Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump
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Official Audit Report-Issued July 31, 2012

Central Massachusetts Special Education Collaborative

For the period July 1, 2009 through June 30, 2011

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The Central Massachusetts Special Education Collaborative (CMSEC) was established in 1975 as an association of two local school districts: Worcester and Webster. CMSEC is a governmental entity organized pursuant to Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth's Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as education collaboratives. During the period covered by our audit, CMSEC employed approximately 150 individuals, including part-time employees, and provided educational and clinical services through five different school programs to approximately 500 students.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor has conducted an audit of certain activities of CMSEC for the period July 1, 2009 through June 30, 2011. The scope of our audit included a review and examination of certain aspects of CMSEC operations during the audit period. Our audit objectives were to (1) determine whether CMSEC implemented effective internal controls over certain aspects of its operations, including cash management, administrative expenditures, payroll and benefits, procurement of goods and services, budgeting, and educator evaluations and licensure, and (2) conduct transaction testing in selected areas to assess CMSEC's business practices and its compliance with applicable laws, rules, and regulations.

Our audit identified that CMSEC failed to properly administer its retirement benefit programs, which caused a number of its employees to lose the opportunity to earn additional retirement income. Further, CMSEC did not utilize appropriate pricing methodologies for its program services, which resulted in its accumulating a questionable surplus totaling over $4.5 million. Finally, CMSEC had not established adequate internal controls over many aspects of its operations, which resulted in thousands of dollars in inadequately documented expenses.

In 1982, the Massachusetts Commissioner of Insurance administratively determined that all eligible non-teaching employees of educational collaboratives should contribute to the Massachusetts State Employees' Retirement System (MSERS) rather than the Social Security system. During 1985, the state Legislature enacted Chapter 631 of the Acts of 1985, amending Chapter 40, Section 4E, of the Massachusetts General Laws, formally establishing education collaboratives as public entities and therefore legally qualifying all non-teaching staff of education collaboratives as eligible to participate in the MSERS. In Massachusetts, most public employees, including those who work for education collaboratives, are prohibited from participating in the Social Security system if they are otherwise covered by a public contributory retirement system such as the MSERS. Consequently, by no later than the enactment of Chapter 631 of the Acts of 1985, all of CMSEC's non-teaching staff should have been enrolled in the MSERS and should not have continued to contribute to the Social Security system. However, we noted that since 1985 and through our audit period, CMSEC continued to require its non-educational staff (which averaged 80 individuals during our audit period) to contribute into the Social Security system and not the MSERS. There are several financial consequences of CMSEC's failure to properly administer its employees' retirement benefit programs, the most significant of which is that eligible members of CMSEC's staff may have lost the opportunity to receive additional retirement income had they been enrolled in the MSERS.

As a local governmental entity, CMSEC should establish systems that allow it to accurately account for revenues and expenses and to develop detailed budget estimates so that it can establish accurate prices or fees for its program services. Accurate budget estimates and accounting of revenue and expenses are also essential for board oversight purposes. The Massachusetts Department of Revenue's Division of Local Services (DLS) and the state's Office of the Attorney General (OAG) have issued guidance relative to the amount of fees governmental agencies such as CMSEC can charge for their services. This guidance effectively states that the amount of fees a governmental agency should charge for services should not exceed its actual cost of providing the services. We found, however, that CMSEC's pricing system has allowed it to charge excessive fees to its school districts, resulting in CMSEC's accumulating $4,562,211 in total fund balances (profits) as of the end of fiscal year 2011, which is inconsistent with DLS and OAG guidance.

We found that CMSEC had not developed and implemented an adequate system of internal controls over various aspects of its operations. For example, CMSEC did not have policies and procedures relative to the procurement of goods and services, was not effectively monitoring payments made to staff for sick time, did not require staff to submit adequate documentation to substantiate the business purposes of expenses, and was not performing reconciliations of its accounting records to detect potential irregularities. As a result, we found over $24,000 in procurements that were not conducted in accordance with state law, $1,630 in improper payments to staff members for sick time that they did not earn, over $21,000 in inadequately documented expenses, and significant variances in CMSEC's accounting records (totaling over $87,000 in one month) resulting from transactions that were not recorded in CMSEC's financial records in the month in which they occurred.

INTRODUCTION

Background

The Central Massachusetts Special Education Collaborative (CMSEC) was established in 1975 as an association of two local school districts: Worcester and Webster. CMSEC is a governmental entity organized pursuant to Chapter 40, Section 4E, of the Massachusetts General Laws, which allows school districts, with the approval of the Commonwealth's Department of Elementary and Secondary Education (DESE), to enter into intergovernmental agreements establishing cooperative public entities referred to as education collaboratives by stating, in part:

> *Two or more school committees of cities, towns and regional school districts and boards of trustees of charter schools may enter into a written agreement to conduct education programs and services which shall complement and strengthen the school programs of member school committees and increase educational opportunities for children.*

CMSEC operates under the control of a Board of Directors composed of either the Superintendent or the Superintendent's designee[1] from its member districts. CMSEC's Collaborative Agreement states that its mission is to "provide special education and related services to the pupils of member school committees when it is determined that such services and programs can most effectively and economically be provided on a collaborative basis." CMSEC also offers services to non-member school districts.

