

TOWN OF OAK BLUFFS, MASSACHUSETTS

MANAGEMENT LETTER

YEAR ENDED JUNE 30, 2017

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To the Honorable Board of Selectmen
Town of Oak Bluffs, 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 Oak Bluffs, Massachusetts ("the Town") as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, 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.

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

However, we became aware of matters that are opportunities for strengthening internal controls and enhancing 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, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

March 29, 2018

TOWN OF OAK BLUFFS, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2017

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PRIOR YEAR COMMENTS RESOLVED

In Fiscal Year 2017 the Town was able to address and rectify the matter noted below. Although this matter was not an item that indicated major breakdown in internal controls it appears that management treated these with the utmost importance.

INDIRECT COST RATE ALLOCATION

Comment

Included in the General Fund budget are amounts paid by the General Fund on behalf of the Wastewater Enterprise Fund. The Town has historically referred to these charges as “indirect costs”; however, the majority of these charges are direct in nature (debt service, pension assessment, health insurance, and MWPAT fees) and represents direct costs of the enterprise fund. The most accurate way to charge an enterprise fund is to budget and pay for as many direct expenses in that fund and not rely on an allocation.

Indirect costs by definition represent total costs (salaries, telephone costs, health insurance, electric, heating and other utility costs, pension expense and other similar costs) that are borne by an overhead department not related to the Enterprise Fund (the Treasurer’s office for instance) and then reasonably and systematically allocated to the enterprise fund. A small percentage of the current allocation does include a percentage of the collector’s office salary; however, the method of determining this allocation is based on an estimate that was developed prior to the commencement of the FY 2010 budget cycle.

The use of the simple allocation method of the percentage of the total expenditure budget may not be the most accurate methodology to use for the allocation of cost for each department. Some costs may be better allocated using a different basis. For example, the normal allocation basis for building expenses is determined by the square feet occupied by a department in relation to the total occupied square feet of the building.

Action Taken by Management to Resolve Matter

Management was able to commit to writing current practices that result in the development of the budgetary indirect cost calculations.

PRIOR YEAR COMMENTS PARTIALLY RESOLVED

CONTROL OF MUNIS ACCESS AND USER RIGHTS

Comment

The process of allowing an employee to have access to MUNIS, and the process of assigning particular user rights to the employee's MUNIS profile, was not strictly governed and monitored. Currently, access to MUNIS is initiated by a phone call to the IT Director. The phone call could be initiated by a department head or a general employee but in almost all cases there is no document trail that would allow the IT Director to determine if the request for MUNIS access should be allowed or not. We have been told that sometimes "common sense" allows the Director to make a yes/no decision without having to consult with other members of Town management. On other occasions the IT Director will consult with, and defer to, the Town Accountant's advice regarding a particular access request.

Status

As part of the design and implementation process of a new Treasury receipt module in MUNIS, the Town is in the process of reviewing everyone's user rights to the MUNIS system. Although management appears to understand the seriousness of this important control aspect, the adoption of a formal method of requesting user access has not occurred. We have been told that the process will be revamped and better documented as the design and implementation of the new system nears completion.

Continued Recommendation

We recommend that, when addressing the earlier comment concerning written policies and procedures, management develop criteria to be considered when determining the appropriateness of allowing an employee to have access to MUNIS. Once it has been determined that an employee should have access to MUNIS further consideration to occur to determine particular user rights within MUNIS. A form should also be developed that will serve to memorialize in writing management's wishes for a particular user profile within MUNIS. At a minimum, the form should be approved by the Town Accountant prior to the request being presented to the IT Director.

LACK OF FORMAL POLICIES AND PROCEDURES MANUALS

Comment

There is a lack of formalized policies and procedures that documents the daily, monthly, and yearly procedures of staff members that are assigned to the Town's financial operations. While staff members account for finances under the Uniform Municipal Accounting System (UMAS) guidelines, UMAS does not get into the specifics as to how information should be accumulated from municipality to municipality. To date, the Town has begun to compile a master booklet of policies and procedures for all of the key financial reporting offices; however, not all offices are fully documented and up to date in the specific detail of their operations.

Status

During 2016 and continuing through 2017, the Town has drafted various policies and procedures examples of which include the accounts payable cycle, the budget process, debt management, revenue generation, unfunded liabilities, and fraud prevention.

Continued Recommendation

We recommend that management continue the progress made in establishing an overall documented framework for its financial operations. Each financial department head should expand upon the progress made so far and document the daily, weekly, and monthly, quarterly, and yearly duties and responsibilities for each employee assigned to a particular finance related office. In the event of an emergency, the documentation should be compiled in manner that can be easily read and understood.

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.

Status

During 2016, the Town drafted a fraud risk policy that:

- Establishes whistleblower protection;
- Establishes an overall framework that shares proper internal controls and fraud prevention among the department heads;
- Provides guidance to allow department heads to determine what may constitute an act of fraud;
- Establishes an investigative response to suspected instances of fraud;
- Provides tips to prevent Town related instances of fraud.

