

TOWN OF NANTUCKET, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2009



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The Honorable Board of Selectmen
Town of Nantucket, Massachusetts:

In planning and performing our audit of the basic financial statements of the Town of Nantucket, Massachusetts (Town), as of and for the fiscal year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the Town's basic 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A control deficiency 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 significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We consider the following deficiencies to constitute material weaknesses.

- Failure to act on previously communicated weaknesses.
- Inadequate design of internal control over significant accounts.
- A failure to perform reconciliations of significant accounts.
- Inadequate documentation of the components of internal control.

During our audit we became aware of several additional matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

The Town of Nantucket's written responses to the comments identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management of Town of Nantucket, Massachusetts, and is not intended to be and should not be used by anyone other than these specified parties.

We have already discussed these comments and suggestions with various Town personnel, and we will be pleased to discuss them in further detail at your convenience.

Powers & Sullivan

December 29, 2009

TOWN OF NANTUCKET, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2009

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Material Weaknesses

MATERIAL WEAKNESSES

Failure to Act on Previously Communicated Weaknesses

The material weaknesses communicated herein represent control deficiencies that have been identified and reported to management for several years and have not been adequately resolved. The existence of significant deficiencies may be known and may represent a conscious decision to accept that degree of risk because of cost or other considerations. Management or those charged with governance are responsible for making decisions concerning costs to be incurred and related benefits. Failure by management to assess the effect of significant deficiencies previously communicated and to either correct them or conclude that they will not be corrected represent a material weakness in the Town's system of internal controls.

Inadequate Design of Internal Control Over Significant Accounts

Management must rely on the financial information generated by the Treasurer's Office, the Collector's Office and the Accounting Office to make decisions that affect Town strategy in developing and meeting short-term and long-term financial goals. Consequently, management must be confident that the information they base their decisions on is complete and accurate. This confidence is gained when there is reasonable assurance that the internal control structure over cash, receivables, revenues and expenditures is of sound design and is functioning as intended.

Each of the Offices noted above play a key role in developing and monitoring of a sound internal control structure. These roles are summarized as follows:

- The Accountant is responsible for establishing and maintaining procedures to assure that 1) all Town receipts and disbursements are properly authorized and recorded in the general ledger accurately and timely and 2) all journal entries are properly recorded and documented.
- The Treasurer's Office is responsible for establishing and maintaining procedures to 1) properly safeguard the Town's cash and investments and 2) assure that all receipts and disbursements are reported accurately and timely.
- The Collector's Office is responsible for establishing and maintaining procedures to 1) assure all bills submitted to the Office are collected as quickly as possible 2) secure the Town's interest in property for delinquent taxes and 3) process receipts promptly in order to maximize cashflow.

Considering these general roles, our review of the internal control structure of these Offices revealed the following deficiencies:

- The Treasurer's cash book was not accurately reconciled to the bank balances throughout the year.
 - The Treasurer's cashbook reconciliations to the bank statements continue to contain variances that have been carried for several years.
 - The Town discontinued use of the old vendor and payroll accounts and opened new accounts as of July 1, 2008 for the new fiscal year to begin a new reconciliation process. The old accounts were not reconciled throughout the fiscal year and continue to remain open with both bank and book carrying balances. The remaining bank balances in the accounts are not supported by outstanding checks that have not cleared.
 - The Treasurer was unable to reconcile the new payroll bank account, and turned the reconciliation process over to the Finance Director, who also has access to the Town's general ledger.

- The intent of opening new vendor and payroll bank accounts was to maintain what is referred to as zero balance accounts. This system requires the value of each warrant to be transferred into the vendor or payroll account exactly to cover the checks issued, and the book balance remains at zero. The intent is to simplify the reconciliation process since the outstanding checklist would equal the bank balance, and would be the only reconciling item. The new payroll and vendor accounts have not been maintained at a zero balance since July of 2008.
 - Although the activity in the general ledger was reconciled to the Treasurer's cashbook throughout the fiscal year, a consistent variance of approximately \$36,000 was not identified until several months after year end.
 - The Town has not performed reconciliations between the balances of individual enterprise funds accounts on the general ledger and the supporting bank balances. Variances identified six months after the end of the fiscal year required material adjustments.
 - The County's cash balances were not reconciled from the ledger to the Treasurer's cashbook and to the banks throughout the fiscal year. Reconciliations were performed subsequent to year end.
 - The Treasurer found a County bank account, several months after year end, totaling \$42,300 that has not been recorded on the Treasurer's cashbook.
- Activity for Nantucket County was not properly recorded on the general ledger throughout the year, which resulted in several adjustments to the ledger balances six months after the end of the fiscal year. Additionally, adjustments identified by the Town during the fiscal year 2008 audit process were not recorded in the County's ledger during fiscal year 2008 or 2009.
 - The Town does not have internal procedure manuals clearly defining the responsibilities of each position within the financial departments. Formally documented procedures and responsibilities of each position would clarify the process and ensure that the intended controls over the Town's assets are being achieved.

