

TOWN OF NANTUCKET, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2011



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The Honorable Board of Selectmen
Town of Nantucket, Massachusetts

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Town of Nantucket, Massachusetts (Town), as of and for the fiscal year ended June 30, 2011, 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:

- Inadequate design and operation of internal control over significant accounts.
- Failure to comply with procurement laws and regulations.

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.

Powers & Sullivan LLC

February 21, 2012

TOWN OF NANTUCKET, MASSACHUSETTS

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JUNE 30, 2011

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Material Weaknesses

MATERIAL WEAKNESSES

Inadequate Design and Operation of Internal Control Over Significant Accounts

For several years control deficiencies have been identified and reported to management related to the timely reconciliation of significant accounts such as cash, interfund receivables and payables and accounts receivable. During the last few months of fiscal year 2011, the Town has taken a systematic approach to addressing each of the previously identified weaknesses, and has made significant progress. The process of reconciling accounts such as cash and interfund receivables and payable (due to/from accounts) and accounts receivable on a monthly basis has provided the Town with greater assurance that all financial activity has been reported in the Town's general ledger. An additional and equally important step in the process of verifying that all activity is recorded accurately is to reconcile the balances and activity in the general ledger to the supporting documentation. This process would identify activity that may have been recorded in the wrong account or fund, which could have a significant impact on management decisions and the Town's financial position. This step is typically accomplished through monthly reconciliations of account balances with the individual departments responsible for the activity and through reconciling appropriation balances with departments. The Town has deferred the implementation of this process to fiscal year 2012.

Management must rely on the financial information generated through the Town's ledgers 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. We recognize that the Town has taken significant steps in improving controls by reconciling cash, interfund receivables and payables and accounts receivable and through addressing many of the legacy account variances that have been carried for several years. However, the Town's internal control system must include a process for verifying that activity has been accurately recorded within the Town's records for the system to function as intended.

The status of previously reported internal control deficiencies are as follows:

- Several years ago, the Town discontinued the use of the main vendor and payroll accounts and opened new accounts with the intent that this would help the cash reconciliation process. 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. With the assistance of outside consultants, the Town has reconciled the activity in the new vendor and payroll accounts as of June 30, 2011. However, new payroll and vendor accounts have not been consistently maintained at a zero balance. We continue to recommend maintaining both the vendor and payroll accounts at a zero balance as this will simplify the reconciliation process on a go forward basis.
- 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. In prior years, we noted that the Town did not have a process for transferring the cash from the Enterprise Fund Accounts to reimburse the vendor account timely or accurately. In fiscal year 2011, the Town has improved on performing reconciliations between the balances of individual enterprise fund's accounts on the general ledger and the supporting bank balances by making more timely cash transfers and by requiring the Airport and the Wannacomet Water Company to sign off on the activity, but not the balances of the bank accounts. Since this process did not take place for the entire year, and the actual balances were never reconciled, variances were identified

subsequent to year end between the Treasurer's cashbook and the General Ledger related to the cash accounts held for the Nantucket Memorial Airport. The variance totaled approximately \$500,000 and required material adjustments that were not identified through the reconciliation process. Additionally, the lack of a system to reconcile the balances throughout the year required an analysis by both the Town and Airport Finance Directors to reconcile the actual transfers made. 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.

- Significant adjustments were made to the fiscal year 2010 general ledger subsequent to the prior audit. Over \$730,000 in expenditures were recorded in the general fund for fiscal year 2010 on March 31, 2011. These expenditures, along with adjustments required to close out old unreconciled vendor and payroll accounts resulted in a restatement of the Town's general fund beginning balance totaling \$993,000.
- 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. During fiscal year 2011, adjustments have been made to the beginning balances of the schedule of unspent bond proceeds when the unspent balances were reconciled to the related cash. We recommend that the Town implement a system to monitor capital projects and the associated authorized funding mechanisms to both ensure the timely borrowing for authorized projects and to allow for the reallocation of unspent bond proceeds once projects have been completed.