During the period covered by our audit, CMSEC employed approximately 150 individuals, including part-time employees, and provided educational and clinical services through five different school programs to approximately 500 students. A detailed description of the services offered to children by CMSEC during the audit period appears in the Appendix to this report.

CMSEC's revenue primarily comes from tuition payments charged to both member and non-member school districts based upon a per-student, per-program basis. A summary of the funding CMSEC received during the period covered by our audit appears in the following table:

[1] The designated board members during our audit period were the Directors of Special Education from Webster and Worcester.

Revenue	Fiscal Year 2010 Amount	Fiscal Year 2011 Amount
Tuition - Member	$ 9,270,513	$ 9,735,707
Tuition - Non-Member	1,115,700	1,279,269
Clinical and Consulting	82,516	127,143
Fundraising	22,022	15,110
Interest Income	12,245	12,670
Miscellaneous	15,571	11,186
Total	$10,518,567	$11,181,085

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor conducted an audit of certain activities of CMSEC for the period July 1, 2009 through June 30, 2011. The scope of our audit included a review and examination of certain aspects of CMSEC's operations during the audit period. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit objectives consisted of the following:

- Determine whether CMSEC implemented effective internal controls over certain aspects of its operations, including: cash management, administrative expenditures, payroll and benefits, procurement of goods and services, budgeting, and educator evaluations and licensure.

- Conduct transaction testing in selected areas to assess CMSEC's business practices and its compliance with applicable laws, rules, and regulations.

The specific areas reviewed included the following:

- Tuition payments made by member school districts

- Budgeting and program pricing

- Procurements for goods and services and employee reimbursements

- Payroll and personnel expenses, including benefits
- Compliance with DESE requirements regarding teacher licensures and employee evaluations
- Banking and account reconciliations

In order to achieve our objectives, we first assessed the internal controls established and implemented by CMSEC over those aspects of its operations that were being audited. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through CMSEC's accounting system. We used this assessment in planning and performing our audit tests. We held discussions with CMSEC officials and with the Executive Director of the State Board of Retirement. We reviewed CMSEC's organizational charts, policies, and procedures when available and all applicable laws, rules, and regulations. We also examined CMSEC's internal financial statements, invoices, and other pertinent financial records to determine whether expenses incurred were reasonable; allowable; properly authorized and recorded; and in compliance with applicable laws, rules, and regulations. A description of the nature and extent of our audit testing in each area is described in detail in each of the audit results contained in this report.

Our audit was not made for the purposes of forming an overall opinion on CMSEC's financial statements. We also did not assess the quality and appropriateness of all program services provided by CMSEC. Rather, our report was intended to report findings and conclusions on the extent of CMSEC's compliance with applicable laws, rules, and regulations, and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. IMPROPER ADMINISTRATION OF CMSEC'S RETIREMENT BENEFIT PROGRAMS HAS RESULTED IN THE LOST OPPORTUNITY FOR SOME EMPLOYEES TO EARN ADDITIONAL RETIREMENT INCOME

In 1982, the Massachusetts Commissioner of Insurance administratively determined that all eligible non-teaching employees of education collaboratives should contribute to the Massachusetts State Employees' Retirement System (MSERS), as opposed to the Social Security system. During 1985, the state Legislature enacted Chapter 631 of the Acts of 1985, amending Chapter 40, Section 4E, of the Massachusetts General Laws, formally establishing education collaboratives as public entities and therefore legally qualifying all non-teaching staff of education collaboratives as eligible to participate in the MSERS. In Massachusetts, most public employees, including those who work for education collaboratives, are prohibited from participating in the Social Security system if they are otherwise covered by a public contributory retirement system such as the MSERS. Consequently, by no later than the enactment of Chapter 631 of the Acts of 1985, all of the Central Massachusetts Special Education Collaborative's (CMSEC's) non-teaching staff should have been enrolled in the MSERS and should not have continued to contribute to the Social Security system. However, we noted that since 1985 and through our audit period, CMSEC continued to require its non-educational staff (which averaged 80 individuals during our audit period) to contribute into the Social Security system and not the MSERS. There are several financial consequences of CMSEC's failure to properly administer its employees' retirement benefit programs, the most significant of which is that eligible members of CMSEC's staff may have lost the opportunity to receive additional retirement income had they been enrolled in the MSERS.