Summary

In summary, the objectives of an internal control structure are to safeguard the assets of the Town and provide reasonable assurance that transactions are executed in accordance with management's authorization and recorded properly in the Town's ledgers. The omission of one or more elements of internal control can compromise the Town's ability to obtain these objectives. We have concluded that the deficiencies noted above, individually and collectively, represent material weaknesses in the Town's system of internal control under standards established by the American Institute of Certified Public Accountants.

These deficiencies constitute being classified as material weaknesses because they represent significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Town's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Furthermore, we believe that the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

For several years, we have recommended that the Town implement procedures to monitor all general ledger balances throughout the year and to reconcile those balances with the supporting Treasurer's cash book and other supporting documentation on a regular basis to identify and correct errors during the normal course of operations.

The procedures should include a process for insuring that all transactions are processed timely and correctly. We have also recommended that the Treasurer's balances be reconciled to both the bank balances and the general ledger monthly and that record of the reconciliation process be maintained by both the Treasurer and the Town Accountant.

As indicated by Statement on Auditing Standards #112, *Communicating Internal Control Related Matters Identified in an Audit*, employees or management who lack the qualifications and training to fulfill their assigned functions represent a strong indication of a material weakness in internal controls. The lack of ability to properly reconcile the Treasurer's cashbook to the bank balances is an indication that staff does not possess the necessary competency to implement internal controls that would reduce to a relatively low level the chance that errors or irregularities could occur in the normal course of business and not be prevented or detected by the Town's internal control structure.

Town of Nantucket Response

Management has assessed the effect of previously communicated weaknesses, and a program of correction and improvement was initiated in 2008 and continues. Much progress has been made on previously communicated weaknesses. The Town of Nantucket contracted with a third party consultant in 2008 to provide assistance to the Finance Department in development and implementation of internal controls. The implementation of the consultant's recommendations is partially complete, with additional procedures to be implemented in the remainder of fiscal 2010 and in fiscal 2011. Management has identified this program of improvement as a high priority. Individual recommendations in this letter will be assigned a priority level, along with those recommended by the third party consultant, for an implementation plan.

Over the past decade, the Town of Nantucket has moved from a small town operation towards more professional financial operations. The Town has overcome significant challenges during that time, and still has challenges to meet. Nevertheless, in terms of financial operations, the Town is in a better position now than it has been in at least fifteen years.

The operating challenges of 2009 included, but were not limited to: budgetary pressures, prior years' work to be completed, staff absences, an independent review of procedures and processes, and implementation of recommended changes. Despite the challenges, the Finance Department provides accurate information for multiple purposes, reports and constituencies. Like most municipalities, strict control over line item budgets provides a level of control over expenditures.

Staff members are competent and have the skill, knowledge and ability to perform their duties. The Treasurer has completed the education, experience and examination requirements to become a Certified Massachusetts Municipal Treasurer, and has maintained certification by completing continuing education requirements. The Treasurer safeguards the cash and investments through constant monitoring of the bank accounts on line and in the cash book. During fiscal 2009, the Treasurer and other staff were working not just on 2009 accounts but on 2008 and 2007 as well. All of the staff have performed at a high level in 2009; the volume of work exceeded the time available in which to do it.

The Town, like most municipalities, does not issue interim financial statements, and does not have a "financial reporting" department. Thus, the annual audit is the one complete review of all accounts, and a significant stopping point in the year for review and adjustment of the financial records. During Fiscal 2009, audits were completed for Fiscal 2007 and 2008.