Additional internal control deficiencies:

- The Town recorded payables from the Wannacomet Water Company to the Sewer and Siasconset Water enterprise funds without recording a corresponding receivable. This has the effect of understating revenue received during fiscal year 2011. As part of the monthly reconciliation of the "due to/due from" accounts, we recommend that other interfund receivables and payables also be reconciled.
- As noted above, the Town does not have a reliable system both for reconciling individual fund balances with departments and for monitoring the activity of capital projects and the associated borrowing or other funding. Both of these weaknesses have contributed to variances between the Town's operating and capital accounts of the Nantucket Memorial Airport. The Town is currently in the process of identifying the activity that should have been recorded between these two funds, recording correcting entries, and determining the overall impact that it this will have on the Town's finances.
- The Nantucket Memorial Airport has constructed a number of capital projects which were authorized to be funded partially through state and federal grants and partially through long-term borrowing. Since grant revenue was not monitored on a project by project basis, the final Airport portion of each project was not calculated and was not borrowed. In these cases the Airport's share of projects was paid with cash from the operating fund as the project invoices were paid. The Town is in the process of reconciling the activity of each of the Airport projects and determining the amount that should have been borrowed and the options currently available. In some cases, the Town may have lost the ability to borrow the Airport's share of these projects.

Failure to Comply With Procurement Laws and Regulations

During the current fiscal year the Town discovered several Town departments, including the Nantucket Memorial Airport, Wannacomet Water Department, and the School Department were not following procurement laws as specified in Massachusetts General Law. Several departments lacked proper documentation of obtaining three oral or written quotes as well as not entering into signed contracts for various capital improvement projects and other services such as maintenance.

Chapter 30B of the Massachusetts General Laws, the Uniform Procurement Act, establishes uniform procedures for local governments to use when contracting for supplies, services, and real property. All Chapter 30B contracts in the amount of \$5,000 or more must be in writing. There are also several other key sections of the law that pertain to municipal procurement. The major laws addressing municipal procurement include:

- *M.G.L. c.7 § 38A-1/2 (Design services)*
- *M.G.L. c. 149 (Building Construction)*
- *M.G.L. c. 30, §39M (Mass Highway)*
- *M.G.L. c. 90B, §34 (Mass Highway)*
- *M.G.L. c. 30B, Non Building (Local Level)*
- *M.G.L. c. 30B, Supplies and Services (Local Level)*

We recommend that the Town strengthen controls over procurement to ensure compliance with the proper procurement laws. As part of this system, all purchases should be evaluated to determine whether, over the course of the fiscal year, the Town will spend in excess of the competitive bidding thresholds for the same or similar items or services and all departments should be required to maintain support to document procurement decisions made. If a written contract is required, a copy of the executed contract should be provided to the Town's Finance Department.

To address this issue, subsequent to year end, the Town has implemented a system to require departments to provide proof of contracts, as required by MGL, and has requested that all contracts be provided to the finance department where they are scanned and filed. This process allows the Town to verify a contract's existence when purchase orders are submitted by Town departments.

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.

Management's Response

Previously reported comments:

Zero Balance Vendor and Payroll Accounts: The Treasurer has transferred exact amounts for payroll and accounts payable/vendor accounts in Fiscal Year 2012 to maintain zero balance accounts; however the accounts will continue to have minimal variances month to month due to interest being earned on the last day of each month.

Enterprise Fund Cash Reconciliations: The Town believes that separate bank accounts are no longer necessary and will work with the respective Enterprise Funds to close the applicable accounts by the end of Fiscal Year 2012. The Town implemented an internal process in May of 2011 that required both the Enterprise Fund Business Office Managers to sign in agreement with the "Transaction Detail Report", which includes the balances of the bank accounts, within the Treasurer's Cashbook at the end of each month. If there was a question or concern, the Enterprise Fund Business Officer Managers had the opportunity to resolve the issue with the Treasurer within 30 days. Although the signature process didn't occur each month in Fiscal Year 2011, both the Wannacomet Water and Airport Business Office Managers signed the designated form that they were in agreement with the Treasurer's Cashbook transaction history from July to June, 2011.

