MERRIMACK SPECIAL EDUCATION
COLLABORATIVE

FINANCIAL STATEMENTS

June 30, 2012

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FRITZ DEGUGLIELMO LLC
CERTIFIED PUBLIC ACCOUNTANTS
& BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statement of net assets of Merrimack Special Education Collaborative (a collaborative organized under the Laws of the Commonwealth of Massachusetts) as of June 30, 2012, and related statements of revenues, expenses and changes in net assets, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of Merrimack Special Education Collaborative's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2012, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 15, 2012 on our consideration of Merrimack Special Education Collaborative's internal control over financial reporting and 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 on internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 3 be presented to supplement the basic financial statements. Such information, although not 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 for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the 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.

Fritz DeGuglielmo LLC
Certified Public Accountants
November 15, 2012

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MERRIMACK SPECIAL EDUCATION COLLABORATIVE

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2012

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, 2012 with comparative information from the fiscal years ended June 30, 2011 and 2010. Please read it in conjunction with the financial statements that begin on page 4.

This financial report consists of several financial statements:

Statement of Net Assets – The Statement of Net Assets 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 Assets – The Statement of Revenues, Expenses and Changes in Net Assets 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

	2012	2011	2010
Current Assets	$14,307,479	$ 5,743,050	$ 3,847,011
Property & Equipment, net	146,660	137,046	79,472
	$14,454,139	$ 5,880,096	$ 3,926,483
LIABILITIES AND NET ASSETS			
Liabilities			
Current Liabilities	$ 1,078,256	$ 3,238,892	$ 3,185,078
Long Term Liabilities	-	636,689	789,759
Total Liabilities	$ 1,078,256	$ 3,875,581	$ 3,974,837
Net Assets			
Operating-unrestricted	$13,288,980	$ 1,927,226	$ (127,826)
Invested in capital assets, net of related debt	86,903	77,289	79,472
	$13,375,883	$ 2,004,515	$ (48,354)

Subsequent to June 30, 2012, the Collaborative entered into a settlement agreement with Merrimack Education Center, Inc., as a result of which the Collaborative recognized a gain on settlement of $8,491,924 in these financial statements. In fiscal 2012, the increase in net assets 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 service revenues. As a result of the significant increase in net assets, the Collaborative generated a higher cash balance as of 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.

In 2011, the increase in net assets was approximately $2,053,000 due to a significant decrease in administrative services and building rent, 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 assets, the Collaborative generated a higher cash balance as of June 30, 2011.

SUMMARY OF ACTIVITIES

	2012	2011	2010
Revenues*	$21,781,523	$21,328,663	$19,524,038
Expenses*	18,920,079	19,275,794	17,430,114
Change in net assets	$ 2,879,444	$ 2,052,869	$ 2,093,924

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

Operating Revenues
In 2012 and 2011, operating revenues increased by approximately $453,000 and $1,805,000, respectively, or 2% and 9%, respectively, due primarily to an increase in service fees received.

Operating Expenses
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.

In 2011, operating expenses increased by approximately $1,846,000 or 11% due primarily to increases in staffing required for increased enrollment and services.

CAPITAL ASSETS AND OBLIGATIONS
During 2012, the Collaborative purchased a new server and copier, as well as leasehold improvements at a program location at a total cost of $55,328.

BUDGETARY HIGHLIGHTS
The Collaborative's annual budget for fiscal 2012 was approved by its Board of Directors. For the fiscal year ended June 30, 2012, the Collaborative received operating revenues, excluding on-behalf payments by the Massachusetts Teachers' Retirement Board, of approximately $21,782,000 compared to budgeted revenues of approximately $21,695,000. The difference between actual revenues received and budgeted revenues is primarily due to slightly higher fees for service collected than budgeted.

For the fiscal year ended June 30, 2012, the Collaborative incurred actual expenditures, excluding on-behalf payments by the Massachusetts Teachers' Retirement Board, of approximately $18,920,000 compared to budgeted expenditures of approximately $19,635,000. The difference between actual expenditures incurred and budgeted expenditures is primarily due to lower than expected re-negotiated building lease and maintenance costs required to provide services.

