

June 20, 2008

To the Board of Selectmen
Town of Littleton
37 Shattuck Street
P.O. Box 1305
Littleton, MA 01460

Dear Members of the Board:

In planning and performing our audit of the financial statements of the Town of Littleton, Massachusetts as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Town of Littleton, Massachusetts'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 of Littleton, Massachusetts's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town of Littleton, Massachusetts's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Town of Littleton, Massachusetts's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Town of Littleton, Massachusetts's financial statements that is more than inconsequential will not be prevented or detected by the Town of Littleton, Massachusetts's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Town of Littleton, Massachusetts's internal control. We believe that the following deficiency (Cash) constitutes a material weakness.

Internal Controls over Cash

The internal control procedures (in the Treasurer's Office) for recording, reporting and reconciling cash were weak during fiscal year 2007. As a result, errors were made in the Treasurer's cashbook when posting both deposits, transfers and payments. Also, several bank accounts were not properly reconciled and the Treasurer's cash was not reconciled to the Town's general ledger in a timely manner throughout the fiscal year. At June 30, a small variance existed between the Treasurer's cashbook and the general ledger. Also, some variances existed between the cashbook and the banks.

We recommend that the Town make efforts to improve its procedures relating to recording, reporting and reconciling cash. Timely reconciliation procedures relating to cash (cashbook to bank statements and cashbook to general ledger) are a key component to an effective internal control structure. Once the Town

has become current in its reconciling procedures, each month should be reconciled prior to the end of the next month.

Management Response

I do acknowledge that over the fiscal period defined, there was a significant deficiency in this area. I would also like to validate that while these deficiencies did not result in a material misstatement in the financial records, it is a matter that I take most seriously and will address with the restructuring of the finance departments this coming fiscal year. Starting with the soon to be appointed Treasurer under the Finance Director's administrative direction, there will be a clearly defined and monitored monthly reconciliation procedure. I feel that with this written performance objective, there will be much improvement and this issue will be resolved to your satisfaction.

We consider the following to be control deficiencies or other matters that we want to communicate to you.

Internal Controls over Financial Transactions

Recently, new standards were adopted by the American Institute of Certified Public Accountants (AICPA) that will affect what we are currently required to report to you and the manner in which we conduct our audits in the future. Although some of the changes relate to terminology (i.e. a reportable condition is now a significant deficiency), the new standards lower the threshold for what is considered a deficiency. What may not have been reported as a finding in the past could be considered a significant deficiency in the future.

The new standards place a heavy emphasis on management's responsibility for establishing, documenting and periodically reviewing its systems of internal control over key financial transaction cycles (i.e. payroll, purchase/disbursements, accounts receivables and cash) and over financial reporting. A goal of the standard is to heighten management's awareness that they are ultimately responsible for their financial statements and systems of internal control and, therefore, must weigh and manage the associated risks. In establishing the controls, management is responsible for assessing the fraud risk related to each cycle. The new standards require us to report a deficiency when an entity has "inadequate documentation of the components of internal control". Even though a system of internal control may be in effect, there should be some form of documentation (i.e. narrative or flow chart) that identifies the key elements of the control procedures. The documentation requirement is a means to ensure that management's intended significant controls are known and can be evaluated during the audit process. Adequate documentation of internal control policies also provides a mechanism to ensure that management's intentions relating to internal control will be available when there is turnover in key financial positions.

The Town has done a good job documenting its internal control procedures in its procedures manual. However, since the standards suggest that "those that govern" (the Board of Selectmen and upper management) are responsible for the internal control structure, there should be documentation that the Board approves of the controls described in the manual. The Board should, also, document its risk assessment (i.e. potential for fraud or material errors) of the various cycles (cash receipts, payroll and purchase/expenditure).