In 1935, the federal government enacted the Social Security Act, limiting Social Security insurance coverage to private sector employees while imposing an employment tax on workers and their employers. States, including their political subdivisions and employees, were not included in this legislation because there was a constitutional concern about taxing the states for the employer portion of the Social Security tax.

Some states that did not have retirement systems, however, expressed a desire to cover certain employees, and in the Social Security Amendments of 1950, Congress enacted Section 218 of the Social Security Act (42 United States Code 418). This law, effective January 1, 1951, allows states to enter into voluntary agreements with the Social Security Administration (SSA) to provide Social Security coverage for their state and local governments. Upon execution of a federal-state agreement, a state can then enter into voluntary agreements with its political subdivisions to provide desired coverage.

Massachusetts is one of several states whose public employees are not covered by Social Security.[2] Massachusetts' Section 218 agreement excludes public employees from Social Security coverage if they are otherwise covered by a public contributory retirement system. If a public entity does not participate in a public retirement system, and seeks coverage for its employees under Social Security, it must obtain an amendment known as a "modification" to the underlying Section 218 agreement. According to the Executive Director of the State Board of Retirement, the Commonwealth has entered into several modifications to its Section 218 agreement with the SSA that has allowed certain public entities to participate in the Social Security system; however, there are no modifications to the Section 218 agreement for education collaboratives.

Chapter 631 of the Acts of 1985, amending Chapter 40, Section 4E, of the Massachusetts General Laws, formally established education collaboratives as public entities. Chapter 40, Section 4E, states, in part:

> *The education collaborative shall be deemed to be a public entity and shall have standing to sue and to be sued to the same extent as a city, town or regional school district.*

As public employees, upon the enactment of Chapter 631 of the Acts of 1985, eligible CMSEC employees should have been enrolled in the MSERS rather than continue to contribute to the Social Security system. However, we noted that during calendar years 2009 and 2010, although all of CMSEC's educational staff (averaging 114 individuals) were enrolled in the Massachusetts Teachers' Retirement System, all of CMSEC's non-educational staff (approximately 80 individuals) contributed to the Social Security system rather than the MSERS. Based on this information, we reviewed CMSEC's payroll records for calendar years 1985 through 2010 and determined that 368[3] non-educational staff employees of CMSEC contributed to the Social Security system instead of the MSERS since 1985.

[2]Nationally, most state employees participate in the Social Security system; the major exceptions are state employees of Alaska, Colorado, Louisiana, Maine, Massachusetts, Nevada, and Ohio.

[3] Calculation does not include calendar year payroll information for 1989.

During our audit, we attempted to determine the effects that CMSEC's failure to properly administer its staff retirement benefits may have had on the Commonwealth, CMSEC, and the individuals involved. In terms of CMSEC's costs, according to the Executive Director of the State Board of Retirement, the MSERS charges an administrative fee to each collaborative participating in the state retirement system based on a percentage of the total employee wages paid by the entity during the calendar year. According to officials at the State Board of Retirement and the Public Employee Retirement Administration Commission, this administrative fee has fluctuated over the years from a high of 15.18% in fiscal year 1985 to the current rate of 7.8%, and has averaged approximately 8.32% during the period between fiscal years 1985 and 2010. In contrast, CMSEC paid the SSA an amount equal to 7.65% of each employee's gross wages up to a maximum of $106,800. Consequently, the amount CMSEC paid to participate in the Social Security system for the employees in question was on average slightly less (.67%) than what it would have had to pay the Commonwealth for these employees to participate in the state retirement system.

In terms of employee contributions, from calendar years 1985 through 2010, employees participating in the Social Security system were required to pay 7.65%[4] of their gross pay as a Social Security tax. In contrast, employees who were members of the state retirement system were required to contribute to the system at various rates that, in many cases, were slightly higher than what they would have been required to pay in Social Security taxes. Specifically, Massachusetts public employees hired from January 1, 1984 to June 30, 1996 contribute at a rate equal to 8% of their gross pay, whereas employees hired from July 1, 1997 to the present contribute at a rate of 9% of their gross pay. Also, employees hired on or after January 1, 1979 are required to contribute an additional 2% on the amount of their gross pay that exceeds $30,000. Consequently, if the CMSEC employees in question were properly enrolled in the MSERS rather than the Social Security system, they would have contributed an additional .35% to 1.35%, plus an additional 2% on gross income over $30,000, of annual gross wages.

[4] CMSEC employees are currently paying 6.2% of their gross pay in Social Security tax. During 1985 through 1987, the rate was 5.70%, and from 1988 through 1989 the rate was 6.06%. Additionally, employees hired after March 31, 1986 pay an additional 1.45% for the Medicare portion of the Social Security tax. Prior to 1986, the Medicare portion was 1.35%.

