

TOWN OF LITCHFIELD, NEW HAMPSHIRE

Management Letter

For the Year Ended December 31, 2009

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To the Board of Selectmen
Town of Litchfield, New Hampshire

In planning and performing our audit of the financial statements of the Town of Litchfield, New Hampshire as of and for the year ended December 31, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the Town of Litchfield'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 certain deficiencies in internal control that we consider to be material weaknesses.

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.

During our audit we also became aware of several other matters that we believe represent opportunities for strengthening internal controls and operating efficiency.

Additional Offices:

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

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, Board of Selectmen, 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
September 7, 2010

PRIOR YEAR RECOMMENDATIONS:

1. Improve Monthly Reconciliations (Material Weakness)

In 2008, The Town did not have a formal system in place to reconcile key general ledger accounts. Monthly reconciliations are necessary to prove the accuracy of general ledger records as well as to provide a method of checks and balances between the financial departments. The lack of this procedure results in an increased risk that the Town's accounting records could contain errors or omissions. This was evidenced by the significant adjustments that were required by the Town's outside consultants to accurately report the Town's cash and receivable account balances.

We recommend the Town establish formal procedures to reconcile the following critical general ledger balances on a monthly basis:

- Cash - overall balances should be reconciled to the Treasurer.
- Receivables - each balance should be reconciled to the Tax Collector.
- Impact fees/escrow balances - should be reconciled to responsible Town departments.

Implementation of this recommendation will provide assurance that the Town's internal financial reports are accurate. It will also provide the necessary checks and balances over the Treasurer and Tax Collector Offices to ensure that errors or irregularities are identified and corrected in a timely manner.

Town's Response:

The Town has established a policy for the reconciliation between the Treasurer, Tax Collector/Town Clerk and Selectmen's Office during 2009. This policy requires the monthly reconciliations between all three groups with the participation and signoff of the Board of Selectmen. This policy reconciles the cash receivables by the Tax Collector/Town Clerk, the Treasurer's balances to the bank statements and the balances of the various escrow accounts held by the Treasurer.

2. Develop Departmental Receipt Policies and Procedures

The Town currently does not have formal written policies and procedures for departments to follow for collecting and remitting departmental receipts. Although we did not detect any errors or irregularities during our audit, the lack of formal policies and procedures increases the risk that such situations could occur and go undetected.

We recommend the Town establish formal written departmental receipt policies and procedures, which should address, at a minimum, the following:

- Standardized receipt logs
- Standardized receipt turnover forms
- Requiring two signatures on the receipt turnover form
- Requiring departments remit receipts to the Collector
- Prohibiting the collection of currency, wherever feasible
- Establishing frequencies of turnovers and physical security over receipts

We further recommend that the Town perform periodic internal audits of the various departments to assure compliance with the policies and procedures that are adopted. This should result in improved controls over departmental receipts and reduce the likelihood of irregularities occurring.

We also recommend that a copy of the departmental receipt turnover form be provided by departments directly to the Town Administrator in order to reconcile with the receipt postings. This will provide a necessary measure of checks and balances between departments.

Town's Response:

The Town of Litchfield will develop a policy for the collection and remitting of receipts. It is the intention of the Board of Selectmen that the policy will include the observations and suggestions outlined in the 2008 audit management letter. Timing of this policy will be prior to the end of the year 2010.

3. Other Internal Control Areas

A key component of any financial statement audit is the evaluation of internal controls. This evaluation is accomplished through inquiry, observation and testing. The following weaknesses were noted as a result of our evaluation of controls during our 2009 audit. We understand some of these issues may have been addressed by the Town in late 2009 or 2010. We will be available to discuss these with the Town in more detail.

Town-Wide Issues:

- Establish a formal fraud policy for Town employees.

Town's Response:

A fraud policy was established and became effective July 1, 2010.

General Ledger Issues:

- Maintain all funds (other than trustee of trust funds) in the general ledger.
- Maintain organized records for all adjusting journal entries, including explanations and support.
- Provide expenditure reports to departments at least monthly.
- Provide revenue reports to all departments that collect revenues.

Town's Response:

All funds are being entered in the general ledger. The Town has begun to maintain all adjusting journal entries with documentation and support attached in a monthly filing system suitable for audit.

All department heads, Trustees, Budget Committee members, and Selectmen receive weekly expense against budget reports and monthly they receive a report of revenues against forecasted revenues. Further, this information is made available to the public through web posting.

Payroll Issues:

- Establish employee personnel files, including documented pay rate approval forms.
- Prohibit the distribution of paychecks until the payroll is formally approved by the Board of Selectmen.

Town's Response:

All personnel files are maintained in the Town Administrator's office. In 2010, pay rate changes and notices are being added to those files as they occur. By the end of the year, new forms will be distributed to all departments for use to document pay rate changes and reasons and will be subsequently added to the personnel files. Payroll and check printing functions are now performed in the Selectmen's office, allowing Selectmen to sign payroll on the Monday prior to check distribution on Thursdays.

