

MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT

MANAGEMENT LETTER

JUNE 30, 2007



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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, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered 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 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 entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity'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 entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control 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.

This communication is intended solely for the information and use of management of Manchester Essex Regional School District, and is not intended to be and should not be used by anyone other than these specified parties.

November 5, 2007

MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT

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Develop an Information Technology Disaster Recovery Plan

Prior Year Comment

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 – *Unresolved*. No significant progress was made in Fiscal 2007.

Recommendation

To avoid severe impairment to the District's computer operations in the event of a prolonged failure or localized disaster, we continue to recommend that the District do the following:

- Establish a priority processing plan based on the impact of the delay expected for equipment replacement.
- Investigate alternate facilities to provide sufficient processing time for critical applications.
- Perform periodic test operations at the alternate facility and document the contingency operating procedures.
- Provide for notification of equipment changes at the alternate facility and for updating the plan periodically.

Management's Response

The Business Manager in conjunction with the Network Administrator will develop a written contingency plan for ensuring the continued operation of data processing in the event of a localized disaster.

Segregation of Duties

Prior Year Comment

Segregation of duties is normally difficult to accomplish within a small organization, but management should be ever mindful of areas that can easily be improved upon. An example is in the area of cash. One individual enters data into the accounts payable system, has check signing authority, and performs bank reconciliations. The same situation exists related to the payroll function. Some suggestions for improving internal control over this area are to have the Business Manager open the bank statement and scan canceled checks and other transactions for any unusual or improper items, or have a different individual perform the bank reconciliation. We believe that either alternative is feasible for the District.

Current Status – *Resolved*. The District's Accounting Office segregated the reconciliation duties associated with the payroll and accounts payable functions so that the individuals processing daily transactions are no longer responsible for reconciling the bank accounts.

Withholding Accounts

Prior Year Comment

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 that ensure all withholdings are being paid out and charged to the appropriate withholding account.

Current Status – *Unresolved*. No significant progress was made in Fiscal 2007.

Recommendation

We continue to recommend that the 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 Business Manager will make resolving this issue a priority this year.

Recording Activity Directly to Fund Balance

Prior Year Comment

Numerous revenues, expenditures and adjustments were posted directly to fund balance in a majority of the District's funds in fiscal year 2006.

All activity should be posted to subsidiary accounts of its respective fund. By doing so, interim reporting of budget to actual results to management will be accurate and more easily generated, preparation of end of year report will be facilitated and the year end audit process will be more efficient.

Current Status – *Resolved*. The Business Manager established and utilized the appropriate revenue and expenditure subsidiary accounts.

Fraud Risk Assessment

Prior Year Comment

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 recommend 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. When conducting the self-assessment, questions such as the following can be considered:

- What individuals have the opportunity to misappropriate assets? These are individuals who have access to assets susceptible to theft and to records that can be falsified or manipulated to conceal the theft.
- Are there any known pressures that would motivate employees with the opportunity to misappropriate assets? Pressures may relate to financial stress or dissatisfaction. In assessing whether these pressures may exist, the assessor should consider whether there is any information that indicates potential financial stress or dissatisfaction of employees with access to assets susceptible to misappropriation.
- What assets of the District are susceptible to misappropriation?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could assets be stolen? Assets can be stolen in many ways besides merely removing them from the premises. For example, cash can be stolen by writing checks to fictitious employees or vendors and cashing them for personal use.
- How could potential misappropriation of assets be concealed? Because many frauds create another account. Generally, fraud perpetrators may use accounts that are not closely monitored.

Current Status – *Unresolved*. No significant progress was made in Fiscal 2007.

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 Business Manager has attended several workshops on fraud risk assessment and plans to have discussions with both clerical and management level groups this year to assess the District's vulnerability and discuss means of detection and prevention of fraud.

Statement No. 45 of the Governmental Accounting Standards Board

Comment

The Governmental Accounting Standards Board (the GASB) issued Statement No. 45 *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. This Statement requires that:

1. a systematic, accrual-basis measurement and recognition of other postemployment benefits (OPEB) cost over a period that approximates employees' years of service and;
2. information about actuarial accrued liabilities associated with OPEB be reported and whether, and to what extent, progress is being made in funding the plan.

To implement GASB 45 the District will have to adopt actuarial calculations for OPEB that are similar to pension calculations. This means the District will have to have an actuarial valuation performed. This actuarial valuation is similar in nature to pension plan valuations in that future OPEB costs are considered to be part of today's employee costs. It is intended to answer the question "How much should the contribution be today to finance tomorrow's cost?"

The actuarial valuation will be required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. Failure to obtain an actuarial valuation will result in a qualification to the independent auditors' opinion on the basic financial statements. The District is required to implement GASB 45 in fiscal year 2009.

Additionally, it has been recognized that organizations that have filed for Medicare Part B will have a lower liability in the GASB 45 calculation because Part B of the Medicare Program is medical insurance. This coverage helps pay for medical and surgical services by physicians, as well as certain other health benefits such as ambulance transportation, durable medical equipment, outpatient hospital services, and independent laboratory services. Any costs assumed by Medicare Part B will reduce the City's OPEB obligation

Recommendation

We recommend that management obtain an actuarial valuation and review the different insurance options that may reduce the liability.

Management's Response

The District is aware of the need for an actuarial valuation in order to be in compliance with GASB No. 45 by fiscal year 2009 and will seek vendors and budget funds for completion of the work at the appropriate time.

