

HAMILTON-WENHAM REGIONAL SCHOOL DISTRICT

MANAGEMENT LETTER

JUNE 30, 2011

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To the Honorable School Committee
Hamilton-Wenham Regional School District
Wenham, Massachusetts 01984

In planning and performing our audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Hamilton-Wenham Regional School District as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) 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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 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 Town's internal control and 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 operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding 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 of the Hamilton-Wenham Regional School District, and is not intended to be and should not be used by anyone other than these specified parties.

February 1, 2012

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MATERIAL WEAKNESSES

MATERIAL WEAKNESSES

Management must rely on the financial information generated by the accounting and treasury functions to make decisions that affect the Hamilton-Wenham Regional School District's (the District) 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 Treasury function is responsible for establishing and maintaining procedures to 1) properly safeguard the Town's cash and investments and 2) assure that all receipts and disbursements are reported accurately and timely.

During our audit, we became aware of several matters that we consider to be material weaknesses in the District's system of internal controls. As detailed below, these matters include the absence of cash reconciliation procedures, material uncorrected and unidentified accounting errors, and a lack of proper segregation of duties.

Absence of Cash Reconciliation Procedures

The general ledger cash balances were not reconciled to the bank balances at any time during the fiscal year. Several of the bank balances were not reconciled to the Treasurer's book balances at any time during the fiscal year. During our audit, we noted approximately 150 transactions not recorded on the general ledger. The most significant unrecorded transaction was a debt principal and interest payment totaling \$1,623,641. A lack of reconciliation procedures indicates a weakness in the system of internal controls and increases the likelihood that material errors may occur and go undetected. Audit adjustments have been proposed and accepted to record these transactions.

Material Uncorrected and Unidentified Accounting Errors

During our audit, we noted numerous accounting errors that were not identified and corrected by the District. A lack of identifying and correcting accounting errors and misstatements is a weakness in the system of internal controls. Audit adjustments were proposed and recorded to correct the errors noted below.

- Warrants payable reported a deficit balance totaling \$112,226. The warrants payable should have totaled \$426,055 and as a result was misstated by \$538,281.
- The general ledger included a prior year interfund receivable and payable totaling \$286,939 that was not reversed at the beginning of the fiscal year.
- The balance in the circuit breaker fund exceeded the maximum allowable balance by approximately \$287,000. Circuit breaker reimbursements can only be carried forward for one fiscal year. Therefore, at year-end, the balance in the fund cannot exceed the amount received in any given fiscal year. Any excess balance must be transferred to the general fund.

- \$121,000 of Medicaid receipts was included in the special revenue funds. Medicaid receipts are required to be deposited into the general fund where the reimbursable expenditures were recorded.
- The District did not collect debt assessments, totaling \$62,127, from the Town of Wenham and did not record a receivable on the general ledger to reflect the amount that was outstanding at year-end. We believe that the underlying reason, that this error was not identified, is because the debt assessment was not included in the budget document (see "budget process" comment on page 6 for additional information) and was not voted/approved by each member community. Another factor that contributed to the District not identifying the error is the fact that the District did not include budgets in the debt service fund. As a result, no budget to actual comparisons were performed during the year. Neither the Town nor the District had identified this error and we do not believe that it would have been detected outside of the audit process.
- Beginning balances were not allocated, in the special revenue grants and gifts fund, capital projects fund or scholarships fund, to the applicable activities at the beginning of the fiscal year and as a result, the individual activities fund balances were misstated during the fiscal year.
- Voted transfers to fund the operating budget and to fund over-expenditures, in the special revenue funds, were not recorded. Voted transfers should be recorded as soon as all of the necessary votes and approvals have occurred.
- Numerous revenue and expenditure misclassifications were noted within the grant funds.

Lack of Proper Segregation of Duties

While reviewing the District's internal controls, we noted several instances where proper segregation of duties does not exist. A lack of proper segregation of duties indicates a weakness in the system of internal controls and increases the likelihood that material errors may occur and go undetected.

