

TOWN OF CARLISLE, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2012



Certified Public Accountants

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To the Honorable Board of Selectmen
Town of Carlisle, Massachusetts

In planning and performing our audit of the financial statements of the Town of Carlisle, 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 September 20, 2012, 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 Audit Committee, the Board of Selectmen and others within the organization and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Sullivan, Rogers & Company, LLC". The signature is written in a cursive, flowing style.

September 20, 2012

TOWN OF CARLISLE, MASSACHUSETTS

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Comments and Recommendations

Council on Aging

Comment

We reviewed the systems of internal control related to cash receipts of the Council on Aging (COA) and identified the following deficiencies:

- The COA maintains several written policies and procedures related to cash receipts. However, the policies and procedures do not cover all aspects of the COA's cash receipt activities. In addition, the existing policies and procedures are not centrally organized in one "master" manual (either electronically or in hard copy format).
- The COA maintains documents such as participation forms, sign-in sheets, etc. to document participation and attendance in various activities (podiatry clinics, exercise classes, etc.) offered by the COA. In some instances, manual notations of payments made by the participants are written on the forms. However, this is not being done on a consistent basis for all activities. In addition, many of the forms that document *individual* participant payments do not calculate the *total* amount received for each activity.

The majority of the forms are also completed manually, which does not provide for the most effective and efficient documentation of cash receipts by activity. Electronic record-keeping (i.e. Excel spreadsheets) of the cash receipts collected for each of the COA's activities would allow the COA to reconcile total cash receipts by activity to the number of participants. In addition, such record-keeping would provide analytical value for management to evaluate the success of each activity offered by the department.

- Some of the COA's activities involve van rides. Some of these activities end after Town Hall's normal business hours, such that the receipts cannot be turned over to the COA at the end of the day. This is a weakness in safeguarding cash receipts.
- The COA does not utilize duplicate (i.e. one copy for the department, one copy for the payee) pre-numbered receipts for amounts collected unless specifically requested by the payee. Utilizing duplicate pre-numbered receipts would provide additional documentation of cash receipts and facilitate the reconciliation of daily cash receipts to amounts collected.
- In certain circumstances, the COA must pay vendors in advance for certain activities. Previously, the former COA Director utilized a checking account to access funds to pay for such activities. This account has since been closed. At this time, the COA does not have policies and procedures for handling this type of activity.

Recommendation

We recommend management:

- Develop and implement centrally organized written policies and procedures related to all aspects of the COA's cash receipts processes
- Develop and implement electronic record-keeping of cash receipts collected for each activity offered by the COA and reconcile the number of participants to cash receipts collected.
- Develop and implement policies and procedures for night deposits of van ride collections

- Consider the cost/benefit of utilizing duplicate copy pre-numbered cash receipts for all collections
- Develop and implement policies and procedures related to the COA's petty cash requirements

Management's Response

Management will develop and implement centrally organized written policies and procedures related to the COA's cash receipts processes of the department.

Management will develop and implement electronic record-keeping of cash receipts collected for activities offered by the COA. In the short-term this will probably be accomplished through the use of Excel spreadsheets. Longer term the COA has plans to purchase software that has been designed specifically for COAs and Senior Center activity tracking. This will provide measurable data that will help the COA evaluate the success of its activities.

The COA will be able to reconcile the number of participants to cash receipts collected for activities that call for a regular fee. An example of such an activity would be a COA sponsored exercise class. However, for some events or services, it should be noted that the receipts collected are voluntary in nature, which does not lend itself to reconciliation by a review of the number of participants. An example of an event where payment is voluntary would be one of the COA sponsored luncheons. Councils on Aging commonly refer to the revenue raised through such events as "donations" rather than as "fees". However one chooses to refer to the collection process, the voluntary nature of the payment means that the receipts themselves often do not match up with expectations based purely on the number of participants.

Service Organization Controls

Comment

The Town, like many local governments in Massachusetts, engages third-party service providers (service organizations) to process certain financial transactions (such as payroll). 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

Management will attempt to identify each service organization processing transactions which the Town utilizes, and request an applicable SOC report annually. Further, management will begin including a provision in all service organization contracts requiring that the service organization provide an appropriate SOC report annually.

Police Off-Duty Details

Comment

As reported in prior years' Management Letters, we identified several vendors that frequently receive off-duty detail services (including services received in fiscal year 2012) that owe the Town money for unpaid details from prior fiscal years. The Town does not have a formal policy addressing the collection of outstanding bills from vendors prior to performing new services.

In addition, the Town does not have a formal policy related to calculating an allowance for uncollectible police detail receivables and/or writing off uncollectible receivables.

