

Financial Statements

June 30, 2013

**Pacific Heritage Academy dba
Pacific Heritage School**

Pacific Heritage Academy dba Pacific Heritage School

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Independent Auditor's Report

The Board of Directors
Pacific Heritage Academy dba Pacific Heritage School
Salt Lake City, Utah

Report on the Financial Statements

We have audited the accompanying financial statements of Pacific Heritage Academy dba Pacific Heritage School (PHA), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Heritage Academy dba Pacific Heritage School as of June 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued a report November 27, 2013 on our consideration of Pacific Heritage Academy dba Pacific Heritage School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of 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 in considering Pacific Heritage Academy dba Pacific Heritage School's internal control over financial reporting and compliance.

Salt Lake City, Utah
November 27, 2013

Pacific Heritage Academy dba Pacific Heritage School

Statement of Financial Position

June 30, 2013

Assets	
Current Assets	
Cash	\$ 455,597
Accounts receivable	1,965
Government grants and contracts receivable	<u>11,578</u>
Total current assets	<u>469,140</u>
Property and Equipment	
Capital lease - building	5,390,388
Furniture	83,718
Equipment	<u>128,359</u>
Total property and equipment	5,602,465
Less accumulated depreciation	<u>(259,589)</u>
Net property and equipment	<u>5,342,876</u>
	<u>\$ 5,812,016</u>
Liabilities and Net Assets	
Current Liabilities	
Accounts payable	\$ 28,750
Accrued liabilities	137,103
Capital lease obligation, current portion	7,213
Note payable, current portion	<u>41,231</u>
Total current liabilities	214,297
Capital lease obligation, less current portion	5,421,215
Note payable, less current portion	<u>91,423</u>
Total liabilities	5,726,935
Net Assets	
Unrestricted	<u>85,081</u>
	<u>\$ 5,812,016</u>

Pacific Heritage Academy dba Pacific Heritage School

Statement of Activities
Year Ended June 30, 2013

Unrestricted Net Assets	
Revenues and other support	
Federal	\$ 97,986
State	2,470,127
Student activities	15,655
Interest	6
Other	13,256
	<u>2,597,030</u>
Total revenues and other support	
Expenses	
Program services - school	
Salaries	1,030,091
Employee benefits	204,386
Professional and technical services	245,462
Purchased property services	46,938
Other purchased services	47,961
Supplies and materials	124,420
Property and equipment	36,790
Depreciation and amortization	259,589
Interest	390,811
Other expenses	4,041
	<u>2,390,489</u>
Supporting services	
Management and general	31,598
	<u>2,422,087</u>
Total expenses	
Change in Net Assets	174,943
Net Assets, Beginning of Year	<u>(89,862)</u>
Net Assets, End of Year	<u>\$ 85,081</u>

Pacific Heritage Academy dba Pacific Heritage School

Statement of Cash Flows
Year Ended June 30, 2013

Operating Activities	
Change in net assets	\$ 174,943
Adjustments to reconcile change in net assets to net cash from operating activities	
Depreciation	259,589
Change in assets and liabilities	
Accounts receivable	(1,965)
Prepaid assets	7,483
Government grants and contracts receivable	(11,578)
Accounts payable	23,827
Accrued interest	41,945
Accrued liabilities	<u>135,437</u>
Net Cash from Operating Activities	<u>629,681</u>
Investing Activities	
Purchase of property and equipment	<u>(189,561)</u>
Net Cash used for Investing Activities	<u>(189,561)</u>
Financing Activities	
Principal payments on capital lease	(3,905)
Principal payments on note payable	<u>(32,346)</u>
Net Cash used for Financing Activities	<u>(36,251)</u>
Net Change in Cash	403,869
Cash and Cash Equivalents, Beginning of Year	<u>51,728</u>
Cash and Cash Equivalents, End of Year	<u>\$ 455,597</u>
Non-Cash Activities	
Capital lease	\$ 5,390,388
Supplemental Disclosure of Cash Flow Information	
Interest paid	\$ 385,296

Note 1 - Summary of Significant Accounting Policies

Operational Purpose

Pacific Heritage Academy dba Pacific Heritage School (PHA) is a nonprofit corporation organized under the laws of the State of Utah. PHA operates one charter school in Salt Lake City, Utah, for students from kindergarten to eighth grade. PHA uses the power of education, the endurance of language and culture, and the virtue of relationships and community to help young people on voyages of discovery. Through thoughtful inquiry, challenging curricula, rigorous requirements, and compassionate service students learn who they are and what they can become. PHA creates learning experiences and students find their Roots... and their Wings. The charter school began operations in the 2012-2013 school year.

Financial Statement Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and accrued liabilities.

