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**Bill Fraher, CPA**

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**TOWN OF MERRIMAC**

**MANAGEMENT LETTER**

**June 30, 2011**



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The Board of Selectmen  
Town of Merrimac, Massachusetts

Dear Board Members:

In planning and performing my audit of the financial statements of the Town of Merrimac for the year ended June 30, 2011, I considered its internal control structure in order to determine my auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure. However, during my audit, I noted certain matters involving the internal control structure and other operational matters that I am presenting for your consideration.

My consideration of the internal control structure was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that would be considered reportable conditions under standards established by the American Institute of Certified Public Accountants. In addition, because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected by such control structure.

*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 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 Town of Merrimac, Massachusetts' financial statements will not be prevented or detected and corrected on a timely basis. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses.

Other matters involving the internal control structure and other operational matters are presented in the following report. These matters were considered in determining the nature, timing and extent of the audit tests applied in my audit of the financial statements, and this report does not affect my report on those financial statements dated March 12, 2012. I have not considered the internal control structure since the date of my report.

This report is intended solely for the use of the Board of Selectmen and Town Management and is not intended and should not be used by anyone other than these specified parties.

Bill Fraher, CPA  
March 12, 2012

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**Section I - Overview of Operating Results**

[Please note that the discussion of the Town's financial results are based on amounts in the Town's fund financial statements (rather than the entity wide statements), presented in accordance with Generally Accepted Accounting Principles (GAAP).]

At June 30, 2011, the Town's general fund unassigned (formerly undesignated) fund balance in its financial statements was \$499,421, down slightly from \$510,065 at June 30, 2010. Although the Town utilized all prior year free cash during fiscal year 2011 (eliminating the free cash that was certified at June 30, 2010), the Town generated some new free cash from the net 2011 budgetary results. This was the result of unexpended appropriations and revenues over budget, which totaled \$365,430. [Please note that since the GAAP based undesignated fund balance includes a sixty day accrual of approximately \$80,000, certified free cash will be less than undesignated fund balance at June 30, 2011.] The Town also ended the year with \$665,807 in its stabilization fund, up slightly from the prior year amount of \$638,835.

When combined, the Town's undesignated fund balance and stabilization fund make up approximately 9% of the Town's annual budget, up from 7% last year. The Town should attempt to continue building up free cash and stabilization funds as budgetary circumstances allow. While there are no definitive guidelines as to how much the Town should have in these reserves, a general rule is from 5% to 15% of the annual operating budget. As shown, the Town is about in the middle of this range, an improvement from prior years' amounts.

The Town worked hard to maintain a positive financial position during the recent economic slow down and state budget reductions of the past few years. If the economy continues to struggle and local aid continues to be cut, it will be difficult to balance the annual budget and maintain current levels of free cash and stabilization fund balances. The Town should monitor the trend of tax revenues, local aid and other receipts and ensure that annual operating budgets are kept within available revenue and other funding sources. The Town should also attempt to maintain a healthy level of operating reserves to guard against unforeseen budget issues.

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**Section II - Control Deficiencies**

Under auditing standards, there are three categories of internal control deficiencies and other matters that can be identified during an audit. These three categories are material weaknesses, significant deficiencies and control deficiencies. Any items that are identified as material weaknesses or significant deficiencies require modification of the auditor's report on internal control and compliance (which is presented in the report on the financial statements).

***II-A. Material Weaknesses***

There were no material weaknesses noted during this year's audit.

***II-B. Significant Deficiencies***

There were no significant deficiencies noted during this year's audit.

***II-C. Control Deficiencies***

***II-C-1. GASB 34***

In 2005, the Town implemented GASB Statement Number 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Town still has some GASB 34 compliance issues that should be addressed. These include:

- Recording accrued interest on long term debt and compensated absences.
- Recording employee benefits by expense function.
- Converting revenues to the categories required for entity wide statements.

The Town should work on eliminating some or all of these items in the coming year.

***II-C-2. Statements of Auditing Standards on Fraud & Risk Assessment***

The Auditing Standards Board has issued numerous Statements on Auditing Standards (SAS) related to fraud and risk assessment.

One such statement, SAS 99 - *Consideration of Fraud in a Financial Statement Audit*, outlines an auditor's responsibility as it relates to the possibility of fraud. One area where most communities are exposed to fraud risk is in the area of miscellaneous cash receipts. Due to the nature of Town operations, it is necessary that certain miscellaneous cash receipts be

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**Section II - Control Deficiencies (continued)**

***II-C-2. Statements of Auditing Standards on Fraud & Risk Assessment (continued)***

decentralized at various Town departments. Although the dollars involved are often not material to the financial statements, this situation creates an internal control concern.

