

TOWN OF BOURNE, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2012



Certified Public Accountants

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To the Honorable Board of Selectmen
Town of Bourne, Massachusetts

In planning and performing our audit of the financial statements of the Town of Bourne, Massachusetts (Town) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the Town's internal control over financial reporting (internal control) 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.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. We also want to make you aware of a recently issued accounting standard that will significantly impact your financial statements in future years. The memorandum that accompanies this letter summarizes our comments and recommendations regarding those matters. This letter does not affect our report dated April 8, 2013, on the financial statements of the Town.

The Town's written responses to the matters 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, the Board of Selectmen and others within the organization and should not be used by anyone other than these specified parties.

Sullivan, Rogers & Company, LLC

April 8, 2013

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TABLE OF CONTENTS

	Page
Comments and Recommendations	1
Risk Assessment and Monitoring	1
Service Organization Controls	3
Accounts Receivable	4
General Ledger	5
Student Activity Funds	6
Affordable Housing Fund.....	7
Financial Policies and Procedures.....	8
Enterprise Funds	9
Pension Accounting and Financial Reporting.....	10

Comments and Recommendations

Risk Assessment and Monitoring

Comment

When internal controls are *initially* implemented, they are usually designed to adequately safeguard assets. However, over time, these controls can become ineffective due to changes in technology, operations, etc. In addition, changes in personnel and structure, as well as the addition of new programs and services, can add risks that previously did not exist. As a result, all municipalities must periodically perform a risk assessment to anticipate, identify, analyze and manage the risk of asset misappropriation. Risk assessment (which includes fraud risk assessment), is one element of internal control.

The risk assessment should be performed by management-level employees who have extensive knowledge of the Town's operations. Ordinarily, the management-level employees would conduct interviews or lead group discussions with personnel who have knowledge of the Town's operations, its environment, and its processes. The risk assessment process should consider the Town's vulnerability to misappropriation of assets. It should also address operations that involve heightened levels of risk. When conducting the assessment, the following questions should be considered:

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- What operations are the most complex?
- How could assets be stolen?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could potential misappropriation of assets be concealed?
- What prior internal control issues could still continue to be problematic?

Once the areas vulnerable to risks have been identified, a review of the Town's systems, procedures, and existing controls related to these areas should be conducted. The Town should consider what additional controls (if any) need to be implemented to reduce risk.

After risk has been assessed, periodic monitoring of the identified risk areas must be performed in order to evaluate the controls that have been implemented to mitigate the risks. Since control-related policies and procedures tend to deteriorate over time, the monitoring process ensures that controls are fully operational and effective.

Recommendation

We recommend that management develop and implement a risk assessment program to periodically anticipate, identify, analyze, and manage the risk of asset misappropriation. The risk assessment program should be formally documented and become part of the Town's financial policies and procedures manual.

We recommend that management develop and implement a monitoring program to periodically evaluate the operational effectiveness of internal controls. The monitoring process should be documented in order to facilitate the evaluation of controls and to identify improvements that need to be made.

Management's Response

The Town will continue to work to create a Risk Assessment and Monitoring program.

Service Organization Controls

Comment

The Town, like many local governments in Massachusetts, engages third-party service providers (service organizations) to process certain financial transactions (e.g., ambulance billing and collection). In such instances, the related financial transactions are affected by the Town's internal controls and the controls employed by the service organization. Therefore, as part of its monitoring efforts to ensure that internal controls over financial reporting are effective and functioning as intended, Town management must evaluate whether service organization controls are suitably designed and effective.

Furthermore, service organizations often have information regarding employees and customers that must be protected (e.g., social security numbers). Such controls generally relate to the security, availability, processing integrity, confidentiality or privacy of information. Therefore, as part of its monitoring efforts to ensure the privacy and protection of its employees and customers' information, management must evaluate whether service organization controls are suitably designed and effective.

The most effective and efficient way for the Town to accomplish its monitoring efforts is to obtain the appropriate *Service Organization Control (SOC)* reports from its third-party service providers.

