

ROSELLI, CLARK & ASSOCIATES
Certified Public Accountants

TOWN OF UPTON, MASSACHUSETTS

Management Letter
Year Ended June 30, 2020



TOWN OF UPTON, MASSACHUSETTS

MANAGEMENT LETTER

**AS OF AND FOR THE YEAR ENDED
JUNE 30, 2020**

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TRANSMITTAL LETTER

The Honorable Members of the Board of Selectmen
Town of Upton
Upton, 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 Upton, Massachusetts (the “Town”) as of and for the year ended June 30, 2020, 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 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 Town’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Town’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 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.

Roselli, Clark & Associates
Certified Public Accountants
Woburn, Massachusetts
January 12, 2021

OVERVIEW

The COVID-19 outbreak shaped much of the discussion of the Town's operations for the second half of fiscal year 2020 and its effects are expected to materially affect most of fiscal year 2021. The Commonwealth of Massachusetts provided budgetary guidance to the 351 cities and towns within the state in early fiscal year 2021 indicating that it expects to level-fund state aid for fiscal year 2021. Upon final passage of the Commonwealth's budget, the Town's expected net state aid remained relatively consistent with the prior year at approximately \$792,000. Fortunately, the Town's state aid revenue estimates used in its fiscal year 2021 budget were built on the fiscal year 2020 levels.

The Town implemented a number of cost-saving initiatives in response to COVID-19 including the deferral, reduction and/or elimination of many discretionary spending. The Town expects that many revenue sources dependent on user fees and charges as well as certain excise taxes may be materially affected in fiscal year 2021 and possibly into fiscal year 2022.

The Town was awarded approximately \$706,000 in federal Coronavirus Aid, Relief and Economic Security Act ("CARES Act") funding. These funds are administered by the Commonwealth's Executive Office for Administration and Finance. Under the CARES Act, these funds are limited in their use for COVID-19 necessary expenditures and may not be used to substitute lost revenue.

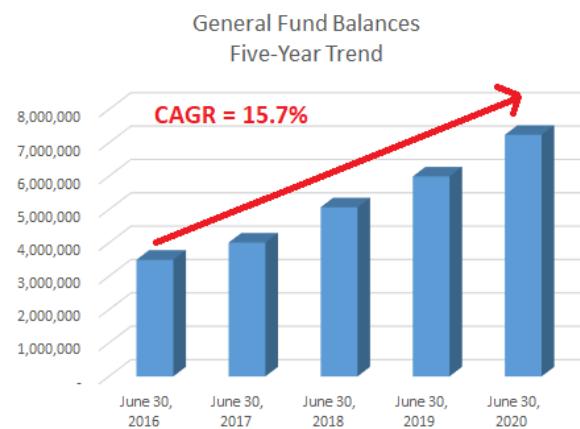
Prior to the COVID-19 outbreak, the U.S. and local unemployment rates were at historic lows. Additionally, labor participation, wages and consumer confidence had been steadily trending higher. The following table illustrates the unemployment rates for Massachusetts as reported by the Commonwealth's Executive Office of Labor and Workforce Development.



Employment in the food, leisure, travel and entertainment industries have been hit particularly hard and continue to struggle. Despite this steep increase in unemployment, residential real estate values continue to rise to historic highs.

The Town's financial condition continues to be good, as measured by the budgetary flexibility in its general fund. Budgetary flexibility is often measured by comparing the assigned and unassigned fund balances in the general fund to the current year's total general fund expenditures. Credit rating bureaus often refer to this as a "reserve ratio." At June 30, 2020, the Town's reserve ratio was approximately 22% versus 20% in the prior year. Credit rating bureaus would consider the Town's reserve ratio to be very strong. Standards & Poor's Financial Services LLC ("S&P") assigns the Town an AA+ credit rating on its long-term general obligation bonds, which is one rating lower than AAA, its highest credit rating. This high credit rating enables the Town to enjoy very favorable terms in the municipal bond market.

