

TOWN OF MERRIMACK, NEW HAMPSHIRE

Management Letter

For the Year Ended June 30, 2012

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To the Town Council

Town of Merrimack, New Hampshire

In planning and performing our audit of the financial statements of the Town of Merrimack, New Hampshire as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the Town of Merrimack's internal accounting control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control, including the possibility of management's override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a material weakness.

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. Material weaknesses are noted in the Table of Contents and comment headings.

Additional Offices:

Andover, MA • Greenfield, MA • Ellsworth, ME • Manchester, NH

During our audit, we also became aware of several other matters that we believe represent opportunities for strengthening internal controls and operating efficiency. The recommendations that accompany this letter summarize our comments and suggestions concerning those matters.

The Town's written response to our comments and suggestions has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

After you have had an opportunity to consider our comments and recommendations, we would be pleased to discuss them with you.

Melanson, Heath + Company P.C.
Nashua, New Hampshire

October 3, 2012

STATUS OF PRIOR YEAR RECOMMENDATIONS:

1. Improve Trust Fund Accounting and Reporting (Material Weakness)

Prior Year Issue:

In the prior years, we recommended the following actions be taken to improve overall trust fund accounting and oversight:

- Properly segregate treasury and accounting responsibilities. One individual was responsible for the accounting and treasury functions, resulting in a lack of segregation of duties, thereby creating a substantial risk for errors and/or irregularities.
- Review Capital Reserve MS-9 for mathematical accuracy. Numerous errors were found on the original version provided to us.
- Reconcile Capital Reserve Funds general ledger equity accounts to the trust activity report (MS-9) prior to filing with the New Hampshire Department of Revenue Administration.
- Fully integrate Permanent Funds into the Town's general ledger and record all activity appropriately.
- Report Permanent Funds' investments at fair market value in the general ledger and reconcile monthly to the investment statements. Additionally, reconcile investments to the trust reports (MS-9 and MS-10) annually, prior to filing with the New Hampshire Department of Revenue Administration. Unrealized gains and losses on the investment statements should be reconciled to the difference between cost basis per MS-9 and MS-10 and the general ledger. Cost basis for all investments should be provided to the custodians.
- Organize the Trust Fund types in a manner consistent with generally accepted accounting principles (primarily GASB 34). The financial records of the Permanent funds and Library funds were largely kept by the custodial bank and complete accounting records were not adequately maintained. School Permanent Funds were reported on the Town's financial statements.

Current Year Status:

In fiscal year 2012, the following recommendations listed above were implemented:

- Capital Reserve MS-9 was reconciled to the general ledger.
- One School Permanent Fund is now reported on the School's financial statements.
- We were informed that another member of the board of trustees is responsible for reviewing and signing check payments to mitigate lack of segregation of duties.
- Cost basis for securities was provided to the custodian, although it lacks a complete audit trail.

Examples of findings noted while reviewing the 2012 MS-9 and 10 forms of the Permanent funds are as follows:

- The cost basis for securities, which was provided to the custodian, was not fully reconciled on the MS-9 and MS-10 reports filed with the state.
- Spendable and non-spendable balances were not appropriately tracked.
- Accumulated amounts from not reporting gains and losses and updating investment income consistently have caused the beginning balances for individual securities to appear inaccurate.
- Securities are sometimes removed and replaced to correct balances from prior years without an adequate audit trail. Substantial changes to beginning balances were noted.
- The number of shares on the MS-9 and MS-10 were not consistently adjusted by stock splits and shares reinvested through dividend reinvestment plans.

Further Action Needed:

We continue to recommend the Town (the Town and the Trustees of Trust Funds) work to establish complete accounting records of the Trust Funds and to properly segregate the responsibility of trust fund accounting and cash management. Implementation of these recommendations will assist in identifying errors immediately and reduce the risk of erroneous reports. We

also recommend that the Town (the Town and the Trustees of Trust Funds) work to resolve the issues noted in the 2012 MS-9 and MS-10 reports.

Town's Response:

The Town agrees that internal controls are important and should be implemented by the Trustees and will continue to be committed to work with the Trustee of Trust Funds to address this issue. The Town will once again encourage the Trustee of Trust Funds to comply with the audit findings and improve the trust fund accounting internal control practices. The Trustees have begun the process of hiring a custodian to help in establishing complete accounting records for the investments of the Town's trust funds. In addition the Trustees have begun segregating the responsibilities between the Trustees as noted. The Town has hired a consultant to go back and correct the issues noted in the MS-9 and MS-10 over the past reports.

2. Obtain Capital Asset Software

Prior Year Issue:

In the prior year, we recommended that the Town maintain the historical cost and depreciation of all capital assets in the finance software. Implementation of this recommendation will streamline and provide improved internal control over existing assets, year-end closing, as well as all future acquisitions and calculations of annual depreciation.

