

Board of School Directors  
Canon McMillan School District  
Canonsburg, Pennsylvania

Ladies and Gentlemen:

We have audited the financial statements of the Canon McMillan School District for the year ended June 30, 2009, and have issued our report thereon dated November 10, 2009. Professional standards require that we provide you with the following information related to our audit.

### Management Letter Comments

#### Risk Management

We would like to take this opportunity to remind the Board and administration of risk management responsibilities in operations of the District's financial affairs. Protection of the District's assets and the proper expenditure and reporting of those assets are two of the primary duties in the roles of governance and administration. A quick summary includes the following:

- Responsibility for informing us about all known or suspected fraud affecting the government involving (a) the governing body (b) management, (c) employees who have significant roles in internal control, and (d) others where the fraud could have a material effect on the financial statements
- Establishing and maintaining internal control, compliance with laws and regulations
- Making all financial records and related information available to the auditors
- Taking responsibility for the accuracy and completeness of those records
- Responsibility for the design and implementation of programs and controls to prevent and detect fraud
- Responsibility to follow-up and take corrective action of prior audit findings

**Fixed Assets**

Previous audits have noted an issue relating to the maintenance of the District’s fixed asset register. We are pleased to note that the register has been reconciled with the District’s historical data and an appropriate balance is now recorded in the District’s financial statements.

**Budgeting**

Over the past several years, audits have shown significant overexpenditure of the General Fund budget. While the District was over its budget this year in a few functional areas, the District was under its expenditure budget in total by nearly \$400 thousand for the first time since the 97/98 school year.

We are pleased to note the significant progress made bringing the budget into line with the real expenditures levels particularly in the functional areas of Regular Instruction Vocational Education, Other Instructional, Plant Services and Student Transportation.

The special education budget continues to be under budgeted (although at smaller levels than in past years) and revenue continues to vary drastically due to state budget and funding issues and real estate tax appeals.

**Payroll Items**

Our previous audit had noted an instance in which an employee’s pay lacked appropriate backup. We are pleased to note that no significant issues were found during the current audit. During the audit, we noted that internal controls have been strengthened. We recommend that payroll clerk continue to focus on minimizing payroll error risks. However, we would also like to emphasize the importance of top level monitoring of controls and procedures.

**Federal Programs**

This year, federal program regulations required a major program compliance audit of Title I, National School Lunch and IDEA Programs. This is the eighth year in which audits of these programs revealed no significant deficiencies in internal controls and no instances of non-compliance. We commend the administration for the excellent work in this area.

**Post Retirement Liabilities**

During the past several years, we have discussed the benefits made to district employees relating to retirement. The following is a history of the value of those benefits.

	<u>Retirement Incentives</u>	<u>Blue Cross Blue Shield</u>	<u>Accumulated Sick Days</u>
June 30, 2003	\$	\$ 491,882	\$ 1,080,004
June 30, 2004	823,755	1,145,163	1,176,951
June 30, 2005	692,769	1,116,383	884,223
June 30, 2006	586,996	1,051,269	1,117,002
June 30, 2007	371,889	861,475	1,257,912
June 30, 2008	358,112	759,912	999,014
June 30, 2009	231,871		919,852

It is important to note that while a continued decrease has been seen over the past five years, current decisions and future contracts can play a heavy role in whether these liabilities continue to decline or if a rise is noted in the coming years.

GASB Statement #45 was implemented during the 08/09 school year. This statement focused on post retirement benefits such as continuation of health insurance benefits. For this reason, the Blue Cross/Blue Shield liability is not reflected above for the 08/09 year.

**GASB Statement #45**

During the year ended June 30, 2009, the District implemented GASB Statement #45. As noted in previous audits, this Standard deals with the accounting for postretirement benefits such as the continuation of health insurance benefits for retirees.

The District is currently using the “pay as you go” funding method provided for in GASB #45. Although not the method preferred under GASB #45, this method does allow the District to directly pay the current portion of the Annual Required Contribution (ARC) of \$1,073,608 while deferring a decision to place into a restricted trust the long term portion as determined by the actuarial valuation. Accordingly, the ARC has been recorded as a liability on the District’s government wide financial statements. There will be an annual increase in the ARC balance for future required payments and accrued interest that are not actually transferred into a restricted trust.

We recommend the District formally establish a restricted trust for these post retirement benefits. The ARC should be transferred annually to the restricted trust. In addition, annually, the general fund should be reimbursed for the cost of the current retiree health care payments incurred during the current school year.

**Cafeteria Fund**

The following is a history of the cafeteria fund profits and losses:

	Profit or Loss	General Fund Contribution	Depreciation Expense	Cash Flow/Deficit before Contribution
June 30, 2005	\$ (67,999)	\$ -0-	\$ 100,389	\$ 32,390
June 30, 2006	(24,678)	-0-	100,357	75,679
June 30, 2007	(39,770)	-0-	99,721	59,951
June 30, 2008	(83,121)	-0-	99,474	16,353
June 30, 2009	(11,955)	-0-	88,889	76,934

The Board should keep in mind that the profit shown above includes depreciation, which is a non-cash expense. When depreciation expense is added back to the net profit, the actual cash inflow for the District can be determined. Thus for 08/09, the cash inflow for the food service fund was \$76,934.

## **Student Activity Funds**

### *High School Activities*

#### Quickbooks File

As in the previous year, audit procedures noted that the computer file for the high school activities fund needs to be cleaned up. Activity within the Quickbooks file is posted incorrectly, and an accurate year end bank reconciliation was unavailable. Through additional time and effort, we were able to reconcile the bank account.