The Town should monitor this area for possible internal control improvements. One possible internal control enhancement is to have periodic internal audits of selected departmental cash receipts, where departmental turnovers are matched to underlying documentation. While other steps could be implemented, the cost of a more tightly controlled system for miscellaneous departmental receipts must be weighed against the related internal control benefits.

The Auditing Standards Board also recently issued several new SAS that are collectively called the "Risk Assessment Standards". These standards change and expand an auditor's responsibility in reviewing, identifying and assessing risks faced during a financial statement audit. These standards also affect management's responsibilities in this area.

One of the elements of an organization's internal control is risk assessment. Therefore, it is important that the Town periodically perform a risk assessment process to analyze, identify and evaluate areas where the Town may be exposed to various financial risks. As part of this process, the Town should review its systems, procedures and internal controls in all material financial and operational areas to determine if any modifications are required to minimize such risk. The Town should also ensure that it has an ongoing monitoring program in place to periodically test the effectiveness of any related policies and procedures that are in place.

***II-C-3. Tracking of Miscellaneous Accounts***

The Town should improve its tracking of certain accounts. During the audit, we noted that the Town does not have a detailed listing of tax possessions. The Town also does not have a summarized list of third party invoices for police details.

The Town finance offices should work with the applicable Town departments to improve tracking of these accounts by implementing more formal documentation on these items. For police details, the Town Accountant should receive third party police detail invoices so that better tracking and reconciling can be performed.

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**Section II - Control Deficiencies (continued)**

***II-C-4. GASB 40***

In 2003, GASB issued Statement Number 40, *Deposit and Investment Risk Disclosures*. In addition to changing the required financial statement disclosures for the Town's cash and investments, this statement outlines the risks the Town undertakes when making investment allocation decisions and when placing funds into the hands of various third parties (such as banks and investment brokers). The Statement recommends that the identified risks be included in the Town's investment policy.

The Town should familiarize itself with the requirements of GASB 40 and ensure that the outlined risks (which include interest rate risk, custodial credit risk and concentration of credit risk) are addressed in its investment policy. The Town should also ensure that the required financial statement disclosures are available for the annual audit.

***II-C-5 Light Department Cash Reconciliation***

There is a variance between cash per the Town's general ledger and the Light Department's general ledger. While the variance is not significant, these amounts should be in agreement.

The Town should implement a monthly cash reconciliation process to reconcile the light and Town ledger cash balances.

***II-C-6 Health Insurance Portability and Accountability Act (HIPAA) Compliance Issues***

During our review of Town expenses, it was noted that some invoices related to the Town's ambulance operations contain information that may be required to be kept confidential under HIPAA requirements.

The Town should review its HIPAA compliance policies and procedures and ensure that it is in compliance with applicable requirements.

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**Section III - Informational Matters/New Accounting & Auditing Standards**

***III-1. GASB 45 - Other Postemployment Benefits (OPEB)***

For the 2009 financial statements, the Town implemented GASB Statement Number 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The implementation resulted in the recording (on the entity wide statements) of a long-term liability of \$283,051. This included the current year's estimated cost (not currently funded) plus the first year of a thirty year amortization of the unfunded actuarial accrued liability of \$3,596,000.

For the 2011 financial statements, the Town continued recording this OPEB liability. The liability at June 30, 2011 is now \$1,069,402 (inclusive of \$220,249 for the light department). Unless the Town adopts the state statute that allows for an irrevocable trust and begins to fund the trust, the GABS 45 liability will continue to grow at a rate of approximately \$350,000 per year until the amortization of the unfunded actuarial accrued liability of \$3,596,000 is complete.

The Town fulfilled its obligation under GASB 45 for its 2009 through 2011 financial statements. As required by GASB 45, the Town will need an updated valuation for the 2012 financial statements. This valuation should include all enterprise funds and all information required for the next three audits.

In future years, as this liability grows with the amortization of the unfunded actuarial accrued liability, the Town should consider addressing a possible long-term funding strategy. The size of the unfunded liability and the existence of a funding plan could have an impact on future bond ratings.

***III-2. GASB 54***

For the 2011 financial statements, the Town implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This statement reclassified fund balances for all governmental funds into the five new classifications of nonspendable, restricted, committed, assigned and unassigned. This statement also required (for financial statement purposes only) the reclassification of the Town's stabilization fund to the general fund as committed fund balance.

The Town has successfully implemented GASB 54. The Town should consider reviewing its fund balance policy to ensure that all GASB 54 requirements have been addressed and policy language is consistent with the new terminology.