Management's response with respect to the specific deficiencies listed above follows.

Cash reconciliations:

The cash reconciliation process improved during Fiscal 2009 and further improvements will be evident in Fiscal 2010. The old vendor and payroll accounts have been closed, and old variances will be reviewed, investigated and / or cleared. The Town concurs that the reconciliation process is simplified with zero balance accounts. Accurate and timely transfers, including transfers to or from the accounts at month end for interest earned, checks voided, or checks voided and re-issued for corrections facilitate the reconciliation process, and such transfers are occurring on a timely basis. The Treasurer asked for assistance in resolving difficult issues with the new payroll account. Likewise, resolving old reconciling items, variances, and balances will require assistance.

As part of the plan of improvement during Fiscal 2009, reconciliations of activity were completed each month, and the year end variance at June 30, 2008 did not change. Further work was subsequently performed on the 2008 variance, and the amount was reduced to the \$36,000 referred to in the comment. The procedure followed was identified at the beginning of the fiscal year, and was recommended in prior years by the audit firm.

Interfund reconciliations, Enterprise funds:

Adjustments, particularly between two enterprise funds, were made several months after year end. Reconciliations of interfund balances will be simplified with timely and accurate transfers, which are currently being made. Improved reporting of cash receipts by one enterprise fund, in accordance with town procedures, will simplify the cash and interfund reconciliation processes. Cash management and reconciliations will be simplified by eliminating some separate bank accounts for some Enterprise funds, under the authority granted to the Treasurer by MGL.

Nantucket County:

The Town concurs that County accounts received little formal attention during Fiscal 2009. Account information is reviewed on line, statements are reviewed regularly, and the activity in the accounts is consistent, predictable, and in accordance with the revenue and expenditures recorded in the General Ledger. The Town concurs that County accounts should be reconciled on a timely basis.

The Treasurer brought forward a County bank account which has apparently not been recorded in year end reconciliations or included in audit documentation since prior to 2000. The last activity in the related general ledger account and in the bank account was in 1999 (prior to the employment of current officials). More history will be reviewed to determine whether the account should have been closed in 1999.

Nantucket County revenue, expenses, and transfers to and from the Town were recorded on the general ledger throughout the fiscal year. Year end entries were made to adjust individual funds for their portion of the activity, to record interest on accounts, and to move entries related to the Land Bank from an interfund account to an intergovernmental account. The Town concurs that audit entries for Fiscal 2008 were not entered into the ledger.

Procedures manual:

The Town is in the process of documenting internal procedures; that task must be prioritized along with other recommendations in this letter and in an independent report. Employees know their responsibility and the tasks are being performed in a timely manner. Reconciliation procedures were provided to two independent outside parties for review.

Other Matters

Prior Year Comments

Massachusetts Highway Grants

Comment

Each year, the Commonwealth of Massachusetts allocates Chapter 90 highway project funds to the Town. These projects require the Town to incur the expenditure first and then submit a request for reimbursement to the Commonwealth. The Chapter 90 revenues and expenditures are accounted for in the Special Revenue fund to enable the financial position of the projects to be monitored and to provide a check and balance over the records of the Public Works Department.

Because it is a reimbursement program, the cash deficit in the Chapter 90 fund, at any given time, should equal the invoices that have not yet been submitted for reimbursement, or that have been submitted and are awaiting reimbursement from the Commonwealth. For several years, the Town's cash deficit has exceeded the known invoices that are awaiting reimbursement. This was most likely caused by a lack of procedures to reconcile invoices to reimbursements and to verify that all reimbursement requests are submitted timely.

To strengthen controls over this program going forward, and to minimize unnecessary deficits, we have recommended the Town reconcile the receivable balance due from the Commonwealth to the cash deficit in the fund and identify any permanent deficit that has been caused by a lack of reconciliation procedures in the past. Once the permanent deficit has been identified, we have recommended that the Town decide how the permanent deficit will be funded and implement reconciliation procedures going forward to ensure that similar permanent deficits do not occur in the future.

Status – Unresolved

As of June 30, 2009, the Town's cash deficit continues to exceed the receivable balance.

