

Town of Franklin

Town Administrator
Tel: (508) 520-4949



Fax: (508) 520-4903

355 East Central Street
Franklin, Massachusetts 02038-1352

Date: December 7, 2018

To: Town Council

From: Jamie Hellen

A handwritten signature in blue ink, appearing to be "J. Hellen", is written over the name "Jamie Hellen" in the "From:" field.

Re: Risk Assessment

For several years, the Town's auditors suggested the Town conduct an organization wide risk assessment. This past year, the Council authorized funding for us to conduct an independent, townwide assessment of risk in a variety of industry standard categories.

Attached is the Executive Summary of this report and the author, Terenzio Volpicelli, is here this evening to do a short presentation on the findings, the items the Town should improve, what steps the Town is taking to remediate those findings and answer any questions.

The full report is online on the Town's Budget page:

<https://www.franklinma.gov/town-budget>

The good news is that the risk assessment shows the Town doing great things and has no major structural issues. The main theme throughout is the auditor has suggested we should document our policies and procedures better and update them more periodically as well.



TOWN OF FRANKLIN, MA

Financial Risk Assessment

Office of the Comptroller

December 2018

TABLE OF CONTENTS

Overview	1
Summary of Financial Risks Identified	7
The Control Environment.....	11
Technology.....	13
Shared Financial Services:	
SCR – Cash Receipts	19
SCD – Cash Disbursements	24
SPR – Payroll and Personnel	29
PT – Property and Excise Taxes.....	35
Dedicated Services – Significant Departments:	
TA – Town Administrator	39
FA – Facilities.....	41
PO – Police Department.....	44
FI – Fire Department	47
BI – Building and Inspections	51
ED – Schools.....	54
PW – Public Works	63
RE – Recreation	67
Dedicated Services – Other Departments:	
TC – Town Clerk	70
LI – Library.....	71
BH – Health Department.....	71
SR – Council on Aging.....	72
VS – Veterans’ Services	72
AH – Affordable Housing Trust	72
Insurance and Bonding	73
Acknowledgments.....	74

OVERVIEW

This financial risk assessment for the Town of Franklin, Massachusetts (the “Town”) was performed in August 2018 under the direction of the Town Comptroller. The purpose of this financial risk assessment is to assist in the evaluation of the adequacy of the Town’s internal controls over financial reporting.

The key accounting cycles identified by the Town at the onset of this project included cash receipts, cash expenditures, payroll and personnel, treasury operations and capital asset management. The effects of technology on these key accounting cycles must be evaluated in any risk assessment process. These key accounting cycles are consistent throughout the Commonwealth for municipalities the size of the Town.

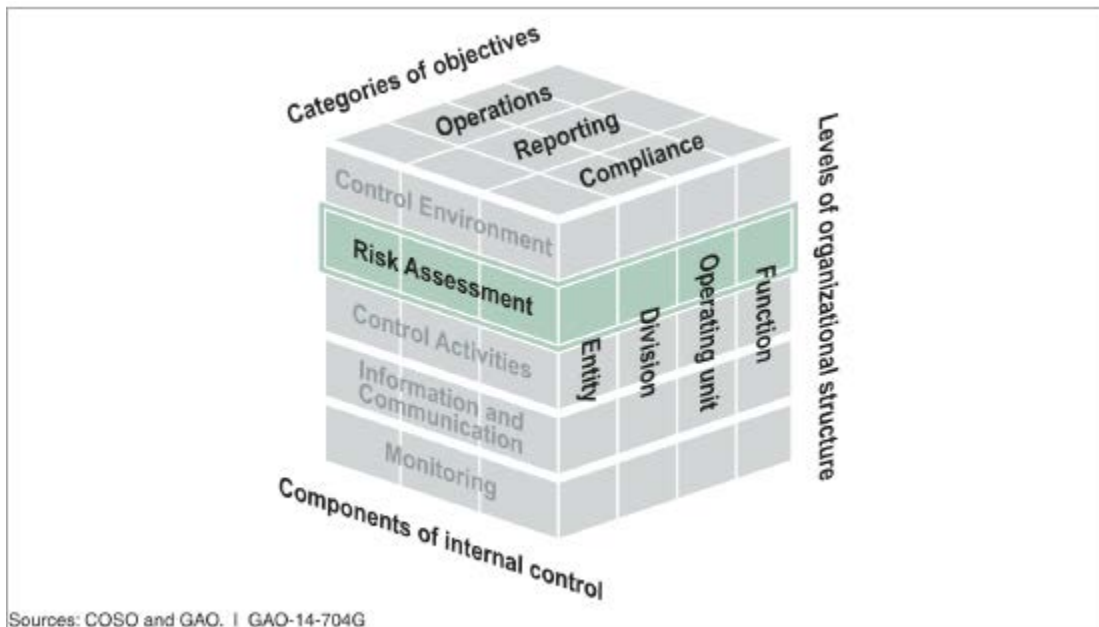
Green Book/COSO Internal Control Frameworks

