



TO: Kennett Township Board of Supervisors

FROM: Amy Heinrich, Finance & HR Director, Treasurer
Subject: 2020 Audit Results – March 16, 2022

Today, we will be presenting the results and follow-up from our 2020 Audit. Our independent audit was conducted by Maillie LLP, a regional leader in the government space. The purpose of this memo is to introduce you to the many documents associated with the audit process to ensure you can see the full picture of our audit process in general and specifically for 2020.

Maillie was selected by Kennett Township in December of 2019 to serve as our external independent auditor to conduct a comprehensive audit. Their proposal document shared at that time provides substantial background information on the company and their audit approach and philosophy. The document is still on our website at the link below.
<https://www.kennett.pa.us/DocumentCenter/View/3786/Maillie-Kennett-Township-Proposal-2019-2021?bidId=>

Maillie Audit Deliverables:

There are three formal deliverables from Maillie that conclude the 2020 audit. These three documents are all on our website for the 2020 audit at the links below.

- **Department of Community and Economic Development (DCED) Financial Statements:**

This is the format required by the DCED, the body within the Pennsylvania state government that regulates township financials. It is cash basis. We will transition to modified accrual for 2021, which is the best practice for local government. At that point, there will be a more sophisticated set of financial statements and footnotes.

<https://www.kennett.pa.us/DocumentCenter/View/5236/2020-Audit---DCED-Submission>

The actual financial statement output discussed above is only one aspect of a comprehensive audit. The extensive audit processes result in two other deliverables. These are letters to the Board of Supervisors required by the American Institute of CPAs (AICPA) via their Statements on Auditing Standards (SAS) for all financial statement audits.

- **Statements on Auditing Standards (SAS) 114 Letter:**

The purpose of the letter is to communicate to those charged with governance, such as the Board of Directors, Audit Committee, President, or Management, the scope of audit procedures performed, significant findings, and other information, such as disagreements with management, audit adjustments and significant estimates, that aren't communicated in the audited financial statements.

<https://www.kennett.pa.us/DocumentCenter/View/5234/2020-Audit-Memo-SAS-114>

- **Statements on Auditing Standards (SAS) 115 Letter:**

The SAS 115 letter is another requirement that communicates any significant deficiencies or material weaknesses in internal controls found during the audit. **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.** While any significant deficiencies or material weaknesses would have been discussed with management during the audit, the AICPA requires the auditor to communicate them to those charged with governance in writing. That is the Board of Supervisors in our

case. Along with identifying deficiencies in the controls, the auditor may also offer recommendations for ways to improve these controls that will help to mitigate risk and strengthen the Township's accounting processes.

<https://www.kennett.pa.us/DocumentCenter/View/5235/2020-Audit-Memo-SAS-115>

Treasurer Overview & Response:

Maillie issued a Qualified Opinion on our 2020 financial statements. It is only qualified due to the absence of an accounting of General Fixed Assets. The DCED standard is based on depreciating from purchase price. We need an updated comprehensive inventory and asset schedule. We were unable to find the previous records internally but are in touch with a valuation company that did a valuation a number of years ago and will be engaged to update accordingly.

We presented the results of the 2019 audit to the Board and the public on April 21, 2021. Maillie identified eight material weaknesses and three other recommendations. Given my review of processes and records since the fraud was discovered and the controls I had already implemented, the concerns and recommendations raised by Maillie were not a surprise to me. By the time we had this meeting in April of 2021, many of the items were already rectified. For your reference, the 2019 audit findings presentation is linked below and includes the detailed response shared at that time on each internal control deficiency or weakness identified by Maillie in the SAS 115 letter. The recommendations align with best practices that we agree are necessary in almost all cases and we implemented as many as possible as quickly as possible.

https://www.kennett.pa.us/DocumentCenter/View/4714/Agenda-Item-5_2019-Audit

The 2020 audit findings show substantial improvement but do still contain two material weakness and 2 other recommendations. Since there is a lag on audit findings, we still expected findings on the 2020 audit. The immediate issues were stopped as soon as the fraud was discovered but true remediation required a full and experienced finance team, process revamp and a new General Ledger system. This began when I joined in October of 2019 but is very extensive and continues to this day.

