

***MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT***

***MANAGEMENT LETTER***

***JUNE 30, 2011***



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To the Honorable School Committee  
Manchester Essex Regional School District  
Manchester-by-the-Sea, Massachusetts 01944

In planning and performing our audit of the basic financial statements of the Manchester Essex Regional School District as of and for the fiscal year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Manchester Essex Regional School District's internal control over financial reporting 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 Manchester Essex Regional School District's internal control. Accordingly, we do not express an opinion on the effectiveness of the Manchester Essex Regional School District'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. 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 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. We consider the deficiencies in the District's internal control, presented in the memorandum that accompanies this letter, to be material weaknesses.

In addition, we became aware of other 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.

We will review the status of these other matters and material weaknesses during our next audit engagement. We have already discussed these comments and suggestions with various District personnel, and 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.

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 30, 2012

**MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT**

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# ***MATERIAL WEAKNESS***

## **MATERIAL WEAKNESS**

Management must rely on the financial information generated by the accounting and treasury functions to make decisions that affect the District's strategy in developing and meeting short-term and long-term financial goals. Consequently, management must be confident that the information they base their decisions on is complete and accurate. This confidence is gained when there is reasonable assurance that the internal control structure over cash, revenues and expenditures is of sound design and is functioning as intended.

Each of the functions noted above plays a key role in the development and monitoring of a sound internal control structure. These roles are summarized as follows:

- The accounting function is responsible for establishing and maintaining procedures to assure that 1) all District receipts and disbursements are properly authorized and accurately and timely recorded in the general ledger and 2) all journal entries are properly recorded and all have complete supporting documentation.
- The Treasurer function is responsible for establishing and maintaining procedures to 1) properly safeguard the District's cash and investments and 2) assure that all receipts and disbursements are reported accurately and timely.

We consider the following matters to be a material weakness in the District's system of internal controls:

### ***Reconcile the General Ledger Cash Balances to the Treasurer's Balances***

A cash reconciliation of the Treasurer's cash book to the general ledger was not completed for any month during fiscal 2011. Monthly reconciliations are the primary internal control procedure relating to the District's cash accounts. Without timely reconciliations the District can not be assured that errors might not be detected and resolved in a timely manner and through the normal course of operations. Additionally, it is generally more efficient to reconcile accounts when transactions are recent and situational facts are fresh in mind. In all circumstances unreconciled amounts should be investigated and resolved and not be allowed to carry over from month to month.

### ***Resolve Unidentified Payroll Account Reconciling Items***

For several years we have communicated to you that the payroll bank account has had significant and recurring reconciling items, some of which crossed fiscal years. This situation remained unchanged in fiscal 2011. Furthermore, we were unable to obtain sufficient documentation to support the 2011 reconciling items, and adjustments to reconciling items made during the year. As noted above, unreconciled amounts should be investigated and resolved each month. Furthermore, all reconciling items and adjustments should be substantiated with the appropriate supporting documentation.

### ***Other Matters***

Because of the internal control matters noted above, we with the consent of management, extended our cash procedures for the purpose of ascertaining that the District's significant cash balances and the underlying transactions were recorded and properly accounted for. While completing these extended procedures, the following matters were noted:

### ***Partial Funding of Payroll Warrants by Treasurer***

In several instances, the Treasurer funded an estimated amount for payroll warrants and subsequently reconciled the payroll warrant to fund the difference between the estimated and actual warrant totals. This creates timing differences and complicates the cash reconciliation process. We recommend that the Treasurer fund the actual amount of the warrant to eliminate these reconciling items.

***Student Activity Bank Account Funding is not Posted to the General Ledger until after Fiscal Year-End***

Disbursements to the principals' checking account were not posted to the general ledger until after fiscal year-end. This creates a monthly reconciling item that increases over the course of the fiscal year and unnecessarily complicates the reconciliation process. We recommend that the funding of the principals' checking accounts be processed through the District's warrant process and that the posting to the general ledger occurs when the warrants are processed.

Management's Response

Timely cash reconciliations have been a recurring challenge that the District began to address in fiscal 2011.

Our auditors have noted previously that the Business Office should consider adding some level of accounting support to be more in line with similarly-sized organizations. Our original organizational structure has led to delayed postings to the general ledger, which in turn has prevented a timely and consistent monthly reconciliation. Other process problems have also frequently caused payroll posting data to be provided in periodic batches throughout the year, instead of individually, at the time of each bi-weekly pay.

The District began a Central Office restructuring in fiscal 2011, and with related budgetary savings, hired a financial data specialist who subsequently assumed primary responsibility for payroll. The payroll posting process has been improved significantly, and postings now typically occur within one day of each pay, instead of throughout the year as in prior years. The District is now considering ways to increase the number of hours dedicated to basic accounting activities as well.

With prior year auditor feedback in mind, the District also took steps in fiscal 2011 to improve reconciliation of the payroll account. The District enlisted the support of a CPA firm to develop an improved reconciliation tracking tool to replace the treasurer's cash book, and identify variances more quickly. This led to several months with only minor reconciling items in this account.