CMSEC's failure to properly administer retirement benefits for its staff may have decreased these employees' potential retirement income. For public employees, the amount of retirement benefits an individual receives depends on his or her age on the date of retirement, the number of years of creditable public service, and the average of the highest three consecutive years of regular compensation in a public position. For example, the annual pension of an individual with 20 years of creditable public service, retiring at age 60 with an average highest three years of regular compensation of $50,000 per year would be calculated by multiplying the age factor (which at age 60 is 2.0) times the individual's number of years of creditable service (20) to get the pension percentage, or 40%. This pension percentage is then multiplied by the individual's calculated average highest three years of regular compensation of $50,000 to get a $20,000 annual pension. In order to obtain vested benefits in the state retirement system, an employee must have at least 10 years of creditable service.

In contrast, an individual's Social Security retirement benefits are based on an individual's age at retirement and his or her highest 35 years of earnings, which are adjusted or "indexed" to account for wage inflation. An employee must be at least 62 to start collecting Social Security retirement benefits; however, to receive maximum benefits, an individual must be at least 66 or 67 years of age, depending on the employee's date of birth. Additionally, in order to be eligible to receive retirement benefits, an individual must earn a minimum of what the SSA refers to as 40 credits. A credit is earned when you earn a minimum dollar amount; in 2010 the minimum amount needed to earn a credit was $1,120. Up to four credits can be earned per calendar year, so someone who earns at least $4,480 in any calendar year will earn the full four credits for that calendar year. During calendar year 2010, the maximum Social Security retirement income benefit that an individual could receive was $2,346 per month, or $28,152 annually.

In terms of retirement benefits, we found that CMSEC's failure to properly administer retirement benefits for certain staff members may have caused these staff members to potentially forgo significant additional retirement income over their lifetimes. Of the 368 different employees of CMSEC who incorrectly contributed to the Social Security system, 22 individuals had worked 10 or more years for CMSEC which, as noted above, is the number of years of employment an individual must work for a public agency to earn vested retirement benefits in the state retirement system.

In order to illustrate the differences in retirement income an individual would receive under both retirement systems under similar circumstances, we compared the projected state retirement and Social Security retirement income benefits for four employees who worked for CMSEC for at least 18 years. We calculated their Social Security benefits based on the age in which they would receive their maximum Social Security retirement benefits (either age 66 or 67). For each employee, we obtained actual annual wage information from the date the employee was hired at CMSEC through calendar year 2010.[5] We then projected each employee's annual wages at the age of retirement by increasing 2010 salaries annually by 2.58%, the average increase in the inflation rate based on the Consumer Price Index for the previous 10-year period.[6] Based on our analysis, we determined that the four employees in our example would have been eligible to receive more in retirement benefits under the state retirement system than they would have under the Social Security system, as illustrated in the following table:

Employee Title	Years Employed at CMSEC as of December 31, 2010	Potential Retirement Date	Annual Estimated State Retirement Benefits[7]	Annual Estimated Social Security Benefits	Annual Difference
Business Manager	21	5/3/2011	$56,738	$17,796	$38,942
Administrative Assistant	23	11/1/2021	$56,702	$19,680	$37,022
Instructional Assistant	23	12/11/2024	$21,480	$12,204	$9,276
Teacher's Aide	18	10/23/2036	$40,825	$17,244	$23,581

As can be seen from the information in the table, because CMSEC has not properly administered its employee retirement benefits, it may have denied certain employees the opportunity to receive additional retirement income over their lifetimes.

[5] This wage information did not include calendar year 1989 wage information due to unavailability. Consequently, we estimated each individual's 1989 wages by averaging their 1988 and 1990 wages.

[6] January 1, 2001 to December 31, 2010: total cumulative inflation rate for the period was 25.77% based on the Consumer Price Index. The average annual inflation rate for the 10-year period was approximately 2.58%.

[7] State retirement income benefits were calculated assuming that each employee elected to receive the maximum available retirement benefit under Option A of the state retirement system.

We brought this matter to the attention of the Executive Director of CMSEC, who stated that she was unaware that non-educational staff members were required to be enrolled in the MSERS.

Recommendation

CMSEC should work with the affected staff members, the SSA, and the State Board of Retirement to resolve this issue. In the future, CMSEC should ensure that all of its employees are enrolled in the state retirement system and not the Social Security system.

