

MANCHESTER ESSEX REGIONAL SCHOOL DISTRICT

MANAGEMENT LETTER

JUNE 30, 2002



323 New Boston Street
Woburn, MA 01801
T 781 937 9322
F 781 937 9474

www.powersandsullivan.com

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

 member

In planning and performing our audit of the general purpose financial statements of the Manchester Essex Regional School District (District), for the fiscal year ended June 30, 2002, we considered the District's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the District's general purpose financial statements and not to provide assurance on internal control. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the District's ability to initiate, record, process, and report financial data consistent with the assertions of management in the general purpose financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe that the conditions identified as material weaknesses in the accompanying memorandum are material weaknesses.

During our audit we also became aware of other matters that are opportunities for strengthening internal controls and operating efficiency.

The memorandum that accompanies this letter summarizes our comments and suggestions concerning the reportable conditions and other matters.

These reportable conditions and other matters, which were considered by us during our audit, do not modify the opinion expressed in our report, dated March 20, 2003, on the general purpose financial statements.

This report 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.

We have already discussed these comments and suggestions with various District personnel, and we will be pleased to discuss them in further detail at your convenience.

March 20, 2003

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MATERIAL WEAKNESSES

Comment

The majority of the District's transactions are initiated and processed by the District's Superintendent's Office (Office). Throughout the fiscal year, the District's School Committee (Committee) relies on the information generated by the Office to make decisions that affect District strategy in developing and meeting its short-term and long-term financial goals.

The Committee must be confident that the information they base their decisions on is complete and accurate. This confidence is gained when the Committee is assured that the internal control structure over cash, revenues and expenditures is of sound design and functioning as intended.

The Office's role in the District's internal control structure is to establish and maintain procedures that 1) properly safeguard the District's cash and 2) assure that all financial transaction (i.e. receipts and disbursements) are reported accurately and timely.

The Office is also responsible for establishing and maintaining procedures that assure 1) that the District's receipts, disbursements and journal entries are recorded in the general ledger accurately and timely and 2) that all transactions are supported by proper documentation.

With this in mind, our review of the internal control structure of this Office revealed the following material deficiencies:

- The District did not keep an accounting of cash transactions (i.e. cash book) that clearly identified the source, amount, or classification of revenues and expenditures.
- The general ledger cash balance was not reconciled to the bank statements. As a result financial reports, particularly a balance sheet, could not be generated.
- General ledger monitoring and maintenance was either not performed or not performed in a timely manner.
- Numerous revenue and expenditure transactions were not recorded in the general ledger during the fiscal year.

Summary

The objective of a system of internal control is to safeguard the assets of the District and provide assurance that transactions are executed in accordance with management's authorization and recorded properly in the District's general ledger. The omission of one or more elements of internal control can compromise the District's ability to obtain these objectives. We have concluded that the deficiencies noted above represent material weaknesses in the District's system of internal control under standards established by the American Institute of Certified Public Accountants.

These deficiencies constitute being classified as material weaknesses because they represent significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements. Furthermore, we believe that the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that

errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Recommendation

1. We recommend that a policy and procedure manual be developed that identifies and documents all elements of the internal control structure of the District. The manual should include, but not be limited to, key areas such as cash, grant and student activity accounting; budget development and monitoring; and month end and year end closing and reporting procedures.
2. We recommend that the District establish a cashbook and reconcile that cashbook to the individual bank statements each month.
3. We recommend that the cashbook be reconciled to the general ledger each month.
4. We recommend that all financial transactions be recorded in the District's general ledger in a timely manner.
5. We recommend that general ledger accounts be reviewed, analyzed and reconciled on a monthly basis.
6. We recommend that the School Committee be provided with interim financial reports, generated from information contained in the general ledger, on a monthly basis.

OTHER COMMENTS AND RECOMMENDATIONS

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENT #34

Comment

The GASB is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. In June of 1999, the GASB issued Statement #34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments.

The implementation of GASB Statement #34 will require the District to allocate additional resources of time and money during both the transition period and subsequent years. There will be major changes of how assets, liabilities, revenues and expenses are accounted for, each of which poses its own different set of transition and long-term solutions. One example is the requirement that fixed assets, including infrastructure, will be reported at historical cost, net of accumulated depreciation. A transitional project to inventory and value all fixed assets is a major undertaking. Subsequent to the initial inventory, a fixed asset sub-system must be maintained to track all additions, disposals and depreciation.

As of the date of this letter the District does not have a documented plan that will ensure a successful implementation. The continued lack of action increases the possibility that the fiscal year 2003 basic financial statements will be delayed or may contain significant audit opinion qualifications.

Recommendation

We recommend management develop immediately a strategy to implement GASB 34.