The first material weakness cited by Maillie for 2020 is the "Investigation into Activities of Prior Township Manager". The investigation of fraudulent activity and the recovery of funds was ongoing in 2020. These expenses are recorded in 482.00 Judgements and Losses, which is the reason this item is cited. There is not an ongoing weakness in current controls. While the investigation is over and Lisa Moore plead guilty and is incarcerated, the recovery efforts continue. If the costs are material, this item will likely continue to appear to report the costs under Judgements and Losses.

The second material weakness is for Escrow funds related to development projects. The escrow records were not complete, nor did we trust the accuracy of what existed from prior management. A thorough review was performed of each escrow account. This process took a substantial effort and continued into 2021 but was completed prior to closure of the 2020 audit. This is what caused the extended timeline for the 2020 audit and financials. The 2020 audited financial statements include the impact of the completed research. Most amounts owed by developers have been paid. Processes are in place to ensure accurate and timely reporting and re-billing of escrow accounts. Further process enhancement via Sage Intacct is under research.

As part of the Escrow clean-up, as of the end of 2020, there is a net liability due from the Escrow Fund to the General Fund for \$207K for reimbursement of escrow bills paid by the General Fund. There is also a liability from the Sewer Fund to the Escrow Fund for \$50K as a result of money movements made by Ms. Moore. As part of the clean-up, these liabilities have both been cleared via repayment to and from the appropriate funds.

The first "other recommendation" made by Maillie relates to the sewer billing process. Almost all of the noted items for sewer billing have been rectified. We are continuing to map the entire sewer system vs. billing accounts to ensure all users are billed appropriately. We are working with our Public Works department, the Borough of Kennett Square, Chester Water and AECOM, our engineering firm, to address all issues.

Lastly, Maillie recommended a set of material to be received by the Board. We have continuously improved the set of management reports that the Board and the public get every month. We include balance sheets, income statements along with views vs. budget, prior year and by department. The Board also has access to dynamic dashboards to drill into supporting details. The only item we hadn't implemented is a report on every individual revenue receipt. I just built one on Sage and am distributing it for Jan-Feb 2022. It's 18 pages for 2 months, which may prove to be an overwhelming amount of data to have meaning to the Board.

We have conducted many detailed reviews of balance sheet line items to ensure the accuracy of our entire balance sheet. While we are still validating some liabilities, they are relatively immaterial, and we expect the 2021 audit to proceed much more quickly. The new General Ledger also includes back-up attachments for every entry which will make the audit processes substantially more efficient. However, we have been on a multi-year transition to align our accounting practices, annual report and financial statements with the Government Accounting Standards Board (GASB) and associated modified accrual accounting. The 2021 audit output will reflect the new annual report format including a Management Discussion and Analysis and a full set of financial statements and footnotes. This is a large project for both our auditors and internal team. Despite the additional effort, we aim for completion by the fall of 2022, much ahead of the audit schedule for the last two years.



2020 Audit: Management Response to Internal Control Findings & Recommendations (SAS 115)

March 11, 2022 | 11:00 a.m. | Board Information Session

Introduction to 2020 Audit Findings

- Kennett Township appointed Maillie LLP as the Township Auditor in 2020 for the 2019 audit.
- 2019 included fraudulent activity from the former Township Manager, therefore the audit findings were not a surprise
- Maillie presented the 2019 audit findings with material weaknesses at a public Board of Supervisors Meeting on April 21, 2021.
- Township staff presented a response with updates on controls implemented to that date that covered most identified items.
- A few remaining items were addressed in 2021 with the implementation of Sage Intacct, our new general ledger system, and other process and system enhancements. We are still continuing to improve processes and controls.
- You will see this as we discuss the 2020 audit findings today. This presentation responds and comments in detail to each item identified in the 2020 audit as a weakness or recommendation.
- **Defined Term: 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**