Significant Adjustments: This action was a result of addressing legacy cash issues for both the Town and County that date back to the early 2000's that were corrected in Fiscal Year 2011.

Monitoring of Capital Borrowing: In Fiscal Year 2011, the Town of Nantucket instituted internal controls for capital projects. All general fund, sewer, and solid waste enterprise departments' capital projects were reconciled.

Current year comments:

Wannacomet Water Company Payables: On a monthly basis, the Town of Nantucket is recording the receivables in the respective Enterprise departments (Sewer, Siasconset Water, and Wannacomet Water). In Fiscal Year 2012, the Town plans to close the single bank account that necessitates the account payable entry. In addition, the Town will reaffirm the importance of providing commitments for the respective Enterprise departments to the Finance Department on a monthly basis.

Nantucket Memorial Airport Capital Borrowing: In Fiscal Year 2012, the Town's Finance Department with assistance from an independent financial consultant re-created all Nantucket Airport capital project activity dating back to 2005. The task identified several Airport Capital projects that were subject to borrowing and/or grant receipts where borrowing wasn't in place, or grant reimbursements weren't submitted in a timely manner to offset expenditures. In order to address the issues of the past years, several steps will be taken at the 2012 Annual Town Meeting including but not limited to transfers from Airport projects with excess bond proceeds; borrowing; and a combination of general fund subsidies and chargebacks to the Airport Enterprise Fund operating budget to address deficits in capital projects that are no longer eligible for long-term borrowing opportunities. Prior to implementing adequate internal controls, there were gaps in accounting for Airport capital borrowing and grant receipts. Controls are now in place to prevent this. Cooperation is required from departments not under the direct jurisdiction of Town Administration.

In accordance with SEC regulations, the Town will adopt and distribute to all Town, School, and Enterprise Departments a "Post Issuance Tax Compliance Procedure for Tax Exempt Obligations and Other Tax Benefited Obligations" in the 3rd Quarter of Fiscal Year 2012.

Procurement Law and Regulations: The Town of Nantucket agrees with the auditor's recommendation. The Chief Procurement Officer and Finance Department are working collectively to mitigate, to the extent possible, disbursements to vendors without the proper procurement process taking place. Additional controls have been put into place. These controls include a centralized procurement process. Departments no longer have the ability to enter invoices into the Town's invoice processing system without a Town issued purchase order number. The next step of internal controls is to ensure all Town, School, and Enterprise departments have a purchase order in place prior to communicating orders to vendors for goods or services. In addition, in January of 2012, the Chief Procurement Officer provided a mandatory training for all Town, School, and Enterprise Fund departmental staff that was conducted by the Inspector General and Attorney General's office of the State of Massachusetts.

Other Matters

Prior Year Comments

Account Activity Reconciliation

Prior Year Comment

Activity for the Town of Nantucket was not properly recorded on the general ledger throughout the year resulting in 7 adjustments which were identified several months after year end during the audit process for fiscal year 2011. In the prior year, 37 late Town adjusting journal entries were recorded. These late adjustments were mainly to record transfers and to correct balances at year end. Some of the permanent entries should have been recorded in prior fiscal years however they were not previously identified due to the lack of adequate account reconciliation between the information recorded in the Town's general ledger and departmental records. The need for these adjustments is an indication that the Town is not performing routine account reconciliations and making corrections to accounts during the fiscal year. This puts the Town at risk of inaccurate financial reporting. As previously indicated, we recommend a system to verify that balances are accurate throughout the year. It should be noted, that the number of late adjustments has been significantly reduced from prior years through the reconciliation processes over cash, interfund balances, and accounts receivable that were implemented in the last few months of the fiscal year.

Current Status – Unresolved

We continue to recommend that the Town implement procedures to reconcile account balances and activity during the fiscal year to reduce the number of late adjustments recorded subsequent to year end.

Management's Response

The Town prepared internal procedures in October of 2011 to have the Town, School, and Enterprise Fund departments sign under penalty of perjury all account activity respective to their departments on a quarterly basis. The intent is to start this process in the 4th quarter of Fiscal Year 2012. This is a significant change to current town business practices and will take time for full implementation across all Town, School, and Enterprise Fund departments.

