

MERRIMACK SPECIAL EDUCATION
COLLABORATIVE

FINANCIAL STATEMENTS

June 30, 2013

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

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FRITZ DEGUGLIELMO LLC
CERTIFIED PUBLIC ACCOUNTANTS
& BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Merrimack Special Education Collaborative
Billerica, Massachusetts

Report on the Financial Statements

We have audited the accompanying financial statements of Merrimack Special Education Collaborative (a collaborative organized under the Laws of the Commonwealth of Massachusetts), which comprise the statement of net position as of June 30, 2013, and the related statements of revenues, expenses, and changes in net position, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Merrimack Special Education Collaborative, as of June 30, 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3–4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2013, on our consideration of Merrimack Special Education Collaborative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Merrimack Special Education Collaborative's internal control over financial reporting and compliance.



Certified Public Accountants

Newburyport, Massachusetts

December 2, 2013

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013

Our discussion and analysis of Merrimack Special Education Collaborative's ("The Collaborative") financial performance provides an overview of the Collaborative's financial activities for the fiscal year ended June 30, 2013 with comparative information from the fiscal years ended June 30, 2012 and 2011. Please read it in conjunction with the financial statements that begin on page 5.

This financial report consists of several financial statements:

Statement of Net Position – The Statement of Net Position provides a presentation of the Collaborative's assets and liabilities as of the date of the financial statements.

Statement of Revenues, Expenses and Changes in Net Position – The Statement of Revenues, Expenses and Changes in Net Position presents the results of the operations of the Collaborative, providing information of the revenue sources and related expenses during the year.

Statement of Functional Expenses – The Statement of Functional Expenses identifies expenses incurred during the year by classification.

Statement of Cash Flows – The Statement of Cash Flows provides information on the cash receipts and cash disbursements during the year and the changes in working capital components.

FINANCIAL HIGHLIGHTS

ASSETS

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current Assets	\$14,571,474	\$14,307,479	\$ 5,743,050
Property & Equipment, net	<u>278,170</u>	<u>146,660</u>	<u>137,046</u>
	<u>\$14,849,644</u>	<u>\$14,454,139</u>	<u>\$ 5,880,096</u>

LIABILITIES AND NET POSITION

Liabilities			
Current Liabilities	\$ 3,029,002	\$ 1,078,256	\$ 3,238,892
Long Term Liabilities	<u>5,950</u>	<u>-</u>	<u>636,689</u>
Total Liabilities	<u>\$ 3,034,952</u>	<u>\$ 1,078,256</u>	<u>\$ 3,875,581</u>
Net Position			
Operating-unrestricted	\$11,545,406	\$13,288,980	\$ 1,927,226
Invested in capital assets, net of related debt	<u>269,286</u>	<u>86,903</u>	<u>77,289</u>
	<u>\$11,814,692</u>	<u>\$13,375,883</u>	<u>\$ 2,004,515</u>

During fiscal 2013, the Collaborative's board of directors voted to distribute approximately \$2,000,000 of the proceeds from the settlement agreement with Merrimack Education Center, Inc. ("MEC") to its member districts. In fiscal 2013, the increase in net position before the distribution to the member districts was approximately \$439,000. As a result of receiving the proceeds from the settlement agreement with MEC, the Collaborative generated a higher cash balance as of June 30, 2013. Current liabilities increased by approximately \$1,951,000, primarily due to settlement proceeds designated for member districts but not distributed as of June 30, 2013.

In fiscal 2012, the increase in net position before the gain from settlement agreement was approximately \$2,879,000 due to a significant decrease in administrative services and an increase in service revenues, combined with keeping personnel costs in line with the additional increases in service revenues. As a result of the significant increase in net position, the Collaborative generated a higher cash balance as of

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2013

June 30, 2012. In addition, current liabilities decreased in fiscal 2012 due to the extinguishment of debt as a result of the settlement agreement with Merrimack Education Center, Inc.