Current Year Status:

We understand that the Town intends to convert capital assets records from the current spreadsheets to the general ledger.

Further Action Needed:

We recommend the Town complete this conversion by December 31, 2012.

Town's Response:

The Town continues to work toward converting its capital assets records from Excel documents to the Finance Software. Over the last couple of years, there were a couple of issues with the software that the Town continues to work through. We will try to be fully implemented by June 30, 2013.

3. Improve Internal Control over Departmental Receipts

Prior Year Issue:

In the prior year, we recommended that the Code Enforcement department (a division of the Fire Department) improve controls over receipts, primarily by obtaining an automated cash register.

Current Year Status:

During fiscal year 2012, we noted the following weaknesses in the Code Enforcement Department remain:

- The Fire Department is not automated.
- Checks are not stamped “For Deposit Only - Town of Merrimack” upon receipt.
- A lack of segregation of duties exists over cash receipts, as the same individual responsible for cash also has access to receipts records at the Code Enforcement Department.
- The Code Enforcement Department does not use its read only access to the Town’s general ledger to reconcile revenues between the Department’s records and the Town’s general ledger.
- Building permits are not pre-numbered.

Further Action Needed:

We continue to recommend the Finance Department work with the Fire Department and the software vendor to automate the building permits and other departmental receipts to make sure that the software tracks all needed information and automatically issues pre-numbered permits and receipts. Automation will improve controls over building permits and other fire receipts and mitigate risk of lack of segregation of duties due to limited staff in the department. It will also improve efficiency by eliminating manual duplication of work. We also recommend the Finance Department to perform internal audits of the departments on at least a semi-annual basis.

Town’s Response:

The Finance Department will continue to monitor the cash collection process for the Building Department. The Fire Department has begun implementation of new software to help track building permits. Once operational, this will

improve efficiency and tighten internal controls. In addition, the Finance Department will continue to train the staff on proper cash management procedures.

CURRENT YEAR RECOMMENDATIONS:

4. Update Existing Fund Balance Policy

The Town's fund balance policy has not been updated to incorporate accounting changes that resulted from the Governmental Accounting Standard Board Statement #54.

Specific items that should be updated in the Town's fund balance policy include (but not limited to):

- Required/desired level of unrestricted net assets.
- Specify prioritization of use of fund balance amounts when multiple sources are used for one project, grant or activity (i.e., general fund monies are appropriated to partially fund a capital project, or a grant match).
- Specify the body or official authorized to make assignments of fund balance and applicable time constraints on each assignment.
- Distinguish between encumbrance (commitments related to contracts not yet performed and orders not yet filled) and other assignments (previously called designations).
- Define any approval process for modifying existing assignments.

We recommend that the Town update the existing fund balance policy to provide guidance over the above noted areas.

Town's Response:

The Finance Director will continue to go to training sessions relating to GASB No. 54 and begin to implement the necessary changes in the Town's existing Fund Balance Policy.

5. Develop a More Formal Risk Assessment Process

The Town informally performs its own risk assessment for possible fraud or material misstatements through various policies and procedures and regular reviews of trends in the financial statements. Risk assessment is a management function designed to identify where an organization may be vulnerable to errors and/or irregularities. A complete risk assessment process involves a written description of risk areas identified by those charged with governance (management and elected officials) and a description of how the organization intends on responding to the risks. As part of this process, the Town should pay particular attention to its assessment of the Control Environment; specifically, the risks associated with related parties and potential conflicts of interest. Specific monitoring activities to address these risks should be documented and implemented as well.

We recommend that the Town implement a more formal risk assessment process that includes written identification of areas where potential fraud or material misstatements to the basic financial statements may occur. Regular department head meetings could be used as a starting point for such risk assessment discussion.

Town's Response:

The Town will work toward developing a Risk Assessment Process over the next fiscal year.

6. Prepare to Implement GASB 68

Beginning in fiscal year 2015, the Town is required to implement the Governmental Accounting Standards Board (GASB) Statement 68 – *Accounting and Financial Reporting for Pensions* that will require the unfunded pension liability be recognized on the Town's Statement of Net Assets, including enterprise funds. It is widely expected that the implementation of this accounting standard will have a material impact on the Town's basic financial statements.

We recommend the Town begin planning for the implementation of GASB 68, which includes gaining an understanding of the new requirements, educating applicable financial statement users, and ensuring that the Town's applicable portions of unfunded retirement system's unfunded liability is audited and available for inclusion in your financial statements. We will be monitoring best

practices for implementing this standard across the state and will provide guidance in the coming year.

Town's Response:

The Finance Director will continue to go to training sessions relating to GASB No. 68 and will begin to formalize an implementation plan as it relates to this pronouncement.