The CPA firm has also been helping the District to upgrade its policies and procedures for overseeing Student Activity funds. Included in the upgraded School Committee policy draft is the requirement that "funds for the checking accounts will be issued from the Agency Fund upon submission of receipts to the District Treasurer...in accordance with the District warrant-processing schedule." This requirement will provide the information needed to record a journal entry at the time of each transfer, instead of in periodic batches throughout the year.

## ***PRIOR YEAR COMMENTS***

## **Statement No. 54 of the Government Accounting Standards Board**

### Prior Year Comment

In February 2009, the GASB issued Statement #54, *Fund Balance Reporting and Government Fund Type Definitions*, which is required to be implemented in fiscal 2011. The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

### Current Status

The District implemented the standards of GASB Statement #54 for the year ending June 30, 2011. The fund balance designations have been appropriately reported.

## **Withholding Accounts**

### Prior Year Comment

In the prior year, we indicated that the payroll withholding liability accounts were not reconciled on a monthly or quarterly basis. The balance in each withholding liability account should represent amounts withheld from employees but not yet paid out. This is usually one week to one month worth of withholding, depending on the type of withholding. These accounts should be reconciled on a regular basis to ensure that all withholdings are being paid out and charged to the appropriate withholding account.

### Current Status

During fiscal 2011, the District hired a human resource and financial data specialist who, in addition to processing payroll and working on other payroll related issues, has been auditing employee withholdings against plan enrollment to ensure that proper withholdings are being made. However, as of fiscal year-end, the overall withholding balance went from a \$22,000 positive balance to a (\$42,000) negative balance. This change is mainly attributable to health insurance withholdings.

### Continuing Recommendation

We continue to recommend that procedures be implemented to ensure that correct amounts are paid from the withholding accounts and that the accounts are reconciled in a timely manner.

### Management's Response

The District recently performed a detailed audit of employee withholdings spanning all of fiscal 2011 and 2012. This process, which will be repeated periodically throughout each fiscal year, allows the district to ensure that withholding balances are accurate and identifies adjustments that may be needed. Going forward, this procedure can also be used to match monthly payments to receipts.

## **Fraud Risk Assessment**

### Prior Year Comment

In the prior year, we indicated that 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 recommended that the District 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 District'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 District 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 District, its environment, and its processes. The fraud risk assessment process should consider the District's vulnerability to misappropriation of assets.

### Current Status

The District conducted an outside-party review of various Business Office functions and practices in fiscal 2011, which included some feedback on fraud prevention measures.

### Continuing Recommendation

We continue to recommend that management develop and implement a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation.

### Management's Response

The District will endeavor to perform a more comprehensive assessment in the coming year and will use feedback from the outside review to make adjustments as necessary.

## **Reconcile Student Activity Funds**

### Prior Year Comment

In the prior year, we indicated that the District is required to maintain its student activity funds in a manner that is mandated by Massachusetts General Law, Chapter 71, Section 47 of the Acts of 1996. The student activity accounts should be used exclusively to account for student activity funds. The raising and expending of activity money by student bodies should have but one purpose: to promote the general welfare, education and morale of all students through the financing of the normal legitimate co-curricular activities of the student body operation.

In reviewing current policies and procedures we noted that the elementary student activity bank accounts are not reconciled with the elementary school student activity records.

### Current Status

No significant progress was made in fiscal 2011 to resolve this matter.

### Continuing Recommendation

We continue to recommend that the student activity bank accounts (checking and savings) are reconciled with the elementary school student activity records on a monthly basis.

### Management's Response

We reconcile all school level transactions within the agency account. Additionally, the checking accounts have been entered into QuickBooks as of July 1, 2011 to allow for the reconciliation and tracking of the student activity sub-accounts.

## **Establish a Program for Evaluating Employee Performance**

### Prior Year Comment

In the prior year, we indicated that the Business Office does not have a prescribed standard or written record for measuring, evaluating, and reporting employee performance. It has been demonstrated that individuals generally accomplish more and work better as a team when they fully understand their responsibilities and have a common agreement with their superiors about the job objectives and performance standards on which they will be evaluated.

### Current Status

Job descriptions have been created for new employees and restructured positions. Additionally, District management meets regularly with members of the Central Office to discuss open items and related performance issues that can arise from time-to-time. Performance reviews do occur for custodial and food service staff, but are not implemented consistently for Central Office staff.

### Continuing Recommendation

We continue to recommend that the Business Office complete the implementation of its personnel performance evaluation program. We continue to recommend the following actions:

- The preparation and issuance of written job responsibilities for all personnel.
- An employee evaluation and progress report prepared at regular intervals by the employee's supervisor, discussed with the employee, and filed in the employee's personnel file. Ideally, the employee would have an opportunity to challenge the supervisor's evaluation and record comments before signing it as an indication that it had been discussed with the supervisor.

### Management's Response

The District will continue its work in fiscal 2012 to produce remaining job descriptions that do not exist currently. Additionally, the District has already created a new performance evaluation tool for Central Office staff that will enable more formal and regularly occurring reviews in the future.