SUMMARY OF ACTIVITIES

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Revenues*	\$21,986,575	\$21,781,523	\$21,328,663
Expenses*	<u>21,547,768</u>	<u>18,920,079</u>	<u>19,275,794</u>
Change in net position, before distributions issued to member municipalities	\$ <u>438,807</u>	\$ <u>2,879,444</u>	\$ <u>2,052,869</u>

* Excludes Massachusetts Teachers' Retirement Board "on-behalf" payments.

Operating Revenues

In 2013 and 2012, operating revenues increased by approximately \$205,000 and \$453,000, respectively, or 1% and 2%, respectively, due primarily to an increase in service fees received.

Operating Expenses

In 2013, operating expenses increased by approximately \$2,628,000 or 14%. The increase was due primarily to an increase in payroll expense and related expenses of approximately \$2,259,000 due to increases in administrative and program staff. Professional and consulting fees increased by approximately \$472,000 in fiscal 2013 due primarily to fees paid in connection with the potential purchase and renovation of new program locations, which were determined to be unfeasible and were abandoned during fiscal 2013.

In 2012, operating expenses decreased by approximately \$356,000 or 2% due primarily to decreases in administrative services and decreases in the use of outside consultants.

CAPITAL ASSETS AND OBLIGATIONS

During 2013, the Collaborative purchased software, network equipment, IT infrastructure, as well as a vehicle at a total cost of \$216,423. The Collaborative also incurred capital costs at 40 Linnell Circle in the amount of \$37,095.

BUDGETARY HIGHLIGHTS

The Collaborative's annual budget for fiscal 2013 was approved by its Board of Directors. For the fiscal year ended June 30, 2013, the Collaborative received operating revenues, excluding on-behalf payments by the Massachusetts Teachers' Retirement Board, of approximately \$21,987,000 compared to budgeted revenues of approximately \$20,285,000. The difference between actual revenues received and budgeted revenues is primarily due to increased enrollment.

For the fiscal year ended June 30, 2013, the Collaborative incurred actual expenditures, excluding on-behalf payments by the Massachusetts Teachers' Retirement Board, of approximately \$21,548,000 compared to budgeted expenditures of approximately \$21,262,000. The difference between actual expenditures incurred and budgeted expenditures is primarily due to higher than expected payroll and related expenses.

CONTACTING THE COLLABORATIVE

This financial report is designed to provide readers of the financial statement an overview of the Collaborative's financial activities. If you have questions in regard to this report, contact Chris A. Scott, Ph.D., 40 Linnell Circle, Billerica, MA 01821, or at 978-528-7800.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF NET POSITION
June 30, 2013

ASSETS

Current Assets	
Cash and cash equivalents	\$ 10,796,101
Accounts receivable, net	3,144,687
Prepaid expenses and other assets	3,198
Cash held for municipalities	627,488
Total Current Assets	<u>14,571,474</u>
Non-current Assets	
Furniture, equipment, vehicles and leasehold improvements, net	278,170
Total Non-current Assets	<u>278,170</u>
Total Assets	<u>\$ 14,849,644</u>

LIABILITIES AND NET POSITION

Current Liabilities	
Current portion of capital lease payable	\$ 2,934
Accounts payable and accrued liabilities	991,115
Advance payments	303,875
Member municipalities accounts	1,731,078
Total Current Liabilities	<u>3,029,002</u>
Capital lease payable, net of current portion	5,950
Total Liabilities	<u>3,034,952</u>
Net Position	
Operating-unrestricted	11,545,406
Invested in capital assets, net of related debt	269,286
Total Net Position	<u>11,814,692</u>
Total Liabilities and Net Position	<u>\$ 14,849,644</u>

See accompanying notes to financial statements and independent auditor's report.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the year ended June 30, 2013