Town of Nantucket Response

Management agrees that there are differences that need to be resolved by corrective action. For the periods prior to July 1, 2001, there is approximately \$166,445 to be resolved. For the period 2002 – 2006, there is approximately \$32,236 to be resolved. For the period 2007 – 2009, no resolution is necessary. All expenditures for these periods have been submitted for payment, and payment has been received.

Depending on the cause for the differences, corrective actions would consist of either submission of invoices for payments, funding for amounts that were incorrectly charged to the Chapter 90 grant, or correction of accounting errors.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Accounting For Trust Fund Balances

Comment

Several of the Town's trust fund balances recorded on the general ledger do not agree with the balance of the funds on deposit in the bank. Such variances can be misleading and leave the Town at risk of overspending available balances and of inaccurate financial reporting.

For several years, we have recommended that the Town implement procedures to reconcile the Trust fund balances reported on the general ledger to the bank balances on a monthly basis. As of June 30, 2009, the bank and ledger balances for trust funds tie in total, however, several variances exist between individual funds. Lack of such a reconciliation puts the Town at risk of inaccurately reporting trust fund balances, overspending trust fund balances, and improperly allocating interest income to the individual trust fund accounts.

Status - Unresolved

There has been no significant change in this area.

Town of Nantucket Response

We concur with the recommendation. Trust Funds are in the custody of a major bank's Trust Department, and the Town now receives monthly statements. Procedures for the timely transfer of funds for the reimbursement to the Town for payments made through the Town's vendor payment process will be implemented. This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Commingling Cash Accounts of Enterprise Funds

Comment

The Town maintains separate bank accounts to account for the cash balances and investment earnings of the Enterprise Funds. All Town bills, including those of the Enterprise Funds, are initially paid from the Town's vendor checking account. The Town does not have a process for transferring the cash from the Enterprise Fund Accounts to reimburse the vendor account timely or accurately. When the transfers are made, they often do not agree to the amounts on the warrants. As a result, the interest accruing in the Enterprise Fund accounts is overstated, the interest accruing to the General Fund is understated, and the recordkeeping required to monitor the variance between the actual transfers made and the bills paid contributes to the Town's inability to reconcile cash and due to/due from accounts between the Town's general ledger and the internal records of the Enterprise Funds on a regular basis.

For several years, we have recommended that the exact warrant amounts be transferred from the enterprise funds at the time the warrants are issued. This should result in a bank balance equal to the ledger balance for the enterprise fund cash and would reduce the balance in the due to/from accounts.

We have also recommended that procedures be implemented to reconcile the cash and due to/due from balances between the general ledger and the internal records of the Enterprise Funds and that variances be and corrected in a timely manner.

Status – Partially resolved

During fiscal year 2009, the Town made a cash transfers to reconcile the due to/from accounts with some of the enterprise funds, and has improved the process for transferring the total warrant amounts from the enterprise funds bank accounts as the warrant is processed.

Nevertheless, significant un-reconciled variances remained between the cash and due to/from accounts reported by the Town and the supporting bank balances, and there were a significant number of variances between the warrant totals and the amounts transferred from the bank accounts. The majority of the differences that continue to exist are in the Airport Enterprise Fund accounts.

Town of Nantucket Response

The cash transfer process improved during Fiscal 2009 and further improvements will be evident in Fiscal 2010, including accurate and timely transfers. Payroll and vendor payments are paid from one disbursement account each, for the entire town, followed by transfers into those accounts from several other Town (including Enterprise fund) bank accounts. Some commingling of cash accounts occurs in the normal course of events. State and many federal payments are made directly to a pooled account. One Enterprise fund bills and collects payments for two other enterprise funds. Receipts at one Enterprise fund are not reported on a timely basis for timely entry into the General Ledger.

Cash management and reconciliations will be simplified by eliminating some separate bank accounts for some Enterprise funds, under the authority granted to the Treasurer by MGL. A review of accounts will be undertaken to determine which accounts may reasonably be closed.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Fraud Risk Assessment

Comment

The opportunity to commit and conceal fraud exists where there are assets susceptible to misappropriation and inadequate controls to prevent or detect the fraud. To address this risk, we recommend that the Town perform a risk assessment to identify, analyze, and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. Thus, ideally, the Town's internal control should include performance of this assessment, even though our annual financial statement audits include consideration of fraud.