## **Adopt a Cash and Investment Policy**

### Prior Year Comment

In the prior year, we indicated that new accounting standards have highlighted the need for governmental entities to consider adopting cash and investment policies that take into account custodial, credit and interest rate risk. Such policies establish guidelines for matters such as 1) the types of banks the District should have deposits with; 2) the maximum period that an investment can be held and; 3) the highest concentration the District can have in any one investment type or issuer.

### Current Status

No significant progress was made in fiscal 2011 to resolve this matter.

### Continuing Recommendation

We continue to recommend that the District develop and formalize a cash and investment policy that includes both long and short-term objectives.

### Management's Response

The District Treasurer has identified a policy template that can be used to create a customized cash and investment policy for MERSD. The District will endeavor to draft a policy for School Committee review in fiscal 2012.

## **Audit of Student Activity Funds**

### Prior Year Comment

In the prior year, we indicated that the Massachusetts Association of School Business Officials (MASBO) published a student activity accounts manual, in May of 2007, to assist school districts with the operation and management of student activity accounts under the provisions of Massachusetts General Law (MGL), Chapter 71, Section 47, as amended by Chapter 66 of the Acts of 1996. To comply with the MGL, the MASBO recommends that annual audits of the student activity funds be performed. The audit may be an internal audit conducted by the Director of Finance and Operations, if so approved by the School Committee. However, at least one time every three years, the audit should be performed by an independent audit firm.

### Current Status

No significant progress was made in fiscal 2011 to resolve this matter.

### Continuing Recommendation

We continue to recommend that the District implement policies and procedures to comply with the MASBO recommendation.

### Management's Response

As noted, the District has been working with a CPA firm to upgrade policies and procedures related to Student Activity Accounts. Additionally, a significant amount of time has been spent correcting prior-year accounting of individual activity balances, moving accounting records to a software-based solution and identifying club advisors for each account to ensure that transactions are recorded correctly. With these improvements in place, the District will be in a position to audit its Student Activity Accounts later this year.

### **Assess Organizational Structure/Roles and Responsibilities**

#### Prior Year Comment

In the prior year, we indicated that the Director of Finance and Operations current duties include, among other things, general ledger account reconciliations, recording and posting journal entries to record payroll on the general ledger, recording and posting monthly adjusting entries to the general ledger, reviewing and posting vendor warrants to the general ledger, completing monthly and year-end closing procedures and account reconciliations. In our experience, many of these accounting functions are typically performed by an accountant and are not part of the Director of Finance and Operations primary roles and responsibilities.

We believe that the District should assess the current roles and responsibilities being performed by the Director of Finance and Operations and consider adding an accountant's position to the organizational structure. The accountant would perform the accounting functions that are currently assigned to the Director of Finance and Operations. This organizational structure would bring the accounting staff inline with similar sized school Districts, would increase the controls over the District's accounting functions, and would be an additional resource for management by providing them with budgets, analyses, and other reports that could be useful in making decisions.

#### Current Status

The District has hired a human resource and financial data specialist to assist with Business Office responsibilities, including account reconciliations. This position was subsequently modified to include processing payroll and drafting payroll-related general ledger entries for the Director of Finance & Operations.

#### Continuing Recommendation

We continue to recommend that the District further assess the current roles and responsibilities being performed by the Director of Finance and Operations and consider reassigning them to other positions within the business office while being mindful of proper segregation of duties.

### Management's Response

The new position has improved Central Office performance and puts the District in a better position to address ongoing challenges related to timing of recording ledger transactions and account reconciliations. As noted, the District is now considering ways to increase the number of hours dedicated to basic accounting activities as well.

## ***CURRENT YEAR COMMENTS***

## **Segregation of Duties**

### Comment

During our audit of the District's cash balances, we noted that a segregation of duties within the payroll and accounts payable functions was lacking. It is crucial in a system of internal control for no one employee to be able to complete a transaction from start to finish. Currently, the payroll clerk is responsible for processing the biweekly payroll, has access to and issues manual checks, as well as has access to the Treasurers signature stamp which is loaded into the payroll system. The accounts payable clerk has the ability to enter new vendors into the master file, process invoices, and post transactions directly to the general ledger.

### Recommendation

We recommend that the District review its internal controls over payroll and accounts payable, and consider reassigning transaction processing functions in a manner that will achieve greater segregation of duties.

### Management's Response

The District has made process modifications to prevent individual employees from completing transactions from start to finish. New employees and vendors may no longer be added into the software systems without approval from the Director of Finance & Operations. The District is investigating options within each software system to automate these required approvals.

## **Centralize Chapter 30B Compliance Information**

### Comment

Chapter 30B compliance information for some purchases has been maintained by the Facilities Office and not centrally within the District Office. The Director of Finance and Operations monitors Chapter 30B compliance when approving purchase orders.

### Recommendation

We recommend that the District develop a centralized system where Chapter 30B compliance information, for all school locations, is stored in a single location.

### Management's Response

The District has moved compliance documentation to the Central Office Accounts Payable files, so that Chapter 30B documentation can be kept with related invoices and approved purchase orders.