Revenues	
Massachusetts Teachers' Retirement Board	\$ 361,578
Services and other program revenues	20,729,734
State contracts	1,243,931
Other	12,910
Total Revenues	<u>22,348,153</u>
Expenses	
Program	19,627,123
Administrative	2,282,223
Total Expenses	<u>21,909,346</u>
Change in Net Position, before distributions issued to member municipalities	438,807
Distributions issued to member municipalities	<u>(1,999,998)</u>
Change in Net Position	(1,561,191)
Net Position – Beginning of Year	<u>13,375,883</u>
Net Position – End of Year	<u><u>\$11,814,692</u></u>

See accompanying notes to financial statements and independent auditor's report.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2013

Program Expenses	
Payroll	\$ 12,006,287
Fringe benefits and payroll taxes	3,052,728
Professional and consulting fees	50,719
Transportation and travel	731,610
Rent	1,709,011
Maintenance and custodial	454,264
Telephone, communications and utilities	326,505
Materials, supplies and equipment	691,949
Small business expenses	233,606
Field trips	59,795
Training programs	62,769
Other	41,260
	<u>19,420,503</u>
Bad debt expense	145,535
Depreciation	61,085
Total Program Expenses	<u>\$ 19,627,123</u>
Administrative Expenses	
Payroll and related expenses	\$ 817,701
Professional and consulting fees	1,089,194
Rent	17,881
Maintenance and custodial	46,368
Insurance	93,921
Materials, supplies and equipment	96,602
Telephone, communications and utilities	7,090
Training programs	39,427
Office expense and miscellaneous	72,873
	<u>2,281,057</u>
Depreciation	1,166
Total Administrative Expenses	<u>\$ 2,282,223</u>
Total Expenses	<u><u>\$ 21,909,346</u></u>

See accompanying notes to financial statements and independent auditor's report.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF CASH FLOWS
For the year ended June 30, 2013

Operating Activities	
Receipts from members and others	\$ 24,324,407
Payments to suppliers and others	(8,453,073)
Payments to employees	(12,672,289)
Cash provided by operating activities	<u>3,199,045</u>
Investing Activities	
Purchase of equipment	(253,518)
Cash used in investing activities	<u>(253,518)</u>
Financing Activities	
Proceeds from capital lease	11,793
Payments on capital lease	(2,909)
Cash provided by financing activities	<u>8,884</u>
Net increase in cash and cash equivalents	2,954,411
Cash and cash equivalents at beginning of year	7,841,690
Cash and cash equivalents at end of year	<u>\$ 10,796,101</u>
Reconciliation of change in net position to net cash provided by operating activities:	
Operating activities	
Change in net position	\$ (1,561,191)
Adjustments to reconcile change in net position to net cash provided by operating activities:	
Depreciation	62,251
Bad debt expense	145,535
Distributions issued to member municipalities	1,999,998
Change in working capital	
Accounts receivable and other	2,275,881
Accounts payable and other	276,571
Cash provided by operating activities	<u>\$ 3,199,045</u>
Supplemental Data:	
Interest paid	\$ 93
Taxes paid	<u>\$ -</u>

See accompanying notes to financial statements and independent auditor's report.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Collaborative

The Merrimack Special Education Collaborative (The “Collaborative”) is an educational collaborative of the school districts of Billerica, Chelmsford, Dracut, Groton-Dunstable Regional, Nashoba Valley Technical, North Middlesex Regional, Tewksbury, Tyngsborough, and Westford. The Collaborative is a public entity under the jurisdiction of its member school committees, whose appointees comprise its board of directors.

The Collaborative provides high quality academic, therapeutic and vocational services to individuals referred by local school districts and social service agencies.

The Collaborative’s financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments and governmental entities through its pronouncements (Statements and Interpretations). Governments and governmental entities are also required to follow pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 (when applicable) that do not conflict with or contradict GASB pronouncements. The more significant accounting policies established in GAAP and used by the Collaborative are discussed below.