Recommendation

We recommend management:

- Implement a policy to prohibit the performance of off-duty detail services to vendors that owe the Town for prior services rendered. The policy should specify a dollar threshold (i.e., any vendor that owes more than a specified dollar amount) and aging threshold (i.e., any vendor that has owed the Town for longer than a specified period of time) related to prohibiting services.
- Implement a policy to analyze (annually, at a minimum) the collectability of police detail receivables for the purpose of calculating an allowance for uncollectible receivables and/or writing off uncollectible amounts.

Management's Response

The Police Department will review the recommendations with the objective of developing a policy and procedure to limit the performance of off-duty detail service to those third parties from which the Town has not received timely payment for prior details. The policy would exclude situations which require an emergency response, or in cases where public safety is involved. The Police Department will also begin to review the collectability of police detail receivables on a quarterly basis for the purpose of determining collectability and or to write off uncollectible amounts.

Financial Policies and Procedures Manual

Comment

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
- Purchase orders
- Cash disbursements
 - Payroll
 - Vendor
- Personnel (i.e., hiring, payroll and related changes, etc.)
- Month-end and year-end closing procedures
- Departmental activities, including, but not limited to:
 - Recreation
 - Council on Aging

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

We recommend that management develop and implement a formal financial policies and procedures manual.

Management's Response

Management agrees with our auditor's observations, and will continue to review current policies and procedures and to develop new financial policies and procedures documents where necessary. Initial work to develop written policies was commenced during fiscal 2012, and will continue during the upcoming fiscal year. The required changes will be implemented to address any identified deficiencies.

Risk Assessment and Monitoring

Comment

Risk assessment (including fraud risk) is one element of internal control. The Town's risk assessment process is informal and conducted during the year through various Department Head and other meetings. We believe that implementation of a formal risk assessment and monitoring program would strengthen the Town's overall internal controls over financial (and fraud) risk.

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 formal 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 formal monitoring program to periodically evaluate the operational effectiveness of internal controls. The monitoring process should be formally documented in order to facilitate the evaluation of controls and to identify improvements that need to be made.

Management's Response

Management fully supports this recommendation. Risk assessment and monitoring is an on-going process that must continue to evolve to anticipate, identify, and manage the risk of misappropriation. The Town will continue developing a formal documented program for risk assessment to become part of the Town's financial policies and procedures. Through constant monitoring and communication, the Town's management will be able to evaluate the operational effectiveness of its internal controls, and identify and implement improvements that may need to be made.

Develop and Document a Disaster Recovery Plan

Comment

The Town has property insurance; however it does not have a formal (i.e., written) and complete plan of action in case its offices should be destroyed by a fire, natural disaster such as a flood or tornado, or a bombing or other terrorist act. Such a disaster could strike at any time, perhaps without warning. In that case, the Town would have to act quickly to take steps critical to assessing and recovering from loss of, or damage to, its premises; furniture and equipment; and electronic data.

A well-thought out and documented disaster recovery plan would help Town personnel act quickly and appropriately at a time when the stress and disruption of a disaster might adversely affect their memory, emotions, and judgment. It would also help others take charge in place of managers who might be lost, injured, or otherwise unavailable at the time of the crisis.

As part of developing a disaster recovery plan, arrangements should be made for protection of files and for use of backup space, equipment and furniture, or services should a disaster occur. In addition, while developing the plan, management personnel could take the opportunity to reassess the adequacy of its property insurance and to learn about some of the financial assistance that might be available to the Town after a disaster so that such assistance could be requested as quickly as possible.

Recommendation

In fiscal year 2007, a working group was formed to review the Town's technology infrastructure. The group analyzed and reviewed disaster recovery plans with the operational managers within the Town's government. We recommend management continue its progress by developing and implementing a written disaster recovery plan, with at least one copy stored in a secure, off-site location. We suggest that the documentation include the following:

- A list of key contacts, including all employees and their emergency contacts, insurance companies, key suppliers and customers, and important professional services such as restoration specialists.
- A current schematic showing how the computer system is designed and connected.
- A current, complete set of documentation for all of the operating systems and application software (including version numbers).
- A copy of the schedule for the off-site storage of backup data and programs.
- A list of safety and community services that might be needed.
- A list of pre-arranged temporary alternative work sites.
- A list of probable equipment and supplies that would be needed for recovery operations and related vendors.

The disaster recovery plan should be reviewed, updated, and tested at least annually. This will allow the disaster team members to assess the plan's continued appropriateness and feasibility in light of current conditions and to become familiar with implementing each step of the plan so that they could act more quickly and decisively at the time of the disaster.

Management's Response

In fiscal year 2007, a working group was formed, headed by a member of the Board of Selectmen to review the Town's technology infrastructure. The group includes the Town Administrator and an independent information technology (IT) specialist. A large part of their continuing work has been to analyze and review disaster recovery plans with the operational managers within the Town's government. The development of a formal set of disaster recovery plans and procedures is continuing to be reviewed, enhanced, and maintained on a regular basis.

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 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’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’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

It is management’s intention to take the necessary steps to implement GASB Statement No. 68 in a timely manner.