Continued Recommendation

We recommend the Board of Selectmen consider adopting this policy as an official Town document. We further recommend that the Town document a “strengths and weakness” assessment for each major point of revenue and expenditure to determine what areas the Town has a practical risk of fraud. Doing so will further the Town’s effort in creating a proactive response to fraud.

STUDENT ACTIVITY FUNDS

Comment

The Town maintains a combined student activity fund depository and checking account under the care, custody, and control of the school principal. The School is required to maintain its student activity funds, and related bank accounts, in a manner that is mandated by Massachusetts General Law, Chapter 71, Section 47. In reviewing the current procedures we noted that enhancements are needed for the Town and School Department to comply with guidelines, issued by the Department of Elementary and Secondary Education, which provide suggested practices to assist towns and school districts in ensuring that the cash management of the student activity funds is managed according to MGL.

Massachusetts General Law Chapter 71 allows the school committee to authorize the Principal to receive money in connection with the conduct of certain student activities and to deposit such money, with the Town Treasurer into an interest bearing bank account, established by the vote of the school committee to be used for the express purpose of conducting student activities. Interest earnings on such funds shall be retained by the fund and the school committee shall determine for what purpose such earnings may be used. In addition, the school committee needs to authorize the Town Treasurer to establish a checking account from which the funds may be expended exclusively for student activity purposes as authorized by the school committee. Funds received from student activities fundraisers and fees may only be deposited into an account under the care, custody and control of the Town Treasurer.

The school committee needs to vote and set the maximum balance that may be on deposit in the student activity checking account. The principal or designee, who operates and controls the student activity checking account, needs to be bonded in an amount determined by the Town Treasurer. To the extent that the funds are available in the student activity agency fund depository account, funds, up to the maximum balance set by the school committee, are to be transferred from the depository account through the warrant process to fund the related checking account. The process of replenishing the student activity fund checking account shall be subject to administrative procedures prescribed by the Town Treasurer.

Status

The school committee has established a \$25,000 maximum that may be retained within the student activity fund checking account. Also, during 2017, School officials have obtained an appropriate level of bonding for school personnel who have care, custody and control of the checking account.

Continued Recommendation

We recommend that the Town establish the appropriate bank accounts as required under MGL. We also recommend that the Town and the School Department review the DESE guidance to ensure that all aspects of student activity fund cash management is in compliance with MGL and DESE guidance.

TAILINGS

Comment

The Town has a current liability of approximately \$20,000 that relates to checks that were written to vendors and/or employees, went unclaimed for a period of time, were voided and then record as a liability in accordance with the Commonwealth's abandoned property (tailings) laws. Since this liability has not been reconciled with the actual check listing of the Treasurer we can place no reliance on its accuracy.

We were able to review relevant documentation suggesting that the Treasurer is adhering to the abandoned property laws; however, we were not provided with a comprehensive document that details all of the individual balances within the tailings account maintained by the Treasurer nor were we provided with documentation that would indicate that the Treasurer and Accounting Office is reconciling this account on a periodic basis.

Status

As the municipal abandoned property laws only applies to checks outstanding for more than 1 year, during calendar year 2017 and continuing through 2018, the Town worked to identify all outstanding checks greater than 1 year old. These checks are still being carried as outstanding checks which results in a continuing reconciling item between the bank and the Treasurers cashbook.

Continued Recommendation

We recommend that going forward, the Treasurer's office void the outstanding checks that have been deemed to be abandoned with the cash being added back to the Treasurer's cashbook. At the same time an accounting entry should be made to MUNIS so that cash per the ledger and the related tailings liability is adjusted to match the tailings list maintained by the Treasurer. Any variances between the value of checks voided by the Treasurer and the MUNIS ledger adjustments will need to be investigated for appropriate disposition. This list should be updated continually when outstanding checks are voided and deposited into the liability account and when checks are re-issued out of the tailings account. Additionally, we recommend that this account be reconciled to the ledger monthly as part of the overall cash reconciliation process.

UNRESOLVED COMMENTS OF THE PRIOR YEAR

ENTERPRISE FUND REPORTING

Comment

The Town presents a Wastewater Enterprise Fund in accordance with state law and generally accepted accounting principles (GAAP); however, the Town ledgers have not been appropriately adjusted to report these activities separately from governmental activities. As a result, management is faced with a process to extract such information via spreadsheet and ledger reports to present the appropriate balances and activity for each fund.

The purpose of a computerized accounting system, such as the one employed by the Town, is to enhance transparency in the recording of transactions and to provide real time data that management can use to make time sensitive decisions in regards to funding and cash flow. Relying on a system that is dependent upon manual calculations increases the risk of error and slows down the timeliness of financial information produced.

Continued Recommendation

We recommend that management make the necessary changes to its accounting ledgers and fund structures so that enterprise fund capital project fund activity and enterprise fund long-term debt account information can be moved from their current classifications on the ledger to appropriate classifications reserved for enterprise fund reporting.