In its governmental funds financial statements, which most closely resembles the Town's statutory accounting records, the Town's unassigned fund balance in its general fund exceeded \$5.2 million at June 30, 2020 and its total fund balance totaled over \$7.2 million. The Town's general fund balance has been steadily growing. A five-year trend of the Town's total fund balances is presented in the table at right; over the past five years, the total general fund balance has increased approximately 15.7% annually.



The Town's most significant long-term liabilities pertain to its net pension and net other postemployment benefit liabilities, which total approximately \$16.4 million in the aggregate at June 30, 2020. The Town is a participating employer in the Worcester Regional Retirement System, or WRRS. The WRRS has ninety-nine individual contributing entities including the Town, whose proportionate share of the WRRS net pension liability was nearly \$9.2 million at June 30, 2020. The WRRS expects annual appropriations to increase greater than 4% annually for the foreseeable future. The Town's net other postemployment benefit liability amounted to approximately \$7.2 million at June 30, 2020. The Town's OPEB trust is estimated to be approximately 8.8% funded at June 30, 2020, which is slightly better than the Massachusetts median for communities of the Town's size and budget.

The Town's long-term debt load is very manageable. The Town's total long-term debt at June 30, 2020 is \$6,735,000.

The remainder of the report reflects informational items, findings and recommendations. This discussion is intended to provide the Town and its management with recommendations for improvement in accounting and financial operations. The Town should review these recommendations and, if determined to be cost-effective, implement these improvements.

INFORMATIONAL ITEMS

New Lease Accounting Standard

The Town will be required to adopt a new accounting standard relative to leases beginning in fiscal year 2022 (deferred one year by the GASB). This new accounting standard will dramatically change the manner in which governments report lease transactions.

Under this new accounting standard, many lease obligations that were previously accounted for by the Town as an expenditure similar to rent expense will be recognized as an asset with a corresponding liability (similar to debt). Additionally, if the Town leases property to another party, the Town will report a receivable for the present value of the future lease payments and a corresponding deferred inflow of resources.

The new accounting standard (GASB Statement No. 87) defines a lease as a contract that conveys control of the right to use another entity's nonfinancial assets (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles and equipment. Any contract that meets this definition should be accounted for under this new accounting standard.

To effectively implement this accounting standard, the Town will need to perform the following for its lease obligations:

1. Identify all *material* leases. At first pass, this appears to be a straight-forward process. However, some lease arrangements, as defined under the accounting standard, may not use the term "lease" in the agreement or other paperwork. Furthermore, not every agreement that is labeled a lease will meet the accounting standard's definition of a lease. The Town should perform the following:
 - a. Scan disbursement details to identify recurring payments in similar amounts to third parties. This may be indicative of a leasing arrangement.
 - b. Meet with departments that are most likely to lease equipment like technology, public works and police departments. Inquire about the existence of leases and correspond the results of these inquiries with the procedures in a.
 - c. Materiality will play a role in this analysis. A lease arrangement for a Town's postal meter will not have as great an impact as its lease of a fleet of police cruisers. The Town should work with its auditors to identify a dollar threshold for this analysis.
2. Gather the lease agreements/contracts for the Town's leases. Create a central repository for lease agreements either in paper or electronic format.
3. Create a database or spreadsheet of the key lease terms, which will include the lessor name, payment terms, description of the lease and renewal options, if any.

If the Town is receiving regular, periodic payments from another party for that party's use of the Town's property, a similar process needs to be followed to account for the Town as a lessor.

Once this data has been accumulated, work with your auditor to determine the best manner to calculate the lease figures.

A similar lease accounting standard was recently adopted for nongovernment accounting with public companies adopting this lease standard beginning in calendar year 2019. There are numerous publications on the difficulties public companies experienced in this implementation. One of the most common problems many public companies faced was not starting this process early enough. We encourage the Town to begin this process soon.