Student Activity Funds

Comment

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 areas in which the process can be improved.

- Reimbursements to the principal's checking accounts are not funded through the warrant process.
- The elementary student activity bank accounts are not reconciled with the elementary school student activity records.
- The High School checking account was used to reimburse \$5,503.92 to a teacher that purchased airline tickets for the debate club on a personal credit card. This expenditure was to be funded by a general fund appropriation specifically voted for this purpose. This action circumvented the District's warrant process.

The statute also requires an annual audit of these accounts. At a minimum such audits should include:

- a reconciliation of the cash balances as shown in the checkbook and bank statements;
- a review of compliance with the school committee's adopted procedures; and
- a review of the supporting documentation for a randomly selected sample of payments.

These annual audits can be conducted by personnel in the school business office. For accounts with authorized limits exceeding \$25,000, Districts should consider having the audit conducted by an outside accounting firm at least every two or three years.

Recommendation

We recommend that reimbursements to the principal's account be funded through the warrant process.

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

We recommend that the District use the student activity bank accounts to exclusively account for student activity funds that meet the criteria as previously discussed.

We recommend that the District conduct annual audits of the student activity accounts as required by the statute.

Management's Response

The District will implement reimbursing principals' accounts through the warrant process immediately. The Business Manager reconciles the high school account monthly with bank statements and has begun an audit of the high school account. The elementary accounts will be audited when the high school is complete.

Use of Personal Credit Cards

Comment

We understand that employees may use their personal credit cards for various purchases ranging from supplies and equipment to airline tickets. We recommend that the District prohibit the use of personal credit cards and require that employees use a District credit card. Allowing the use of personal credit cards exposes the District to internal control risks, complicates sales tax issues, and may unfairly benefit an employee (i.e. airline mileage or similar benefits through affinity programs). The use of a District credit card generates valuable purchasing data useful for negotiation with suppliers and also identifies when employees are not using preferred suppliers.

Recommendation

We recommend that the District discontinue the practice of allowing employees to use personal credit cards for purchases on behalf of the District. Instead, we recommend that the District require the use of District credit cards. We also recommend that District credit cards only be used when it is not feasible for the purchase to be made through the normal warrant process.

Management's Response

Administrators have been apprised of the recommendation to reduce personal credit card use and the District has acquired a credit card which can be used when it is not feasible to use the warrant process. The District already has credit cards for Home Depot and Staples which can be used in emergencies. The District will also pursue the use of Open PO's at various establishments that are commonly used for emergency purchases.

Use of Stabilization Funds

Comment

In accordance with Massachusetts General Law, Chapter 71, Section 16G½, a "District may appropriate stabilization funds by vote of two-thirds of all the members of the regional District school committee for any purpose for which regional school Districts may borrow."

We noted that the District charged \$127,735 of expenditures to the Stabilization fund for asbestos removal and duct work. The District was unable to provide a school committee vote authorizing the use of stabilization funds for this purpose.

Recommendation

We recommend that the District ensure that all future expenditures from the Stabilization fund are in accordance with the provisions of Massachusetts General Law, Chapter 71, Section 16G½.

Management's Response

The District will ensure that any further use of the Stabilization Fund will be in accordance with Massachusetts General Laws including authorization by a formal vote of the school committee and moving the funds to a separate capital project account.

Treasurer – Old Reconciling Items

Comment

We noted that many reconciling items, some over one year old, are being carried on monthly cash reconciliations. This causes additional time to be spent by personnel to reconcile the bank accounts each month.

Recommendation

We recommend that checks and other uncleared reconciling items that are over six months old be investigated and removed from the bank reconciliation and that the original transaction be reversed. Research should be done periodically to eliminate large numbers of old items being carried from month to month.

Management's Response

The Treasurer is in the process of investigating outstanding reconciling items in order to eliminate them.

Establish a Program for Evaluating Employee Performance

Comment

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.

Recommendation

We recommend that the Business Office adopt a personnel performance evaluation program that would include the following features:

- The preparation and issuance of written job responsibilities for all personnel.
- A periodic reappraisal of employee functions to determine that each employee is fully employed in useful operations.
- A mutual understanding between the superior and subordinate about job description, operating objectives, and performance standards.
- A periodic review of employee performance against these goals.
- 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 Superintendent and Business Manager have begun the process of developing job descriptions and gathering evaluation tools in order to implement an evaluation process. It is expected that this will be completed and implemented by the end of the fiscal year.

Payroll Processing

Comment

The District's teacher's contract runs from September 1 through August 31 while payroll is currently processed every two weeks with teachers paid on a Thursday for wages earned the previous two weeks. Because of when the contract period begins; and the timing of the pay periods and pay date; the School has experienced timing issues that have effected appropriations voted in the budget process.

For example, the teacher's contract states that the first payment for each contract year is due in September. However, due to the timing of the bi-weekly payroll, the first check for FY2008 was paid out in August. Not only was this payment outside the budget year, but it represented a payment in advance of the work being performed.

Recommendation

We recommend that the District budget for the actual payroll "earned" in the budget fiscal year, regardless of when the pay date is. We also recommend that the School either 1) adjust the individual pay checks so that the proper amount is paid out in each fiscal year, or 2) consider modifying the pay date to be semi-monthly, which would eliminate issues such as the extra day created leap year.

Management's Response

The District is pursuing resolution of this issue with the Manchester-Essex Teachers' Association.