PHA is required to report information regarding its financial position and activities according to three classes of net assets:

Unrestricted - accounts for unrestricted net assets available for support of PHA's operations. Assets designated by the Board of Directors for a specific purpose also are accounted for in this category.

Temporarily Restricted - accounts for resources currently available for use, but expendable only for purposes specified by the donor.

Permanently Restricted - accounts for gifts requiring that the principal be invested in perpetuity with income only from such investments available for use in accordance with the donors' stipulations.

Restricted and Unrestricted Net Assets

Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire (this is, when a stipulated time restriction ends or purpose restriction is accomplished) in the reporting period in which the revenue is recognized. All other donor-restricted contributions are recorded as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Revenue Recognition

The principal source of operating funds for PHA is derived from federal, state, and local funds. PHA receives state funding based on the number of students enrolled in PHA. PHA also receives federal and state grants on a reimbursement basis; accordingly, grant revenues are recognized when qualifying expenses have been incurred and all other grant requirements have been met. Amounts of restricted grants received in excess of expenditures are recorded as deferred revenue.

Property and Equipment

Property and equipment additions over \$1,000 are recorded at cost, or if donated, at fair value on the date of donation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 7 years, or in the case of capitalized leased assets or leasehold improvements, the lesser of the useful life of the asset or the lease term. When assets are sold or otherwise disposed of, the cost and related depreciation or amortization are removed from the accounts, and any remaining gain or loss is included in the statement of activities. Costs of maintenance and repairs that do not improve or extend the useful lives of the respective assets are expensed currently.

Nonprofit Status

PHA is organized as a Utah nonprofit corporation and has been recognized by the Internal Revenue Service (IRS) as exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3), qualifies for the charitable contribution deduction under Section 170(b)(1)(A)(vi) and (viii), and has been determined not to be a private foundation under Section 509(a)(1). PHA is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. In addition, PHA is subject to income tax on net income that is derived from business activities that are unrelated to their exempt purposes. PHA has determined it is not subject to unrelated business income tax and has not filed an Exempt Organization Business Income Tax Return (Form 990-T) with the IRS.

PHA believes that it has appropriate support for any tax positions taken affecting its annual filing requirements, and as such, does not have any uncertain tax positions that are material to the financial statements. PHA would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred.

Cash and Cash Equivalents

PHA considers all short-term cash investments with original maturity dates of three months or less to be cash equivalents. At June 30, 2013, cash and cash equivalents included \$455,597 held in commercial banks of which \$250,000 was insured by the Federal Deposit Insurance Corporation.

Credit Risk

Credit risk associated with accounts receivable is considered to be limited due to high historical collection rates and because substantial portions of the outstanding amounts due from governmental agencies.

Allocation of Expenses

Directly identifiable expenses are charged to programs and supporting services. Management and general expenses include those expenses that are not directly identifiable with any specific function, but provide for the overall support and direction of PHA.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Contributed Services

Amounts for donated services are reflected in the financial statements only if the services create or enhance nonfinancial assets. PHA pays for most services requiring specific expertise. No amounts have been reflected in the financial statements for donated services. However, many individuals volunteer their time and perform a variety of tasks that assist PHA with specific program services and various committee assignments.

Subsequent Events

Management has made an evaluation of subsequent events through November 27, 2013, the date on which the financial statements were available to be issued. Management has not identified any subsequent events requiring disclosure.

Note 2 - Concentrations

The majority of PHA's revenue comes from the U.S. Government and the State of Utah (passed through the Utah State Office of Education). Federal and state revenue was 98.9% and of total unrestricted revenue and support for the years ended June 30, 2013.

Note 3 - Capital Lease

PHA has a lease agreement for their school building, which they entered on the commencement date of August 29, 2012, with a capitalized cost of \$5,390,388. Initial annual rental payments equal 9.5% of the original building cost (including land) and are paid monthly. In the fourth year after the commencement date, the monthly payment is increased by 3%. Management has determined this lease is a capital lease. The capital lease obligation has been calculated based on the future lease payments discounted using an imputed interest rate of 9.46% for the 20 year term of the lease.