- The accounts payable clerk has administrator access to the District's accounting system and is responsible for assigning privileges to users of the system.
- Both the accounts payable clerk and the payroll clerk have access to check stock.
- Both the accounts payable clerk and the payroll clerk have the ability to and are responsible for printing signed checks from the accounting system.
- Both the accounts payable clerk and the payroll clerk are responsible for mailing signed checks to the payees.
- Both the accounts payable clerk and the payroll clerk are responsible for maintaining the accounts payable and payroll master files, respectively.
- Both the accounts payable clerk and the payroll clerk have the ability to post transactions to the general ledger.
- Numerous instances where accounts payable and payroll warrants were issued prior to being reviewed and approved by any members of the School Committee.
- We were informed that there have been instances where payroll warrants were issued prior to being reviewed and approved by the Business Manager, Treasurer or School Committee.

In summary, the objectives of an internal control structure are to safeguard the assets of the District and provide reasonable assurance that transactions are executed in accordance with management's authorization and recorded properly in the District's ledgers. 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, individually and collectively, 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 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 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

We recommend that the District address the matters noted above through training, proper resource allocation and the development and implementation of written policies and procedures.

OTHER MATTERS

BUDGET PROCESS

Comment

A Massachusetts Department of Elementary and Secondary Education (DESE) directive regarding the regional school district budget process indicates that the regional school committee shall propose, by a majority vote, a budget containing all proposed operating expenditures, capital expenditures, and debt service payments to be paid from the general revenues of the regional school district. Upon review of the District's budget document, we noted that budgets for capital expenditures and debt service payments were omitted from the document.

We also noted that the District proposed capital expenditures in a fiscal 2012 budget proposal document and that expenditures have been incurred in fiscal 2012 related to the proposed expenditures. However, there was never an official vote by the School Committee or the member communities authorizing the expenditures.

Additionally, we noted that the District does not include debt service budgets or the applicable assessments as budgeted line-items in its accounting system. Entering these budgets into the accounting system is an important control that would allow the District to determine if all debt had been charged to the general ledger and if all debt assessments had been received from member communities.

Recommendation

We recommend that the District include all capital expenditures and debt service payments in the budget document and that the wording of the vote include acceptance of the capital expenditures and debt service payments.

We recommend that the District obtain the necessary votes to approve the capital expenditures that are being incurred in fiscal 2012.

We recommend that budgets be included in the general ledger for capital expenditures and debt service payments.

CAFETERIA DEFICIT

Comment

The District's standard accounting practices for the cafeteria fund includes charging employee benefits to the fund, which results in an overall fund balance deficit that must be voted and funded from E&D. If the District does not plan to raise the cafeteria fees to cover the employee benefits, then the District may want to consider eliminating this practice as there is no substantial benefit to be derived from this process.

Recommendation

We recommend that the District consider eliminating the practice of charging employee benefits to the cafeteria fund and subsequently voting to fund the deficit.

ACCOUNTING POLICIES AND PROCEDURES MANUAL

Comment

We noted that the District does not maintain a written policy and procedures manual documenting day-to-day processing and controls and, as such, is at risk if critical tasks cannot be completed due to an extended or unforeseen absence. A formal policy and procedures manual will assist each department head in the training of new departmental employees thereby reducing the amount of time required away from the daily departmental operations.

The policy and procedures manual should also include month end and year end closing procedures checklists. Documented checklists will help ensure proper procedures are performed by appropriate personnel, in a logical order, and in a timely fashion.

Recommendation

We recommend that each Principal develop a policy and procedures manual that includes proper reviews and approvals by management. The document should be written with sufficient detail to allow a new employee the ability to complete the task by reviewing its respective directions. This document should be updated for any system or policy changes. A master manual of all procedures should be maintained and stored in a secure location. In addition, all department heads should be familiar with all policies and procedures within their office and be able to complete all necessary tasks in order to sufficiently train employees.

