

MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT

MANAGEMENT LETTER

JUNE 30, 2010



100 Quannapowitt Parkway
Suite 101
Wakefield, MA 01880
T. 781-914-1700
F. 781-914-1701
www.powersandsullivan.com

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, 2010, 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.

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.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions concerning those matters.

The Manchester Essex Regional School District's written responses to the comments identified in our audit have 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 of the Manchester Essex Regional School District, and is not intended to be and should not be used by anyone other than these specified parties.

Wakefield, Massachusetts
March 31, 2011

MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT

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PRIOR YEAR COMMENTS

Develop an Information Technology Disaster Recovery Plan

Prior Year Comment

In the prior year, we indicated that the District should develop a written contingency plan to ensure the continued operation of data processing in the event of a localized disaster or hardware failure.

Current Status

The District has completed a written disaster recovery plan.

Withholding Accounts

Prior Year Comment

In the prior year, we indicated that the payroll withholding liability accounts do not appear to be 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

No significant progress was made in fiscal 2010 to resolve this matter.

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

We have initiated a comprehensive examination of our reconciliation processes for payroll and withholding accounts. From this work, we have begun to identify the most common sources of reconciling exceptions, and we are using this information to create a more effective process for regular recurring reconciliations in the future.

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

No significant progress was made in fiscal 2010 to resolve this matter.

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

Management has attended two seminars on this topic and is taking steps to bring recommended practices to MERSD. Additionally, we have discussed opportunities for process improvements with our auditors that we will begin to implement in fiscal 2011.

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 middle and elementary student activity bank accounts are not reconciled with the middle and elementary school student activity records.

Current Status

No significant progress was made in fiscal 2010 to resolve this matter.

Continuing Recommendation

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

Management's Response

The District has begun a comprehensive review of its handling of Student Activity Funds and is seeking to put in place various process improvements related to fund balance tracking at all schools (including use of new software), reconciliations, authorizations and internal auditing in advance of conducting an external audit.

Treasurer - Old Reconciling Items

Prior Year Comment

In the prior year, we noted that many reconciling items are being carried on the payroll account reconciliations. As of June 30, 2010, these items totaled approximately \$282,000. The Treasurer was unable to provide supporting documentation for several of these items at the time of our audit. Carrying reconciling items and not correcting errors on a timely basis causes additional time to be spent by personnel to reconcile the bank accounts each month. It is less time consuming to research and resolve these items if they are done on a monthly basis.

Current Status

No significant progress was made in fiscal 2010 to resolve this matter and the reconciling items increased by \$112,000 over the amount being carried in the prior fiscal year.

Continuing Recommendation

We continue to recommend that errors noted in the cash reconciliation process be corrected on a monthly basis. Research should be done periodically to eliminate large numbers of old items being carried from month to month.

Management's Response

As noted above (see withholding accounts), we have initiated a comprehensive examination of our reconciliation processes for payroll and withholding accounts. From this work, we have begun to identify the most common sources of reconciling exceptions, and we are using this information to create a more effective process for regular recurring reconciliations in the future.

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

Periodic reappraisal of employee functions and job descriptions, operating objectives, and performance standards are discussed at monthly staff meetings. The District is still in the process of completing written job descriptions for all employees. The use of employee evaluation forms has been implemented, however not all evaluations were completed.

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

We have initiated a project to assemble, update and/or create job descriptions as appropriate for all central office personnel, which will form the basis for employee reviews we intend to conduct toward the end of fiscal 2011.

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 2010 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

Although the District follows state guidelines for investing its cash, it does not have a formal policy in place. The District is currently working on updating its policy manual and will research and adopt an appropriate policy during the next fiscal year.

CURRENT YEAR COMMENTS

Timely Reconciliations of Cash

Comment

The Treasurer and Director of Finance and Operations are responsible for completing timely reconciliations of the activity and balances of cash. We believe this function is one of the most important elements of the overall internal financial controls of the District.

Internal control procedures should be designed in a manner that ensures all activity is recorded in the Treasurer's cash book as the transactions occur. At the same time as the activity is being posted to the cash book, a corresponding posting would be made to the general ledger maintained by the Director of Finance and Operations. The cash book balance and the general ledger cash balance should match at all times. At the end of each month, the Treasurer would complete the reconciliation between the cash book and bank statements. The Treasurer and Director of Finance and Operations would then reconcile the cash book to the general ledger balance.

Discussions with management indicate that while monthly reconciliations are being performed, it often takes several months for them to be completed.

Recommendation

We recommend that management implement internal control procedures for completing monthly reconciliations between the general ledger and cash book on a monthly basis.

Management's Response

Due to resource constraints in the Central Office, conducting timely cash reconciliation has been a challenge for the District for several years. As a first step, we have worked with staff to ensure that data key inputs related to posting receipts and payrolls can occur on a more timely basis, which has been done. We are now also investigating ways to access more regular accounting support so that other required journal entries can be posted in a more timely manner. Additionally, we anticipate using an available module from our accounting system to streamline reconciliations through use of technology. These process and resource adjustments should enable the district to move from an irregular cash reconciliation process to a more regular one with the ultimate goal of reconciling cash on a monthly basis in the near future.

Audit of Student Activity Funds

Comment

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.

Recommendation

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

Management's Response

As noted above, the District has begun a comprehensive review of its handling of Student Activity Funds and is seeking to put in place various process improvements related to fund balance tracking at all schools (including use of new software), reconciliations, authorizations and internal auditing in advance of conducting an external audit.

Statement No. 54 of the Government Accounting Standards Board

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.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund types, capital projects fund types, and permanent fund types are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better

alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

Recommendation

As it appears that this GASB Statement will significantly impact the fund balance classifications presently reported, we recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes, and to formulate plans to be used in explaining these changes to interested parties within the District and to the external users of the District's financial statements.

Management's Response

The Director of Finance & Operations recently attended a seminar on this topic and has become familiar with the new reporting requirements.

Assess Organizational Structure/Roles and Responsibilities

Comment

The business manager's current duties include, among other things, general ledger account reconciliations, posting payroll to the general ledger, making adjusting entries to the general ledger, and completing year-end closing procedures. In our experience, these accounting functions are typically performed by an accountant and are not part of the business manager's primary roles and responsibilities. We believe that the District should assess the current roles and responsibilities being performed by the business manager and consider adding an accountant's position to the organizational structure. The accountant would perform the accounting functions that are currently assigned to the business manager. 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.

Recommendation

We recommend that the District assess the current roles and responsibilities being performed by the business manager and consider adding an accountant's position to the organizational structure.

Management Response

The District's new superintendent and business manager have initiated a review of organizational structure within the central office and will incorporate this recommendation into their evaluation process.