

ROSELLI, CLARK & ASSOCIATES
Certified Public Accountants

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2021



TOWN OF STERLING, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2021

TABLE OF CONTENTS

Transmittal letter.....	1
Overview	2 – 3
Informational Items, Findings and Recommendations	4 – 6



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TRANSMITTAL LETTER

The Honorable Members of the Select Board
Town of Sterling, 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 Sterling, Massachusetts (the "Town") as of and for the year ended June 30, 2021, 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 Select Board, and others within the Town, and is not intended to be, and should not be, used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Roselli, Clark & Associates".

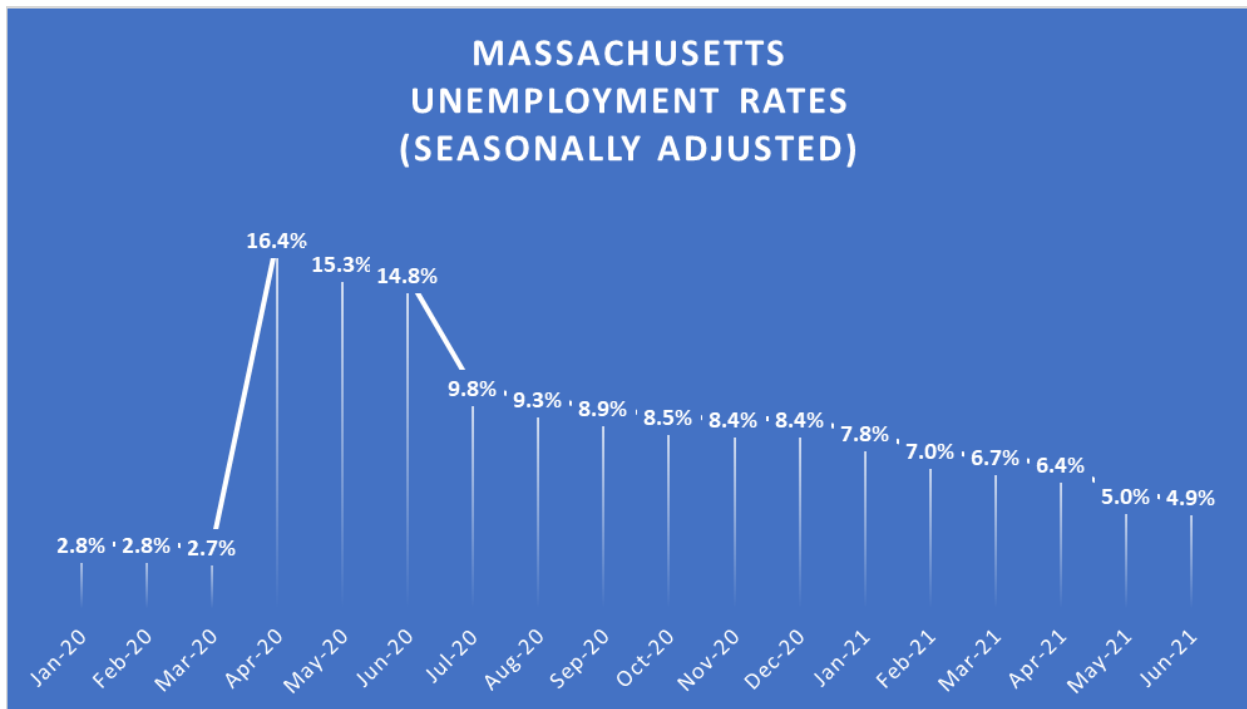
Roselli, Clark & Associates
Woburn, Massachusetts
January 14, 2022

OVERVIEW

The COVID-19 outbreak continued to significantly affect nearly every aspect of the Town's operations during fiscal year 2021. Massachusetts communities entered fiscal year 2021 with a number of uncertainties, not the least of which was the level of fiscal year 2021 state aid, employment and supply chain issues and the evolving workplace and community dynamics associated with vaccines, mask mandates, remote work/education and social distancing.