The Comptroller General of the United States issues *Standards for Internal Control in the Federal Government*, which provides the overall framework for establishing and maintaining an effective internal control system. This publication is commonly known as the “Green Book.”

The Green Book sets forth an internal control framework based on seventeen control principles. The seventeen control principles are organized into five components of internal control:

1. The Control Environment
2. **Risk Assessment**
3. Control Activities
4. Information and Communication
5. Monitoring

The second component of internal control is Risk Assessment, which is the process in which the Town’s management assesses the risks it faces as it seeks to achieve its goals and objectives. The Town’s management must assess risk it faces from both internal and external sources.



The Green Book is substantially similar to the internal control framework most commonly used in private industry – COSO. In fact, the Green Book was rewritten in 2014 to more closely resemble the COSO internal control framework with a number of modifications that are intended to make the COSO internal control framework more suitable to federal, state and local governments.

Risk assessment is the process by which:

1. Management identifies risk and defines risk tolerances based on clearly defined business objectives;
2. Management identifies, analyzes and responds to risks related to achieving its business objectives;
3. Management considers the risk of fraud when performing item 2 above; and
4. Management identifies, analyzes and responds to changes in its operations that may affect its previous risk assessments.

In terms of this financial risk assessment, the Town has a clearly defined business objective – the delivery of municipal services to its residents in a timely, ethical and effective manner while complying with all applicable state and federal laws and regulations. Deviations from these objectives are areas of increased risk.

Financial risks are assessed using a “bottoms up” approach. While individual departments operate under the supervision and direction of the Town Administrator and Town Council and/or other elected committee, each department has its own unique manner of business operation. Accordingly, this financial risk assessment is performed at the department level.

Inherently, fraud risks in municipalities generally surround the following areas:

- Cash theft
- Unrecorded revenue receipts
- Check tampering
- Payroll fraud:
 - Falsification of hours
 - Ghost employees
- Fraudulent disbursements:
 - Billing schemes
 - Fictitious vendors
- Bid rigging
- Bribery, corruption and abuse of power

Finally, financial risk assessment is an ongoing process that is greatly affected by changes in the Town’s operations. The following changes are examples of what would prompt the reevaluation of financial risks:

- New accounting system
- New point of sale system
- Frequent changes in leadership (particularly in Town Administration, Treasury and Comptroller’s offices)
- Effect of new legislation or regulation

Quantitative and Qualitative Risk Assessment

The first step in any financial risk assessment process is to identify the most significant account balances and/or transaction types within an organization. In the case of the Town, a quantitative risk assessment was performed using revenues reported in the Town’s MUNIS accounting system for fiscal years 2018 (preliminary), 2017, 2016 and 2015. The purpose of the quantitative risk assessment was to identify significant revenue transactions by department as well as observe multi-year trends in the reported revenues. The following departments were compiled as a result of the quantitative risk assessment:

Department	Significant Sources of Revenue	Significance of Revenues	Significance of Payments for		Is the Dept. Significant?
			Payroll	Vendors	
Collector	Property and excise taxes	High	Low	Low	Yes
Administrator	Cell tower rentals Alcoholic beverage licenses Comcast/Verizon PEG	High	Low	Moderate	Yes
Comptroller	None	Low	Low	Low	No
Assessor	Property and excise taxes Fees	High	Low	Low	Yes
Treasurer	Fees Intergovernmental receipts Investment income	Moderate	Low	Low	Yes
Clerk	Licenses Fees	Moderate	Low	Low	No
Conservation	Fees	Low	Low	Low	No
Planning	Fees	Low	Low	Low	No
Zoning Board	Fees	Low	Low	Low	No
Human Resources	None	Low	Low	Low	No
Technology	None	Low	Moderate	Moderate	Yes
Facilities	None	Low	High	High	Yes
Police	Details Fees Grants	Moderate	High	High	Yes
Fire	Ambulance charges Permits Fees	High	High	High	Yes
Buildings and Inspections	Permits Fees	High	Low	Low	Yes
Animal Control	Fees	Low	Low	Low	No
Public Works	Permits Fees Recycling center Chapter 90 grants	High	High	High	Yes
Board of Health	Permits Fees	Low	Low	Low	No
Library	Rentals Fees Fines Grants	Low	Moderate	Moderate	No