The fraud risk assessment can be informal and performed by a management-level individual who has extensive knowledge of the Town that might be used in the assessment. Ordinarily, the management-level individual would conduct interviews or lead group discussions with personnel who have extensive knowledge of the Town, its environment, and its processes. The fraud risk assessment process should consider the Town's vulnerability to misappropriation of assets. When conducting the self-assessment, questions such as the following can be considered:

What individuals have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.

Are there any known pressures that would motivate employees with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.

What assets of the Town are susceptible to misappropriation?

Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?

How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use.

How could potential misappropriation of assets be concealed? Because many frauds create accounting anomalies, the perpetrator must hide the fraud by running through an adjustment to another account. Generally, fraud perpetrators may use accounts that are not closely monitored.

We have recommended that management develop and implement a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation.

Status - Unresolved

The Town has not developed or implemented a fraud risk assessment program.

Town of Nantucket Response

The AICPA Auditing Standards Board issued eight Statements on Auditing Standards (SAS Nos. 104-111), collectively referred to as the Risk Assessment Standards. These Standards became effective for audits of financial statements for periods beginning on or after December 15, 2006. The Town agrees that an internal assessment of fraud risk is an important part of internal controls. Part of the ongoing plan for improvement includes the development of a fraud risk assessment program. This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Accounting for Off-Duty Police and Fire Details

Comment

The Town records payments to police and fire personnel for details in an agency account on the General Ledger. Since it is the Town's practice to pay for details prior to receiving payments from the vendors, the agency fund typically has a negative cash and negative liability balance.

The Town also records a receivable and deferred revenue when the police detail bills are sent out to vendors. The Town does not have procedures to reconcile the negative cash and the receivable balances. Although the variances could represent details paid to officers and not yet billed, this has not been determined due to a lack of procedures to reconcile the variances.

We have recommended that the Town implement procedures to reconcile the deficit cash balances to the receivable balances to identify and address any permanent deficit and to ensure that all police details paid to officers are ultimately billed to vendors and collected.

We also recommend that the Town document and implement procedures to address uncollectible detail receivables. The documentation should address procedures for collection and for abatement and funding for receivables that have been determined to be uncollectible.

Additionally, if it is the Town's policy to pay officers in advance, we recommend that the Town follow the guidance from MGL to provide "seed" money to fund the advance payment and the activity should be recorded in a special revenue fund, as it not agency activity if the officers are paid in advance of the reimbursement from the vendors.

Status – Unresolved

The Town has not implemented procedures to reconcile off-duty police and fire detail accounts.

Town of Nantucket Response

The recommendation has three parts:

- a) reconcile the deficit balance to the receivable balance
- b) establish procedures for the write-off (and consequent internal funding to the off-duty account) for uncollectible accounts
- c) provide seed money to eliminate the deficit which results from payment to officers in advance of receiving payments from the private party contractors.

In Fiscal 2009, total paid out to officers for off duty detail pay was \$489,848. Total billed to 3rd parties was \$559,028 (additional charges are for administrative costs and for the employer's share of Medicare payroll tax). Total collections were \$557,329, and total adjustments to accounts receivable were \$15,331.

Systems are in place to ensure that all police details that are paid out in payroll are billed to the third parties who hire the off duty officers – the payroll entries and billing to 3rd parties are almost simultaneous, and work from the same system. Thus, all the entries take place in one fund, and that fund is limited to entries related to off-duty detail, and the fund is self-reconciling.

The cash deficit in excess of the receivable at year end was \$67,207. This amount represents adjustments made to billings, over a period of several years, which have not been funded. The receivable at year end was \$65,261. This amount represents billings outstanding: for payments to officers and Medicare tax already paid out by TON,

plus a small administrative fee. The total cash deficit at year end was \$132,468. This amount approximates what would be required in seed money and funding for non collectible amounts.

Warrant articles have been proposed for two fiscal 2010 Town Meetings to provide funding for the deficit: for seed money and for past write-offs.

This recommendation to establish procedures for write-offs and for funding future write-offs will be assigned a priority level in relation to all recommendations for an implementation plan.

Dental Insurance Withholding Deficit

Comment

The Town had a deficit balance of approximately \$278,000 in the dental insurance withholding account at year-end. The deficit is partially the result of employee withholdings not being matched to premiums paid, and to the Town not adequately increasing employee withholdings when insurance rates were increased.