Federal assistance was offered in the form of the 2020 Coronavirus Aid, Relief and Economic Security Act ("CARES Act") funding, which was required to be expended by October 31, 2021. This federal assistance was supplemented by the 2021 American Rescue Plan Act ("ARPA"), for which the Town was awarded up to approximately \$2.4 million. There is more flexibility in the ARPA award than the CARES funds, including the ability to replace lost public sector revenues. Currently, ARPA funds must be obligated by December 31, 2024 and expended by December 31, 2026.

While there has been significant improvement in the Massachusetts labor market, employment levels have not returned to their pre-pandemic levels, as illustrated in the unemployment table below.



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 strong as measured by the budgetary flexibility in the Town's 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, 2021, the Town's reserve ratio was approximately 30%, which was a significant improvement from the prior year's reserve ratio of 25%. Credit rating bureaus would consider the Town's reserve ratio to be very strong. Currently, Moody's Investor Services assigns an Aa2 credit rating to the Town's general obligation bonds, which is its third

highest rating and signifies that the Town has a very strong capacity to meet its financial commitments. This strong credit rating affords the Town to borrow funds for large capital projects at very favorable interest rates.

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 \$7.3 million at June 30, 2021 and the total fund balance approached \$9.1 million.

The Town maintains a relatively low level of debt in both its governmental activities and business-type activities, which affords it a good deal of flexibility to meet future capital needs.

The Town and its light department established OPEB trust funds several years ago. OPEB trusts are intended to assist the Town in funding its future postemployment health and welfare benefits to its employees. The Town has been making annual contributions to the OPEB trust, which its independent actuary estimates to be approximately 10.9% funded at June 30, 2021; the light department's OPEB trust is estimated to be approximately 60.2% funded as of December 31, 2020 (its fiscal year end). The establishment of an OPEB trust and continuing contributions, while not currently mandated by Massachusetts General Law, are prudent business decisions that are viewed very favorably by credit rating bureaus.

The remainder of the report reflects informational items and 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. Items that have been repeated from past letters to management are so indicated.

INFORMATIONAL ITEMS, FINDINGS AND RECOMMENDATIONS

Network Security

As previously reported, ransomware continues to affect municipal organization in the United States. 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 have a role in the Town's 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, providing employee training, regularly backing up and monitoring digital data and requiring users to rotate passwords periodically. The Town must continually address this issue as it is more likely than not that this risk will only intensify in the years to come. The Town's outsourced technology provider completed a network vulnerability review in 2019. We understand that the Town is currently evaluating performing a follow-on network security review and enhancing remote access via dual-factor authentication. We applaud the Town's diligence in this area and continue to recommend that these vulnerability assessments be completed biennially, at a minimum.

Increased Frequency of Phishing Scams Throughout the Commonwealth

As previously reported, 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 treasury personnel surrounding these issues, including how to spot some "red flags" that may reveal these scams via email communications. We understand that the Town has implemented 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.

ARPA

The Town was awarded approximately \$2.4 million in federal awards through the Coronavirus State and Local Fiscal Recovery Funds established by the American Rescue Plan Act of 2021 (“ARPA”). The City received its first round of funding in late fiscal year 2021 (approximately \$216,000). ARPA funds can be deployed in a less restrictive manner than the CARES Act funding the City received in fiscal years 2020 and 2021.

The use of ARPA funds will require periodic reporting to the United States Department of the Treasury (“U.S. Treasury”). Furthermore, it is possible that these funds may subject the Town to a separate compliance audit for its federal grants, which is commonly referred to as a single audit. We will work closely with the Town over the next several months to determine whether a single audit will be needed for fiscal year 2022 (or 2023) and provide guidance to the Town to assist it in preparing for this process.