Auditee's Response

In response to this issue, CMSEC officials provided the following comments:

> *When CMSEC was first established in 1975, prior to both the 1982 decision of the Massachusetts Commissioner of Insurance and the amendment of Chapter 40, Section 4E of the Massachusetts General Laws, CMSEC's employees properly participated in the social security system. There is nothing to suggest that CMSEC was ever advised by legal counsel, DESE, or any other party that, by virtue of the enactment of Chapter 40, Section 4E, CMSEC was required to alter its employees' participation in the social security system. CMSEC notes the language of M.G.L. c. 32, §28(4) which has been interpreted to require collaboratives to vote to accept the provisions of Chapter 32, § § 1-28 (see, Middlesex Retirement Board v PERAC and State).*
>
> *CMSEC has taken immediate action to address this issue for current and past employees with the MA State Employee Retirement System (MSERS). Affected employees (past and present) will be enrolled in MSERS by April 1, 2012. CMSEC is in the process of retrieving both employee and employer social security contributions for the period from January 2008 to the present and is facilitating the payment of those contributions to MSERS on behalf of those affected employees. In addition, CMSEC is in discussions with the Social Security Administration, the Internal Revenue Service, our external accountant and legal counsel to insure that all appropriate steps are taken as quickly as possible to include the maximum retroactive period of enrollment allowable for CMSEC employees by these government agencies.*

2. INAPPROPRIATE PRICING METHODOLOGIES FOR CMSEC'S PROGRAM SERVICES HAS RESULTED IN ASSESSMENTS TO MEMBER SCHOOL DISTRICTS THAT DO NOT RELATE TO BUDGETED COSTS AND A SURPLUS OF OVER $4.5 MILLION

As a local governmental entity, CMSEC should establish systems that allow it to accurately account for revenues and expenses and to develop detailed budget estimates so that it can establish accurate prices or fees for its program services. Accurate budget estimates and accounting of revenue and expenses are also essential for board oversight purposes. The Massachusetts Department of Revenue's Division of Local Services (DLS) and the state's Office of the Attorney General (OAG) have issued guidance relative to the amount of fees governmental agencies such as CMSEC can charge for their services. This guidance effectively states that the amount of fees a governmental agency should charge for services should not exceed its actual cost of providing the services. We found, however, that CMSEC's pricing system has allowed it to charge fees to its school districts in a manner that is inconsistent with DLS and OAG guidance, resulting in CMSEC's accumulating $4,562,211 in total fund balances (profits) as of the end of fiscal year 2011.

Municipal government agencies in Massachusetts have been advised by DLS and the OAG that service fees may be used to offset the costs of providing services but may not be used to produce a surplus or profit in excess of the costs of the program. For example, on December 24, 2003, the then Massachusetts Attorney General responded to an inquiry from the Town Clerk of Bridgewater regarding the implementation of a fee by the town by stating, in part:

> *In approving the fees established in Article XXXXIII, we remind the town that fees cannot exceed the limits imposed on local government by the Constitution and the statutes of the Commonwealth. Valid fees are distinguishable from invalid taxes by three criteria: (i) the fee is assessed for a particular government service benefiting the party paying the fee in a manner not shared by other persons; (ii) the person assessed has the option to decline the service and thus avoid the charge; and (iii) the amounts paid compensate the town for its costs and expenses of providing the services rather than raising revenues. Emerson College v. Boston, 391 Mass. 415, 427-28 (1984). Moreover, a lawful fee is one that covers only the permit granting authority's reasonably anticipated costs of providing the services for which the fee is assessed. Southview Cooperative Housing Corp. v. Rent Control Board of Cambridge, 396 Mass. 395, 402 (1985).*

The Commonwealth's Executive Office for Administration and Finance (EOAF) promulgated similar guidance for use by state agencies. Specifically, EOAF Bulletin No. 6 states, in part:

> *Fees may not be used purely as a tool to raise revenue, but should reflect the government's expense in providing the service associated with the fee. Expenses may be defined as the reasonable costs imposed on an agency for providing a service or regulating an activity, including administrative and enforcement costs.*

In order to ensure that their established prices or fees are consistent with the aforementioned guidance, government entities such as CMSEC must ensure that they utilize effective budgeting and cost accounting practices to establish their fees.

CMSEC's Collaborative Agreement describes how payment for its services will be determined, as follows:

> *The direct and indirect costs of each program, as determined by the Board, shall be paid by member school committees on the basis of the number of pupils enrolled in each program from the respective school committees.*

However, we found that although CMSEC prepares a budget that estimates its revenues and program costs for the upcoming fiscal year, it does not use this budgetary information to establish its program pricing. During our audit, we asked CMSEC officials what methodology CMSEC actually uses to establish the prices it charges for its services. In response, these officials stated that the prices for CMSEC's program services are not based on budgeted revenues and expenses, but on what tuitions other collaboratives and private schools in the area are charging for similar services. Even though CMSEC did not raise its program rates during our audit period, it reported excess revenues totaling $932,282 for fiscal year 2010 and $843,816 for fiscal year 2011. As of June 30, 2011, CMSEC had accumulated a total of $4,562,211 in total fund balances. Further, despite CMSEC's accrual of these substantial excess revenues, CMSEC's Executive Director stated that she considered raising CMSEC's tuition for fiscal year 2012 because it has not been raised for several years.