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 978-528-7820.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF NET ASSETS
June 30, 2012

ASSETS

Current Assets	
Cash and cash equivalents	$ 7,841,690
Accounts receivable, net	2,077,102
Prepaid expenses and other assets	229,547
Cash held for municipalities	80
Settlement receivable	4,159,060
Total Current Assets	14,307,479
Non-current Assets	
Furniture, equipment and leasehold improvements, net	146,660
Total Non-current Assets	146,660
Total Assets	$14,454,139

LIABILITIES

Current Liabilities	
Accounts payable and accrued liabilities	$ 1,062,601
Advance payments	15,575
Member municipalities accounts	80
Total Current Liabilities	1,078,256
Total Liabilities	1,078,256
Net Assets	
Operating-unrestricted	13,288,980
Invested in capital assets, net of related debt	86,903
Total Net Assets	13,375,883
Total Liabilities and Net Assets	$14,454,139

The accompanying notes to financial statements are an integral part of these statements.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the year ended June 30, 2012

Revenues	
Massachusetts Teachers' Retirement Board	$ 233,016
Services	20,377,517
State contracts	1,280,289
Other	123,717
Total Revenues	22,014,539
Expenses	
Program	17,090,746
Administrative	2,044,349
Total Expenses	19,135,095
Change in Net Assets, before gain from settlement agreement	2,879,444
Gain from settlement agreement	8,491,924
Change in Net Assets	11,371,368
Net Assets – Beginning of Year	2,004,515
Net Assets – End of Year	$13,375,883

The accompanying notes to financial statements are an integral part of these statements.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2012

Program Expenses	
Payroll	$10,339,918
Fringe benefits and payroll taxes	2,572,939
Professional and consulting fees	64,198
Transportation and travel	715,720
Rent	1,546,268
Maintenance and custodial	551,975
Telephone, communications and utilities	374,738
Materials, supplies and equipment	498,730
Small business expenses	203,085
Outdoor education	48,331
Training programs	45,713
Other	40,041
	17,001,656
Bad debt expense	60,000
Depreciation	29,090
Total Program Expenses	$17,090,746
Administrative Expenses	
Payroll and related expenses	$ 687,607
Administrative service expense	385,449
Professional and consulting fees	603,359
Rent	70,823
Maintenance and custodial	56,574
Insurance	63,114
Materials, supplies and equipment	50,839
Telephone, communications and utilities	28,435
Training programs	8,140
Office expense and miscellaneous	73,385
	2,027,725
Depreciation	16,624
Total Administrative Expenses	$ 2,044,349
Total Expenses	$ 19,135,095

The accompanying notes to financial statements are an integral part of these statements.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE
STATEMENT OF CASH FLOWS
For the year ended June 30, 2012

Operating Activities	
Receipts from members and others	$ 21,137,079
Payments to suppliers and others	(6,358,026)
Payments to employees	(10,805,943)
Cash provided by operating activities	3,973,110
Investing Activities	
Purchase of equipment	(55,328)
Cash used in investing activities	(55,328)
Net increase in cash and cash equivalents	3,917,782
Cash and cash equivalents at beginning of year	3,923,908
Cash and cash equivalents at end of year	$ 7,841,690
Reconciliation of change in net assets to net cash provided by operating activities:	
Operating activities	
Change in net assets	$ 11,371,368
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	45,714
Bad debt expense	60,000
Gain from settlement agreement	(8,491,924)
Change in working capital	
Accounts receivable and other	(547,587)
Accounts payable and other*	1,535,539
Cash provided by operating activities	$ 3,973,110
Supplemental Data:	
Interest paid	$ -
Taxes paid	$ -

*Accrued operating expenses of $1,845,752 incurred in fiscal 2012 were used to offset the amounts to be received from the settlement agreement described in Note K.

The accompanying notes to financial statements are an integral part of these statements.

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, Westford, and Whittier Regional Vocational Technical. Effective July 1, 2012, Whittier Regional Vocational Technical was no longer a member of the Collaborative. 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 are insured by the Federal Deposit Insurance Company up to $250,000. From time to time, the Collaborative maintains bank account balances in one of the banks in excess of the federally insured limits. That bank is participating in the FDIC's Transaction Account Guarantee Program which insures in full all balances held in non-interest bearing accounts through December 31, 2012.

Revenues

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

Receivables

The receivables 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, 2012 there was an allowance for doubtful accounts of $60,000.

NOTE A – (continued)

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.

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.

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.

Subsequent Events

Subsequent events have been evaluated through November 15, 2012, which is the date the financial statements were available to be issued.

NOTE B – PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2012 consists of the following:

Office furniture and equipment	$147,153
Leasehold improvements	39,980
Website	42,500
Accumulated depreciation	(82,973)
Property and equipment, net	$146,660

Depreciation expense for the year ended June 30, 2012 was $45,714.

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 $1,617,091 and equipment lease expense was $43,462 for the year ended June 30, 2012.

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

2013	$1,634,492
2014	273,898
2015	10,210
2016	324
2017	81
Thereafter	-
	$1,919,005

NOTE D – ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following as of June 30, 2012:

Tuition and services to districts	$2,004,706
State contracts	132,396
	2,137,102
Allowance for doubtful accounts	(60,000)
	$2,077,102

During fiscal 2012, the Collaborative established an allowance for doubtful accounts in the amount of $60,000 and accordingly recognized $60,000 of bad debt expense for the year ended June 30, 2012. 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.

