

TOWN OF NANTUCKET, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2010



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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, 2010, 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.

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 and operation of internal control over significant accounts.

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 summarized 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 the 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.

February 28, 2011

TOWN OF NANTUCKET, MASSACHUSETTS

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JUNE 30, 2010

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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. In 2008 the Town contracted with a third party consultant to provide assistance to the Finance Department in the development and implementation of internal controls. We have been advised that management has assessed the effect of previously communicated weaknesses and the results of the report of the third party consultant and has identified a program of improvement as a high priority. The Town initially took several steps toward the implementation of the recommendations made by the third party consultant. However the recommendations have not been fully implemented and we have not noted significant improvement in fiscal year 2010. We consider the amount of time that has passed and management's failure to adequately act on these weaknesses to represent a material weakness in the Town's system of internal controls.

Inadequate Design and Operation 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

have not been reconciled since that time. The bank accounts have subsequently been closed, however the Treasurer continues to carry a net balance of over \$219,000 which is not supported by a listing of outstanding checks that have not cleared.

- The Treasurer was unable to reconcile the new payroll bank account. The unreconciled variance at the beginning of audit fieldwork in October was approximately \$64,000. By the end of fieldwork the variance was reduced to approximately \$16,000 which has remained unreconciled.
 - 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.
 - The Town receives outstanding check lists from the bank for the new vendor and payroll bank accounts. The lists include all checks issued as they have been transmitted from the Town to the bank, all checks cleared at the bank, and a summary of which checks remain outstanding. The outstanding lists from the bank are not accurate because voided checks and issued checks have not been accurately transmitted to the bank. As a result, the Town continues to rely on the outstanding check lists from the MUNIS system, and additional time is spent reconciling the MUNIS outstanding check list to the bank list. This procedure is inefficient and may have contributed to the problems with reconciling the payroll account.
 - The Town issued approximately \$70,500 in checks from the payroll account made payable to the Town of Nantucket which were not deposited into another Town bank account until subsequent to year end. As a result, only half of the transaction (the disbursement) was recorded on the Town's records in fiscal year 2010 and the cash was not recorded in the Town's books as of June 30. This practice caused inaccurate financial reporting and increased the Town's risk of errors or abuse.
 - The Town has not performed reconciliations between the balances of individual enterprise fund's accounts on the general ledger and the supporting bank balances. Variances identified after the end of the fiscal year required material adjustments.
 - Although the County bank account reconciliations were completed during the fiscal year, several journal entries after year-end continued to change the ledger balance and as a result the County's final cash reconciliations were provided to us to audit on the last day of audit fieldwork and contained approximately \$175,000 in unsupported reconciling items.
- Activity for the Town of Nantucket was not properly recorded on the general ledger throughout the year resulting in 37 late Town adjusting journal entries recorded between October 5, 2010 and February 7, 2011. The entries included over \$638,000 in transfers that should have been recorded in prior fiscal years which were previously unidentified due to a lack of adequate reconciliation between the information recorded in the Town's general ledger and departmental records. The number of late adjustments is a strong indication that the Town is not performing routine account reconciliations and making corrections to accounts during the fiscal year and puts the Town at risk of inaccurate financial reporting and of inaccurate reporting and testing of federal expenditures.

- The Treasurer has not transferred the exact amount of the warrants from the airport bank accounts to reimburse the Town accounts on a timely basis throughout the year. This resulted in several adjustments at year end, and required an analysis by both the Town and Airport Finance Directors to reconcile the transfers made. The net result was that funds were over-transferred from the airport accounts by approximately \$830,000 at year end. This system is inefficient as it required unnecessary time to identify the variances between the transfers and the warrants and to correct the transfers after year end. This also caused cash to be misstated between the Town and Airport bank statements throughout the year which impacts investment earnings.
- Several of the supporting schedules provided to us during audit fieldwork in October were inaccurate and changed during the audit. For example, the list of unspent appropriations that were to be carried forward to fiscal year 2011 changed several times. The initial listing would have resulted in a small deficit in the Town's education line. Once this was identified, the amounts were adjusted, and the education line was no longer overspent. Also, the schedule of authorized and unissued debt and the schedule of unspent bond proceeds both changed by several million dollars during this time.
- The Town does not have a reliable system for monitoring capital borrowing and the associated capital expenditures. The Town's schedule of unspent bond proceeds indicates that bond proceeds dating back to fiscal year 2003 have not all been expended. We were advised that expenditures may not have all been properly charged against the bond proceeds in prior years. In one case a project was completed and funds were expended that were not funded with borrowed funds as authorized. Several adjustments were made to the schedule of unspent bond proceeds subsequent to year end when the unspent balances were reconciled to the related cash.