The Collaborative, in accordance with GASB Statement No. 34, is considered a special purpose governmental entity engaged only in business type activities and is not a component unit of another governmental entity. As such, the basic financial statements of the Collaborative are reported on the same basis as an enterprise fund, which is a proprietary fund in fund financial statements. The Collaborative does not have any funds other than the enterprise fund, and it is not a proprietary fund that is part of a government wide financial statement. As such, the notations “enterprise fund” and “proprietary fund” do not appear on the Collaborative’s financial statements.

Cash and Cash Equivalents

The Collaborative considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Collaborative maintains its uncollateralized cash balances in three financial institutions. The balances in two of the financial institutions are insured by the Federal Deposit Insurance Company up to \$250,000. From time to time, the Collaborative maintains bank account balances in excess of the federally insured limits. The Collaborative also maintains cash and cash equivalents at the Massachusetts Municipal Depository Trust which is collateralized by its underlying assets. At June 30, 2013, the Collaborative’s uninsured cash balances totaled \$11,325,008.

Revenues

Revenues consist primarily of billings to member municipalities or other cities and towns for providing programs and services.

Accounts Receivable

Accounts receivable consist of all revenues earned at year end and not yet collected. Major receivable balances include tuitions and certain related charges.

The Collaborative records its bad debts using the allowance method. As of June 30, 2013 there was an allowance for doubtful accounts of \$60,000.

Member Municipalities Accounts

“Member municipalities accounts” represent member funds held by the Collaborative for use as directed by the individual member municipalities for use in the Collaborative’s various programs and services. “Cash held for municipalities” represents amounts to be distributed to the member municipalities. See Note O for more information on funds held on behalf of member municipalities.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE A – (continued)

Property and Equipment

Property and equipment are capitalized at historical cost. Depreciation is computed on the straight-line method using estimated useful lives of two to five years for websites, computer equipment, furniture, fixtures and program equipment and five to ten years for leasehold improvements.

Use of Estimates

Management uses estimates and assumptions in preparing financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, and reported revenues and expenses. Actual results could vary from the estimates used.

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Advertising Costs

Advertising costs are expensed as incurred. For the year ended June 30, 2013, advertising costs charged to expense were \$3,893.

Subsequent Events

Subsequent events have been evaluated through December 2, 2013, which is the date the financial statements were available to be issued.

NOTE B – PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2013 consists of the following:

Office furniture and equipment	\$186,007
Leasehold improvements	39,980
Vehicles	21,793
Software	66,140
Construction in progress	37,095
Accumulated depreciation	(72,845)
Property and equipment, net	<u>\$278,170</u>

Depreciation expense for the year ended June 30, 2013 was \$62,251. During fiscal 2013, the Collaborative disposed of property and equipment with a total cost of \$132,135 and accumulated depreciation of \$72,378.

NOTE C – OPERATING LEASE OBLIGATIONS

The Collaborative leases various classroom and office spaces and office equipment under operating leases that expire at various times through September 2016. Classroom and office lease expense was \$1,726,892 and equipment lease expense was \$53,380 for the year ended June 30, 2013.

The future minimum lease obligations under these lease agreements are as follows:

2014	\$1,464,286
2015	266,160
2016	256,274
2017	81
2018 & Thereafter	-
	<u>\$1,986,801</u>

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE D – CAPITAL LEASE OBLIGATION

During fiscal year 2013, the Collaborative entered into a capital lease agreement for the purchase of a vehicle with a cost of \$21,793. For the year ended June 30, 2013, depreciation expense in the amount of \$4,359 was recorded on the vehicle under capital lease. Interest paid on the lease was \$93 for the year ended June 30, 2013. The balance of the capital lease payable at June 30, 2013 was \$8,884.

The future minimum lease obligations under the capital lease agreement are as follows:

2014	\$2,934
2015	2,961
2016	<u>2,989</u>
	<u>\$8,884</u>

NOTE E – ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following as of June 30, 2013:

Tuition and services to districts	\$3,136,926
State contracts	<u>67,761</u>
	3,204,687
Allowance for doubtful accounts	<u>(60,000)</u>
	<u>\$3,144,687</u>

The Collaborative has established an allowance for doubtful accounts in the amount of \$60,000. The allowance is based on specific identification of probable losses and an estimate of additional losses based on historical experience. Account balances are charged off against the allowance when it is probable the receivable will not be recovered. For the year ended June 30, 2013, bad debt expense in the amount of \$145,535 was recorded for uncollectible accounts.