(continued)

Department	Significant Sources of Revenue	Significance of	Significance of Payments for		Is the Dept.
		Revenues	Payroll	Vendors	Significant?
Recreation	Fees Rentals	Moderate	Moderate	Moderate	Yes
Council on Aging	Fees State grants	Moderate	Low	Low	No
Veterans' Services	Donations Grants	Low	Low	Low	No
Historical Commission	None	Low	Low	Low	No
Schools	School lunch After school program fees Athletic fees Bus transportation fees Federal and state grants	High	High	High	Yes
Water Enterprise	User fees	High	High	High	Yes
Sewer Enterprise	User fees	High	High	High	Yes
Solid Waste Enterprise	User fees	High	High	High	Yes

(concluded)

It is important to note that the classification of a department's significance in the table above is solely based on financial transactions and processes. Departments such as the Town Clerk or Council on Aging are significant to the Town's overall mission to provide municipal services to its residents; however, the financial operations of these departments are not significant to the Town as a whole and there were no qualitative risks identified that would change this assessment.

The results of this initial quantitative risk assessment confirmed the Town's initial assessment of its key accounting cycles with the exception of the capital asset management process. The Town outsources its capital asset management to an independent third party, who is provided detailed accounting records each year to identify capital asset additions (\$15,000 capitalization threshold). Additionally, this firm works with individual departments to identify asset disposals made each year. As specialists in this field who have serviced the Town for many years, the use of these specialists reduces the risk associated with capital asset management to an acceptable level.

Secondly, a qualitative risk assessment was then performed to identify unusual characteristics of a department's financial operations that would expose itself to a greater degree of risk. For some departments, there are inherent risks associated with their operations, particularly those that have cash transactions and are not located in the Town Municipal Building. Other departments will have specific risks such as presence of prior audit findings. The following qualitative risk factors were considered for all Town departments:

- High degree of complexity in federal grant compliance
- Significant related-party transactions not in the ordinary course of business
- Complexity of procurement processes
- Reliance on outside contractors/consultants
- Unrealistic budgetary goals
- A history of fraud, abuse of power, corruption and/or misappropriation of assets
- Domination of management by a single individual or small group without compensating controls such as an effective oversight body
- Lack of suitable skills to manage day-to-day department operations, including its finances
- High turnover in management level employees
- Management's reputation within the community

- History of significant audit findings, violations of law and regulations
- Affect department has on other key processes

As a result of the qualitative risk assessment, the Comptroller, Procurement and Human Resources were deemed to be significant based on the affect these departments have on accounting and payroll processes. None of these departments generate revenues and their annual expenditures are not very significant. However, these departments are involved in many aspects of the Town’s shared financial operations.

Interviews and Observations

Interviews and observations were performed for the significant Town departments as well as a number of other departments during the period commencing July 31, 2018 and concluding on August 16, 2018. In total, forty-four (44) Town employees were interviewed and where necessary key operating procedures and internal controls observed in practice. Interviews focused the key accounting processes applicable for the significant Town departments. Processes were detailed and served as the basis upon which the financial risk assessment was performed.

In addition to interviews and observations at all significant departments, interviews and observations were also performed for the following departments:

- Town Clerk
- Library
- Council on Aging
- Veterans’ Services
- Board of Health
- Affordable Housing Trust

Financial Risk Assessment Threshold Definitions

In connection with this financial risk assessment, the degree to which financial risks are present need to be assessed using the following thresholds:

HIGH	The threat of error, noncompliance, abuse of power, fraud or other deficiency in operation and/or internal control may have a material affect on the Town’s underlying accounting records. Remediations for these risks should be prioritized.
MODERATE	The threat of error, noncompliance, abuse of power, fraud or other deficiency in operation and/or internal control could be significant and may arise to the level of material. Remediations for these risks should be addressed but are not critical at this time.
LOW	The threat of error, noncompliance, abuse of power, fraud or other deficiency in operation and/or internal control is not material to the Town’s underlying accounting records.

