that the Town implement internal controls in the Library to ensure that all Town funds are appropriately turned over to the Town Treasurer.

Town's Response:

In July 2011 the Treasurer reviewed the policies and procedures of handling cash receipts with the Library Director. These policies and procedures were previously prepared and adopted during FY 2008 with recommendations by our independent auditors. All cash receipts are reported daily by the library staff to the director and then the director deposits all receipts weekly with the Treasurer. Monthly, the Director receives a report of revenue from the Town Accountant and reconciles this to her own records. A meeting with the Library Board of Trustees was also held to inform them of the cash receipt policies and procedures that are to be followed at the Library as well as all other departments.

2. Monitor Collateralization of Cash Balances

At June 30, 2011, the Town had approximately \$ 8 million on deposit which was only partially secured by FDIC and DIFM insurance. Since FDIC insurance generally only covers the first \$ 250,000 in each bank, at June 30, 2011, the Town had approximately \$ 1.3 million on deposit that was in excess of the insurance. In the event of a bank failure, these deposits would be at risk.

We recommend the Town work with its primary banks to establish a formal cash investment policy. In many cases, the bank can offer a means of collateralizing account balances. Although this additional security may result in lower investment earnings, it would provide additional assurance that Town deposits are secure.

Town's Response:

As of September 22, 2011, the Town of Saugus has entered into a Repurchase Agreement with the financial institution(s) where account balances exceed the \$ 250,000 FDIC insurance limits and no other DIFM insurance is maintained. The funds are collateralized by overnight investment service on excess funds over the \$ 250,000 balance. The financial institution sells to us, US agency issued securities and buys back the securities the next day, at a slightly higher price. All funds are collateralized at no less than 102% of the balance.

3. Reconcile High School Student Activity Fund Accounts

High School student activity fund accounts were reconciled at June 30, 2011; however, there were old outstanding items that need to be addressed as well as variances that need to be adjusted as these accounts had not been reconciled in many years. In addition, we noted balances for old graduated classes dating back to 1989, scholarships, and grants which are not appropriate student activities. Further, there were a few accounts that had deficit balances at June 30, 2011.

We recommend that student activity accounts be reconciled on a monthly basis. In addition, we recommend that accounts with deficit balances be funded and that inappropriate accounts be closed. We further recommend that the decentralized student activity accounts be audited annually in accordance with Massachusetts General Laws Chapter 71, Section 47.

Town's Response:

The High School activity fund accounts are reconciled on a monthly basis but that reconciliation in the past included only the checking account. The money market account was included as of the June 30, 2011 reconciliation and will continue to be included going forward. Although the occurrence of deficit balances is minimal, we agree that they should not occur and they will be

cleared and prevented going forward. With respect to old class accounts and old reconciling items, we agree for the need to clear these items and they will be cleared in FY 2012. With respect to scholarships and grants, we will look to segregate those in separate funds in FY 2012. With respect to annual auditing of the student activity funds, we agree that audits need to be done and an examination of revenue and expense activity for FY 2010 was done for both the High School and Middle School activity funds and audits will commence for FY 2012 and forward.

FOLLOW-UP ON PRIOR YEAR ISSUES:

The following issues were reported in the prior management letter, but have not yet been fully resolved.

4. Other Prior Year Issues

The following section of the management letter identifies several other prior year recommendations that are reported in a very summarized manner. We will be available to discuss these issues in more detail to ensure that there is a clear understanding of the issues and recommendations.

- Monitor inactive and old special revenue and capital project fund accounts to determine the disposition of remaining surplus and deficit balances, and establish a plan to fund deficit balances.
- Establish formal trust fund investment policies to maximize investment returns at desired risk thresholds.
- Monitor water and sewer operating budgets to ensure that operating losses do not occur. In fiscal year 2011, both funds incurred operating losses. The loss in the water fund caused a deficit fund balance at June 30, 2011 of \$ 302,303 (on a statutory basis).

Town's Response:

During fiscal year 2011, the Town Accountant closed several special revenue funds and raised on the Fiscal Year 2012 Tax recap the deficit special revenue account balances. All Departments have been notified of their respective special revenue funds surplus balances, and they are currently spending

down these accounts. Certain surplus special revenue accounts do have restrictions and the accounting department is currently researching Town Meeting votes and a determination will be made by management on how to proceed with such surplus balances.

In October 2011, the Treasurer drafted and accepted Investment Guidelines for General Funds and Other Operating Funds as well as Trust Funds and Bond Proceeds. Those guidelines will be implemented in 2012 to maximize investment returns with desired risk. The guidelines as stated here were written based on the suggested format of the Government Finance Officers Association as recommended by the Massachusetts Collector Treasurers Association.

Excess spending has occurred on a limited number of occasions in both enterprise funds due to emergency situations which arise due to an unusually high number of expensive repairs for water breaks and sewer line collapses, plus unanticipated abatements and adjustments. Controls were put in place during the current fiscal year. The Town Accountant reviews and analyzes the year to date budget reports on a weekly basis and supplies the Director of Public Works with a copy of the year to date budget reports for the Water and Sewer Enterprise Funds.