NOTE F– ADVANCE PAYMENTS

During fiscal 2013, members prepaid \$303,875 of fiscal 2014 tuition, and the Collaborative has recorded this amount as deferred revenue at June 30, 2013.

NOTE G – EMPLOYEES' RETIREMENT PLAN

The Collaborative's employees participate in the Massachusetts Teachers or State Retirement Plan, a statewide multiple-employer public employee retirement system covering all employees of local school districts within the Commonwealth of Massachusetts. These retirement systems are cost sharing public employee retirement systems with one exception: all risks and costs are not shared by the Collaborative but are the liability of the Commonwealth of Massachusetts. These systems are funded primarily through state and employee contributions, and the Collaborative has no legal obligation for paying benefits. Presently, the Collaborative must pay to the Commonwealth 5.6% of all non-teacher salaries as the employer's share of the state retirement system. As discussed below, the Collaborative may be required in certain situations to make limited contributions on behalf of certain employees.

All employees who are employed for one-half or more of the standard workload at a comparable rate of pay are eligible to participate in either the Massachusetts Teachers or State Retirement Plan. Participants have a vested right to retirement benefits at age fifty-five with at least ten years of service, or at any age with at least twenty years of service, if they do not withdraw deposits. The Commonwealth of Massachusetts contributes a percentage of the employee's gross earnings except for those Collaborative employees being paid from and participating in federally funded programs. The employees contribute a percentage of their gross earnings, based on the date of entry into the plan. These funds are withheld by the Collaborative and transmitted to the Commonwealth. The Collaborative contributes 5.6% of the gross salaries to the Massachusetts State Retirement Plan for those employees not covered under the Massachusetts Teachers Retirement plan. The contributions to the Massachusetts State Retirement Plan for the years ended June 30, 2013 were \$323,592.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE G – (continued)

GASB Statement No. 24 requires cities and towns to report pension payments made to retirees by the Massachusetts Teachers' Retirement Board. The Commonwealth of Massachusetts makes a contribution to the Massachusetts Teachers' Retirement Board on behalf of educators employed in the Commonwealth who participate in the Massachusetts Teachers' Retirement System. GASB 24 requires the Collaborative to disclose these "on-behalf" payments contributed to the plan, which amounted to \$361,578 during fiscal year 2013.

NOTE H – COMPENSATED ABSENCES

The Collaborative allows eligible employees to carryover unused vacation time up to 10 days per year and to accrue a maximum of 25 days total. At the end of the fiscal year, any unused vacation time in excess of the above amounts is forfeited. The Collaborative's vacation accrual for the year ended June 30, 2013 was \$74,244.

NOTE I – RISK MANAGEMENT

The Collaborative is exposed to various risks of loss relating to torts, theft or damage of, and destruction of assets; error and omissions; injuries to employees; and natural disasters. The Collaborative has obtained a variety of commercial liability insurance policies that pass the risk of loss listed above to independent third parties. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Collaborative. Settled claims have not exceeded the insurance coverage in any of the past three fiscal years.

The Collaborative offers eligible participants access to various health and life insurance. Payment, in the form of premiums, is generally made monthly. The payments are funded in part from the Collaborative and payroll withholdings from active employee participants or direct payments from certain other eligible participants. In general, the Collaborative pays 79% of the cost of insurance for those participants that qualify.