The balance in this account should represent amounts withheld from employees that have not yet been paid to fund the employee's share of dental insurance as of the end of the fiscal year. The amounts should be paid out, for their original purpose, shortly after the end of the fiscal year.

We have recommended that the Town implement procedures to verify that employee withholdings are commensurate with premiums paid, and that the balance in the withholding accounts reflect only amounts withheld from employees that have not yet been paid.

Status – Unresolved

The Town has not yet reconciled the full reason for the deficit balance in this account, or determined what the correct balance should be. The deficit balance has increased during fiscal year 2009 by over \$23,000.

Town of Nantucket Response

The Town concurs. This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Monitoring Grant Proceeds and Receivable Balances

Comment

The Town has financed several capital projects through the loan program offered through the Massachusetts Water Abatement Trust (MWPAT). This program allows communities to borrow funds at reasonable interest rates to finance qualifying water and wastewater projects. Funds borrowed are reported as a liability once the loan has been approved. However, funds are not received until the qualifying expenditures have been made and the invoices have been submitted by the Town and approved by MWPAT.

In prior years, the Town did not have a system of internal controls in place to properly monitor this process. This resulted in a negative impact on the Town's cash flow, since capital expenditures were not submitted for reimbursement timely. Additionally, the Town was unable to reconcile the amount of funds not drawn down

through the MWPAT, putting the Town at risk of not drawing down all funds owed.

Until the funds are drawn down, the Town should record a receivable on the general ledger to monitor the amount of money that has been borrowed and recorded as a liability, but has not yet been received. Additionally, the Town should have a system to submit the necessary paperwork to draw down funds from MWPAT as quickly as possible once the expenditure has been made. This would provide a positive impact on the Town's cash position and a more accurate picture of the amount that can still be spent on the project that will be eligible for reimbursement.

We have recommended that the Town implement a system to monitor the receivable from MWPAT as well as to request reimbursements from MWPAT as timely as possible once the expenditures have been made.

Status –Resolved

The Town has improved systems for monitoring the MWPAT receivable balances and for requesting reimbursements on a timely basis.

Journal Entry Control

Comment

During prior years, our review of the Town's journal entries revealed entries that lacked adequate support to document the reason for the adjustments to the Town's general ledger, or for which the support and approval could not be provided.

We have recommended that the Town take steps to insure that all journal entry adjustments made to the general ledger be properly authorized, and supported with full explanations and reference to adequate supporting data.

Status –Resolved

The Town was able to provide supporting documentation for all journal entries selected for testing during the fiscal 2009 audit.

Warrants Payable Balances

Comment

The Town's general ledger contained unsupported balances for warrants payable at year end. The unsupported balances in the general fund totaled approximately \$32,000, and there were also small unsupported balances in several other funds. We were advised by the Town that ledger balance was incorrect, and that they were caused from computer glitches that occurred during the year.

We continue to recommend the Town implement procedures to identify and correct inaccurate account balances on the general ledger.

Status –Unresolved

There has been no significant change in the Town's process for monitoring and properly recording warrants payable amounts on the general ledger.

Town of Nantucket response

Unusual balances in A/P (those which do not clear in the normal course of events) arise from voided checks, voided payments, or actual payment amounts which differ from the anticipated payment amounts. Periodic review of the A/P balances is performed, and large amounts are further investigated immediately. The entire balance across all funds as of June 30, addressed by this comment is \$36,903. The majority of the June 30 balance cleared in July 2009. The current balance across all funds as of December 31, addressed by this comment is \$8,960.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Use of Fiscal Year 2009 Appropriations to Pay Fiscal Year 2008 Expenses

Comment

During the fiscal year 2008 audit, our review of payments made subsequent to year end identified approximately \$11,000 in payments for goods received and/or services provided during fiscal year 2008, which were paid for with fiscal year 2009 funds.

The Town's finance department is responsible for establishing a system of controls to review expenditures to ensure they are reported in the proper budgetary period. Lack of such controls puts the Town at greater risk of noncompliance with budgetary laws and regulations, misstatements in financial reporting, or the inability to prevent and detect fraud in the Town's financial statements.

We recommended the Town review and strengthen its procedures for reviewing and approving expenditures.

Status –Resolved

Our fiscal year 2009 testing did not identify similar expenditures.