A number of factors are considered in applying a financial risk assessment threshold on a given process including the nature of the vulnerability, internal and external threat sources and the existence and effectiveness of existing internal controls. Additionally, qualitative assessments such as the effect a financial risk will have on the public’s confidence in the Town and its leadership, the possibility of an

interruption of public service and the unauthorized disclosure of sensitive data factor into these applications.

Summary of Gaps in Internal Control Observed in the Financial Risk Assessment

Refer to the next section of this report.

Post Assessment

Financial risk assessment is a continual process. The recommendations identified in the table above and described more fully elsewhere in this report should be evaluated by the Town's executive management and implemented after making a number of considerations. The Town intends to perform periodic updates to this financial risk assessment when circumstances arise and require update such as a change in accounting systems.

SUMMARY OF FINANCIAL RISKS IDENTIFIED

The goal of this and any financial risk assessment is to reduce the level of financial risk to an acceptable level. Recommended control enhancements must be evaluated by the Town’s executive leadership giving consideration to, among other things, cost versus benefit, sensitivity of the data involved, Massachusetts General Laws and voter preferences.

The following summarizes gaps in internal control and areas that Town may consider in improving internal controls to address these gaps and either mitigate or eliminate the identified financial risks. Fuller details are provided in the body of the report.

HIGH Risk Areas

Identifier	Risk Area	Risk Reduced to Acceptable Level	Remediation to Consider
IT2	In the event of a disaster, the Town is unable to restore information systems in a timely manner.	Partially	Formalizing a disaster recovery plan.

Town Action(s): A disaster recovery program is being compiled and is expected to be completed on or before March 1, 2019.

SCD4	Disbursements are not compliant with Massachusetts procurement laws and regulations.	Partially	Formalizing a Town-wide procurement manual together with standardized forms to evidence compliance with Massachusetts procurement laws.
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Town Action(s): A revised procurement policy with standardized forms to document compliance with Massachusetts procurement laws is in draft and is expected to be completed on or before March 1, 2019.

MODERATE Risk Areas

Identifier	Risk Area	Risk Reduced to Acceptable Level	Remediation to Consider
IT3	In the event of a disaster, the Town is unable to restore power to operate key computer systems.	Partially	Installing a backup power generator at the Town Municipal Building.

Town Action(s): A backup power generator for the Town Municipal Building will be included in the next capital plan. Procurement and installation of this device is expected on of before June 30, 2019.

IT5	Town employees fall victim to phishing/ransom attack.	Partially	Formalizing a computer use policy; providing additional end user training; and conducting phishing simulations through a third-party security firm.
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Town Action(s): A Town-wide computer security training program will begin in calendar year 2019. Internal phishing simulations have been performed to assist in tailoring these trainings. Additionally, the Town is codifying its policies and procedures on Internet, email and social media use.

IT8	Terminated employees continue to have access to Town data.	Partially	Enabling technology that removes emails from terminated employees' smartphones.
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Town Action(s): The Town is implementing a "exit checklist" for all terminations that includes actions by payroll, human resources and technology.

SCR9	Absence of written turnover policies and procedures.	Partially	Formalizing and communicating a Town-wide turnover policy.
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Town Action(s): The Town is updating an old turnover policy and expects to have this completed on or before December 1, 2018. The Town's turnover policy will be distributed to all departments.

SCD5	Contracts with outside parties are not properly reviewed and/or authorized.	Partially	Transmitting contracts to vendors in restricted pdf format versus in Word files, which are easily modified.
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Town Action(s): The Chief Procurement Officer has begun transmitting contracts as protected pdf's.

SPR2	Changes to employee pay rates in MUNIS are made without authorization.	Partially	Running audit reports in MUNIS that identify changes in pay rates with each pay run, which are reviewed by Human Resources for validity.
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Town Action(s): The Town is evaluating the existing audit reports within MUNIS and may consider developing a custom report to facilitate this internal audit function.

SPR8 ED8	Payroll warrant is not properly reviewed and approved.	Partially	Requiring the review and approval of school payroll warrants by the School Business Administrator.
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Town Action(s): The School Business Administrator is now approving school payroll warrants.