FINANCIAL POLICIES AND PROCEDURES MANUAL

Comment

We noted that the District does not maintain a written policy and procedures manual documenting the District's financial goals and objectives. A formal policy and procedures manual will establish benchmarks for E&D, fund balance levels, a long-term capital and debt plan, capitalization thresholds for fixed assets, and other important financial indicators.

These policies and procedures will provide a framework for management to utilize when making important financial decisions.

Recommendation

We recommend that the District develop a written financial policies and procedures manual. This document should be updated for any new policy changes that are put into effect. A master manual of all procedures should be maintained and stored in a secure location.

PRESCHOOL AND KINDERGARTEN REVOLVING FUNDS

Comment

At fiscal year-end, the preschool and kindergarten revolving funds had fund balances totaling \$60,961 and \$461,236, respectively. These balances have accumulated in the funds over the past several years because the District does not charge all direct and indirect costs to the revolving funds. As a result, the general fund has paid for these costs and, in our opinion; the remaining balances in these revolving funds should be voted and returned to the general fund.

Recommendation

We recommend that the District adopt policies and procedures that will result in a consistent and rational allocation of both direct and indirect costs on an annual basis. This will ensure that expenditures are consistently charged to the program and will enable the District to properly set rates to cover the anticipated costs.

We also recommend that the District vote to transfer these excess balances to the general fund to become part of E&D.

SAFEGUARDING ASSETS

Comment

Various assets owned by the District are susceptible to fraud and abuse if they are not properly safeguarded. The following observations were made during the course of our audit, in relation to areas where internal controls can be improved, to better safeguard the District's assets:

- Check stock is pre-numbered, however the use of payroll check stock is not controlled through the use of a log book. However, a log book is maintained to account for the accounts payable check stock.
- The check stock is stored on a shelf in a closet. We observed that the closet is open during normal working hours and may be accessible to other employees after hours. In our opinion, storing the check stock in a closet is not an adequate safeguard.
- The District does not maintain a fixed asset inventory system for inventory control purposes.

Recommendation

We recommend that a log book be maintained to ensure that the payroll check stock is properly accounted for.

We recommend that check stock be stored in a locked safe to make sure that it is properly safeguarded.

We recommend that the District consider implementing a fixed asset inventory system to enhance inventory control. The District could set a dollar threshold requiring assets of a certain value to be tagged and logged into an inventory system. This would provide the District with a much greater level of control over the level that currently exists.

MAINTAIN FIXED ASSET LISTING FOR FINANCIAL REPORTING PURPOSES

Comment

The District's fixed assets, for financial reporting purposes, are tracked on an Excel spreadsheet. The listing includes the original cost, the acquisition date, the estimated useful life, current year depreciation and accumulated depreciation. During fiscal 2011, the District completed building improvements totaling approximately \$1.3 million. However, these items were not added to the fixed asset master listing.

Recommendation

We recommend that the fixed asset master listing be monitored and maintained on a regular basis. As new assets are acquired they should be added to the master listing. As equipment is disposed of it should be removed from the listing.

DEVELOP PROCEDURES CONCERNING COMPUTER PASSWORDS

Comment

The District does not have written policies and procedures concerning the role of user passwords in securing information and promoting an appropriate segregation of duties.

During our audit, we noted an instance where a computer password was posted on an employee's computer. The problem is that the password was visible to others who could use it to gain unauthorized access to the computer and thus to the District's network. Some computer specialists have estimated that as much as 80% of network security breaches occur from within the network rather than from outside hackers.

Recommendation

We recommend that written procedures be developed concerning the assignment, modification, and deletion of user passwords. Passwords should be changed at least once every six months. Written policies will help to ensure that password assignments, deletions, and modifications are performed in a manner consistent with management's intentions.

We also recommend that management remind employees of the importance of keeping their passwords secure and instruct them to remove visible postings of their passwords.