NOTE E– ADVANCE PAYMENTS

During fiscal 2012, members prepaid $15,575 of fiscal 2013 tuition, and the Collaborative has recorded this amount as deferred revenue at June 30, 2012.

NOTE F – 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 7.8% 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 7.8% 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, 2012 were $339,747.

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 $233,016 during fiscal year 2012.

NOTE G – 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, 2012 was $80,691.

NOTE H – 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 I – 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, 2012 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 February 2010, the Office of the State Auditor for the Commonwealth of Massachusetts (the "State Auditor") notified the Collaborative that it intended to conduct an audit of the Collaborative covering the periods from July 1, 2007 to June 30, 2010. The Collaborative responded to the State Auditor's request for documentation and the State Auditor concluded its audit in August 2011. The agency made various recommendations based on the audits and requested updates in March 2012 on the recommendations. The Collaborative has responded to the audit and status update requests.

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 J, and the settlement agreement described in Note K between the Collaborative and 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. The Collaborative had stopped paying MEC for services, as recommended by the Office of the Inspector General until a final determination was made. See Notes J and K for further information on agreements and the settlement with MEC.

NOTE I – (continued)

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, 2013 at which time the DESE will perform an evaluation of the Collaborative.

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

During fiscal year 2006 the Board of Directors of the Collaborative approved the Administrative Services and License Agreement between the Merrimack Special Education Collaborative (MSEC) and Merrimack Education Center, Inc. (MEC). The agreement was updated, effective on July 1, 2009. Under the agreement, MEC shall furnish to MSEC the services and licenses to use real property owned by MEC at an agreed upon rate indexed on an annual basis. This agreement had an initial term of 10 years commencing on July 1, 2009 and was to automatically renew for successive periods of 10 years unless either party provides notice of termination not less than 6 months and not more than 9 months prior to the end of the term.

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 in the amount of $100,290. The cost of the telephone system was $89,636 and was capitalized. The remainder of the agreement is for support services over three years. The agreement is payable over three years in the amount of $33,430 per year. As of June 30, 2012, the Collaborative still owes two payments on the phone system in the amount of $66,860.

During fiscal 2012, as a result of recommendations by various state agencies, the Collaborative terminated the 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. Amounts outstanding under the old agreement have been adjusted in accordance with the settlement agreement described in Note K. The charges incurred under the new agreements for the year ended June 30, 2012 were as follows:

Administrative Services	$ 385,449
Transportation	601,620
Information Technology	111,222
Space Lease and Maintenance	1,893,493
	$2,991,784

As of June 30, 2012, amounts payable to MEC for the agreements above were $2,056,046. However, some of these payables have been offset with the settlement receivable described in Note K.

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

The Collaborative entered into a settlement agreement with Merrimack Education Center, Inc. (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 is to receive a gross settlement of $7,254,812 which is to be offset with amounts owed to MEC for current operating expenses totaling

NOTE K – (continued)

$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 and appears as "Settlement receivable" in these financial statements.

Prior to fiscal 2012, the Collaborative owed MEC approximately $1,237,112 under the administrative services and license agreements described in Note J and the 2006 settlement agreement described above. Because these amounts were released as part of the settlement, the Collaborative has included them as part of the gain from settlement agreement on the Statement of Revenues, Expenses and Change in Net Assets. Therefore, the total gain from settlement agreement is $8,491,924, as shown in these financial statements.

NOTE L – 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.

NOTE M – COMMONWEALTH OF MASSACHUSETTS SURPLUS REVENUE RETENTION

The cumulative excess (deficiency) 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 $93,382 in fiscal 2012. The Collaborative's accumulated surplus as of June 30, 2012 was $2,441,425.

NOTE N – SUBSEQUENT EVENTS

Subsequent to June 30, 2012, the Collaborative entered into a settlement agreement with Merrimack Education Center as described in Note K. No other significant subsequent events occurred.

NOTE O – HIGHEST COMPENSATED EMPLOYEES

The five highest compensated employees of the Collaborative during fiscal 2012 were as follows:

Name	Title	Total Compensation
Bradley Brooks	Principal	$ 95,657
Robert McArdle	Former Interim Executive Director	$ 95,207
William Bryant	Principal	$ 92,931
Timothy Callahan	Principal	$ 91,238
Donna Goodell	Former Co-Executive Director	$ 73,496

The base salary of the current executive director, Dr. Chris Scott, for fiscal 2013 is $165,000.