Management Response

After discussions with and recommendations by the Town Administrator, we will be recommending that the Board of Selectmen establish an Audit Advisory Committee in the upcoming months. This committee would be charged with reviewing management letters and monitoring the Town's progress in formulating and completing a corrective action plan, including Town responses to issues raised. The committee would periodically report its findings to the Board of Selectmen. Responsibility to formulate responses and an

action plan would fall to the Finance Director and Town Administrator, with the input of finance officers. The suggested makeup of the committee would include one member each from the Board of Selectmen, Finance Committee, School Committee, and Light & Water Board.

Additionally, the recently created Finance Department Procedures Manual will be presented to both the Audit Advisory Committee and the Board of Selectmen for acceptance and approval of the internal controls defined within.

Internal Controls – Reconciling Procedures

The Town Accountant performs procedures to reconcile the Treasurer's cashbook balance to the general ledger balance. Currently, the procedures do not include reviewing the Treasurer's bank statements, outstanding check lists or other reconciling items. As a result, the Town Accountant is not certain that the Treasurer's cashbook is supported by balances in financial institutions.

Historically, most municipalities have relied on the procedures performed during the annual audit to verify that the cashbook balances have been properly reconciled to their respective bank accounts. Although, this has been standard operating procedures for a number of years, new auditing standards state that an audit firm cannot be considered a part of an entity's internal control structure.

In order to enhance the Town's internal control environment, we recommend that the Town Accountant periodically review the Treasurer's bank reconciliations and verify that the cash book is supported by deposits in financial institutions. Bank statements, outstanding check lists and other reconciling items should be reviewed. The Town Accountant should initial the Treasurer's bank reconciliation in order to document that a review was made.

Management Response

In order to address the new standards you reference, we will include a minimum of an annual review of the official bank statements by the Accountant in reconciling to the general ledger. This will commence with the newly appointed Treasurer under the administrative direction of the Finance Director.

Infrastructure Assets

The Town implemented Governmental Accounting Standards Board Statement Number 34 (G.A.S.B. 34) during fiscal year 2003. The G.A.S.B. 34 required the Town to report capital assets in its financial statements. In order to ease the implementation process, a phase in period of four years was allowed for general infrastructure assets (i.e. streets, sidewalks). The phase in period ended June 30, 2007.

Even though the G.A.S.B. allowed a phase in period, standards required us to issue an adverse opinion on the financial statements related to the governmental activities (the enterprise funds do reflect all assets).

We recommend that the Town hire a consultant to value its infrastructure assets. The assets value and the related accumulated depreciation should be determined as of June 30, 2008, so that the adverse opinion can be changed during the next audit period. The value of the assets and the accumulated depreciation should also be obtained as of June 30, 2007 so that we can have an adjusted beginning balance for the statement of activities

Management Response

The Infrastructure Asset Valuation study has commenced as of May 2008, and will be fully accounted for the fiscal period ending June 30, 2008.

Liability Accounts

Health Insurance Trust Fund

The liability accounts in the Health Insurance Trust Fund have balances that should be reviewed. Two of the accounts have significant deficit balances (Medical Insurance Payable – Teachers - \$56,306 and Retiree Insurance Escrow Payable - \$82,725) while one account has a very large positive balance (Medical Insurance Payable – CTY - \$193,392). It is possible that disbursements that caused the deficit balances should have been charged to the account with the positive balance.

We recommend that the Town Accountant review the liability accounts to determine the cause of the deficits. If a correcting journal entry is made, sufficient documentation should be retained to support the entry. The Town Accountant should also review the fiscal year 2008 activity to ensure that this is not an ongoing problem.

Management Response

The Health Insurance Trust Fund has been corrected to reflect the entries that were needed to resolve the deficit balances in the liability accounts. These deficit balances were created by disbursements posted to the Teachers Medical Insurance and Retiree Insurance accounts in error. These disbursements should have been posted to the Medical Insurance-CTY account that contains a surplus.

With the implementation of the new financial software as well as the Town's decision to purchase health insurance through MIIA and discontinue the practice of being self-insured, I am comfortable that this will not be an issue in the future years.