Fixed Asset Deletions, Disposals and Transfers

Comment

Since the implementation of GASB Statement #34, the Town has compiled a detailed listing of all assets owned by the various departments of the Town. Maintaining this list requires the Town to account for additions, deletions, disposals, and transfers of fixed assets. At this time, the Town is maintaining the fixed assets listing, which is updated annually for financial reporting purposes, by recording depreciation and by adding fixed assets purchased during the year. In prior years, the Town had not implemented procedures to account for fixed asset deletions, disposals or transfers. In order to maintain a complete and accurate fixed asset listing, and to facilitate accurate financial reporting, the Town needed to work to develop procedures to identify and record fixed asset deletions, disposals and transfers.

We recommended that management develop and implement procedures to identify and record fixed asset deletions, disposals and transfers.

Status – Resolved

The Town has implemented a process of verifying, through insurance records, major capital asset deletions and disposals during the year. Although there is not a procedure in place to identify deletions of smaller assets not appearing on the insurance records, the majority of these assets are fully depreciated, and residual values are not material to the Town's financial statements. The Town has indicated that they plan to verify the disposals and deletions of smaller capital assets through a verification process directly with the departments.

Borrowing for Deficits at Year End

Comment

At the end of fiscal year 2008, the Town had several capital projects which had deficit cash and fund balances at year end. Several of these projects are still in progress and have not been completely financed. Under-financed projects drain on the Town's cash flows and can have a negative impact on the amount of funds certified by the Department of Revenue as available for appropriation in the subsequent year.

Recommendation

We recommended that management investigate all capital projects that have deficit cash balances and determine if funding is necessary to better manage cash flows and available funds.

Status – Resolved

The Town has implemented procedures regarding cash flow planning, spending, and borrowing.

Current Year Comments

Payroll Timesheets

Comment

During our review of the Town's payroll process, we noted instances where departmental transmittals did not contain the approving signature of the department head. The transmittals are compilations of employee timesheets for each department. The lack of an approving signature on some transmittals is an indication that the employees' time was not reviewed or approved, which increases the risk that employees could be overpaid or underpaid.

Recommendation

We recommend that the Town require the proper department head approvals on all payroll transmittals.

Town of Nantucket response

A standardized process was implemented for payroll reporting at the beginning of Fiscal 2010 (the payroll period beginning July 6, 2009).

Other Post-Employment Benefits Actuarial Valuation

Comment

Now that the Town has met the requirements for implementation of GASB Statement No. 45, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, it is time to acknowledge the requirements necessary to stay in compliance with the GASB and obtain the information necessary to complete the Town's annual audit.

For financial reporting purposes, and actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) if 200 or more, or at least triennially for plans with total membership of fewer than 200.

This means that an updated actuarial valuation dated July 1, 2009 will have to be obtained in order for the Town to remain compliant with GASB Statement #45, for fiscal years of 2010 and 2011. This is two years after the original July 1, 2007 valuation which was used for the fiscal year 2009 audit.

On a go forward basis, the actuarial valuation should be calculated based upon the 4% discount rate, this percentages falls in-line with the Town's current funding policy. For financial reporting purposes, it is also necessary for the actuarial valuation to segregate Nantucket County, Nantucket Regional Transit Authority (NTRA), Nantucket Islands Land Bank, and the various Enterprise funds separately from the Town of Nantucket's liability.

Recommendation

We recommend that the Town work with their actuarial firm to assure that information needed for the next valuation report is provided in ample time for the fiscal year 2010 audit.

Town of Nantucket response

Town Management is aware of and has communicated to elected and appointed officials the requirements of GASB Statement No. 45. In July, 2009, a contract was signed for the revaluation of the OPEB liability, in accordance with those requirements. The valuation will exclude the NRTA and Land Bank portion, as they are contracting for a separate report and will make independent funding decisions regarding their OPEB liability. The contract does not specify that the County or Enterprise funds should be split out. Until the TON decides to actually fund the liability, or until the next contract, for fiscal 2012, management believes that a reasonable allocation at year end is sufficient for splitting out the liability for the County and for each Enterprise fund for audit reporting purposes.