NOTE P –COSTS OF PROVIDING SERVICES IN THE OVER 22 PROGRAM

Total direct costs incurred by the Collaborative in its over 22 program, funded in part by contracts with agencies of the Commonwealth of Massachusetts, totaled $851,629 for the year ended June 30, 2012.

FRITZ DEGUGLIELMO LLC
CERTIFIED PUBLIC ACCOUNTANTS
& BUSINESS ADVISORS

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 the
Merrimack Special Education Collaborative
Billerica, Massachusetts

We have audited the financial statements of Merrimack Speciation Education Collaborative (a collaborative organized under the Laws of the Commonwealth of Massachusetts) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 15, 2012. 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.

Internal Control Over Financial Reporting

Management of Merrimack Special Education Collaborative is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Merrimack Special Education Collaborative's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

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. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness (finding 2012-1).

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Merrimack Special Education Collaborative's financial statements are free of 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*.

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Merrimack Special Education Collaborative's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Merrimack Special Education Collaborative's response and, accordingly, we express no opinion on it.

We noted certain matters that we reported to management of Merrimack Special Education Collaborative in a separate letter dated November 15, 2012.

This report is intended solely for the information and use of management, Board of Directors, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Fritz DeSaglielmo LLC
Certified Public Accountants
Newburyport, Massachusetts
November 15, 2012

Finding 2012-1:

Condition- Material transactions were not properly reflected in the Collaborative's general ledger system in fiscal 2012.

Criteria- All transactions must be recorded in the period recognized.

Cause- During late fiscal 2012, the Collaborative transitioned to an internal finance and human resource staff after contracting services with Merrimack Education Center to perform those functions. As a result of the transition, and during a period of time where the new staff and systems had not yet been implemented, certain expenses primarily related to the various agreements with Merrimack Education Center, had not been recorded to the Collaborative's general ledger. In addition to those expenses, certain other expenses incurred in fiscal 2012 but not paid until after June 30, 2012, were not properly accrued to fiscal 2012.

Potential effect- Material understatement of several expense categories in the financial statements and improper reporting to management and the board for decision making purposes.

Recommendation- We recommend that a system be implemented to track appropriate expenses as incurred, including proper recording of vendor invoices into the general ledger system. Periodic review of subsequent activities should be performed to determine if expenses have been accrued properly. The Collaborative has hired appropriate staff but policies related to the financial system are still in progress. The Collaborative should standardize financial procedures and issue written policies to appropriate staff in order to ensure financial statements are properly stated.

Management's Response: Throughout fiscal 2012, the Collaborative continued its efforts to ensure that it can provide all of its own administrative services. As part of the process of transferring from the Merrimack Education Center, Inc. ("MEC") all administrative support and services previously provided by MEC on behalf of the Collaborative, including without limitation, payroll services, financial services, accounting services and human resources services to the internal administrative and financial staff positions at the Collaborative, the Collaborative entered into a Transitional Services Agreement with MEC. The initial term of the Transitional Services Agreement commenced on July 1, 2011 and expired on February 29, 2012. The Collaborative renewed the Transitional Services Agreement on three occasions, extending the renewal term through May 31, 2012. The administrative services for which the Collaborative contracted, and compensated, MEC under the Transitional Services Agreement for this time period specifically included recording journal entries, recording fixed assets, reconciling bank statements, assisting in the preparation for fiscal year end, accounts payable and receivable and data entry, among other things.

The Collaborative and MEC subsequently entered into a First Amendment to the Transitional Services Agreement dated as of June 1, 2012 whereby the parties agreed that MEC would continue to provide certain administrative services through the end of fiscal year 2012. The administrative services for which the Collaborative contracted, and compensated, MEC under the First Amendment to the Transitional Services Agreement for this time period specifically included, among other things, recording transaction and journal entries, reconciling bank statements, assisting with fiscal year 2012 audit preparations, closing accounts payable and receivable, data entry, and providing a copy set of the Collaborative's financial and accounting records. The First Amendment to the Transitional Services Agreement since has expired pursuant to its terms. To the extent that material transactions were not properly reflected in the Collaborative's general ledger system in fiscal year 2012, the Collaborative submits that certain contractual obligations were not performed.

However, during fiscal year 2012, the Board of Director for the Collaborative hired an Executive Director, Director of Finance and Operations, and a Systems Director, who are responsible for, among other things, the immediate oversight of internal administrative reporting responsibilities and systems. The Collaborative has established a purchase order system and accounts payable module to ensure a proper recording of vendor invoices and payments into the Collaborative's general ledger. The Board of Directors, the Executive Director, and Collaborative management remain committed to the review, study, revision and implementation, where necessary, of proper policies and procedures related to the financial management systems at the Collaborative.