Massachusetts Highway Grants

Prior Year 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.

Current Status - Resolved

As of June 30, 2011, the Town has reconciled the Chapter 90 revenues and expenditures for the fiscal year and has adjusted for any previously unidentified variances. In addition, the state reimbursement requests for fiscal 2011 were submitted timely and the June 30, 2011 deficit now agrees to the receivable.

Accounting For Trust Fund Balances

Prior Year Comment

For several years, we have reported that 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.

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, 2011, 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.

Current Status - Unresolved

There has been no significant change in this area during the current year; however the Town is planning on implementing procedures to reconcile the Trust funds in fiscal 2012.

Continuing Recommendation

We continue to recommend that the Town implement procedures to reconcile the Trust fund balance reported on the general ledger to the bank balances on a monthly basis.

Management's Response

The Town of Nantucket agrees with the recommendation. On June 30, 2011 variances in the trust fund accounts did exist; however all activity was reconciled for Fiscal Year 2011 and included in the final trial balances provided to the auditors on September 30, 2011. The Town made great strides in this area at the close of Fiscal Year 2011 by reconciling trust fund balances and instituting the new Uniform Massachusetts Accounting Standards (UMAS) accounting codes for all trust and agency funds. In Fiscal Year 2012, the Town reconciles the General Ledger accounts with the Treasurers Cashbook and Bank Balance in Trust and Agency funds on a monthly basis.

Fraud Risk Assessment

Prior Year 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.

Current Status - Unresolved

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

Continuing Recommendation

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

Management's Response

The Town of Nantucket concurs with the recommendation. In Fiscal Year 2012, the Town plans to issue a request for proposal (RFP) for a third party to conduct such an assessment of at least 3 departments each year for the next three years. Upon the completion of the proposed contract services, the Town will re-evaluate the internal workload to determine if this process has the ability to be performed internally as opposed to outsourced.

Accounting for Off-Duty Police and Fire Details

Prior Year Comment

During the prior year we noted that 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 did 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 had not been determined due to a lack of procedures to reconcile the variances.

We have recommended 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.

Current Status – Partially Resolved

As of June 30, 2011, the negative cash balance and the detailed receivable reports provided from the Town's system were unreconciled by less than \$5,000. The Police Department did not generate and save the June 30th detailed aging reports from their system and were unable to regenerate the year end reports. Therefore, the Town was able to substantiate the negative cash balance within \$5,000, however, the balance was not reconciled with the Police Department which is the department primarily responsible for collecting the funds.

Continuing Recommendation

We continue to recommend the Town implement procedures to reconcile cash to the accounts receivable balances and to reconcile the ledger balances to the records maintained by the Police Department. Additionally, once the balances have been successfully reconciled, the Town should determine the cash flow needs to continue to pay officers in advance of collecting funds and consider appropriating funds for this purpose to maintain a positive cash balance as allowed by M.G.L. Chapter 44, Section 53C.

Management's Response

The Town concurs with the recommendation. In Fiscal Year 2012, a new Accounting Clerk was hired within the Finance Department. This position's primary focus is to ensure all accounts receivable for the Town and Enterprise departments are reconciled on a monthly basis. The monthly reconciliation includes the Off Duty Police and Fire Details. We intend to resolve this finding within Fiscal Year 2012 and future years by performing budget transfers from the Town's Police and Fire Department budgets to the Off-duty detail fund; or by including an annual warrant article for seed-money for the off duty detail fund; or a combination thereof.

Insurance Withholding Deficits

Prior Year Comment

During the prior year we noted that the Town had a deficit balance of approximately \$213,000 in the dental insurance and life insurance withholding accounts. As of June 30, 2011 the deficit balance was reduced to approximately \$55,000. This deficits in this account have been partially the result of employee withholdings not being matched to premiums paid, and 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.

Current Status - Unresolved

The deficit balance in total has decreased during fiscal year 2011; however the Town has not yet reconciled the full reason for the deficit balances in these accounts, or determined what the correct balances should be.