SPR11	Town employees are unaware of Town personnel policies.	Partially	Updating its employee handbook, which has become outdated, and adopting a Town-wide code of conduct.
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Town Action(s): Human Resources is compiling a revised, comprehensive personnel policies manual that includes the Town's most recent harassment policy and code of conduct and expects to complete this before March 1, 2019.

FI1	Not all ambulance services are billed.	Partially	Formalizing the policies and procedures for the entire ambulance billing cycle.
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Town Action(s): The Fire Department is compiling its ambulance policies and procedures and expects to have this complete on or before March 1, 2019.

FI4	Ambulance receivables are not reviewed for collectability.	No	Formalizing an ambulance receivables review process, which includes a policy on the write-off of ambulance receivables.
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Town Action(s): The Fire Department is compiling its ambulance policies and procedures and expects to have this complete on or before March 1, 2019.

ED3	School disbursements are made for unauthorized vendor transactions.	Partially	Requiring the Superintendent to review and signoff vendor warrants.
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Town Action(s): The Superintendent is now approving all vendor warrants.

RE4	Sensitive personal data of recreational services may become compromised.	Partially	Evaluating the PCI compliance features of the online registration and payment system; destroying all sensitive financial data provided by registrants seeking “scholarship.”
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Town Action(s): Scholarship applications and relative financial information is now stored in a secure location and the Department has added these measures to its policies and procedures.

LOW Risk Areas

Identifier	Risk Area	Risk Reduced to Acceptable Level	Remediation to Consider
IT6	Unauthorized parties gain access to computer data rooms.	Partially	Removing all signage that identifies computer rooms.

Town Action(s): Identification of these rooms is necessary for public safety (primarily fire) and maintenance purposes. The Town will continue to evaluate this low risk item.

SPR6	Deductions for payroll withholdings are correct.	Partially	Confirming withholding rates with the Norfolk County Retirement System for all new hires transferring creditable service from another qualifying Massachusetts pension system to ensure withholding rates are correct.
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Town Action(s): The Town will follow-up with the NCRS on retirement withholding rates for employees with a greater risk of having an incorrect pension withholding rate.

FA1	Town-purchased supplies are used for unauthorized purposes.	Partially	Evaluating mechanical parts inventory for obsolescence and developing an inventory tracking system for mechanical parts and supplies inventory.
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Town Action(s): A complete inventory of mechanical parts and supplies will take place before the close of fiscal year 2019. Excess and obsolete parts will be disposed of in accordance with applicable general and environmental laws and regulations.

PO1	Not all outside details are billed accurately to outside contractors.	Yes	Implementing an off-the-shelf accounting system like QuickBooks to manage outside police details billings and collections.
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Town Action(s): The Town will evaluate the use of an accounting package. Additionally, another employee is being trained for backup purposes.

PO3	Cash collections at Police Department are not adequately safeguarded.	Partially	Making more frequent turnover of collections to the Town Treasurer. See also SCR10.
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Town Action(s): The Police Department has begun making more timely turnovers to the Town Treasurer. The Town's turnover policy will be distributed to all departments.

TC1	The Town Clerk is an elected position.	No	Appointing its Town Clerk.
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THE CONTROL ENVIROMENT