Recommendation

CMSEC should immediately take measures to ensure that it establishes a pricing methodology for its program services that is consistent with DLS and OAG guidelines. Further, CMSEC, in consultation with DLS, the OAG, and the Department of Elementary and Secondary Education, should establish an appropriate methodology to remit its surplus funds to its member districts and those non-member districts that use its services.

Auditee's Response

In response to this issue, CMSEC officials provided the following comments:

> *The CMSEC has taken steps to implement a pricing methodology for FY13 that is based on actual anticipated expenses by program. The prior method of budgeting was based on anticipated salaries by program, building rentals by site, and a prorated amount by student for all other expenses. The member districts were only charged for an amount equal to the anticipated expenses, less an estimated amount for non-member tuitions. The additional revenues received by CMSEC are the result of a higher than anticipated enrollment from non-member districts.*
>
> *CMSEC's Articles of Agreement supports the existence of a reserve fund to respond to contingencies that may arise. Prudent management demands and the recent passage of Chapter 43 of the Acts of 2012: An Act Relative to Improving Accountability and Oversight of Education Collaborative, addresses as well, the establishment and existence*

of such reserves. The reserve's purpose is to provide stability and to protect the integrity of our educational programs, as a stabilization fund does for municipalities.

CMSEC is conducting several studies to assist in long term planning and program improvement. We are in the process of an actuarial study to determine the amount of post employment benefits that must be retained by the organization to comply with GASB 45; we are assessing our long term needs in technology, data management, building and space requirements, capital equipment and educational programming and supports. The recommendations from these studies may indicate needs that will be allocated from the reserves.

The Auditor states that CMSEC accumulated $4,562,211 in profits as of the end of fiscal year 2011. However, that figure reflects the funds necessary to pay operating expenses, educational and administrative staff over the summer vacation period when no revenues would be received by CMSEC. At the conclusion of the summer vacation period, on August 31, 2011, a point in time which more accurately reflects the usual balance of funds held by CMSEC, CMSEC's total fund balance was $2,559,494.99, which represents approximately three months' operating expenses for CMSEC. Nevertheless, CMSEC will seek official guidance from DLS and the Attorney General as to the appropriate allowable amount to be held in reserves and the CMSEC Board of Directors will take action to comply.

Auditor's Reply

As stated in our report, we found that during our audit period CMSEC's pricing system allowed it to charge excessive fees to its school districts, resulting in CMSEC's accumulating $4,562,211 in total fund balances (profits) as of the end of fiscal year 2011, which is inconsistent with DLS and OAG guidance. Moreover, we also found that CMSEC's management clearly did not have a strategy to manage its surplus revenue balance given that, despite CMSEC's accrual of these substantial excess revenues, CMSEC's Executive Director told us that she considered raising CMSEC's tuition for the fiscal year 2012 because it has not been raised for several years. We do not dispute the fact that it is a sound business practice to maintain a certain amount of surplus funds in a reserve account in order to ensure that CMSEC can meet its short-term financing and other expenses. However, the amount of surplus revenues that should be kept in such a reserve account by a collaborative should be pre-established in the manner required by the recently enacted Chapter 43 of the Acts of 2012, based on CMSEC's estimated financial needs and in accordance with DLS and OAG guidelines.

In its response, CMSEC asserts that as of August 31, 2011, its actual fund balance was only $2,559,495. Because this date is beyond our audit period, we cannot comment on this assertion. Our report states the amount of excess revenues that were being retained by CMSEC as of June 30, 2011, was $4,562,211. CMSEC's stated fund balance of $2,559,495 appears excessive, since it would represent an amount equal to approximately 23% of CMSEC's total funding for fiscal year 2011. Nevertheless, based on its response, CMSEC is taking measures to address our primary concern in this area: ensuring appropriate pricing so that districts are charged only for CMSEC's anticipated costs.

3. IMPROVEMENTS NEEDED IN INTERNAL CONTROLS OVER FINANCIAL AND MANAGEMENT ACTIVITIES

We found that CMSEC had not developed and implemented an adequate system of internal controls over various aspects of its operations. For example, CMSEC did not have policies and procedures relative to the procurement of goods and services, was not effectively monitoring payments made to staff for sick time, did not require staff to submit adequate documentation to substantiate the business purposes of expenses, and was not performing reconciliations of its accounting records to detect potential irregularities. As a result, we found over $24,000 in procurements that were not conducted in accordance with state law, $1,630 in improper payments to staff members for sick time that they did not earn, over $21,000 in inadequately documented expenses, and significant variances in CMSEC's accounting records--totaling over $87,000 in one month--resulting from transactions that were not recorded in CMSEC's financial records in the month in which they occurred.