MART Fares

The Town has established a liability account in order to record the receipts and disbursements relating to bus fares for the Montachusett Regional Transportation Authority (MART). The bus is typically used in association with the Council on Aging. As of June 30, 2007, the MART liability account had a deficit balance of approximately \$26,000.

A deficit in this type of liability accounts generally indicates that user charges are not sufficient to meet the related costs. Liability fund deficits can also negatively impact the Town's "free cash".

We recommend that the Town accountant review the activity related to the MART account.

Management Response

The MART Fares Account deficit has also been resolved this fiscal year due to improvements made in the timeliness that the Council on Aging submits for reimbursement from MART.

While the account will always have a deficit balance due to the nature of the reimbursement request process, generally the deficit is limited to one or two months of actual expenses. The Town could request front-loading this account at a subsequent Town meeting if it seems necessary.

Postemployment Benefits

Employee benefits can include pensions, health insurance and life insurance. These benefits are part of the “exchange of salaries and benefits” for employee services rendered. Whereas the cost of the health insurance and life insurance for active employees is incurred while the employees are in active service, pensions and the postemployment health care benefits are taken after the employees’ services have ended. Nevertheless, both types of benefits constitute compensation for employee services (i.e. the employees have “earned” their postemployment benefits prior to leaving service).

From an accrual accounting perspective, the cost of the pensions as well as other postemployment benefits (OPEB), generally should be associated with the period in which they were earned rather than when the benefits are paid (often many years later). However, in current practice OPEB expenses are funded on a “pay as you go” basis. By operating on the “pay as you go” method, governments have incurred an unfunded liability. Also, financial statements do not reflect an OPEB liability or expense until they are paid.

As a result, the Governmental Accounting Standards Board (GASB) has released two statements (#43 – Financial Reporting for Postemployment Benefit Plans Other Than Pensions and #45 Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions) relating to the accounting treatment and financial reporting for postemployment benefit plans other than pensions (the pension issue had been addressed by previous GASB Statements).

The objectives of these statements are to improve financial reporting by reflecting OPEB expenditures as they are earned and by reporting any unfunded liability. The unfunded liability at the beginning of the transition year is zero. The unfunded liability at the end of year one is the difference between an actuarially determined contribution requirement and the amount actually contributed by the employer. The Governmental Accounting Standards Board has no statutory authority to require governments to fund the unfunded liability. However, it is their hope that recognition of the liability and its effect on the financial statements will cause governments to do so.

Even if government chooses not to fund the OPEB liability, there will be some increased costs. An actuarial valuation is required at least biennially for OPEB plans with a total plan membership (including active employees, terminated employees not yet receiving benefits and retired employees or beneficiaries who are currently receiving benefits) of 200 or more. Triennial actuarial valuations are required for plans with less than 200 plan members. The GASB has allowed for an “Alternative Measurement Method” for employers with fewer than 100 plan members. However, the alternative method is fairly complex and requires some familiarity with actuarial techniques. In addition to the direct costs that will be incurred for actuarial valuations, many believe that bond ratings will be decreased (causing increased interest costs) if the unfunded liability is not addressed.

Funding the OPEB liability will have a direct impact on the Town’s ability to fund its operating budget. The Town is required to implement GASB statement #45 in fiscal year 2009. As a result, it is important that the Town become aware of the requirements, consider its options and develop a long range plan that addresses this significant issue.

Management Response

The Town is actively working towards defining the unfunded liability on postretirement benefits. For fiscal 2008, the Treasurer’s Office has engaged the services of an outside consultant to provide the services necessary to complete this project.

Once this liability is defined, this liability would then be presented along with a long term funding plan as an expense for consideration by the Board of Selectmen and the Finance Committee within the budget process.

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

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After you have had an opportunity to consider our findings and recommendations, we shall be pleased to discuss them further with you. We would like to thank you for the cooperation and courtesy given to us during the course of the engagement.

Very truly yours,

Giusti, Hingston and Company

Giusti, Hingston and Company
Certified Public Accountants