Management Report

for

Cyber Village Academy
St. Paul, Minnesota
June 30, 2010

MMKR
CERTIFIED PUBLIC
ACCOUNTANTS

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To the Board of Cyber Village Academy
St. Paul, Minnesota

We have prepared this management report in conjunction with our audit of Cyber Village Academy's (the Academy) financial statements for the year ended June 30, 2010. The purpose of this report is to make certain required communications to those who have responsibility for oversight of the financial reporting process and to provide comments resulting from our audit process. We have organized this report into the following sections:

- Audit Summary
- Basic Funding for Public Education in Minnesota
- Financial Trends of Your School
- Accounting and Auditing Updates
- Legislative Summary

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

This report is intended solely for the information and use of those charged with governance, the Board, management, and those who have responsibility for oversight of the financial reporting process and is not intended to be, and should not be, used by anyone other than these specified parties.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

October 11, 2010

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AUDIT SUMMARY

We hereby provide you with the following summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the Board, administration, or those charged with governance of the Academy.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the governmental activities and major fund of the Academy as of and for the year ended June 30, 2010. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards,* as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our letter to you dated July 8, 2010. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Audit Opinion on the Academy's Financial Statements

We have issued an unqualified opinion on the Academy's financial statements. After performing our audit tests and procedures, we have concluded that the basic financial statements fairly present the Academy's financial position and changes in financial position for the year ended June 30, 2010.

Report on Internal Controls and Compliance Over Financial Reporting

We reported one material weakness in the Academy's internal controls over financial reporting. The Academy has a limited segregation of duties in the initiation and recording of journal entries. Journal entries are being initiated and posted to the Academy's general ledger by several staff members of the Academy's contracted accounting service provider that are responsible for processing academy transactions. Currently, no procedures are in place for the review and approval of journal entries by the Academy's Director or Board.

Our testing did not indicate any findings related to compliance over financial reporting.

Report on Compliance With Minnesota Laws and Regulations

We reported one Minnesota Legal Compliance finding in the current year as follows:

- Minnesota Statute § 471.425 requires charter schools with Boards that meet monthly to pay each vendor obligation according to the terms of each contract within 35 days after the receipt of the goods or services or the invoice for the goods or services. Two disbursements selected for testing were not paid within the required 35-day time period.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Academy are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year.

We noted no transactions entered into by the Academy during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

AUDIT ADJUSTMENTS

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. For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Academy's financial reporting process (that is, cause future financial statements to be materially misstated). We did not propose any audit adjustments as a result of our audit.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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 estimates affecting the financial statements were:

> General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the Academy. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other schools and the MARSS data for fiscal year 2010 is not finalized until well into fiscal year 2011. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident school and also utilizing some estimates, particularly in the area of enrollment options.
>
> Special education state aid includes an adjustment related to tuition billings to other schools for special education services which are computed using formulas derived by the Minnesota Department of Education (MDE). Because of the timing of the calculations, this adjustment for fiscal 2010 is not finalized until after the Academy has closed its financial records for the fiscal period. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the Academy.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We reviewed and tested management's procedures and underlying supporting documentation in the areas discussed above. We concluded that the accounting estimates and management judgments appeared to consider all significant factors and resulted in appropriate accounting recognition.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

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 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 Academy'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.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Academy's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 11, 2010.

BASIC FUNDING FOR PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. The last section of this report, which contains a summary of legislative changes affecting charter schools, gives an indication of how complicated the funding system is. The following section provides some state-wide funding and financial trend information.

STATE GENERAL FUND BUDGET OUTLOOK

The state of Minnesota has experienced a series of major budget shortfalls and a steadily deteriorating financial condition in recent years. Local governments and other entities dependant on the state for funding have, in turn, had to deal with the resulting state aid cuts, holdbacks, and unallotments. For the fiscal year 2010–2011 biennium, the adopted state budget was balanced using several large accounting "shifts," one-time federal stabilization funds, and aid reductions. The accounting shifts, further explained in the Legislative Summary section of this report, include delaying state aid payments to school districts and charter schools, and accelerating the recognition of districts' tax levy revenue with an offsetting reduction in state aid. Both of these types of shifts typically do not reduce district or charter school revenues but significantly reduce their cash flow, forcing an increasing number to use short-term borrowing for daily cash-flow needs. The state intends to pay these shifts back when it has the financial ability.

Current state budget projections for the fiscal year 2012–2013 biennium predict further significant shortfalls that will likely need to be addressed. Realistically, the state has already used up most of the accounting shifts available for this purpose, and additional federal assistance cannot be counted on. The upcoming election, which will result in a new Governor and potentially a number of new legislators, will have a substantial impact on how the state will address its budget predicament and the future direction of education funding. And, of course, the economy, while showing some signs of recovery, is unlikely to turn around quickly enough to solve the state's budget issues in the short-term. All of this adds up to a period of continued financial uncertainty for Minnesota school districts and charter schools.

BASIC GENERAL EDUCATION REVENUE

The largest single funding source for Minnesota schools is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a school is entitled to aid.

