

TOWN OF CARVER, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2012



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To the Honorable Board of Selectmen
Town of Carver, Massachusetts

In planning and performing our audit of the basic financial statements of the Town of Carver, Massachusetts, (Town) as of and for the fiscal year ended June 30, 2012, 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 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 deficiency in internal control 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 and correct misstatements on a timely basis.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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

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

April 9, 2013

TOWN OF CARVER, MASSACHUSETTS

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COMMENTS AND RECOMMENDATIONS

Design of Internal Control Over Significant Bank Accounts

Management must rely on the financial information generated by the Treasurer's Office and the Accounting Office to make decisions that affect Town strategy in developing and meeting short-term and long-term 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 is of sound design and is functioning as intended.

Each of the Offices noted above plays a key role in developing and monitoring 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 2) all journal entries are properly recorded and documented and 3) that all departments are providing detailed and accurate accrual information on a timely basis.
- The Treasurer 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.

Considering these general roles, our review of the internal control structure of the Treasurer's Office revealed the following:

- Cash receipts are not being posted in a timely manner. During the year and at year end postings lagged in excess of one month. This is despite the implementation of a new cash management system in February 2012, which, by design, provides the Treasurer with the ability to update the general ledger daily.
- Electronic Fund Transfers (EFT's) are posted only at month end and appear to be based on the information recorded in the bank statement. EFT's should be posted when the transfers occur and then reconciled to the bank statement.
- The Bank of America account reconciliation reported several outstanding items/discrepancies that were between three and five month old.
- The payroll account is not funded in an amount equal to the payroll warrant. Currently, amounts deposited into this account are based on "estimates" of what the actual payroll should be. The explanation we received for this is that ADP could not provide the total funding amount in a timely manner. We believe this should change. The payroll account should be managed as a zero dollar imprest account. Funding of the account should be equal to the amount of the payroll warrant and any balance in should represent outstanding checks.
- ADP is authorized to make payments to the various taxing authorities such as the Internal Revenue Service, State Department of DOR and Division of Unemployment. We became aware that some of these payments were not appearing on the payroll warrant. MGL requires all disbursements made by the Town to be approved by the Town Accountant and authorized by the Board of Selectmen.
- During the year approximately \$17,000 Universal Health Care Taxes payments were made from the Bank of America Account to the Division of Unemployment. Not only did these amounts not appear on the payroll warrant, Massachusetts cities and towns are exempt from this tax.

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.

The consistent inability of the Treasurer's Office to reconcile cash in a timely manner is a control deficiency. We also noted that the reconciliation process, when performed, appeared to rely heavily on the Town Accountant's involvement in order to keep the general ledger somewhat current. This involvement included access to the Treasurer's component of the Zobrio system (see comment below).

The full implementation of the Zobrio system may eliminate the issues noted above. However, it is our opinion that should the design of this system, and its implementation, result in the continued inability to meet baseline, standard results expected of cash management and reporting, this management comment could escalate to a significant deficiency in internal control or a material weakness.

We are also aware that the matters discussed above have been communicated to the Town by prior auditors and the Department of Revenue - Division of Local Services. These reports also concluded that there exists a need for the Treasurer's Office to post receipts, report revenue/expenditure activity, and reconcile cash in a timely manner.

The fact that these comments have been noted in previous years can be construed as indication that management either:

- does not have the competency meet the roles and responsibilities of the position,
- lacks the motivation to address the problem or,
- lacks system tools needed to accomplish the task.

The implementation of the new Zobrio system is a critical element in providing a solution to the primary financial reporting and cash management issues of the Town. Its success, or failure, will be influenced by the three elements noted above.

Year End Closing Process

Comment

We are aware that the Town is unable to perform the year-end close in a timely manner for the past several years. While acknowledging that the matters discussed in the previous comment have contributed to this, the closing process can also be impacted because important procedures are not performed on time while others are performed too early in the process. As a result, there can be delays in producing closing entries, trial balances, schedules, reconciliations, account analysis, and financial reports needed by management and the Department of Revenue.

We believe that the year-end closing could proceed more quickly by developing a closing schedule that indicates who will perform each procedure and when completion of each procedure is due and accomplished. The timing of specific procedures could be coordinated with the timing of management's need for the information with the due dates monitored to determine that they are being met.

Review User Profiles To Limit Unnecessary Access To Sensitive Data

Comment

In general, it is good practice to periodically review and assess user profiles to limit access to sensitive data such as, cash receipts, accounts payable, accounts receivable, human resource data, vendor and payroll master files and general ledger maintenance. By limiting access to this data, the Town can reduce fraud risk and protect the integrity of the data maintained in the system.