There are two types of SOC reports that service auditors provide to service organizations for the benefit of their users, which are as follows:

- SOC 1 (previously SAS 70) reports – provide an opinion on controls at a service organization that are likely to be relevant to a user entity's internal control over financial reporting
- SOC 2 reports – provide an opinion on controls at a service organization that are related to the American Institute of Certified Public Accountants (AICPA) Trust Service Principles, which are (1) security; (2) availability; (3) processing integrity; (4) confidentiality; and (5) privacy.

Service organizations should be engaging a service auditor to provide the appropriate SOC report(s) and should make the resulting report available to their customers (e.g., the Town).

Recommendation

We recommend the Town identify each service organization utilized and request the applicable SOC report (annually).

Because all service organizations are an extension of the Town's internal control, we recommend all service organization contracts include a requirement to obtain the appropriate SOC report (annually).

Management's Response

The Town will work to identify all of the service organizations it currently does business with and request and document the appropriate SOC reports.

Accounts Receivable

Comment

At June 30, 2012, many nominal variances exist between the detailed accounts receivable records maintained by the Collector and the accounts receivable control accounts maintained by the Finance Director on the general ledger.

Although immaterial from an audit perspective, proper internal controls require accounts receivable balances to be reconciled monthly.

Recommendation

We recommend procedures be implemented to investigate and resolve the variances identified above.

Management's Response

The Finance Department will work to resolve the discrepancies between the detailed receivable records of the Town Collector to the General Ledger.

General Ledger

Comment

Our prior year Management Letter reported the following regarding the setup and maintenance of the general ledger:

1. Inter-fund transfers in and transfers out accounts are not included as part of the subsidiary accounting ledgers. As a result, inter-fund transfers in and out are recorded directly to control/fund balance accounts.
2. A separate subsidiary fund is utilized to process all disbursements related to refunds, payroll withholdings and teacher's summer pay.
3. Several instances whereby journal entries were recorded directly to control/fund balance accounts
4. Several instances whereby revenues were being posted incorrectly because the appropriate revenue account did not exist in the subsidiary ledgers

During fiscal year 2012, significant progress was made regarding the deficiencies identified above.

Recommendation

We recommend procedures be implemented during fiscal year 2013 to fully resolve the deficiencies identified above.

Management's Response

All changes necessary to the general ledger have been completed in fiscal year 2013.

Student Activity Funds

Comment

The Town maintains student activity funds for several of its schools. Massachusetts General Laws (MGL) Chapter 71, Section 47, which establishes various guidelines related to student activity funds, states the following:

“There shall be an annual audit of the student activity funds which shall be conducted in accordance with procedures as agreed upon between the school committee and the auditor based upon guidelines issued by the department of education.”

Based on our discussions with the Director of Business Services, the School Department internally performed agreed-upon procedures on the student activity funds during fiscal year 2012. However, the procedures performed (and findings and recommendations) were not documented.

In addition, the Massachusetts Association of School Business Officials’ (MASBO) *Student Activity Accounts Guidelines for Massachusetts School Districts* recommends an independent audit firm conduct audits or agreed-upon procedures at least once every three (3) years.

Recommendation

We recommend the School Department document its internally performed agreed-upon procedures on its student activity funds. Such documentation should include identification of the procedures performed, findings and recommended corrective actions.

We recommend the School Department consider the MASBO recommendation to have an independent audit firm conduct the student activity fund audit or agreed upon-procedures at least once every three (3) years.

Management’s Response

The school department has initiated a process that requires the Director of Business Services to conduct an annual performance audit of all student activity accounts based upon MGL, Chapter 71, Section 47 or the guidelines issued by the department of education. The documentation of the procedures performed and findings will be recorded and maintained.

Affordable Housing Fund

Comment

The Town maintains an affordable housing fund established under the provisions of MGL Chapter 44, Section 55C. A clause in MGL Chapter 44, Section 55 states the following:

“The books and records of the [fund] shall be audited annually by an independent auditor in accordance with accepted accounting practices.”

A separate annual audit is not being performed on the Town’s affordable housing fund.