NOTE J – COMMITMENTS AND CONTINGENCIES

The Collaborative participates in state and federal contracts, which are governed by various rules and regulations of the agencies. Costs charged to the respective programs are subject to audit and adjustment by agencies; therefore, to the extent that the Collaborative has not complied with the rules and regulations governing the refunds of any money received may be required and the collectability of any related receivable at June 30, 2013 may be impaired. In the opinion of the Collaborative, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective contracts; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

In June 2011, the Office of the Inspector General for the Commonwealth of Massachusetts (the "Inspector General") issued findings related to a review of Collaborative documentation. The Office of the Inspector General stated that, in its opinion, the Administrative Service and License Agreements described in Note K, and the settlement agreement described in Note L between the Collaborative and Merrimack Education Center, Inc. ("MEC") violate state laws. The Office of the Inspector General recommended that the Collaborative cease paying MEC for services provided under these agreements and demand repayment from MEC of at least \$11.5 million paid in prior years for the settlement and rents in excess of MEC's costs. In October 2013, the Collaborative settled the agreements with MEC. See Note L for additional information on the settlement.

In October 2011, a Memorandum of Understanding was signed with the Department of Elementary and Secondary Education ("DESE") to assist the Collaborative in improving financial management and governance structures of the Collaborative to ensure the quality and effectiveness of education to its students. The Memorandum of Understanding has been extended through June 30, 2014 at which time the DESE will perform an evaluation of the Collaborative.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE K – ADMINISTRATIVE SERVICES AND LICENSE AGREEMENT WITH MERRIMACK EDUCATION CENTER, INC.

During fiscal 2011, the Collaborative entered into an agreement with MECnet, a subsidiary of MEC, for the purchase of a telephone system and related services. The agreement was payable over three years, but during fiscal 2013, the Collaborative returned the system to MEC and received reimbursement for amounts previously paid.

During fiscal 2012, as a result of recommendations by various state agencies, the Collaborative terminated its Administrative Services and License Agreement with MEC and entered into new agreements with MEC for transitional services, transportation, information technology services and space lease and maintenance. During fiscal 2013, the Collaborative only entered into agreements with MEC for transportation services and space lease and maintenance. The charges incurred under the new agreements for the year ended June 30, 2013 were as follows:

Transportation	\$ 534,600
Space Lease and Maintenance	<u>1,597,756</u>
	<u>\$2,132,356</u>

As of June 30, 2013, amounts payable to MEC for the agreements above were \$68,965.

NOTE L – SETTLEMENT AGREEMENTS WITH MERRIMACK EDUCATION CENTER, INC.

The Collaborative entered into a settlement agreement with MEC in fiscal 2006. The settlement agreement stated that the Collaborative must pay MEC \$5,500,000 for services and facility usage provided to the Collaborative in several prior years. As of June 30, 2011, the Collaborative owed \$250,000 under the agreement. However, this payment was released as part of the settlement agreement entered into subsequent to June 30, 2012, as described in the following paragraph.

In October 2012, the Collaborative entered into another settlement agreement with MEC to settle claims related to past expenses, administrative services and license agreements, a credit facility and transitional services agreements. With the exception of certain invoices and charges, all claims against each other have been released. Under the settlement agreement, the Collaborative received a gross settlement of \$7,254,812 which was offset with amounts owed to MEC for operating expenses totaling \$1,845,752, and outstanding amounts under a credit facility entered into in 2009 of \$1,250,000. The net amount of \$4,159,060 was received via wire transfer in October 2012. All gains from the settlement were recognized in fiscal 2012.

NOTE M – TAX POSITION

The Collaborative has adopted the application of the provisions of FASB ASC 740-10 (formerly FASB Interpretation No. 48, *Accounting For Uncertainty in Income Taxes*). The primary tax positions made by the Collaborative are the existence of Unrelated Business Income Tax and the Collaborative's status as an exempt organization under the Internal Revenue Code. The Collaborative currently evaluates all tax positions, and makes determinations regarding the likelihood of those positions being upheld under review. For the years presented, and as a result of adoption, the Collaborative has not recognized any tax benefits or loss contingencies for uncertain tax positions based on its evaluations. The Collaborative is not currently under examination by any taxing jurisdiction. As a Chapter 40 government entity, the Collaborative is exempt from filing certain non-profit filings and, accordingly, there are no returns currently open for examination.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE N – COMMONWEALTH OF MASSACHUSETTS SURPLUS REVENUE RETENTION (OSD)