BUDGET AMENDMENTS

Comment

Once the District adopts its annual budget, the budget is submitted to each of the two member communities for final authorization. We noted instances where the original budget was changed when it reached the community level. These changes effected the assessments that were paid to the District by the communities. The District did not make corresponding adjustments to its appropriation budget. As a result, the budget that the District used to make expenditure decisions throughout the year was not balanced (i.e. the revenues that were budgeted to be received did not equal the authorized expenditures). This process could result in the District overspending funds.

Recommendation

We recommend the District implement procedures to formally adopt a final budget once the original budget has been approved by vote of the member communities and that the final budget be utilized in the District’s system when making expenditure decisions.

STUDENT ACTIVITY ACCOUNTS

Comment

The District does not have records to support the individual balances of each student activity program nor could we reconcile these accounts to the bank account used to record all deposits and receipts. The lack of such records puts the District at risk of overspending individual student activity funds, using the funds of one activity for another, and/or the unauthorized expenditures of student funds.

Additionally, the District does not comply with state laws related to the maintenance of student activity funds. In the future, student activity funds should be maintained in accordance with Massachusetts General Law, Chapter 71 of the Acts of 1996. The law allows the School Committee to authorize School Principals to receive funds in connection with the administration of certain student activities. Such funds would be deposited with the District Treasurer into an interest bearing bank account (the Student Activity Agency Account), that is to be used for the express purpose of administering student activities. Interest earned by the Student Activity Agency Account shall be retained by the fund and disbursed at the discretion of the School Committee. In addition to the student Activity Agency Account, the School Committee may authorize the Treasurer to establish a checking account (the Student Activity Checking Account), from which funds may be expended by the School Principal for the exclusive benefit of student activities. The Student Activity Checking Account will be maintained by the School Principal and may only be used for student activity disbursements.

The School Committee shall vote to set the maximum balance that may be on deposit in the Student Activity Checking Account. The School Principal designated to maintain such Student Activity Checking Account shall give bond to the District in such amount as the Treasurer shall determine to secure the faithful performance of School Principal's duties pertaining such account. To the extent that the funds are available in such Student Activity Agency Account, funds up to the maximum balance set by the School Committee shall be transferred from the Student Activity Agency Account through the warrant process to initially fund such Student Activity Checking Account.

Periodically, to the extent that funds are available in such Student Activity Agency Account, the Treasurer shall reimburse the Student Activity Checking Account, through the warrant process, to restore the limit set by the School Committee. The School Principal shall adhere to the administrative procedures prescribed by the Treasurer. An annual audit of the student activity funds shall be conducted in accordance with the procedures as agreed upon between the School Committee and the auditor based upon guidelines issued by the Department of Education.

Recommendation

We recommend the District account for the individual balances of each student activity, that these balances be reconciled to the corresponding bank accounts and that policies and procedures be implemented to ensure compliance with Massachusetts General Law, Chapter 71 of the Acts of 1996.

GRANT ACCOUNTING

Comment

The District does not have a process for reconciling grant balances from the individuals responsible for grant activity and reporting to the general ledger. We noted several instances where grant expenditures were recorded incorrectly on the general ledger. This weakness could lead to overspending grant funds, inaccurate reporting and puts the District at risk of having to return grant funds for non-compliance with grant agreements.

Recommendation

We recommend the District implement procedures to reconcile grant balances from the individuals responsible for grant activity and reporting to the general ledger on a regular basis and prior to the close-out of any grant.

CHART OF ACCOUNTS

Comment

The District is using a chart of accounts that was copied from another regional school district and was not modified to include account classifications and names that would be most useful to the District. Additionally, the account number structure was not planned in a manner that would maximize the use of the general ledger for complying with external and internal reporting requirements and to provide meaningful management information and budgetary control.

Recommendation

We recommend that the District review the existing chart of accounts and make appropriate revisions to provide consistency with the District's reporting requirements and to provide meaningful management information and effective budgetary control.

BUSINESS MANAGEMENT AND TREASURY FUCTIONS

Comment

During the audit period, the District did not employ a Treasurer, which is statutorily required, or a school business or accounting manager, who would be responsible for all accounting and financial reporting matters. The District also did not have documented accounting and treasury procedures that would insure that all necessary functions were being performed by the existing staff. We believe that this has contributed significantly to the District's inability to process financial transactions and to produce financial information in a timely manner.

Recommendation

We recommend the District hire a manager with strong accounting and communication skills. This individual will be responsible for the coordination of all accounting matters including the recording of financial transactions, the reconciliation of account balances, resolving accounting issues, verifying that transactions are classified properly in the general ledger, maintaining budgetary control, reporting financial activity, and other routine accounting functions. We also recommend that the District hire a Treasurer to comply with statutory requirements and to provide a segregation of duties between the processing of financial transactions and the handling of cash. This, in conjunction with the adoption of a detailed accounting procedures manual, should help produce the consistent and accurate accounting system desired.