Future minimum lease payments under this capital lease obligation are as follows:

<u>Year ending June 30,</u>	
2014	\$ 520,325
2015	520,325
2016	533,333
2017	549,333
2018	565,813
Thereafter	<u>10,101,040</u>
Total minimum lease payments	12,790,169
Less amount representing interest	<u>(7,361,741)</u>
Capital lease obligation	5,428,428
Less current portion	<u>(7,213)</u>
	<u><u>\$ 5,421,215</u></u>

Pacific Heritage Academy dba Pacific Heritage School

Notes to Financial Statements
June 30, 2013 and 2012 and 2012

Property under capital leases at June 30, 2013 includes:

Capital lease - building	\$ 5,390,388
Less accumulated amortization	<u>(224,599)</u>
	<u><u>\$ 5,165,789</u></u>

Note 4 - Note Payable

Note payable consists of a note issued by the Utah State Office of Education in August 2011. The note is unsecured and bears interest at a rate of 1.75 percent through maturity on August 1, 2016. Monthly principal and interest payments of \$3,605 beginning September 1, 2012 are required through maturity. At June 30, 2013, the note payable balance is \$132,654.

Future maturities of the note payable is as follows:

<u>Year ending June 30,</u>	
2014	\$ 41,231
2015	41,968
2016	42,718
2017	<u>6,737</u>
	<u><u>\$ 132,654</u></u>

Other Information

June 30, 2013

**Pacific Heritage Academy dba
Pacific Heritage School**

**Independent Auditor's 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***

The Board of Directors
Pacific Heritage Academy dba Pacific Heritage School
Salt Lake City, Utah

We have audited, 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, the financial statements of Pacific Heritage Academy dba Pacific Heritage School (PHA) which comprise the statement of financial position as of June 30, 2013 and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 27, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered PHA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PHA's internal control. Accordingly, we do not express an opinion on the effectiveness of PHA's internal control.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings as 2013-1 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PHA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's Response to Findings

Pacific Heritage Academy dba Pacific Heritage School's response to the findings identified in our audit is described in the accompanying schedule of findings. PHA's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Salt Lake City, Utah
November 27, 2013

**Independent Auditor's Report on Compliance and on Internal Controls Over Compliance in
Accordance with the State of Utah Legal Compliance Audit Guide**

To the Board of Directors
Pacific Heritage Academy dba Pacific Heritage School
Salt Lake City, Utah

Report on Compliance

We have audited the Pacific Heritage Academy dba Pacific Heritage School's (PHA) compliance with the general and major state program compliance requirements described in the *State of Utah Legal Compliance Audit Guide* for the year ended June 30, 2013.

The general compliance requirements applicable to PHA are identified as follows:

- School Fees

PHA received the following major assistance programs from the State of Utah:

- Minimum School Program

Management's Responsibility

Compliance with the requirements referred to above is the responsibility of PHA's management.

Auditor's Responsibility

Our responsibility is to express an opinion on PHA's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the *State of Utah Legal Compliance Audit Guide*. Those standards and the *State of Utah Legal Compliance Audit Guide* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a material effect on PHA and its major programs occurred. An audit includes examining, on a test basis, evidence about PHA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of PHA's compliance with those requirements.

Opinion

In our opinion, Pacific Heritage Academy dba Pacific Heritage School, complied, in all material respects, with the general compliance requirements identified above and the compliance requirements that are applicable to each of its major state programs for the year ended June 30, 2013.

Report on Internal Control over Compliance

Management of PHA is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered PHA's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of PHA's internal control over compliance.

A deficiency in internal control over compliance 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, noncompliance on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis.

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

Purpose of Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Salt Lake City, Utah
November 27, 2013

Financial Statement Findings

Material Weakness

2013-1 Preparation of Financial Statements and Material Audit Adjustments

Criteria or Specific Requirement:

A good system of internal control contemplates the preparation of financial statements including the relevant footnote disclosures. It also contemplates an adequate system for recording and processing entries material to the financial statements.

Condition:

PHA does not have an internal control system designed to provide for the preparation of the financial statements being audited. The auditors were requested to, and did, draft PHA's financial statements and accompanying notes to the financial statements. During the course of our engagement, we proposed material audit adjustments that would not have been identified as a result of PHA's existing internal controls, and therefore could have resulted in a material misstatement of PHA's financial statements.

Context:

This finding impacts PHA's ability to internally prepare their financial statements and PHA's internal control for all significant accounting functions.

Effect:

The financial disclosures in the financial statements could be incomplete and a material misstatement of PHA's financial statements would not be prevented or detected.

Cause:

PHA does not have an internal control system designed to provide for the preparation of the financial statements being audited or to identify all necessary adjustments.

Recommendation:

This circumstance is not unusual to an organization of PHA's size. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations. A thorough review and reconciliation of accounts should take place prior to the beginning of the audit. This review should be done at both the accounting staff and accounting supervisor levels.

Management Response:

PHA's Board and Management Team were aware of this problem in fiscal year 2013. Therefore at the beginning of fiscal year 2014, a governmental accounting system was put into place that provides a thorough review and reconciliation of accounts and financial statements with accompanying notes to the financial statements prior to the beginning of future audits.