The cumulative excess of revenue received from the Commonwealth of Massachusetts is the amount in accordance with the Commonwealth of Massachusetts Not-for-profit Provider Surplus Revenue Retention Policy, pursuant to 808CMR 1.19(3) of the Pricing, Reporting and Auditing for Social Programs, which allows a provider to retain, for future use, a portion of annual net surplus. Net surplus, from the revenues and expenses with services provided to purchasing agencies, which are subject to 808CMR 1.00, may not exceed 5% of said provider's revenue annually. Furthermore, the cumulative amount of the provider's net surplus may not exceed 20% of the provider's prior year's revenues from purchasing agencies. Surplus revenue retention decreased \$295,855 in fiscal 2013. The Collaborative's accumulated surplus as of June 30, 2013 was \$2,145,570.

NOTE O – DISCLOSURES REQUIRED UNDER MASSACHUSETTS GENERAL LAW C.40 § 4E

Highest Compensated Employees

The five highest compensated employees of the Collaborative during fiscal 2013 were as follows:

<u>Name</u>	<u>Title</u>	<u>Total Compensation</u>
Chris A. Scott, PhD	Executive Director	\$173,428
Camelia Rosca, PhD	Systems Director	\$112,200
William Bryant	Principal	\$109,411
Timothy Callahan	Principal	\$ 95,736
Allison M. Brake	Business Manager	\$ 84,203

Costs of Providing Services in the Over 21 Program

Total direct costs incurred by the Collaborative in its over 21 program, funded in part by contracts with agencies of the Commonwealth of Massachusetts, totaled \$1,106,349 for the year ended June 30, 2013.

Administrative Costs

Total administrative costs incurred by the Collaborative totaled \$2,282,223 for the year ended June 30, 2013. Administrative expenses include all costs that cannot be directly or reasonably applied to a program of the Collaborative. Administrative expenses include salaries, related benefits and payroll taxes, associated with the Collaborative's administrative office (i.e., Executive Director, finance staff, human resources, etc.), as well as other costs associated with maintaining that office (i.e. occupancy, supplies, etc.). The Collaborative directly applies salaries, where appropriate, to its programs and allocates related employee benefits and taxes to those programs. Occupancy, supplies, maintenance and any other cost that can be directly applied, or reasonably allocated, are reported under program expense. See Note A for a description of the functional allocation of expenses.

Accounts Held on Behalf of Others

As disclosed in Note A to the financial statements, the Collaborative holds funds on behalf of certain member districts, for use in program activities or services as directed by the member district. During fiscal 2013, the Collaborative approved distribution of \$1,999,998 back to its member districts either as cash or as tuition credits. As of June 30, 2013, \$1,731,078 remains to be distributed or credited. This amount is presented on the Statement of Net Position as a liability, "Member municipalities accounts." The amount of cash that districts requested but was not paid by the Collaborative until after June 30, 2013 is presented on the Statement of Net Position as an asset, "Cash held for municipalities."

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

NOTE O – (continued)

Related Party Transactions

Cash held for municipalities (member districts) is disclosed above. The Collaborative leases classroom and other program space within member districts. For the year ended June 30, 2013, rent expense under these leases was \$386,800.

Real Property Transactions

Transactions or contracts related to the purchase, sale, rental, or lease of real property are described in Notes B, C and D to the financial statements.