Treasury Issues:

- Document a summary of all Town bank reconciliations on a single form to be used to prove to general ledger balances.
- Consolidate impact/escrow passbook accounts into a master bank account.
- Consider increasing collateralization of bank accounts.
- Void old outstanding checks at least annually.

Town's Response:

- A single summary sheet for all town reconciliations will be introduced at the beginning of 2011.
- All escrow and passbook accounts will be consolidated into a master bank account by December 2010.
- The Town reorganized its overall banking program in the summer of 2010 to include greater collateralization of deposits.
- The Town will begin voiding checks every six months, beginning around December 1, 2010 and continuing every six months thereafter.

Collector Issues:

- Maintain a control log to track receivable activity.

Town's Response:

Control logs have always been maintained in both the Town Clerk and Tax Collector. Up until this year 2010 we have kept a running log in a general ledger which I have in my office.

- Reconcile control log to detail receivable lists, and to Town general ledger receivable records.

Town's Response:

T. Briand started doing this in January 2010 with L. Langille.

- Sign off on receipt turnover forms by two individuals.

Town's Response:

Each day when the daily close out is balanced and completed it is now signed off on by either the Town Clerk/Tax Collector or the deputy. Then there is a line for the Treasurer to sign off on as well.

- Consider using a lockbox service for receipt processing.

Town's Response:

A lockbox program was considered in 2010. The cost of moving to such a service is a significant deterrent. Additionally, the Tax Collector expressed concern that this would be an unacceptable change to the level of customer service, with taxpayers expecting personal contact and the ability to pay their tax bills at Town Hall which would not be possible with the lockbox system.

Trust Fund Issues:

- Bring library trust stock investments in house or contract with a broker.
- Track expendable and nonexpendable portions of trust funds for MS-9 Trustee report.

CURRENT YEAR RECOMMENDATIONS:

4. Budget for Highway Block Grant

The Town reported an estimated revenue for the Highway Block Grant on the tax rate setting form, but did not report an offsetting appropriation. Because this grant is reported in a separate fund, it should reflect a balanced budget. The lack of the appropriation on the tax rate setting form resulted in an unintended reduction in the Town's property tax rate.

We recommend that the budgets for all self-supporting funds, such as the Highway Block Grant, be balanced on the tax rate setting forms. This will neutralize the effect on the Town's property tax rate.

Town's Response:

The Highway Block Grant was balanced on the tax rate setting form for 2010. It is the intention of the Town to utilize the 2010 funds for future work and treat the funds as restricted for that purpose. In 2011, the Town will seek to gross appropriate the funds and present an offsetting expenditure within the Highway Department budget.

5. Other Current Year Issues

During our audit, we also noted the following issues, which are summarized very briefly. We will be available to discuss these issues in more detail with the Town if requested.

Print Receipt Log - The receipt log that is maintained by the Solid Waste facility is maintained on an old computer which is not compatible with any Town printers. As a result, the receipt logs cannot be printed or retained as a permanent document. We recommend the receipt log be maintained on a computer that is capable of printing.

Town's Response:

The Solid Waste facility will have a computer replaced in 2011. A receipt log retention system will be developed involving either printed copies or secure digital submission and archiving.

Monitor/Record Receivables - The Town received certain state funds for 2009 in the first week of January 2010 that were not recorded as a receivable and revenue in the Town's 2009 general ledger. Although this was recorded through the audit process, this resulted in the Town's internal accounts records being understated. We recommend the Town monitor all late receipts to determine whether receivables should be appropriately recorded in the general ledger.

Town's Response:

Beginning in July 2010 accounts receivable was turned over to the Finance Office. All receivables are posted into general ledger and tracked by that office.

Monitor Due From/To Accounts - The Town's general ledger reflects various accounts to track interfund activity. Although the interfund accounts reconciled in total, certain of the accounts reflected balances owed from fund to fund that should have been reimbursed to each other at year end. We recommend the Town periodically monitor the due from/to accounts and actually transfer cash balances between funds to clear amounts due.

Town's Response:

Beginning in 2010 all due from/to accounts are reconciled monthly and cash is transferred at a minimum monthly.

Reconcile Police Detail Receivables - The Police detail receivable account balance in the Town's general ledger differed from the Police Department's records by approximately \$ 500 at year end. We recommend the Police Department reconcile the detail receivable account with the Town's general ledger on at least a quarterly basis.

Town's Response:

As stated under Monitor/Record Receivables, all receivables are now handled through the Finance Office and reconciled monthly.

Report Interest On Abatements Separately - The tax abatement forms currently combine principal and interest. We recommend that principal and interest be reported separately on the abatement form. This will provide an improved audit trail over abatement postings to the general ledger.

Town's Response:

This has been set up beginning in 2010. Once the Tax Collector returns the abatement to the Finance Office stating that the taxes have been paid, she notes the date of payment, interest is calculated and listed separately on the abatement.