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

We concur with the auditor's recommendation and actions are in place to address the issues in the management letter.

In Fiscal Year (FY) 2008, Town Administration contracted with a third party consultant 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 the additional procedures to be implemented in the remainder of FY2011 through FY2012. Processes and procedures that are currently implemented include Accounts Receivable Reconciliations, Cash Reconciliation Process for Controller and Treasurer, Centralized Procurement, Receipt of Reports, Vendor Maintenance, and Year End Invoice Processing.

Cash Reconciliations: Since July 2009, cash activity has been reconciled on a monthly basis with the exception of four key accounts: County Bank of America Accounts Payable Outstanding Checks; Town Citizens Bank Payroll Outstanding Checks; Town Bank of America Accounts Payable Outstanding Checks; and Town Bank of America Payroll Outstanding Checks. The cash activity reconciliation includes a tri-reconciliation of the Treasurer's Cashbook to the Bank and General Ledger. Beginning in March of 2011, the Acting Finance Director(s) will be conducting monthly reviews with the Town Accountant and Treasurer to ensure cash reconciliations are being completed in a timely manner and to assist in resolving open reconciliation items.

Legacy issues pertaining to the old vendor and payroll accounts will be investigated and resolved by the Town Accountant and Treasurer; however this task will take additional time.

Payroll Account: In April of 2010, the Town upgraded its accounting software system, Munis. During this time, the retirement checks that are typically issued in the April time period were not posted. The Treasurer discovered the error in June and worked with Munis support to correct the issue. The outstanding checks crossed fiscal years; therefore the \$70,500 variance was due to a timing difference.

Enterprise Funds: The Town accountant will develop and implement processes to ensure the inter-fund transfer accounts are reconciled on a monthly basis.

County Reconciliations: The County Cash activity was reconciled between the general ledger and the cashbook and provided to the audit firm in a timely manner. The former Finance Director made adjustments during audit work that resulted in a variance. The Assistant Finance Director will work with the audit team to determine the best course of action to resolve the remaining issues.

Late Journal Entries: The Town recognizes the inherent risk associated with late journal entries and plans to develop and implement a process to reduce journal entries made after the fiscal year end.

Enterprise Fund Inter-fund Transfers: Specific to the Airport Enterprise Fund transfer, in this particular instance it was human error. The transfer to cover the warrants was performed twice and discovered by the Treasurer and

Airport staff at a later date during the reconciliation process. In the third quarter of Fiscal Year 2011, the Enterprise Fund balances will be reconciled to the departmental records pertaining to actual transfers made. This process will in turn identify any year end timing issues which will be recorded as a receivable in the format of a due to / due from.

Capital Borrowing and Associated Expenditures: In FY2010, the Town instituted a process where the capital appropriations accounts that were subject to borrowing were inactivating until such time borrowing occurred. In conjunction with the Centralized Procurement process, departments are unable to charge accounts for capital expenditures until borrowing has been approved. The next step of the process will be to review legacy accounts and perform the same action by the end of FY 2012.

Supporting Schedules: A preliminary Statement of Indebtedness was provided to the auditing team during August fieldwork for testing purposes. The final version was provided to the Department of Revenue in November of 2010. Beginning FY2011 and going forward, once the final version is submitted to the Department of Revenue; the audit firm will receive a copy in 48 business hours.

The Town recognizes the importance of resolving the aforementioned issues in a timely basis. As per prior year recommendation, the Town has been focused on ensuring current activities are properly reconciled. The process of addressing legacy issues will require additional time and will be properly investigated as time allows.

The recommendations will be assigned a priority level in relation to all recommendations for an implementation plan by the third quarter of FY2011.

