

**TOWN OF COLONIAL BEACH, VIRGINIA AND
COLONIAL BEACH PUBLIC SCHOOLS**

**COMMENTS ON INTERNAL CONTROL AND
OTHER SUGGESTIONS FOR YOUR
CONSIDERATION**

June 30, 2015

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INDEPENDENT AUDITOR'S REPORT ON COMMENTS AND SUGGESTIONS

To the Honorable Members of Town Council
and School Board
Town of Colonial Beach, Virginia

In planning and performing our audit of the financial statements of the Town of Colonial Beach, Virginia as of and for the year ended June 30, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in circumstances for the purpose of expressing our opinion on the financial statements and to comply with any other applicable standards, such as *Government Auditing Standards* and the regulations set forth in *OMB Circular A-133*, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

If material weaknesses or significant deficiencies were identified during our procedures, they are appropriately designated as such in this report. Additional information on material weaknesses or significant deficiencies and compliance and other matters is included in the ***Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*** which should be read in conjunction with this report.

Additionally, during our audit, we may have become aware of certain other matters that provide opportunities for improving your financial reporting system and/or operating efficiency. Such comments and suggestions regarding these matters, if any, are also included in the attached report, but are not designated as a material weakness or significant deficiency. Since our audit is not designed to include a detail review of all systems and procedures, these comments should not be considered as being all-inclusive of areas where improvements might be achieved. We also have included information on accounting and other matters that we believe is important enough to merit consideration by management and those charged with governance. It is our hope that our suggestions will be taken in the constructive light in which they are offered.

We have already discussed these comments and suggestions with management, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. A review of the status of prior year comments is included on pages 6 through 7.

The Town's responses to our recommendations are included in this report. The responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Brown, Edwards & Company, S. L. P.

CERTIFIED PUBLIC ACCOUNTANTS

Harrisonburg, Virginia
November 17, 2015

**TOWN OF COLONIAL BEACH, VIRGINIA
COMMENTS AND SUGGESTIONS**

TOWN

CORE SERVER

Access to the Town's data room where the server is located is controlled by the Chief Financial Officer. We recommend that administration and custody to information technology assets be restricted to information technology personnel with no transactional responsibility.

DISASTER RECOVERY

Full system backups are produced nightly. Tapes are rotated daily and stored in the same building. We recommend that backup tapes be stored in a separate secured area in case of disaster or theft.

SCHOOLS

CORE SERVER

The School's server room is located in the high school. No heat or smoke detection is in the area. We recommend that proper method of fire detection be put in place to prevent data loss in the event of a disaster.

DISASTER RECOVERY

Full system backups are produced nightly. Tapes are rotated as needed and stored in the same building. We recommend that backup tapes be stored in a separate secured area in case of disaster or theft.

SYSTEM LOG REVIEW

Procedures to assure the completeness and accuracy of input data are partially implemented. There are no regular (automated or manual) reviews of critical logs, including System Administrator logs or exceptions. This increases the risk of an issue or exception remaining undetected. We recommend that the Schools have an independent, knowledgeable employee review critical logs including Administrator activity, failed logins, and any others deemed significant by School administration.

ACCESS PERMISSIONS

There is currently no formal review of system access permissions. It is recommended that on a regular basis, system access rights be formally reviewed to ensure all current employees have appropriate access to the system and former employees' access have been removed.

**TOWN OF COLONIAL BEACH, VIRGINIA
PRIOR YEAR COMMENTS AND SUGGESTIONS**

SEGREGATION OF DUTIES (Current and Prior Year Material Weakness)

One of the more important aspects of any internal control is the segregation of duties. In an ideal system of internal controls, no individual would perform more than one duty in connection with any transaction or series of transactions. In particular, no one individual should have access to both physical assets and the related accounting records. Such access may allow errors or irregularities to occur and either not be detected or concealed. We understand that due to the size of the Treasurer's Office, it may be impractical to completely separate all of these duties.

Specific items related to segregation of duties are discussed below:

- Certain finance department personnel have the ability to collect cash and perform write-offs. The Accounting Manager and the Revenue Payment Manager also have the ability to prepare bills, edit the accounts payable master file, and prepare checks.
- The Accounting Manager has the ability to process payroll and change master payroll file information. If possible, we recommend that an individual independent of payroll processing, review a file change log, to ensure that all changes made to the master payroll file have been approved.
- The Chief Financial Officer has the ability to approve changes in the financial software (BAI). This role has been expanded recently to manage security related concerns relating to the information system.