Continuing Recommendation

We continue to recommend 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.

Management's Response

Town of Nantucket Response: The Town of Nantucket concurs with the recommendation. The Treasury division of the Finance Department continues to reconcile current insurance withholdings on a weekly basis. The remaining variance of \$55,000 in insurance withholdings is a legacy issue which dates back to Fiscal Year 2000. The intent of the Town cover the remaining \$55,000 variance at the 2012 Annual Town Meeting and to continue to research payroll withholdings and payments back to 2000 to complete the reconciliation of the insurance withholding accounts.

Accounting Separately for Bond Proceeds

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

Current Status – Partially Resolved

During fiscal 2011, the Town accounted for all bond proceeds that are to be repaid by the general government in the capital projects fund. The Town is in the process of reconciling the operating and capital balances of the enterprise funds.

Management's Response

The Town of Nantucket agrees with the recommendation. In Fiscal Year 2012, the Town of Nantucket Finance Department in coordination with an independent financial consultant has reconciled the Airport Enterprise Fund department unspent bond proceeds. The identified Airport Enterprise Fund unspent bond proceeds are scheduled for transfers between Airport capital projects in the 2012 Annual Town Meeting Warrant Article 3.

In accordance with SEC regulations, the Town will adopt and distribute to all Town, School, and Enterprise Departments a "Post Issuance Tax Compliance Procedure for Tax Exempt Obligations and Other Tax Benefited Obligations" in the 3rd Quarter of Fiscal Year 2012.

General Ledger Maintenance and Reconciliations for Nantucket County

Prior Year Comment

In the past, we have noted that 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.

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

Current Status - Resolved

In fiscal year 2011 the Town reconciled the due to/due from balances of the county.

Receivable Reconciliations

Prior Year Comment

During our prior year 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 the supporting detail. 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.

Also in the prior year, we noted that Landfill tipping fee receivable reported on the general ledger balance was over \$200,000 greater than the supporting detail for the Landfill.

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

Current Status – Resolved

The Town has accounts receivable reconciliations in place as of June 30, 2011.

Prepaid Expense Balance

Prior Year Comment

In the prior year, we noted there was an account for prepaid expenses that had 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.

We recommended 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.

Current Status - Resolved

The Town corrected this error in fiscal year 2011.

Journal Entry Control

Prior Year Comment

During our prior year review of the Town's journal entries, we noted entries that lacked adequate authorizations. Journal entry authorizations provide a record that the support for the entry has been reviewed and approved.

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

Current Status - Resolved

During journal entry transaction testing for fiscal year 2011 there were no journal entries observed that lacked adequate authorizations.

Commingling of Federal and State Grants

Prior Year Comment

During the prior year, we noted the Town accounted 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.

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

Current Status - Resolved

The Town has implemented new funds that will allow for the separation of Federal and State funding for fiscal year 2012.

Current Year Comments

Invoice Receipt Procedures

Comment

During expenditure testing we noted a number of invoices lacked the required date and time stamp documenting the receipt of the invoice. The Town's policy to date and time stamp each invoice as it is received increases control over the processing of the invoices and the timely payment of bills.

Recommendation

We recommend the Town date and time stamp each invoice as it is received to record the receipt of the invoice as it begins the accounts payable process.

Management's Response

The Town of Nantucket agrees partially with the auditor's recommendation. The Town will implement an internal process to date stamp all invoices received at the department level; however, the Town doesn't see the value of a time stamp at this time.

Purchase Order Dates

Comment

During expenditure testing we noted that a number of purchase orders were dated past their corresponding invoice dates. Creating purchase orders after the invoice is received bypasses the Town's purchasing policies and defeats the control that a purchase order system is intended to provide.. Purchase orders play a primary role as they allow the Town to ensure that budgetary funds are available and that the purchase has been properly approved before funds are expended.

Recommendation

We recommend the Town implement a process to ensure that purchase orders are initiated prior to the procurement of goods and services.

