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MERRIMACK SPECIAL EDUCATION  
COLLABORATIVE

FINANCIAL STATEMENTS

June 30, 2011



## CONTENTS

	<u>Page</u>
Independent Auditors' Report	1
Management's Discussion and Analysis	2-3
Statement of Net Assets	4
Statement of Revenues, Expenses and Changes in Net Assets	5
Statement of Functional Expenses	6
Statement of Cash Flows	7
Notes to Financial Statements	8-13
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	14-15



**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, 2011, 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. The Department of Elementary and Secondary Education administered funds have been reviewed as an integral part of the total Merrimack Special Education Collaborative audit.

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, 2011, 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 7, 2011 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.

The information included in Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplementary information. The supplementary information is a representation of Merrimack Special Education Collaborative's management and has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion on it.

  
Certified Public Accountants  
November 7, 2011

MERRIMACK SPECIAL EDUCATION COLLABORATIVE  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2011

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 years ended June 30, 2011, 2010 and 2009. 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**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current Assets	\$ 5,743,050	\$ 3,847,011	\$ 1,348,324
Property & Equipment, net	<u>137,046</u>	<u>79,472</u>	<u>-</u>
	<u>\$ 5,880,096</u>	<u>\$ 3,926,483</u>	<u>\$ 1,348,324</u>

**LIABILITIES AND NET ASSETS**

<b>Liabilities</b>			
Current Liabilities	\$ 3,238,892	\$ 3,185,078	\$ 2,497,094
Long Term Liabilities	<u>636,689</u>	<u>789,759</u>	<u>993,508</u>
Total Liabilities	<u>\$ 3,875,581</u>	<u>\$ 3,974,837</u>	<u>\$ 3,490,602</u>
<b>Net Assets</b>			
Operating-unrestricted	\$ 1,927,226	\$ (127,826)	\$(2,142,278)
Invested in capital assets, net of related debt	<u>77,289</u>	<u>79,472</u>	<u>-</u>
	<u>\$ 2,004,515</u>	<u>\$ (48,354)</u>	<u>\$(2,142,278)</u>

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2011

In 2011, the increase in net assets was approximately \$2,053,000 due to a significant decrease in administrative and other related party services and an increase in student enrollments. As a result of the significant increase in net assets, the Organization generated a higher cash balance as of June 30, 2011. In addition, current liabilities increased in fiscal 2011 due to the Collaborative holding payments related to the Administrative Services and License Agreement with Merrimack Education Center, Inc.

In 2010, the increase in net assets was approximately \$2,094,000 due to a significant decrease in administrative and other related party services and an increase in student enrollments. As a result of the significant increase in net assets, the Organization generated a higher cash balance as of June 30, 2010. In addition, current liabilities increased in fiscal 2010 due to the increase in borrowings under a credit facility.

**SUMMARY OF ACTIVITIES**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Revenues*	\$21,328,663	\$19,524,038	\$18,237,168
Expenses*	<u>19,275,794</u>	<u>17,430,114</u>	<u>18,102,908</u>
Change in net assets	<u>\$ 2,052,869</u>	<u>\$ 2,093,924</u>	<u>\$ 134,260</u>

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

Operating Revenues

In 2011 and 2010, operating revenues increased by approximately \$1,805,000 and \$1,287,000, respectively, or 9% and 7%, respectively, due primarily to an increase in enrollments.

Operating Expenses

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

In 2010, operating expenses decreased by approximately \$673,000 or 4% due primarily to a reduction in administrative and other services received from Merrimack Education Center, Inc., net of increases in staffing required for increased enrollment.

**CAPITAL ASSETS AND OBLIGATIONS**

During 2011, the Collaborative purchased a phone system for the Organization at a total cost of \$89,636, payable over a three year period.

During 2010, the Collaborative purchased equipment for programs and invested in redeveloping its website. Total related expenditures for the equipment and website were \$84,669.

**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 Robert McArdle, 40 Linnell Circle, Billerica, MA 01821.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE  
STATEMENT OF NET ASSETS  
June 30, 2011

ASSETS

Current Assets	
Cash and cash equivalents	\$ 3,923,908
Accounts receivable, net	1,647,628
Prepaid expenses and other assets	171,434
Cash held for municipalities	80
Total Current Assets	<u>5,743,050</u>
Non-current Assets	
Furniture, equipment and leasehold improvements, net	137,046
Total Non-current Assets	<u>137,046</u>
Total Assets	<u><u>\$ 5,880,096</u></u>

LIABILITIES

Current Liabilities	
Administrative service fee payable, current portion	\$ 905,153
Phone system payable, current portion	29,879
Accounts payable and accrued liabilities	756,952
Advance payments	46,828
Settlement agreement payable	250,000
Credit facility	1,250,000
Member municipalities accounts	80
Total Current Liabilities	<u>3,238,892</u>
Long Term Liabilities:	
Administrative service fee payable, net of current portion	606,811
Phone system payable, net of current portion	29,878
Total Long Term Liabilities	<u>636,689</u>
Total Liabilities	<u>3,875,581</u>
Net Assets	
Operating-unrestricted	1,927,226
Invested in capital assets, net of related debt	77,289
Total Net Assets	<u>2,004,515</u>
Total Liabilities and Net Assets	<u><u>\$ 5,880,096</u></u>