Surplus Net Position

As a result of settlements with MEC described in Note L, the Collaborative's unrestricted net position as of June 30, 2013 was approximately 52% of fiscal 2013 revenues, after distributing \$1,999,998 back to member districts. Due to the special circumstances of the settlements, the Collaborative has obtained a temporary waiver from DESE in order to develop a proper plan to allocate the net position in excess of 25% of revenues, as required by state law. Subsequent to June 30, 2013, but prior to issuance of the audit report, the Collaborative purchased a building (formerly leased from MEC) for \$3,260,000 and the Collaborative's board of directors approved an additional \$4,050,000 to renovate the property. Excluding the \$7,310,000 approved to purchase and renovate the property, unrestricted net position at June 30, 2013 represents approximately 19% of fiscal 2013 revenues.



FRITZ DEGUGLIELMO LLC
CERTIFIED PUBLIC ACCOUNTANTS
& BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Merrimack Special Education Collaborative
Billerica, Massachusetts

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Merrimack Special Education Collaborative (a collaborative organized under the Laws of the Commonwealth of Massachusetts), which comprise the statement of net position as of June 30, 2013, and the related statements of revenues, expenses, and changes in net position, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 2, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Merrimack Special Education Collaborative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Merrimack Special Education Collaborative's internal control. Accordingly, we do not express an opinion on the effectiveness of Merrimack Special Education Collaborative'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 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses that we consider to be a material weakness (finding 2013-1).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Merrimack Special Education Collaborative's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain other matters that we reported to management of Merrimack Special Education Collaborative in a separate letter dated December 2, 2013.

Merrimack Special Education Collaborative's Response to Findings

Merrimack Special Education Collaborative's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. Merrimack Special Education Collaborative's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Merrimack Special Education Collaborative's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Merrimack Special Education Collaborative's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Handwritten signature of Fritz DeAngelis in black ink, followed by the letters "LLC".

Certified Public Accountants

Newburyport, Massachusetts

December 2, 2013

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2013

Finding 2013-1:

Condition- Service billings and payment recording were performed using an internally developed system that required significant reconciliation at year end due to the manual processes involved in the system.

Criteria- All transactions must be recorded in the period recognized and reconciled on a regular basis.

Cause- During late fiscal 2012, the Collaborative transitioned to an internal finance system after contracting services with a third party to perform those functions. As a result of the transition, and a lack of a proper module included in the Collaborative financial software, the Collaborative staff had to develop a means of billing for services. The system developed by the Collaborative is an Excel based system that requires significant reconciliation to ensure data is properly recorded.

Potential effect- Material misstatement of revenues from billed services and related accounts receivable in the financial statements.

Recommendation- We understand that the Collaborative is currently working with its general ledger software provider to implement a billing and receivable module into its software. However, due to the complexity of the project, a trial run of the module is not scheduled until the spring of 2014. Until the module is fully implemented, we recommend that finance staff continue to perform procedures implemented by management, whereby finance staff performs periodic reviews and reconciliations of billings and related deposits to the general ledger.

Management's Response:

The Collaborative has initiated efforts with its financial software provider to develop a fully-integrated billing system. Due to the complexity of this project, it is anticipated that the new billing and collections module will be available in July 2014 (fiscal year 2015).

The business office has established monthly procedures to: 1) segregate related tasks and controls; 2) reconcile all receivables activity to the general ledger; and 3) provide updates to management periodically. Efforts are underway to confirm and collect all unpaid amounts from fiscal year 2013 (approximately 0.7% of total invoiced).



Merrimack Special Education Collaborative

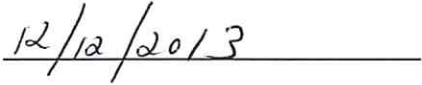
ACCEPTANCE OF THE BOARD OF DIRECTORS

We, the Board of Directors of the Merrimack Special Education Collaborative, have voted to accept the representations of management and the expression of the opinions made by Fritz DeGuglielmo LLC as embodied in the financial statements, supplemental schedules and independent auditor's reports for the year ended June 30, 2013.

We also certify that the representations made by management and the disclosures in the financial statements are accurate and have been correctly and completely disclosed as required by accounting principles generally accepted in the United States of America and under Commonwealth of Massachusetts laws for the year ended June 30, 2013.



Board Chair



Date