Current Status: *Although improvements have been made from the prior year, including having monthly transactions reviewed by another member of management, the above comments are still applicable.*

Management's Response: *Current staffing levels make a total separation of duties impossible to implement. Over the last three years, Management made changes in procedures to improve the segregation of duties wherever possible. We will continue to review our functions and procedures to minimize risk.*

**TOWN OF COLONIAL BEACH, VIRGINIA
PRIOR YEAR COMMENTS AND SUGGESTIONS (Continued)**

AUDIT ADJUSTMENTS (Current and Prior Year Material Weaknesses)

Audit procedures resulted in material audit adjustments to the financial statements. We recommend that the Town and Schools perform regular reconciliations and review of the general ledger to ensure that accounts are appropriately reconciled and reflect the correct balances.

Current Status: *In the current year, there were ten proposed journal entries. The current year adjustments, as described in the letter to those charged with governance, were of significant enough nature to be material to the financial statement users. In addition, during testing, it was discovered that certain school checks written in July were considered as a reconciling item on the June bank reconciliation. In addition, we also noted instances where the school had not remitted signed checks to the vendors on a timely basis. Written checks are not disbursements until the check is released. We recommend that proper cutoff procedures be implemented to ensure that disbursements and expenditures are recorded in the proper period.*

Management's Response: *We made significant improvements to our financial reporting process over the years and continue to pursue areas of improvement each year. We continue to work with our outside consultants and auditors on infrequent and unusual issues to confirm proper accounting treatment.*

SYSTEM LOG REVIEW

Procedures to assure the completeness and accuracy of input data are partially implemented. There are no regular (automated or manual) reviews of critical logs, including System Administrator logs or exceptions. This increases the risk of an issue or exception remaining undetected. We recommend that the Town have an independent, knowledgeable employee review critical logs including Administrator activity, failed logins, and any others deemed significant by Town administration.

Current Status: *Comment is still applicable.*

Management's Response: *This condition exists because of resource limitations. Senior staff will review and present solutions in the coming weeks.*

PURCHASE ORDERS

The purpose of a purchase order system is to control spending of resources and to help ensure only items that are actually received are paid for. The Town has a purchase order system for most Town purchases. We recommend that a similar system be implemented at the Schools. Purchase orders should be approved by the Superintendent or School Finance Director.

Current Status: *A purchase order policy is in place, however many purchases are still made prior to approval. Comment is still applicable.*

Management's Response: *Management will adopt the recommendation as outlined.*

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS

In this section, we would like to make you aware of certain confirmed and potential changes that are on the horizon that may affect your financial reporting and audit.

GASB STATEMENT NO. 72

GASB Statement No. 72, *Fair Value Measurement and Application* addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB Statement No. 72 will be effective for the year ending June 30, 2016.

GASB STATEMENT NO. 74

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* improves the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement 43, and Statement No. 50, *Pension Disclosures*.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

The scope of this Statement includes OPEB plans—defined benefit and defined contribution—administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets also are legally protected from creditors of the plan members.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria.

GASB Statement No. 74 will be effective for the year ending June 30, 2017.

GASB STATEMENT NO. 75

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* improves accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

GASB Statement No. 75 will be effective for the year ending June 30, 2018.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 76

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* identifies—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

GASB Statement No. 76 is effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. Earlier application is permitted.

GASB STATEMENT NO. 77

GASB Statement No. 77, *Tax Abatement Disclosures*, requires governments to disclose information about the nature and magnitude of tax abatements granted to a specific taxpayer, typically for the purpose of economic development. This does not cover programs that reduce the tax liabilities of broad classes of taxpayers, such as senior citizens or veterans, and which are not the product of individual agreements with each taxpayer. The Statement does not consider issues related to recognition.

Financial statement users need information about certain limitations on a government’s ability to raise resources. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this Statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take specific action that contributes to economic development or otherwise benefits the government or its citizens.

This Statement requirements disclosure of tax abatement information about (1) reporting government’s own tax abatement agreements and (2) those that are entered into by other governments that reduce the reporting government’s tax revenues.

Governments entering into tax abatement agreements are required to disclose the following information about the agreements, organized by major tax abatement program, with the option to include disclosure of individual significant agreements in each program:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients
- The gross dollar amount of taxes abated during the period
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

Tax abatement agreements of other governments should be organized by the government that entered into the tax abatement agreement and the specific tax being abated. Governments may disclose information for individual tax abatements of other governments within the specific tax being abated. For those agreements, a reporting government should disclose:

- The names of the governments that entered into the agreements
- The specific taxes being abated
- The gross dollar amount of taxes abated during the period.

GASB Statement No. 77 will be effective for the year ending June 30, 2017.

OFFICE OF MANAGEMENT AND BUDGET (OMB) CHANGES TO SINGLE AUDITS

OMB released final guidance related to federal awards in December 2013. The *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (“Uniform Guidance”) consolidates previous guidance into a streamlined format that aims to improve both its clarity and accessibility, lessen administrative burdens for federal award recipients, and reduce the risk of waste, fraud and abuse (Thomson Reuters “OMB Finalizes Federal Award Changes”). The most significant changes are as follows:

Single audit threshold increase. The audit threshold will be raised from \$500,000 to \$750,000 of federal expenditures. In addition, the Type A program threshold will be increased from \$300,000 to \$750,000. Finally, the percentage coverage of federal expenditures required for testing will be decreased from 50 percent to 40 percent for regular auditees and from 25 percent to 20 percent for low-risk auditees.