Management's Response

The Town of Nantucket concurs with the finding. During testing, a Public Works and a School invoice were identified where the purchase order was created after the date of the invoice. Town, School, and Enterprise departments have received training regarding purchase orders since 2009. In Fiscal Year 2012, we will re-emphasize to all Town, School, and Enterprise Fund departments the importance of the compliance with the requisition and purchase order process.

Capital Assets Land Monitoring

Comment

During the current year audit the Town identified approximately \$1,200,000 of land that was sold in fiscal 2010 and never removed from the Town's capital assets records. This caused the land capital asset balance to be overstated in fiscal 2010, which required a restatement of the beginning land capital asset balance in fiscal 2011. We also noted that land was again sold in fiscal 2011 and the parcels were never reported on the Town's capital asset schedule.

Recommendation

We recommend that the Town implement policies and procedures for to provide better assurance that the Town owned land recorded in the Town's capital asset records is accurate and that land additions and deletions are properly recorded in the proper fiscal year.

Management's Response

The Town of Nantucket concurs with the recommendation. The increase in the activity of the Town's Yard Sale Program has resulted in having to develop a process to ensure that the unusual parcels and various land dispositions (such as "swaps") are correctly and accurately recorded in the Town's Fixed Asset Inventory in a timely manner. In Fiscal Year 2012, the Assistant Town Accountant, Chief Procurement Officer, and Planning Director have identified an internal process to mitigate, to the extent possible, the re-occurrence of this lapse in communication. The next step in Fiscal Year 2012 is to include quarterly reconciliations with the Assessor's records of Town owned land and document the process of reporting changes in Town land sales and acquisitions.

Prior Year County Comments

Escrow Accounts

Prior Year Comment

During the prior year 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.

We recommended 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.

Current Status - Resolved

During the fiscal year the County researched archived information relating to the creation of the escrow accounts and for those balances where existence could not be supported, the balances were removed from the general ledger. However, the reconciliation process revealed that an adjustment of \$171,000 was required to increase County cash in the escrow gift account on the general ledger due to a 2008 reclassification that was never recorded in the County's ledgers.

Current Year County Comments

Vendor and Payroll Accounts

Comment

During the audit of the County's cash it was noted that both payroll and vendor accounts were not maintained at a zero balance. Both accounts were reconciled at year end, however lump sum transfers were made at year end, rather than funding the exact amount of the warrants during the year. Maintaining zero balance accounts would help identify errors in the cashbook and or bank statements more timely. It would also reduce the amount of unnecessary transfers in and out of the accounts.

Recommendation

We recommend that the County maintain both payroll and vendor accounts at a zero balance and that the exact amount of the warrant be transferred rather than year end lump sum transfers.

Management's Response

The Town and County of Nantucket concur with the recommendation. The Treasurer of the Town and County of Nantucket has transferred exact amounts for the payroll and vendor accounts within the 1st and 2nd quarter of Fiscal Year 2012. The intent is to continue this practice going forward.

Unnecessary Bank Fees

Comment

The Town Treasurer maintains two County bank accounts that each receive bank charges of \$20 per month which has substantially reduced the balances in the accounts. During the fiscal year these accounts have been reduced from \$243 to \$23 and \$442 to \$222 due to bank charges when the only activity in these accounts is bank interest. Had the funds been transferred to a bank that does not charge fees for low balance accounts, the Town would have saved \$440 in bank fees over the current fiscal year.

Recommendation

We recommend the Town monitor the bank fees assessed and work to reduce the unnecessary fees paid on low balance accounts.

Management's Response

The Town and County of Nantucket concur with the recommendation. The Treasurer closed all of the accounts that were previously assessed the bank fees in October of 2011.

Prior Year Informational Comment

Government Accounting Standards Board (GASB) Statement #54

In February 2008, the GASB issued Statement #54, *Fund Balance Reporting and Government Fund Type Definitions*, which is required to be implemented in fiscal 2011. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classification that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classification 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 the governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such a fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, 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. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classification. In other fund, 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 amount 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 provision 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.

We recommended that management begin to study and evaluate the impact of this GASB 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.

Current Status - Resolved

The Town successfully implemented GASB Statement #54 in fiscal year 2011.