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, 2010, 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 and process improvement measures. Depending on the cause for 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 by the fourth quarter of FY2011.

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, 2010, several variances exist between individual fund balances carried on the ledger and the corresponding bank balances.

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 reimbursement to the Town for payments made through the Town's vendor payment process were implemented in Fiscal Year 2011.

The Town Accountant and Treasurer will work collaboratively to address the legacy issues within the trust fund balances that date back to the late 1990's.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan during FY2012.

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 - Unresolved

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

During fiscal year 2010, the Treasurer has not transferred the exact amount of the warrants from the airport bank accounts to reimburse the Town accounts on a timely basis throughout the year. This resulted in several adjustments at year end, and required an analysis by both the Town and Airport Finance Directors to reconcile

the transfers made. The net result was that funds were over transferred from the airport accounts by approximately \$830,000 as of June 30, 2010.

Town of Nantucket Response

The cash transfer process has improved in Fiscal Year 2009 and 2010; however transfers need to be conducted in a timelier manner. 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.

The Town Accountant will ensure a process of monthly reconciliation of inter-fund transfers is developed and implemented in the 4th quarter of FY2011. In addition, the Town Accountant in coordination with the Treasurer will review and address "legacy" issues that pertain to the "due to" and "due from" accounts over the course of FY2011 and FY2012.

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 has 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 plan. The Town will review the opportunity to have a third party develop a plan in Fiscal Year 2011 and 2012.

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 is not agency activity if the officers are paid in advance of the reimbursement from the vendors.

Status – Partially Resolved

During fiscal year 2010, the Town appropriated funds to fund the permanent deficit in the detail accounts. However the Town has not yet implemented procedures to reconcile off-duty police and fire detail account

receivable accounts receivable to the cash balance in the account on a regular basis and to implement formal procedures for writing-off uncollectible receivables and funding them on a timely basis.

Town of Nantucket Response

The Town concurs with the recommendation.

On a monthly basis, the Staff Accountant reconciles the off duty police and fire details; however needs to take the process one step further with the reconciliation of cash. Beginning in March of FY2011, the Staff Accountant will meet regularly with the Police Support Staff to ensure the entire process is reviewed on a monthly basis.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan by the fourth quarter of FY2011.

Dental Insurance Withholding Deficit

Comment

The Town had a deficit balance of approximately \$283,000 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 2010 by approximately \$5,000.

Town of Nantucket Response

The Town concurs with the recommendation and is actively reconciling the Dental Withholding accounts on a monthly basis. At the present time, the Town receives rate increases in the month of June. The School Department prepays its dental insurance expenses from June to August of each year. Therefore, the Town has a practice of increasing the premiums in September when the School employees return.

The Town Accountant and Treasurer will determine the need to adjust employee withholdings to ensure increases in the insurance rates properly match the premiums paid by the fourth quarter of FY2011.

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 – Resolved

The Town provided support for the balances recorded as warrants payable as of June 30, 2010.

Payroll Timesheets

Comment

During our review of the Town's payroll process in prior years, 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.

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

Status – Resolved

Payroll timesheets selected for testing during the fiscal year 2010 audit all contained the appropriate authorizations.

Other Postemployment 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.

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.

Status - Resolved

The Town obtained an updated OPEB actuarial valuation report for the fiscal year 2010 audit.

Invoice Approval

Comment

During our review of the Town's support for expenditures during fiscal year 2009, 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.

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

Status - Resolved

The fiscal year 2010 audit testing did not identify any invoices processed without proper supporting documentation.

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.

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.

Status – Unresolved

There has been no significant change in this comment during fiscal year 2010.

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 will take the necessary course of action to ensure bond proceeds are accounted for in the capital projects funds by the fourth quarter of FY2011.

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.

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

Status - Unresolved

There has been no significant change in this comment during fiscal year 2010.

Town of Nantucket Response

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 payment and for payroll and for the subsequent payment by the Land Bank will be updated and tested to separate this "due from" account from true County inter-fund accounts, which will facilitate the reconciliation process.

The Assistant Finance Director and Town Accountant will reconcile the County and Town "due to" and "due from" accounts on a quarterly basis beginning the third quarter of FY2011.