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, 2011

Revenues	
Massachusetts Teachers' Retirement Board	\$ 246,713
Services	19,994,634
State contracts	1,334,029
Total Revenues	<u>21,575,376</u>
Expenses	
Program	17,591,921
Administrative	1,898,524
Depreciation and Amortization	32,062
Total Expenses	<u>19,522,507</u>
Change in Net Assets	2,052,869
Net Assets – Beginning of Year	<u>(48,354)</u>
Net Assets – End of Year	<u><u>\$ 2,004,515</u></u>

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, 2011

Program Expenses	
Payroll	\$ 9,266,328
Fringe benefits and payroll taxes	2,387,235
Professional and consulting fees	455,260
Transportation and travel	814,712
Rent	2,783,427
Maintenance and custodial	753,377
Telephone and utilities	358,528
Materials, supplies and equipment	388,971
Small business expenses	199,856
Outdoor education	73,005
Training programs	33,024
Other	78,198
	<u>17,591,921</u>
Depreciation and amortization	17,538
Total Program Expenses	<u>\$ 17,609,459</u>
 Administrative Expenses	
Payroll and related expenses	\$ 466,810
Administrative service expense	866,392
Professional and consulting fees	319,319
Materials, supplies and equipment	45,789
Training programs	55,559
Office expense and miscellaneous	144,655
	<u>1,898,524</u>
Depreciation and amortization	14,524
Total Administrative Expenses	<u>\$ 1,913,048</u>
 Total Expenses	<u><u>\$ 19,522,507</u></u>

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, 2011

Operating Activities	
Receipts from members and others	\$ 20,797,379
Payments to suppliers and others	(9,578,140)
Payments to employees	(9,607,674)
Cash provided by operating activities	<u>1,611,565</u>
Investing Activities	
Purchase of equipment	<u>(29,879)</u>
Cash used in investing activities	<u>(29,879)</u>
Net increase in cash and cash equivalents	1,581,686
Cash and cash equivalents at beginning of year	2,342,222
Cash and cash equivalents at end of year	<u><u>\$ 3,923,908</u></u>
Reconciliation of change in net assets to net cash provided by operating activities:	
Operating activities	
Change in net assets	\$ 2,052,869
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	32,062
Change in working capital	
Accounts receivable and other	(336,310)
Accounts payable and other	(137,056)
Cash held for municipalities	21,957
Member municipalities account	(21,957)
Cash provided by operating activities	<u><u>\$ 1,611,565</u></u>
<u>Supplemental Data:</u>	
Interest paid	<u>\$ 38,364</u>
Taxes paid	<u>\$ -</u>

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

# MERRIMACK SPECIAL EDUCATION COLLABORATIVE

## NOTES TO FINANCIAL STATEMENTS

June 30, 2011

### 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, Tyngsboro, Westford, and Whittier Regional Vocational Technical. It 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.

In June 1999, the Governmental Accounting Standards Board (GASB) unanimously approved Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments. 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 received. Major receivable balances include tuitions and certain related charges.

The Collaborative records its bad debts using the allowance method. As of June 30, 2011 there was no allowance for doubtful accounts.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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 7, 2011, which is the date the financial statements were available to be issued.

NOTE B – PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2011 consists of the following:

Office furniture and equipment	\$131,805
Website	42,500
Accumulated depreciation	<u>(37,259)</u>
Property and equipment, net	<u>\$137,046</u>

Depreciation expense for the year ended June 30, 2011 was \$32,062. During fiscal 2011, the Collaborative acquired a telephone system with a cost of \$89,636. The Collaborative paid \$29,879 for the telephone system in the current year and the remaining \$59,757 is payable in equal installments over the following two fiscal years.

NOTE C – OPERATING LEASE OBLIGATIONS

The Collaborative leases various classroom spaces and office equipment under operating leases that expire at various times through September 2014. Classroom lease expense was \$132,200 and equipment lease expense was \$52,315 for the year ended June 30, 2011.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE C – (continued)

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

2012	\$ 49,922
2013	15,420
2014	9,316
2015	158
Thereafter	<u>-</u>
	<u>\$ 74,816</u>

NOTE D – CREDIT FACILITY

The Collaborative established a credit facility with Merrimack Education Center, Inc., a related party. As of June 30, 2011, the Collaborative had borrowed the full amount of the facility, \$1,250,000. Interest is payable monthly at 3.25% and principal is due on demand. Interest expense for the year ended June 30, 2011 was \$41,909.

NOTE E – ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following as of June 30, 2011:

Tuition and services	\$1,647,628
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Based on past experience and the relationship with municipalities, management has deemed that the receivables will be collectible. Accordingly, no allowance for doubtful accounts has been established for fiscal 2011.

NOTE F– ADVANCE PAYMENTS

During fiscal 2011, members prepaid \$46,828 of fiscal 2012 tuition, and the Collaborative has recorded these amounts as deferred revenue at June 30, 2011.