We are pleased to note that management has already taken steps to improve this situation and the Quickbooks file will now be regularly reviewed and adjusted by the District's business office.

#### Procedures

During our review of the high school activity fund, we encountered a number of issues that require the District's attention. A review, for which a separate letter will be issued when completed, is being performed to help correct this situation, but a summary of the significant issues is presented below.

- Numerous instances were noted in which income and expense vouchers lacked the required approval of student representatives and activity sponsors.
- Instances were noted in which student activity funds were expended for activities in which students received no benefits.
- Instances were noted in which deposits were not made in a timely manner.
- Approval relating to the transfer of funds to close inactive clubs was not found.

#### *Fundraisers*

We have previously recommend that a fundraiser report be implemented to more accurately account for the proceeds of activity fund fundraisers. While this form has been developed, the consistent usage of this form has not happened yet. We recommend that this form be made a requirement for all fundraisers within the District.

## **Athletic Fund**

### *Gate Receipts*

Our previous audit had found that only the beginning ticket number for each athletic event was attached to the event's revenue report. We are pleased to note that as of the Spring 2009 athletic season, both the beginning and ending ticket stubs are attached to each revenue report.

#### *Athletic Event Officials*

As in the prior year, audit procedures noted that athletic event staff are being paid with checks that simply state the payee as "Official". While this practice can be effective, it is important that the athletic director personally write the name of the specific individual on one copy of the check. Then, during the reconciliation process, the business office will be able to compare payees on specific cancelled checks to a source document to be certain that officials are being paid accurately.

**Investments**

Quality and safety of investments should continue to be a paramount concern to the administration and the Board. The District should continue its annual review of investment policies and procedures for such matters as evaluating safety of potential investments, defining appropriate investments for the District, and diversification analysis.

**District Activities Fund**

During the 08/09 year, the District Activities Fund was created. This fund includes activity such as the Powerade wrestling tournament and the Santa Club which cannot be properly accounted for in another fund and operate for the benefit of the District as a whole.

**Debt Service Payments**

For informational purposes, we have prepared a debt borrowing base schedule for the School District that will help to determine the current potential borrowing capacity of the District at June 30, 2009. It should be noted that this schedule is the basic premise of the borrowing capacity of the District. A more detailed analysis, including the use of future state debt service reimbursements as increases in borrowing capacity, would be required to form a definitive number.

Current Long Term Debt	\$ 87,629,656
Current Borrowing Base Limit	<u>115,349,319</u>
Borrowing Capacity Remaining	<u>\$ 27,719,663</u>

While the above chart details the District's total debt limit, another rule of thumb states that the District's total annual debt service should not exceed 15% of the District's budget.

2008/2009 Debt Service Payments	\$ 6,780,698
15% of 2008/2009 Budget	<u>8,244,292</u>
Yearly Debt Service Payments Available	<u>\$ 1,463,594</u>

During the 08/09 year, the District borrowed the Series of 2008 General Obligation Note for \$743,000. At June 30, 2009, \$316,000 of the proceeds remained in the general fund's fund balance and were spent in the early months of 09/10.

**Debt Related Derivative Activities**

The swaption proceeds are accounted for in the District's debt service fund and those monies are not co-mingled with other funds. The remaining balance in the debt service fund of swaption proceeds was \$3,232,098 at June 30, 2009, as well as a receivable for an amount due from the General Fund in the amount of \$240,000.

The District's interest rate manager and PNC Capital Markets, the swaption counterparty, have recommended the District set aside a portion of the swaption premium to cover issue costs of variable rate bonds should the option be exercised and additional funds to cover the return of state debt service subsidies in the event of exercise.

We recommend the District give careful consideration in spending the proceeds from the swaption as these represent, like any refunding proceeds, non-recurring revenue. In addition, as these derivatives are risky financial instruments, we recommend constant contact with the interest rate manager to re-determine the District's position with respect to its swaption transactions and evaluate the appropriate course of action.

We are pleased to note that management has already taken steps to help mitigate the risks associated with these transactions including 1.) the monitoring of the current values of these options for possible redemption, 2.) as noted on page 34 of the audit report, the October 2009 early redemption of the District's constant maturity swaps when they were in a favorable position for the District, and 3.) the preservation of swaption proceeds in the event they are needed in the future when the swaptions are exercised.

We would like to point out that Auditor General Jack Wagner recently sent a letter to every school district in Pennsylvania urging them to refrain from using interest-rate swaps and to terminate any swaps agreements they may have. This letter may be found at:

<http://www.auditor.gen.state.pa.us/Department/Press/WagnerWritestoAllSDtoStopGamblingTaxpayerMoney.html>

### **Communication with Those Charged With Governance**

#### **Our Responsibility under U.S. Generally Accepted Auditing Standards**

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

#### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter.

#### **Significant Audit Matters**

##### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Canon McMillan School District are described in the notes of the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2008/2009. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

*Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Fair market value of investments
- Fixed assets
- Depreciation expense
- Compensated absences liability

*Difficulties Encountered in Performing the Audit*

No significant difficulties were encountered during the audit.

*Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has recorded all proposed audit journal entries to the books and records.

*Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

*Management Representations*

We have requested certain representations from management that are included in the management representation letter dated November 10, 2009.

*Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

In closing, we would like to thank Dr. McCracken and Mrs. Mansmann and their respective staff members for the superb cooperation we received during our audit. We also thank the Board of School Directors for the opportunity to serve Canon McMillan School District.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Cypher and Cypher". The signature is written in a cursive, flowing style.

Cypher and Cypher  
Certified Public Accountants

November 10, 2009  
Canonsburg, Pennsylvania