Current Year Comments

Receivable Reconciliations

Comment

During our review of the Town's receivables it was noted that the general ledger balances of a number of items related to Our Island Home and the Landfill did not tie to collectors support. The variances related to Our Island Home occurred when the department converted software from QuickBooks to American Health Net in May of 2010. The American Health Net software does provide a detailed accounts receivable aging report; however the total balance of the detail was \$28,000 greater than the balance on the Town's general ledger.

In relation to the Landfill, the tipping fee receivable general ledger balance was over \$200,000 greater than the support maintained by the Town Collector for the Landfill.

Recommendation

We recommend that the Town implement procedures to reconcile the accounts noted above as the general ledger should mirror supporting documentation.

Town of Nantucket Response

The Town currently has Accounts Receivable Reconciliation procedures in place. The Town Accountant is in the process of obtaining access to the two billing systems (Wasteworks and American Health Net) which will allow the ability to track changes and limit the ability for changes to previously reconciled balances.

The Landfill Tipping Fees are collected by Public Works not the Tax Collector. The Town Accountant and Staff Accountant are working directly with the public works support staff and software support to address outstanding issues.

This recommendation will be assigned a priority level in relation to all recommendations for an implementation plan by the fourth quarter of FY2011.

Prepaid Expense Balance

Comment

Per review of the general ledger there is an account for prepaid expenses that has a balance of \$10,900 that has not had activity in several years. We were advised that the balance relates to prepaid tuition for an education program which occurred in July, 2007 (fiscal 2008). During fiscal 2008, the prepaid expense should have been charged to a current year expense by journal entry.

Recommendation

We recommend that the Town correct this error in order to accurately report prepaid expenses and implement procedures to correct errors more timely in the future to produce more accurate financial information.

Town of Nantucket Response

The prepaid expense will be charged to a current year expense by journal entry in Fiscal 2011.

Journal Entry Control

Comment

Our review of the Town's journal entries revealed entries that lacked adequate authorizations. Journal entry authorizations provide a record that the support for the entry has been reviewed and approved.

Recommendation

We recommend that the Town take steps to insure that all journal entry adjustments made to the general ledger be properly authorized.

Town of Nantucket Response

The Town concurs with the recommendation. Beginning in April of 2011, the Operations Coordinator will ensure all necessary authorization is provided to perform journal entries. If an authorization is lacking, the Operations Coordinator will return the journal entry request to the requisitioner.

Commingling of Federal and State Grants

Comment

The Town accounts for federal grants and state grants within the same funds in the general ledger without designation as to which grants are federal and which are state. Since the Town is required to report federal expenditures separately, combining federal and state grants on the general ledger increases the risk that federal expenditures will not be identified. Additionally, the amount of audit testing done on federal expenditures is determined based on federal expenditures. The commingling of these funds makes the process of identifying and reporting federal grants cumbersome, makes the planning process for identifying major federal programs cumbersome, and puts the Town at risk of inaccurate financial reporting.

Recommendation

We have recommended that the Town implement a system to segregate federal and state grants in the general ledger.

Town of Nantucket Response

The Town concurs with the recommendation. In FY2011, the Town Accountant with the assistance of the Operations Coordinator will establish and test new funds for Federal-Education Grants and Federal - Non-educational grants with the intent the new funds would be operational no later than the 1st quarter of FY2012.

Current Year County Comments

Escrow Accounts

Comment

During the audit of the County's cash balances it was noted that the County's general ledger included three escrow accounts that are not supported in the cash book or in bank accounts. We were advised by management that there is no known support for the creation of these escrow accounts and their purpose is unknown.

Recommendation

We recommend the County research the source for the creation of the escrow accounts and take action to remove them from the general ledger if their existence cannot be adequately supported.

Town of Nantucket Response

Management concurs with the recommendation and has performed due diligence to resolve the legacy escrow account issues. The Treasurer and Assistant Finance Director have researched archived information from the late 1990's to determine the establishment of the escrow accounts. At this time, supporting source documents are not available to support the recorded balances.

The Assistant Finance Director will follow up with the auditing team to determine the best course of action by fourth quarter of FY2011.

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.