Changes to major determination process. The criteria to be considered a high-risk Type A program will include failure to have an unmodified opinion on the program, a material weakness in internal controls, or questioned costs exceeding five percent of the program’s expenditures. In addition, there will also be a reduction in the number of high-risk Type B programs that must be tested from one-half to at least one-fourth of low-risk Type A programs.

Proposed Reduction of compliance requirements subject to testing. Per Thomas Reuters PPC Update, “OMB’S original proposal included reducing the number of types of compliance requirements from 14 to 6, with several of the compliance requirements combined. The discussion of major policy reforms in the Uniform Guidance notes that because the compliance supplement is published as part of a separate process, no final changes were made at the time the Uniform Guidance was finalized. However, the Council of Financial Assistance Reform (COFAR) has recommended that any future changes made to the compliance supplement be based on available evidence on past findings and the potential impact of noncompliance for each type of compliance requirement. The COFAR further recommended that additional public outreach be conducted prior to making any structural changes to the format of the compliance supplement in order to mitigate an inadvertent increase in administrative burden.”

Nonfederal entities are required to comply with the Uniform Guidance once the new regulations are in effect which is expected by December 2014. Audit requirements would apply to fiscal years beginning on or after December 26, 2014 (FY ending June 30, 2016).

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

CURRENT GASB PROJECTS

GASB currently has a variety of projects in process. Some of these projects are as follows:

- ***Asset Retirement Obligations.*** The objective of this project would be to improve financial reporting by developing requirements on recognition for asset retirement obligations (ARO), other than landfills. The achievement of this objective would reduce inconsistency in current reporting and, therefore, enhance comparability between governments. The project also will improve the usefulness of information for decisions and analysis of various users of external financial reports of governments by developing disclosure requirements for AROs. An exposure draft document is expected to be issued for public comment in December 2015, with a final statement expected in October 2016.
- ***Blending Requirements for Certain Business-Type Activities.*** The objective of this project is to improve financial reporting by addressing issues related to inconsistent presentation of component units in financial reporting of governments engaged only in business-type activities (BTA). The stated focus of the objective would need to be balanced against the information needs of financial statement users by considering what information is deemed essential to assess accountability, comparability, and transparency in these circumstances. An exposure draft document was issued for public comment in June 2015, with a final statement expected in January 2016.
- ***Comprehensive Implementation Guide Update.*** The objective of this project is to update implementation guidance for the effects of new pronouncements and for additional issues that have come to the attention of the staff. In addition, this project will result in issuance of an annual update to the *Comprehensive Implementation Guide*. An exposure draft document is expected to be issued for public comment in September 2015, with a final statement expected in January 2016.
- ***Conceptual Framework—Recognition.*** The project's objective is to develop recognition criteria for *whether* information should be reported in state and local governmental financial statements and *when* that information should be reported. This project ultimately will lead to a Concepts Statement on recognition of elements of financial statements. Further developments on an Exposure Draft for recognition concepts was put on hold in August 2013 pending research being conducted pursuant to the reexamination of the financial reporting model.
- ***Economic Condition Reporting: Financial Projections.*** The objective of this project is to consider whether guidance or guidelines should be provided for additional information about economic condition, particularly financial projections, as part of general purpose external financial reporting. This project also will include consideration of the information users identified as necessary to assess the risks associated with a government's intergovernmental financial dependencies. The project is currently being deliberated. This project is currently on hold pending resolution of GASB scope.
- ***Fiduciary Responsibilities.*** The primary objective of this project would be to develop guidance regarding the application of the fiduciary responsibility criterion in deciding whether and how governments should report fiduciary activities in their general purpose external financial reports. Other objectives of this project include assessing whether additional guidance should be developed to (1) clarify the difference between a private-purpose trust fund and an agency fund, (2) clarify whether a business-type activity engaging in fiduciary activities should present fiduciary fund financial statements, and (3) consider requiring a combining statement of changes in assets and liabilities for agency funds. An exposure draft document is expected to be issued for public comment in December 2015, with a final statement in October 2016.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

- ***Lease Accounting – Reexamination of NCGA Statement 5 and GASB Statement No. 13.*** The objective of this project is to reexamine issues associated with lease accounting, considering improvements to existing guidance. This project will provide a basis for the Board to consider whether current operating leases meet the definitions of assets or liabilities. This project would provide an opportunity for a fresh look at the existing guidance for any improvements not contemplated by the FASB/IASB project given the unique nature of governmental entities and the complexities of their leasing transactions. An exposure draft document was issued for public comment in January 2015, with a final statement expected in November 2016.