We noted that the Town Accountant had full read/write privileges to the Treasurer's component of the Zobrio System. While this was done to expedite the recording of cash receipts to the general ledger, internal control is compromised when one individual has the ability to initiate, approve and record a transaction, and reconcile balances.

We recommend that the Town conduct a review and assessment of user profiles to identify and limit unnecessary access to the data maintained in the system and that the Town Accountant be given only read access to the Treasurer's component of Zobrio.

Formalize A Cash And Investment Policy

Comment

As part of our audit we noted that the Town invests all funds according to State statute while maximizing that such investments are protected to the fullest extent through FDIC Insurance, Third Party Collateralized Agreements, Depositors Insurance and the MMDT. This is good business practice and we concur with this investment methodology.

However, accounting standards (GASB 40) have highlighted the need for governmental entities to formally adopt cash and investment policies that take into account custodial, credit and interest rate risk. Such policies establish guidelines for matters such as 1) the types of banks the Town should have deposits with; 2) the maximum period that an investment can be held and; 3) the highest concentration the Town can have in any one investment type or issuer.

We recommend that the Town formalize its cash and investment policy and that this policy be adopted by the Board of Selectmen.

Other Post-Employment Benefits - Actuarial Valuation

Comment

The implementation of Governmental Accounting Standards Board (the GASB) Statement #45 requires disclosure and recognition of other post-employment benefits liabilities (OPEB) in the Town's financial statements. For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with total membership of 200 or more, or at least triennially for plans with a total membership of fewer than 200.

Net OPEB obligations associated with enterprise funds, from which contributions are made, should be displayed as liabilities in the financial statements of those funds. An employer's net OPEB obligation is defined as the cumulative difference between the annual OPEB cost and the employer's contributions to the plan, including the OPEB liability at transition, if any.

For the Town to remain compliant with GASB Statement #45 after fiscal 2013, the Town must obtain an updated actuarial valuation that dated July 1, 2013 and can be used for the fiscal 2013 and 2014 audits.

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.

Future Government Accounting Standards Board (GASB) Statements for Pensions and OPEB

Comment

The GASB has issued new pronouncements that will significantly affect the accounting and reporting requirements for Pensions and Other Postemployment Benefits (OPEB). These new standards will start to phase in during fiscal year 2013 and will substantially impact your financial statements and will also affect the requirements for accumulating the necessary data to meet the reporting requirements.

The new standards that have been issued and their effective dates are as follows:

- The GASB issued Statement #63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is required to be implemented in fiscal year 2013.
- The GASB issued Statement #65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented in fiscal year 2014.
- The GASB issued Statement #67, *Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25*, which is required to be implemented in fiscal year 2014.
- The GASB issued Statement #68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*, which is required to be implemented in fiscal year 2015.

The GASB is expected to issue additional standards following #67 & #68 for Pensions, which will similarly affect accounting and financial reporting for OPEB Plans. The GASB is encouraging earlier application of these standards. To briefly summarize these new standards –

- GASB #63 and GASB #65 will require reporting each of the financial position elements in a separate section in the statements of financial position. These elements are Assets, Deferred Outflows, Liabilities, Deferred Inflows, and Net Position; where assets + deferred inflows – liabilities – deferred outflows = net position. These new requirements will affect certain aspects of the financial statements currently and they will pave the way for the new reporting requirements of the new Pension and OPEB standards.
- GASB #67 and #68 will substantially change the reporting for pension liabilities and expenses. Changes in pension liability will be immediately recognized as pension expense or reported as deferred outflows/inflows of resources depending on the nature of the changes. Substantial changes to methods and assumptions used to determine actuarial information for GAAP reporting purposes will be required. Current actuarial methods may continue to be used to determine funding amounts. Employers will report in their financial statements a net pension liability (asset) determined annually as of the fiscal year end. Net pension liability (asset) equals the total pension liability for the plan net of the plan net position. Pension liability is the actuarial present value of projected benefits attributed to past service, and plan net position is the accumulated plan assets net of any financial statement liabilities of the plan.

The Town should expect to record significant pension and OPEB liabilities in the future.

We recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes, and to formulate plans to meet with your actuaries and financial advisers as more information becomes available. You may want to consider how and when this information should be communicated to your constituents and other financial statement users.

Reserve Fund For Future Payment Of Compensated Absences

Current Comment

Effective July 3, 2012, Chapter 40, Section 13D, provides a city, town, or school district with the ability to establish a reserve fund for the future payment of accrued liabilities for compensated absences due any employee or full-time officer upon termination of employment.

At June 30, 2012, the Town's estimate of this liability totaled \$864,000.

We recommend the Town consider accepting the provisions of this section with the goal of incrementally funding this liability.