

September 23, 2011

To the Board of Directors
Island City Academy

In planning and performing our audit of the financial statements of Island City Academy as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered Island City Academy's internal control over financial reporting (internal control) 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 the Academy's internal control. Accordingly, we do not express an opinion on the effectiveness of the Academy's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency 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 misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Academy's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Academy's financial statements that is more than inconsequential will not be prevented or detected by the Academy's internal control. We consider the following deficiency in Island City Academy's internal control to be a significant deficiency:

Financial Statement Preparation

Auditing standards require communication in writing when an entity requires assistance to prepare the financial statements, including the footnotes, in accordance with accounting principles generally accepted in the United States of America. The staff and bookkeeper of the Academy understand all the information included in the annual financial statements; however, assistance of the external auditor was utilized in preparing the footnotes to the financial statements and certain reconciliations required by Governmental Accounting Standards Board Statement #34. Utilization of the external auditor in preparing the footnotes and certain reconciliations to the financial statements assists management with the external financial reporting responsibility. The current process meets the definition of a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Academy's internal control. We consider the following deficiency in Island City Academy's internal control to be a material weakness:

Material Journal Entry

During the course of the audit, it came to the auditor's attention that the bank account for the child care program at Island City Academy was not recorded on the general ledger. In order to reconcile cash, we posted an entry during the audit which is material to the financial statements. We recommend that Island City Academy record the proposed journal entry to reconcile cash. Additionally, if the Academy continues to use this bank account, we recommend that it be reconciled on a monthly basis.

In addition, during our audit, we noted certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated September 23, 2011 on the financial statements of Island City Academy. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:

Review of Internet Usage Policy

Employee access to, and use of, the Academy's Internet resources has increased significantly. Thus, now is a good time to develop or review an official academy policy on acceptable use of the Internet. A sound policy can help limit misuse of the Internet and perhaps provide a basis for legal action, should that be necessary. The policy should be communicated to employees on a regular basis. The following are some matters the policy should cover:

- Internet access includes viewing websites, sending and receiving email, transmitting or receiving electronic files, running Internet applications such as games on the Academy-provided network or Internet, etc.

- Appropriate use of the Internet includes business-related communication with customers, vendors, and other employees; research; information retrieval; and other business-related tasks.
- Inappropriate, prohibited use of the Internet includes accessing or downloading obscene, sexually explicit, pornographic, or politically subversive material; sending or forwarding profane, obscene, sexually explicit, discriminatory, or harassing material; disseminating proprietary or confidential Academy information or trade secrets without authorization; downloading software subject to licensing restrictions in violation of intellectual property rights; or using the Internet for personal gain, illegal or unauthorized political activity, or to maliciously alter, damage, or destroy information.
- All electronic documents created or stored on, and all communications using, the Academy's computers are the Academy's property. Employees should not expect their communications using the Academy's systems to be private or confidential. The Academy may access those documents or communications when warranted by business needs or legal requirements. Also, the Academy can monitor its systems to ensure proper use and prevent security violations.
- Personal use of the Internet (such as for browsing, shopping, playing games, or sending personal email) should be deferred to nonbusiness hours if possible and be kept to a minimum when use is unavoidable during business hours. Personal use should at all times (during business or nonbusiness hours) conform to the above-stated Academy policies concerning inappropriate, prohibited use.

- Files transferred in should be checked for viruses before being opened.
- Violations of the Internet policy may result in restriction or loss of access, termination, and notification of appropriate authorities if there is evidence of illegal activity.

Consider Establishing a Fraud Hotline

The Academy's code of ethics encourages employees to report any suspicions of fraud or misconduct, but it does not provide an effective, practical mechanism for doing so. We believe that as a result, employees would be hesitant to report knowledge or suspicions that could prevent or detect fraud or other misconduct that could be detrimental to the Academy. Studies show that most frauds are known to someone in the defrauded organization and are revealed after a tip is received from someone with knowledge about the fraud. However, an employee may not report suspicions or knowledge of fraud if he or she does not know to whom to report, especially if the perpetrator is someone high up in the Academy or someone to whom the employee reports. We recommend that management consider establishing a fraud hotline.

The very existence of a fraud hotline would serve as a deterrent to misconduct by creating among employees a perception that fraud would be detected and reported. It would also demonstrate the Academy's serious intent to prevent and detect fraud. In addition, the hotline could also be used to report incidents of harassment, unsafe working conditions, violence, or violations of laws or regulations. This would allow the Academy to address such situations in a timely manner and could help prevent or minimize fines, lawsuits, legal liability, or adverse publicity by demonstrating that the Academy has procedures for receiving and addressing complaints.

An effective fraud hotline should have the following features:

- It should be available 24/7. Studies show that 40% of calls to fraud hotlines are made at night or on weekends. Employees typically will not call during normal work hours to report on coworkers or supervisors, and they often will not call back if their first call is not answered.
- The hotline must allow anonymous calls to protect confidentiality so that employees will not fear possible retaliation if they are identified as the whistle-blower.
- Employees should be made aware of the hotline's availability and the reasons why they should use it. This could be done via informational posters, memos, or brochures.

This report is intended solely for the information and use of Island City Academy, management, and others within the Academy, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the cooperation we received from your staff during our engagement and the opportunity to be of service.

Very truly yours,

Manes Costeiran PC