Sound business practices advocate that entities such as CMSEC should establish an adequate internal control system within the organization. Such controls serve many purposes, including: ensuring that organizational goals and objectives are met in an economical and efficient manner; organizational activities are conducted in compliance with applicable laws, regulations, and policies; assets are properly safeguarded against waste, loss, and misuse; and agency transactions are properly authorized, recorded, and reported. In this regard, CMSEC should have a documented, comprehensive plan of internal controls describing its goals and the means by which these goals and objectives should be achieved. An effective internal control system would establish clear lines of authorization and approval for CMSEC's various business functions, such as purchasing, contracting, asset management, payroll, and personnel. In addition, an entity's internal control system should be backed up with a set of detailed subsidiary policies and procedures that would communicate responsibilities and expectations to subordinate staff by providing employees with direction to complete various business operations, such as accounting, billings, cash receipts, accounts payable, human resources, and payroll.

Specific areas in which CMSEC needs to improve its internal controls are detailed below:

a. Failure to Follow State Law for $24,095 in Procurements

As a government entity functioning as an instrumentality of its member school districts, CMSEC is required to comply with Chapter 30B of the General Laws, commonly referred to as the state's Uniform Procurement Act. According to the Chapter 30B implementation guide issued by the state's Office of the Inspector General (OIG), the law, enacted in 1990, is based on certain premises, as follows:

> *Uniform contracting procedures promote competition and fairness. Chapter 30B clarified and demystified local contracting for vendors competing for contracts and for citizens observing the process. . . . Fair, robust competition for larger procurements saves money and promotes integrity and public confidence in government.*

According to Chapter 30B, for any contract ranging from $5,000 to $25,000, the procuring entity must seek written or oral quotes from no fewer than three persons. Specifically, Section 4 of this statute states, in part:

> *Except as permitted pursuant to this section and section seven, for the procurement of a supply or service in the amount of $5,000 or greater, but less than $25,000, a procurement officer shall seek written or oral quotations from no fewer than three persons customarily providing such supply or service. The procurement officer shall record the names and addresses of all persons from whom quotations were sought, the names of the persons submitting quotations and the date and amount of each quotation. A governmental body may require that procurements in amounts of less than $25,000 be based on written quotations or be subject to the provisions of section five.*

According to CMSEC's accounting records, during fiscal years 2010 and 2011, CMSEC made four procurements of goods and services valued at between $5,000 and $25,000. However, based on our review of the documentation CMSEC maintained relative to these procurements, we found that, in three of these four instances, there was no documentation to substantiate that CMSEC obtained the required written or oral quotes. Examples include the following:

Vendor	Date of Purchase	Contract Amount	Goods/Services Purchased
Rediker Software, Inc.	9/11/2009	$12,325	Administrator's Plus software
A.M.F. Construction Co., Inc.	9/24/2010	$6,605	Improvements to school building
Industrial Cleaning, Inc.	11/19/2010	$5,165	School building floor refinishing

Because CMSEC did not solicit competitive bids for any of these procurements as required by Chapter 30B, it cannot be assured that it received the most competitive prices for these goods and services.

b. Employees Improperly Paid $1,630 for Unearned Sick Time

Regarding the earning of sick time, CMSEC's Employee Handbook states, in part:

> *All full-time CMSEC employees are eligible to earn one (1) sick day per month, 10-month contracted employees earn ten (10) sick days per calendar year, and 12-month contracted employees earn twelve (12) sick days per calendar year. Upon expiration of sick leave days earned during any given calendar year, the daily salary deduction of a teacher, instructional assistant, or any other 10-month salaried employee shall be 183rd of their annual salary. All other employees will be calculated according to their yearly work schedule.*

Each of CMSEC's program sites maintains a written overall attendance sheet for all employees working at that site. Each week, this attendance information is provided to CMSEC's Office Manager, who tracks each employee's use of sick time. She then provides any payroll adjustments to the Business Manager, who enters them into CMSEC's automated payroll system for processing. However, we found that CMSEC does not have any policies or procedures that require its staff to conduct payroll reconciliations to identify and correct any errors that may have occurred when processing payroll. Consequently, during our audit we reviewed the fiscal year 2010 and 2011 payroll records for a random sample of 26 of CMSEC's staff members to determine whether each employee's sick leave balances were correctly calculated and proper deductions were made once the employee reached the maximum earned sick leave in accordance with CMSEC's policies. Based on our review, six of the 26 staff members in our sample were paid a total of $1,630 for sick leave that they had not earned and were not entitled to, due to errors that occurred when CMSEC staff entered payroll information into CMSEC's payroll system.

c. Inadequate Documentation Relative to $21,314 in Expenses

Expenditures made by a public entity such as CMSEC should be reasonable and incurred for a public purpose within the scope of expenditures authorized for the entity by law and its governing board and funding and oversight agencies. However, we found that CMSEC had not established adequate internal controls, including formal written policies and procedures, relative to how agency expenses should be documented to substantiate that they were reasonable and appropriate.