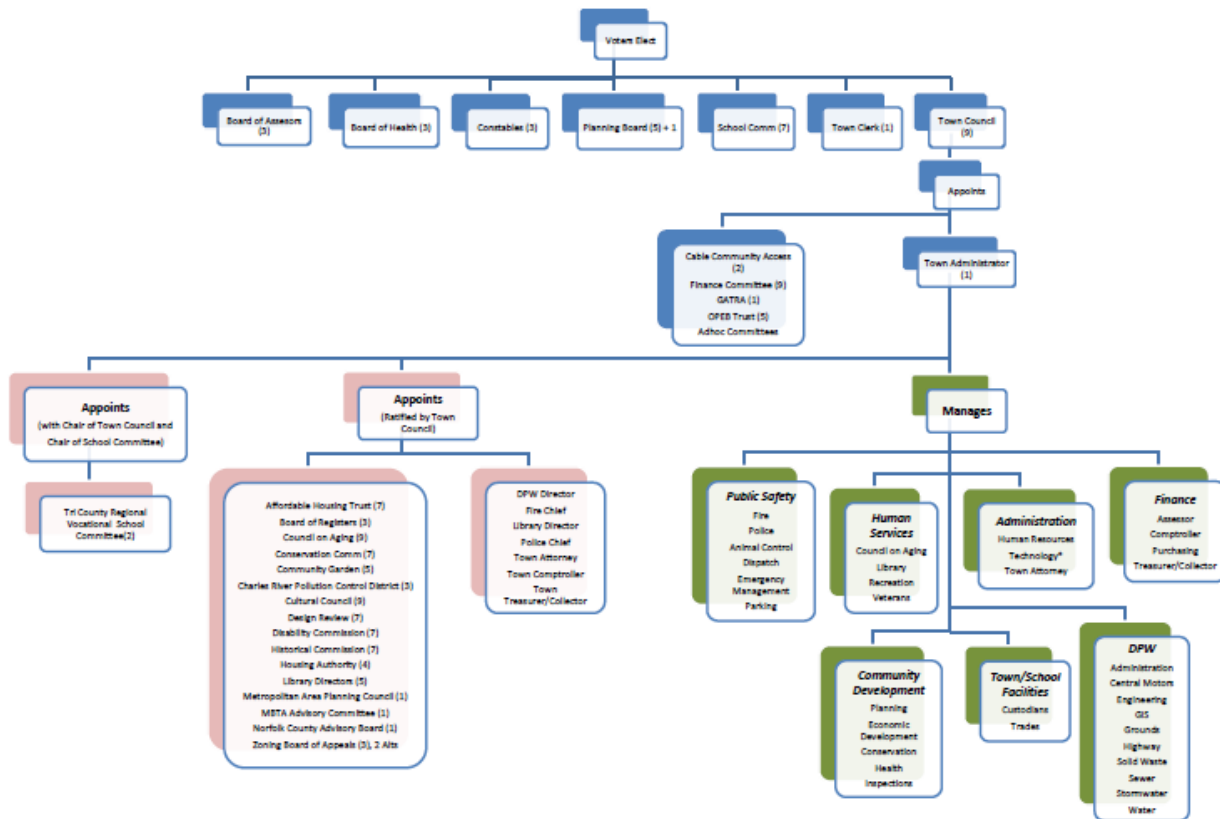
The process of risk assessment should be performed after having evaluated an organization’s control environment. The control environment is best described as the “tone from the top.” Well run and governed organizations share many common traits, not the least of which is a commitment to excellence and ethical business practices, which is delivered in a “top down” manner.

For the Town, this means that the Town Council, School Committee, Office of the Superintendent of Schools and Office of the Town Administrator demonstrate a commitment to integrity and ethical values in their day-to-day operations. It is expected that this commitment becomes contagious within the organization. To evidence this commitment, the Town’s personnel policies manual includes a fraud policy, which has been approved by the Town Council.

The Town Council takes an active role in internal controls. Most notably is the months-long capital and operating budget process, for which the Council has established a budget committee and the entire Council is responsible for the approval of the operating and capital budget.

The Town conducts its day-to-day operations using a clearly defined organizational chart.

Town of Franklin
Organization Chart



Clear communication between the Town Administrator and the individual department heads serves as a key element in the Town's control environment. Seasonally, the Town Administrator's office meets with department heads, their deputies and division leaders to enhance communication and staff collaboration. These meetings are held in the training room at the Town Municipal Building.

Clearly defined job responsibilities assist in holding Town personnel accountable to achieve the Town's objectives. Upon hire or promotion, department heads (who by definition direct their departments) are given job responsibilities. These job responsibilities are developed by the outgoing department head and vetted by the Town's Human Resources department.

Clear roles and responsibilities and regular evaluation of Town personnel also serve as key components on the Town's control environment. Each department head has a set of annual goals – two goals are established by the Town Administrator's office; three goals are established internally by the department heads. Departmental goals are generally focused on improving customer service. The Department heads are required to detail the steps they intend to implement to meet these goals. Furthermore, these goals are reviewed mid-year and at the end of the review year.

To further enhance the communication and interaction between "town" and "school" functions, the Town Municipal Building is organized in such a way that both organizations are housed in the same facility and similar functions are adjacent to each other. For instance, the Town Administrator's office is located adjacent to the School Superintendent's office and the Comptroller's office is adjacent to the School Business Administrator's office. By organizing itself in this manner, more open lines of communications are fostered between the two groups, which for many Massachusetts communities operate as if there were a concrete wall separating each other.