Network Security

Ransomware continues to affect municipal organization in the United States. Ransomware is an insidious type of malware that encrypts, or locks, valuable digital files and demands a ransom to release these files. The most common ransomware attack involves a victim opening an emailed file or clicking an attachment that appears legitimate like an invoice, but actually contains the malicious ransomware code. As these emails often appear to be legitimate, the victim is unknowingly baited into executing the ransomware code. Ransomware attacks are opportunistic; the size of the victim organization and its available resources are not leading indicators to an attack. Once penetrated, ransomware attackers can cause a municipality's technology resources to come to a standstill.

To compound matters, remote access to a government's secure servers and networks has increased greatly as more and more municipal employees are working remotely due to the effects of COVID-19.

Effective protection first requires a commitment from a municipality's leadership to dedicate the necessary resources to best protect the community. Technology personnel (internal and/or outsourced) must continuously exercise diligence in this area. Finally, this commitment then extends to all municipal employees who, whether they like it or not, are part of ransomware prevention/protection.

The U.S. FBI recommends that organizations provide ransomware training for their employees and employ robust technical prevention controls. The FBI also recommends developing a business continuity plan in the event of a ransomware attack. More detailed recommendations by the FBI Cyber Division can be found on the FBI's website.

The Town's technology plans incorporate a number of prevention and protection measures including deploying anti-virus and anti-malware software, managing network permissions and access, regularly backing up digital data and requiring users to rotate passwords periodically. We continue to recommend that the Town perform an in-depth risk assessment surrounding its network security for not only its critical financial functions, but also in areas such as police, fire and the library; attacks within one of these remote departments can penetrate into the Town's critical financial systems. Additionally, the Town should strongly consider additional employee training in this area as an unacceptably high percentage of ransomware attacks are initiated from employees unknowingly activating the ransomware software.

Increased Frequency of Phishing Scams Throughout the Commonwealth

Phishing scams of municipalities throughout the nation have been increasing in frequency and success over the past several years. One of the more common and successful strategies involves fraudsters creating email accounts that appear to belong to legitimate vendors (or even a municipal employee) a community does business with. Over a series of email communications, the fraudster will coerce sensitive information from a community or initiate a change to payment method (i.e., new mailing address or direct deposit/wiring instructions).

We've provided some guidance to the Town's finance personnel surrounding these issues, including how to spot some "red flags" that may reveal these scams via email communications. We also recommend some policy enhancements like requiring changes in direct deposit information to be completed by employees in person and changes to payment methods to vendors to be confirmed independently over the phone or in person if possible.

Finally, we cannot stress enough the need to have up-to-date network security tools and protocols and the need to regularly educate employees on these scams and threats.

Waste, Fraud and Abuse

In July 2018, the Comptroller General of the United States issued revised *Government Auditing Standards*, which is commonly referred to as the "Yellow Book." The new Yellow Book defines the concept of waste in a government as the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve the violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions and inadequate oversight.

The COVID-19 outbreak and the related workforce shutdowns/slowdowns has provided municipalities and opportunity to reassess their current resources and discretionary spending. Costs and expenses previously thought to be required and/or necessary may now be reevaluated and may be considered to be wasteful. We recommend that the Town evaluate the effect its shutdowns/slowdowns have had on its operations and identify potential areas of wasteful spending and take the appropriate next actions.

Transition in Treasurer/Collector Office

In its June 2020 Annual Town Meeting, the Town approved special legislation to change the elected Treasurer/Collector position to an appointment by the Town Manager. At the end of fiscal year 2020, the Town's long-time Treasurer/Collector retired and a new appointed Treasurer/Collector is now serving the Town. Fortunately, the Town did not experience any material service disruptions during this transition.

In our December 11, 2019 letter to management, we completed a departmental review of the then elected Treasurer/Collectors office. Generally, we would offer a progress update to the findings and recommendations made in this letter. However, in light of this transition as well as the effects of the COVID-19 pandemic and staffing changes within this office, an adequate progress update cannot be completed at this time. We intend to evaluate the Treasurer/Collector's progress as part of our fiscal year 2021 financial statement audit.

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