During our audit, we judgmentally selected a sample of 127 of approximately 2,100 expenditures made by CMSEC during fiscal years 2010 and 2011. The expenses selected were in the areas of training, equipment purchases, and direct employee reimbursements. Based on our review, we found that five of these expenses totaling $3,451 did not have any documentation to support the expense. We also found another 27 expenses totaling $17,863, most of which were staff reimbursements (20 of the 27), that had some supporting documentation, such as receipts or an invoice, but did not identify the program in which the expense was incurred or the business purpose of the expense. As a result, there is inadequate assurance that the $21,314 in expenses was necessary and proper.

d. Inadequate Cash Reconciliation Procedures Resulting in Variances of up to $87,724 in CMSEC's Accounting Records

In order to ensure that CMSEC properly safeguards its assets, including its cash, it should conduct regular reconciliations of its bank statements to its financial records. However, we found that CMSEC has not established any formal written policies and procedures relative to conducting such bank reconciliations. During our audit, we did find that CMSEC's Treasurer was preparing bank reconciliations. Specifically, on a monthly basis, CMSEC's accounting staff mails its Treasurer copies of all CMSEC's monthly deposits and the check register listing all of its monthly expenditures. The Treasurer then performs a reconciliation of these records and mails them back to CMSEC's Accounting Department. However, we randomly selected six months of expenditure records, comparing the reconciled cash balances provided by the Treasurer to CMSEC's general ledger, and found variances ranging from $833 to $87,724. We determined that these variances were due to inconsistencies in the way CMSEC's accounting staff recorded deposits, interest, and bank charges to the general ledger. In addition, we found instances in which variances were caused by transactions not being recorded in the general ledger in the month in which the activity occurred.

Recommendation

CMSEC should immediately develop and implement, with the approval of its Board of Directors, formal written policies and procedures relative to its procurement of goods and services, monitoring of staff sick time, documentation of agency expenditures, and reconciliations of its accounting records. Further, it should recover the $1,630 from the six employees in question who received compensation for sick time to which they were not entitled.

Auditee's Response

In response to this issue, CMSEC officials provided the following comments:

> *The collaborative has initiated the process of developing and documenting internal controls with respect to financial and management activities, including the matters shown on the attached list of topics under development. The collaborative recently appointed a Director of Finance who is qualified to investigate, analyze and assist in the development of methodologies to address those topics under development. She has begun the process of reviewing financial and management policies and procedures at other collaboratives and public schools and is responsible for their preparation. The Director of Finance is versed in the procurement process and will participate in the training offered for the procurement officers to assure compliance with Chapter 30B regulations.*
>
> *In addition, an independent auditor has been retained to perform a 2011 audit of our records and to review our new pricing methodology and procedures. Upon completion of the independent auditor's review and comment and after completion of the Director of Finance's analyses of the topics under development, we anticipate that the Board of Directors will consider the various recommendations of the independent auditor and the Director of Finance and will formally adopt and implement written policies and procedures based on those reviews and analyses, utilizing those policies and procedures to communicate to staff members and administrators their respective responsibilities and expectations. Lastly, the accounting records are being reconciled and adjustments will be made to tie to the audited financial statements of 2011.*

APPENDIX

Programs Operated by CMSEC

During the audit period July 1, 2009 through June 30, 2011, the programs offered by the Central Massachusetts Special Education Collaborative (CMSEC) included the following:

Central Massachusetts Academy (CMA): The CMA serves special education students in grades seven through 12 who are currently not making progress in the general school setting. Students who attend CMA generally have a psychiatric diagnosis combined with significant behavioral challenges.

Fanning Learning Center (FLC): The FLC provides services to regular education students in a small, structured, alternative school setting. Students in grades eight through 10 who have been referred to FLC must have a history of school disengagement, academic failure, and behavioral issues in the traditional school setting.

Goddard Learning Center (GLC): The GLC is a special education public day school for students in kindergarten through 12th grade with serious emotional disabilities. The GLC consists of four highly structured therapeutic programs that meet the emotional, social, and academic challenges of the diverse student populations, including students with mental illnesses, autism spectrum disorders, mental retardation, and learning disabilities.

Harwell Learning Center (HLC): The HLC is a public, highly structured, therapeutic day school serving students in kindergarten through eighth grade who have severe emotional disabilities. In addition to group and individualized academic instruction, students receive individual and group counseling, case management, and crisis intervention services. The program focuses on improving academic, social, and coping skills while providing students with a safe, consistent, and positive learning environment. Many students at the HLC also receive support from outside agencies, including the Department of Mental Health and the Department of Children and Families, and the majority of the students receive outside therapeutic and psychiatric treatment.

Woodward Day School (WDS): The WDS is a transitional alternative school that provides a small, structured environment to regular and special education students who have been excluded from school or have a pending felony charge and are suspended. WDS offers students the opportunity to maintain their academic standing during the period of long-term suspension and to facilitate the student's return to school or to a less-restrictive setting.