Recommendation

We recommend the Town comply with MGL Chapter 44, Section 55C, and have a separate annual independent audit performed of the affordable housing fund.

Management’s Response

The Town will comply with MGL Chapter 44 Section 55C and have an audit of the Affordable Housing Fund.

Financial Policies and Procedures

Comment

As reported in prior years' Management Letters, we believe that preparation of a formal policy and procedures manual would improve and standardize the Town's financial policies and procedures.

Without formalized written policies and procedures, the Town is inherently subject to everyday inconsistencies in its operations. It is also difficult to measure performance and efficiencies without a baseline. The number of such inconsistencies can be minimized by the written codification of policies and procedures and insistence on adherence to them.

Such a manual should include policies and procedures relative to all financial functions and processes, including, but not limited to, the following:

- Cash receipts
- Cash disbursements
 - Payroll
 - Vendor
- Procurement
- Grant administration
- Personnel (i.e., hiring, payroll and related changes, etc.)
- Month-end and year-end closing procedures

The manual should also clearly define the objectives, responsibilities and authorizations for all employees/job positions.

The use of written policies, procedures, and job descriptions in conjunction with specific assignment of responsibilities would increase supervisory personnel's effectiveness. Such written documents would decrease the time spent on supervision of clerical personnel and in attempts to define job responsibilities on each occasion of employee turnover.

Recommendation

The Finance Director has begun the process of developing financial policies and procedures for several financial processes. We recommend management continue the development of the financial policies and procedures manual.

Management's Response

The Town will continue development of the policies and procedures manual.

Enterprise Funds

Comment

The Massachusetts Department of Revenue (DOR) issued an "Informational Guideline Release" (IGR 08-101) in April 2008 in which the DOR recommends that every community with an enterprise fund establish a written, internal policy regarding indirect cost allocation, to be reviewed annually. IGR 08-101 also recommends that local financial officials should understand and agree on what indirect costs are appropriated as part of the general fund operating budget and what percentage of these costs should be allocated to enterprise funds.

As reported in prior years' Management Letters, we believe it would be prudent for the Town to follow the DOR recommendations in IGR 08-101 for its enterprise funds.

Recommendation

We recommend the Town implement the recommendations of the DOR as identified in IGR 08-101 by establishing a written, internal policy regarding indirect cost allocation, to be reviewed annually. In addition, as part of the annual budgeting process, Town officials should understand and agree on what indirect costs are appropriated as part of the general fund operating budget and what percentage of these costs should be allocated to the enterprise funds.

Management's Response

The Town is completing its policy on Indirect Cost Allocations for its enterprise funds.

Pension Accounting and Financial Reporting

Comment

In June of 2012, the Governmental Accounting Standards Board (GASB) issued *Statement No. 68, Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*, which revises and establishes new financial reporting requirements for governments that provide pension benefits to its employees and retirees.

The implementation of this Statement will represent a significant change in the accounting and reporting of pension expense and the related liability. For the first time, the Town of Bourne will be required to recognize its long-term obligation for pension benefits as a liability in its government-wide financial statements. The implementation of this Statement will also:

- More comprehensively measure the annual costs of pension benefits
- Place conditions on the use of the discount rate used to measure the projected benefit payments to their actuarial present value
- Require the use of the “entry age” actuarial cost allocation method, with each period’s service cost determined by a level percentage of pay (referred to as attribution method)
- Expand pension related note disclosures
- Expand pension related required supplementary information disclosures

The requirements of this Statement will improve the decision-usefulness of pension information in governmental financial statements and will enhance the comparability of pension information between governmental entities.

Given the significance of the pension fund liability, the financial reporting impact under the new standard will significantly affect the Town of Bourne’s financial statements.

It should be noted that the implementation of GASB Statement No. 68 is strictly a financial reporting standard and does not constitute a state or federal mandate regarding the funding of the net pension obligation.

The Town of Bourne’s required implementation date of GASB Statement No. 68 is fiscal year 2015.

Recommendation

We recommend management familiarize itself with GASB Statement No. 68 to prepare for its implementation.

Management’s Response

Management will begin preparation for the new GASB 68 reporting requirements.