In January 2022, the U.S. Treasury issued a final rule for ARPA; previously, communities were managing this award under an interim final rule. The final rule appears to be more flexible. Under the final rule, the Town may use ARPA funds to:

1. Replace lost public sector revenue.
2. Support the COVID-19 public health and economic response.
3. Provide premium pay for eligible workers.
4. Invest in water, sewer and broadband infrastructure.

The first statutory category is the federal government’s attempt to make whole communities that lost revenues due to government shutdowns and restrictions placed on it and its residents during the pandemic. Essentially, the calculated lost revenue can be used by a community for government services in a *near* unlimited manner.

Under the final rule, the Town may elect a one-time “standard allowance” of up to \$10.0 million or complete a calculation of lost revenue using a U.S. Treasury formula that compares actual revenue to a counterfactual trend. This represents 100% of the Town’s award as the Town’s total award is less than this one-time standard allowance. We recommend that the Town elect the standard allowance.

The Town may use these funds for any service it traditionally provides its residents but cannot be used for debt service, extraordinary pension contributions, replenishing “rainy day funds,” satisfying legal settlements or any use that violates ARPA, the Uniform Guidance and other federal, state and local laws and regulations.

Should the Town allocate a portion of these funds to the Wachusett Regional School District, we strongly recommend that the Town execute a subrecipient award agreement with the district that, among other things, (i) identifies the district’s intended use of these federal funds, (ii) the District’s agreement to adhere to the Uniform Guidance, ARPA guidelines and other federal and state laws, (iii) the District’s agreement to include these funds in its single audit reporting and (iv) the District’s agreement to provide periodic reporting to the Town as to its use of these funds.

Interest Income – U.S. Treasury guidance on ARPA permits ARPA funds to be invested in interest-bearing accounts. Furthermore, U.S. Treasury guidance do not require that such interest be retained for the four eligible statutory categories described above. Therefore, the Town may assign interest earned on ARPA funds to its general fund.

New Lease Accounting Standard

As previously reported, the Town will be required to adopt a new accounting standard relative to leases beginning in fiscal year 2022. The Town should evaluate all *material* recurring transactions with outside vendors and/or customers to identify potential lease arrangements. Once identified, the Town should gather the pertinent lease agreements and create a database or spreadsheet of the key lease terms, which will include the lessor's name, payment terms, description of the lease and renewal options, if any.

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.

Improvements Since our Last Letter to Management

We have recommended that the Town create a rolling multi-year revenue by type/department analysis for several years. Such analyses are useful for budgeting purposes as well as to spot irregularities and/or abnormalities, which may be due to a variety of reasons including fraud. We understand that the Town has recently completed this analysis and is in the process of updating it.

Areas We Continue to Highlight

We continue to highlight the following items that have been communicated in greater detail to management in our previous letters to management.

Fraud Prevention Measures. We are pleased to report that the Town adopted a financial policies and procedures manual in 2018 that included an antifraud policy. That policy reads, in part, "Town officials and department heads are responsible for instituting and maintaining a system of internal controls to reasonably ensure the prevention and detection of fraud, misappropriations, and similar irregularities." To that end, the financial policies and procedures adopted by the Town's Board of Selectmen contain a variety of procedures for account reconciliations, revenue turnovers and the year-end accounting close.

In addition to the procedures included in the financial policies and procedures manual, we continue to recommend that the Town's Operations Manager perform periodic "spot audits" on departments' cash handling procedures as well as payroll and vendor invoice processing.

Spot audits permit the Town to evaluate the cash handling and payroll procedures of a department firsthand. These spot audits also communicate to the Town that the Town's management takes seriously its cash handling and payroll policies and procedures.

Closing Checklist. Closing checklists are used by many organizations to track their periodic/annual accounting closes, assign primary and review responsibilities and better ensure that accounting closes are performed timely and accurately. Closing checklists are seldom used in municipalities, but we believe that the Town would be well served by implementing such a control.

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