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 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. Employees who are employed at

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE G – (continued)

less than half time are enrolled in an OBRA (Omnibus Budget Reconciliation Act) Plan. 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 or OBRA plan. The contributions to the Massachusetts State Retirement Plan for the years ended June 30, 2011 were \$293,155.

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 \$246,713 during fiscal year 2011.

The Collaborative also maintains a tax-deferred retirement plan qualified under section 403(b) of the Internal Revenue Code. The plan allows full-time employees of the Collaborative to defer a percentage of their earnings from current taxation for retirement purposes. The Collaborative provides a match of up to 3% of wages for participants in the plan. During fiscal 2011, the Collaborative provided matching funds to employee 403(b) plans of \$110,448.

NOTE H – COMPENSATED ABSENCES

The Collaborative allows eligible employees to accrue vacation time up to 100% of their stated contract amount. At the end of the fiscal year, any unused vacation time in excess of the contract amount is forfeited. The Collaborative's vacation accrual for the year ended June 30, 2011 was \$100,516.

NOTE I – SETTLEMENT AGREEMENT

The Merrimack Special Education Collaborative (MSEC) entered into a settlement agreement with Merrimack Education Center, Inc. (MEC) in fiscal 2006. The settlement agreement states that MSEC must pay MEC \$5,500,000 for services and facility usage provided to MSEC in several prior years. MSEC paid MEC \$4,000,000 on June 30, 2006 and is required to pay \$250,000 each year thereafter until fully paid per the agreement. The Collaborative paid \$250,000 for the year ended June 30, 2011. There is one remaining settlement agreement payment of \$250,000 due in fiscal 2012. See Note M for additional information on the settlement agreement.

NOTE J – 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.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE K – 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. In addition, provisions in the agreement require direct expenses and allocated expenses be paid within 15 days after the end of the settlement period. This agreement shall have an initial term of 10 years commencing on July 1, 2009 and shall 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. The charges incurred for the year ended June 30, 2011 were \$866,392 for administrative services, \$678,007 for transportation services and \$3,316,671 for use of space and facilities, repairs and maintenance. Amounts incurred for building improvements specifically for Collaborative use have been financed by MEC and are payable over time. Amounts due to MEC at June 30, 2011 are payable as follows:

For the year ending	
June 30,	
2012	\$ 905,153
2013	219,591
2014	179,020
2015	175,109
2016	33,091
Thereafter	-
Total	<u>\$1,511,964</u>

See Note M for additional information on the Administrative Services and License Agreement.

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.

NOTE L – 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 \$13,384 in fiscal 2011.

Prior to fiscal 2010, the Collaborative filed combined Uniform Financial Reports with Merrimack Education Center, Inc. The Collaborative's specific share of surpluses prior to fiscal 2010 could not be determined. The Collaborative's accumulated surplus as of June 30, 2011 of \$2,534,807 includes prior year surpluses based on the combined reports.

MERRIMACK SPECIAL EDUCATION COLLABORATIVE

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE M – 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, 2011 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. The Collaborative has responded to the audit.

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 I 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 has stopped paying MEC for services, as recommended by the Office of the Inspector General until a final determination can be made. However, the financial statements do include expenses and related liabilities as if the agreements were still in effect for all of fiscal 2011. Adjustments, if necessary, will be made to the liabilities when a final determination is made relating to the identified issues.

In October 2011, a Memorandum of Understanding has been signed with the Department of Elementary and Secondary Education 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.

NOTE N – 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 O – SUBSEQUENT EVENTS

Subsequent to June 30, 2011, various agencies requested documentation from the Collaborative. To date, the Collaborative has complied with these requests. Agencies requesting documentation include the United States Attorney for the District of Massachusetts and the following Commonwealth of Massachusetts Offices: Attorney General, State Ethics Commission, Teachers’ Retirement Board and State Board of Retirement. None of these requests currently relate to any known pending contingencies.



**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

Board of Directors  
Merrimack Special Education Collaborative  
Billerica, Massachusetts

We have audited the financial statements of Merrimack Special Education Collaborative (a collaborative organized under the Laws of the Commonwealth of Massachusetts) as of and for the year ended June 30, 2011, and have issued our report thereon dated November 7, 2011. 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

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.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

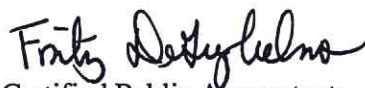
Compliance and Other Matters

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 an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described below:

During fiscal 2011, the Collaborative entered into an agreement with a subsidiary of Merrimack Education Center, Inc., MECnet, to purchase, install and service a telephone system. Documentation for the transaction was not available to indicate if a proper procurement process, including obtaining required bids had occurred prior to signing the agreement. Failure to follow proper procedures on the purchase of the telephone system would result in a violation of state procurement laws. The total cost of the agreement is \$100,290 and is payable over three years. During fiscal 2011, the total cost of service and depreciation recorded as an expense was \$8,058.

We noted certain matters that we reported to management of the Collaborative in a separate letter dated November 7, 2011.

This report is intended solely for the information and use of management, Board of Directors, others within the entity, and 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.



Certified Public Accountants  
Newburyport, Massachusetts  
November 7, 2011