The previous valuation included two estimates, based on two assumptions: 1) funding the ARC, or 2) not funding the ARC. Budgetary constraints have resulted in the decision to not fund the ARC, and consequently, future valuations will be based on that decision, and the liability will be larger as a result.

Invoice Approval

Comment

During our review of the Town's support for expenditures, it came to our attention that the Town processed a payment totaling over \$14,000 at the request of the Airport without a supporting invoice. The only supporting documentation provided was a remittance form which did not include adequate documentation of the vendor, date of purchase, and what the expenses pertained to. The accounts payable clerk processed the payment solely because the remittance form was signed by the Airport Manager. Processing any payments without proper supporting documentation is a breakdown in the Town's system of internal controls.

Recommendation

We recommend that the Town enforce its policy for not processing payments without proper supporting documentation.

Town of Nantucket response

The Town concurs with the recommendation, recognizes the responsibility for controls over disbursements, and will reinforce its policy and procedures throughout the Town.

Accounting Separately for Bond Proceeds

Comment

The Town accounts for bond proceeds received for major capital projects in separate funds on the general ledger. This is the recommended practice, as it allows for a clear record of what bond proceeds have been spent, and what they have been spent on. However, when the Town receives bond proceeds relating to small enterprise fund related projects, they are often accounted for within the enterprise operating funds. This requires the bonded balances to be accounted for outside of the accounting system on spreadsheets, and increases the risk that bond proceeds could be spent for ineligible purposes.

Recommendation

We recommend that the Town account for all bond proceeds in capital project funds on the general ledger, and that the Town continue to account for bond proceeds related to enterprise funds separate from those that will be repaid by the general government.

Town of Nantucket response

The Town's accounting for small enterprise fund related projects funded from bond proceeds provides a clear record of the amount of proceeds remaining unspent. Each project has its own budget; as the bond proceeds are spent, the budget is automatically reduced. Small projects typically are spent within a relatively short time, and the projects are closed out.

Large enterprise fund projects, such as the airport terminal and the Surfside Wastewater Treatment Facility, are accounted for in capital project funds. Projects which have complex funding sources (paid by two funds, or paid by two different bonding sources, MWPAT and general obligation) are accounted for in capital project funds.

Management believes that small capital projects of limited duration are adequately accounted for in the Enterprise funds, that the remaining proceeds of borrowed funds for these projects is easily determined, and that the benefits of having the information in one fund outweigh the drawbacks of adding complexity to the process of transferring enterprise fund dollars from one bank to another to settle vendor payments.

General Ledger Maintenance and Reconciliations for Nantucket County

Comment

The Town did not reconcile the due to/due from balances of the County since prior to fiscal year 2003, and the variance has changed each year. Additionally, many of the other County accounts, including cash, were not monitored on a regular basis throughout the year, and fourteen late Town adjustments were required in an attempt to correct the balances several months after year end.

The lack of timely account reconciliations and a system to monitor the balances throughout the year increases the risk that errors will occur and not be detected and corrected on a timely basis and increases the risk of inaccurate financial reporting.

Recommendation

We recommend the Town improve the reconciliation and general ledger account monitoring process related to the County's general ledger.

Town of Nantucket response

The Town completed a historical review of the County General Fund and the Deeds Excise Fund where the majority of the financial activity for the County is recorded. That review included the periods from 1998 through 2006. Balances between those two funds (including three distinct departments) were reconciled as a result of the review, and have been reconciled annually since that date.

The Town provides payroll services for Nantucket Land Bank, through the County general ledger. Those payroll transactions are recorded as a "due from" for accounting purposes only. The Land Bank settles its payroll transactions promptly, and the related "due from" accounts should zero out regularly. Computer coding for payroll

and for the subsequent payment by the Land Bank will be changed and tested, to separate this "due from" account from true County interfund accounts, which will facilitate the reconciliation process.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan.

Informational Comment

Government Accounting Standards Board (GASB) Statement #54

Comment

In February 2009, the GASB issued Statement #54, *Fund Balance Reporting and Government Fund Type Definitions*, which is required to be implemented in fiscal year 2011. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund types, capital projects fund types, and permanent fund types are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

Recommendation

As it appears that this GASB Statement will significantly impact the fund balance classifications presently reported, we recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes, and to formulate plans to be used in explaining these changes to interested parties within the Town and to the external users of the Town's financial statements.