Qualified Opinion due to Fixed Asset Accounting

- Maillie issued a Qualified Opinion of our 2020 financial statements
- It is only qualified due to the absence of an accounting of General Fixed Assets.
 - The DCED standard is based on depreciating from purchase price
- We need an updated comprehensive inventory and asset schedule.
- We were unable to find the previous records internally but are in touch with a valuation company that did a valuation a number of years ago and will be engaged to update accordingly.

Overview of Audit Findings – 2019 & 2020

We made substantial progress on rectifying the material weaknesses identified in 2019. We have also improved processes which provide for better & more efficient controls, but this work does continue today.

Audit Findings (recapped by management)	2019	2020
Material Weaknesses Sighted	<ul style="list-style-type: none"> • Investigation into activities of prior Twp Manager plus 7 more material weaknesses <ul style="list-style-type: none"> • Escrow Fund • Interfund Balance • Fund Balance • Cash Disbursements / Expenses • Journal Entries • Cash Receipts – Segregation of Duties • Approved Salaries 	<ul style="list-style-type: none"> • Investigation into activities of prior Twp Manager plus one more material weakness • Escrow Fund (which was solved by the close of the 2020 audit)
Other Recommendations Made	<ul style="list-style-type: none"> • 3 Other Recommendations <ul style="list-style-type: none"> • Purchase Orders • Sewer Billing • Documents for Board of Supervisors 	<ul style="list-style-type: none"> • 2 Other Recommendations <ul style="list-style-type: none"> • Sewer Billing • Documents for Board of Supervisors

The full presentation on the 2019 audit can be found on our website: <https://kennett.pa.us/DocumentCenter/View/4714>

Investigation into Activity of Prior Township Manager

Audit Findings <small>(recapped by management)</small>	Management Response
Investigation into Activity of prior Township Manager	<ul style="list-style-type: none">• In 2019, an extensive investigation was conducted by the Chester County District Attorney's office and Marcum LLP, a forensic accounting firm.• Forensic accounting findings were incorporated into legal charges against Moore by District Attorney's office• In October of 2021, Lisa Moore plead guilty and is now incarcerated• Investigation, recovery and clean-up continued in 2020; associated expenses are in line 482.00 Judgements & Losses• There is not an ongoing weakness in current controls• If costs of recovery continue to be material, this item will likely continue to appear

Escrow Funds

Audit Findings (recapped by management)	Management Response
<ul style="list-style-type: none">The Township was unable to provide an accounting of individual escrows held (at the beginning of the 2020 audit process.)	<ul style="list-style-type: none">The escrow records were not complete, nor did we trust the accuracy of what existed from prior management. A thorough review was performed of each escrow account.This process took a substantial effort and continued into 2021 but was completed prior to closure of the 2020 audit. The 2020 audited financial statements include the impact of the completed research.Most amounts owed by developers have been paid.Processes are in place to ensure accurate and timely reporting and re-billing of escrow accounts.Further process enhancement via Sage Intacct is under research.

Sewer Billing

Audit Findings (recapped by management)	Management Response
<ul style="list-style-type: none">• Several areas for improvement:	<ul style="list-style-type: none">• There have been many improvements to Sewer Billing Processes, but the process is also ongoing
<ul style="list-style-type: none">• Water usage volume is typed in manually, which is prone to errors.	<ul style="list-style-type: none">• Volume is now uploaded rather than typed in, totals are verified
<ul style="list-style-type: none">• Monitor a change report (report showing all edits) or other method to ensure sewer billing data isn't improperly manipulated.	<ul style="list-style-type: none">• Our sewer billing system has a report that shows changes which we are monitoring• Account changes are primarily made by an individual separate from the main person responsible for sewer billing to provide segregation of duties• The County report that shows all home sales is used to update accounts for new owners and/or add new accounts for new houses.• New accounts are given a sequential new account number. These show on the bills & bill register at the end & enable easy review new accounts.