USE OF PERSONAL CREDIT CARDS

Comment

Discussions with management indicate that certain departments encounter a recurring use of employees using personal credit cards for Town business. This appears to mainly be occurring in the EMS department when crews are off-island and encounter situations in which they need to pay for costs incurred while on Town business (i.e. ambulance break-down during transport to and from the island that require immediate mechanical attention and hotel stays due to missed boat connections). The Town currently does not have written policies that address the use of employee credit cards for costs incurred while performing an official Town function

The lack of written policies that address the use of personal credit cards for Town business is not sound business practice.

Recommendation

We recommend that the Town develop policies governing the use of personal credit cards for Town business. We also recommend that the Town review recent employee reimbursements to determine what costs may be better managed, and possibly reduced, by developing a list of pre-approved vendors that Town employees, with proper approval, may utilize for recurrent costs that do not occur on a regular basis.

DOCUMENTATION OF INTERNAL CONTROLS

Comment

In December 2013, the U.S. Office of Management and Budget (OMB) issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) in an effort to (1) streamline guidance for federal awards while easing the administrative burden and (2) to strengthen oversight over the expenditure of federal funds and to reduce the risks of waste, fraud and abuse.

The Uniform Guidance supersedes and streamlines requirements from eight different federal grant circulars (including OMB Circular A-133) into one set of guidance. Local governments are required to implement the new administrative requirements and cost principles for all new federal awards and to additional funding to existing awards made after December 26, 2014 (fiscal year 2016).

In conformance with Uniform Guidance, the non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in “Standards for Internal Control in the Federal Government” issued by the Comptroller General of the United States (the Green Book) and the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The COSO internal control framework is generally accepted as a best practice within the industry including the best practices prescribed by the Government Finance Officers Association (GFOA). COSO is a joint initiative of 5 private sector organizations dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence. The original COSO framework was published in 1992 and has been revised several times for changes in operations, technology, and audit risk. The most recent updates to the COSO Internal Control - Integrated Framework were issued in 2013 and are available at www.coso.org.

Management is responsible for internal control and to see that the entity is doing what needs to be done to meet its objectives. Governments have limited resources and constraints on how much can be spent on designing, implementing, and conducting systems of internal control. The COSO Framework can help management consider alternative approaches and decide what action it needs to take to meet its objectives. Depending on circumstances, these approaches and decisions can contribute to efficiencies in the design, implementation, and conduct of internal control. With the COSO Framework, management can more successfully diagnose issues and assert effectiveness regarding their internal controls and, for external financial reporting, help avoid material weaknesses or significant deficiencies.

The COSO internal control framework incorporates 5 major components of internal control, which are supported by 17 principles of internal control as follows:

1. CONTROL ENVIRONMENT
 - 1) Demonstrates commitment to integrity and ethical values
 - 2) Exercises oversight responsibility
 - 3) Establishes structure, authority, and responsibility
 - 4) Demonstrates commitment to competence
 - 5) Enforces accountability
2. RISK ASSESSMENT
 - 6) Specifies suitable objectives
 - 7) Identifies and analyzes risk
 - 8) Assesses fraud risk
 - 9) Identifies and analyzes significant change
3. CONTROL ACTIVITIES
 - 10) Selects and develops control activities
 - 11) Selects and develops general controls over technology
 - 12) Deploys through policies and procedures
4. INFORMATION & COMMUNICATION
 - 13) Uses relevant information
 - 14) Communicates internally
 - 15) Communicates externally
5. MONITORING
 - 16) Conducts ongoing and/or separate evaluations
 - 17) Evaluates and communicates deficiencies

Management should evaluate and assess the government's internal control system to determine whether: each of the five essential elements of a comprehensive framework of internal control is present throughout the organization; whether each element addresses all of the associated principles; and whether all five elements effectively function together.

Recommendation

We recommend management follow the best practice for establishing and documenting their internal control system using the COSO Internal Control Framework.

INFORMATIONAL COMMENT

FUTURE GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS FOR OTHER POSTEMPLOYMENT BENEFITS DISCLOSURES

Comment

- GASB Statement #75 – The GASB has issued new pronouncements that will significantly affect the accounting and reporting requirements for Other Postemployment Benefits (OPEB) similar to the changes that were required for Pensions. This information has been communicated in previous Management Letters and management is preparing for this to occur in fiscal year 2018.
- GASB #75 will substantially change the reporting for other postemployment benefit liabilities and expenses. Changes in other postemployment benefit liability will be immediately recognized as other postemployment benefit 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. Employers will report in their financial statements a net other postemployment benefit liability (asset) determined annually as of the measurement date. Net other postemployment benefit liability (asset) equals the total other postemployment benefit liability for the plan net of the plan net position. The other postemployment benefit liability is the actuarial present value of projected benefits attributed to past service. The plan net position is the accumulated plan assets net of any financial statement liabilities of the plan.