This item was not listed as a material weakness but was highly recommended by Maillie.

Sewer Billing

Audit Findings (recapped by management)	Management Response
<ul style="list-style-type: none">• Ensure all sewer users are getting billed (ensure we aren't missing any)	<ul style="list-style-type: none">• We've had extensive discussions of the sewer billing customers & the sewer system in conjunction with the Public Works Director and Foreman. This is an ongoing process but many concerning areas have been addressed & accounts have been added/updated• We have also engaged the management at the Borough of Kennett Square where appropriate to resolve some problem accounts or meters. (The Borough provides water to many of our sewer users & reads meters on our behalf)• We are now engaging the Township Engineer to compare every parcel within his sewer map vs. sewer billing.
<ul style="list-style-type: none">• Other sewer improvements	<ul style="list-style-type: none">• Harris (software provider) is also printing & mailing our sewer bills, which provides a low cost & efficient service as well as another separation of duties.• Payments are sent to a lockbox service provided by our bank. Lockbox files are uploaded to record in Harris.• Customers can direct their bank's bill pay service to pay the lockbox as well.• Credit card payments are taken online & uploaded to Harris.• These methods drastically reduce the potential for errors & provide segregation of duties.

This item was not listed as a material weakness but was highly recommended by Maillie.

Documents for Board of Supervisors

Audit Findings (recapped by management)	Management Response
<ul style="list-style-type: none">The audit recognized that the Board is seeing and approving invoices via the Bill Voucher process and signing checks.	<ul style="list-style-type: none">Bill voucher (BV) presented in every Board packet and approved at every Board meeting. The BV is signed. Checks are signed by 2 BOS member. All back-up is available via the Sage Dashboards for direct access by the Supervisors.
<ul style="list-style-type: none">Recommend report of receipts for oversight over revenue	<ul style="list-style-type: none">The BOS receives a financial report with revenue by GL account every month. Throughout 2020-2021, we also showed more detail and commentary for tax revenue to enable monitoring for COVID impact.Supervisors have access to Sage and can use the Dashboards to drill into revenue detail.We can also easily generate a canned report and circulate it to the Board.

This item was not listed as a material weakness but was highly recommended by Maillie.

Documents for Board of Supervisors

Audit Findings <small>(recapped by management)</small>	Management Response
<ul style="list-style-type: none">To improve oversight over performance, we recommend that the BOS receive:<ul style="list-style-type: none">A report of budget vs. actuals for revenues and expenses.	<ul style="list-style-type: none">The BOS receives a monthly financial report with revenue and expenses vs. budget. This has been in place since mid-2020.For 2021+, they also have access to Sage and dashboards to drill into all detail as desired.
<ul style="list-style-type: none">A report of current vs. prior year for revenues and expenses.	<ul style="list-style-type: none">In 2020, the monthly financial report didn't include 2019 given the fraud contained in early 2019, the long audit process and the complexity of 2019 QB set-up.In the first half of 2021, the manual monthly financial report showed full-year 2020 results.In the second half of 2021, all of the budget reporting had prior year as the new automated Sage report did not have prior year.Now that we have full-year 2021 history in Sage, in 2022 we can show a comparison to the same period YTD 2021.

This item was not listed as a material weakness but was highly recommended by Maillie.

2021 Audit Process

- We have been on a multi-year transition to align our accounting practices, annual report and financial statements with the Government Accounting Standards Board (GASB) and associated modified accrual accounting.
- The 2021 audit output will reflect the new annual report format including a Management Discussion and Analysis and a full set of financial statements and footnotes.
- This is a large project for both our auditors and internal team.
- Despite the additional effort, we aim for completion by the fall of 2022, much ahead of the audit schedule for the last two years.