The table below presents a historical summary of the basic formula allowance for general education aid:

School Year	Formula Allowance	Percent Increase
2000–2001	$ 3,964	6.0 %
2001–2002	$ 4,068	2.6 %
2002–2003	$ 4,601	13.1 %
2003–2004	$ 4,601	– %
2004–2005	$ 4,601	– %
2005–2006	$ 4,783	4.0 %
2006–2007	$ 4,974	4.0 %
2007–2008	$ 5,074	2.0 %
2008–2009	$ 5,124	1.0 %
2009–2010	$ 5,124	– %
2010–2011	$ 5,124	– %

The table above does not reflect temporary funding changes such as the $51 per pupil unit one-time additional general education aid school districts and charter schools received in 2008–2009, or the technology and operating capital aid received by school districts and charter schools in 2007–2008 ($40 per pupil unit) and 2008–2009 ($55 per pupil unit).

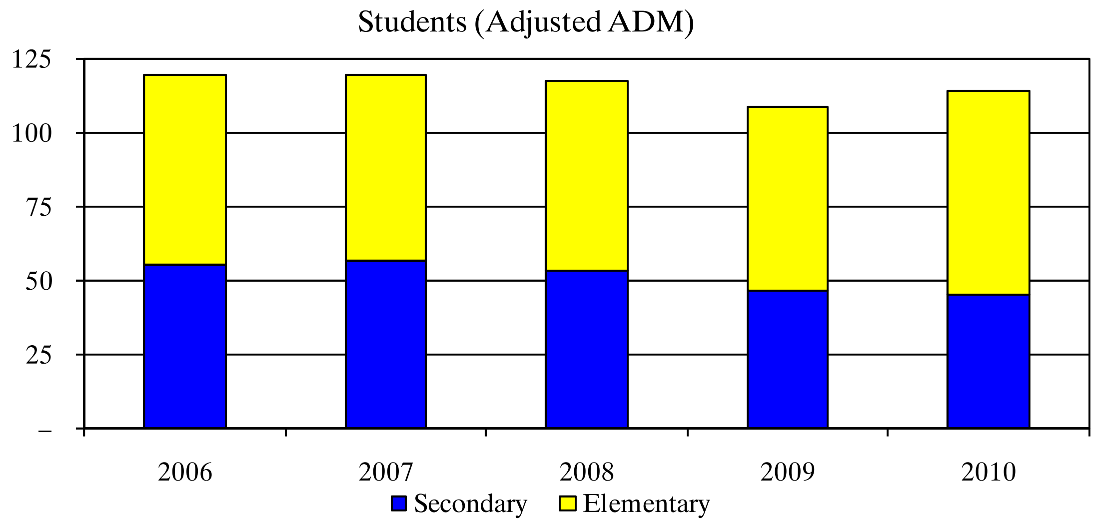
The table also does not reflect a one-time reduction to general education aid in 2009–2010 that was offset dollar-for-dollar by federal stimulus funds used by the state for fiscal stabilization.

The increase in the 2002–2003 fiscal year was unusually large because the State Legislature added $415 to the basic formula allowance to transfer a portion of school district operating referendum revenue from a property tax levy to a state aid. Since charter schools do not have levy authority, they received the benefit of this state aid increase with no offsetting levy reduction.

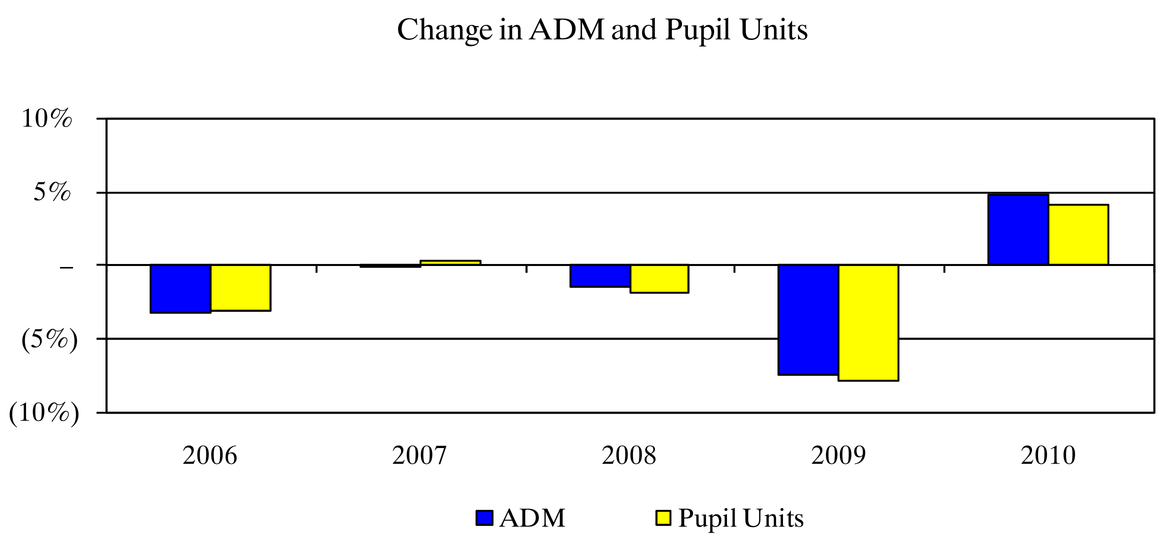
FINANCIAL TRENDS OF YOUR SCHOOL

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The following graph summarizes the ADM served by the Academy over the last five years:



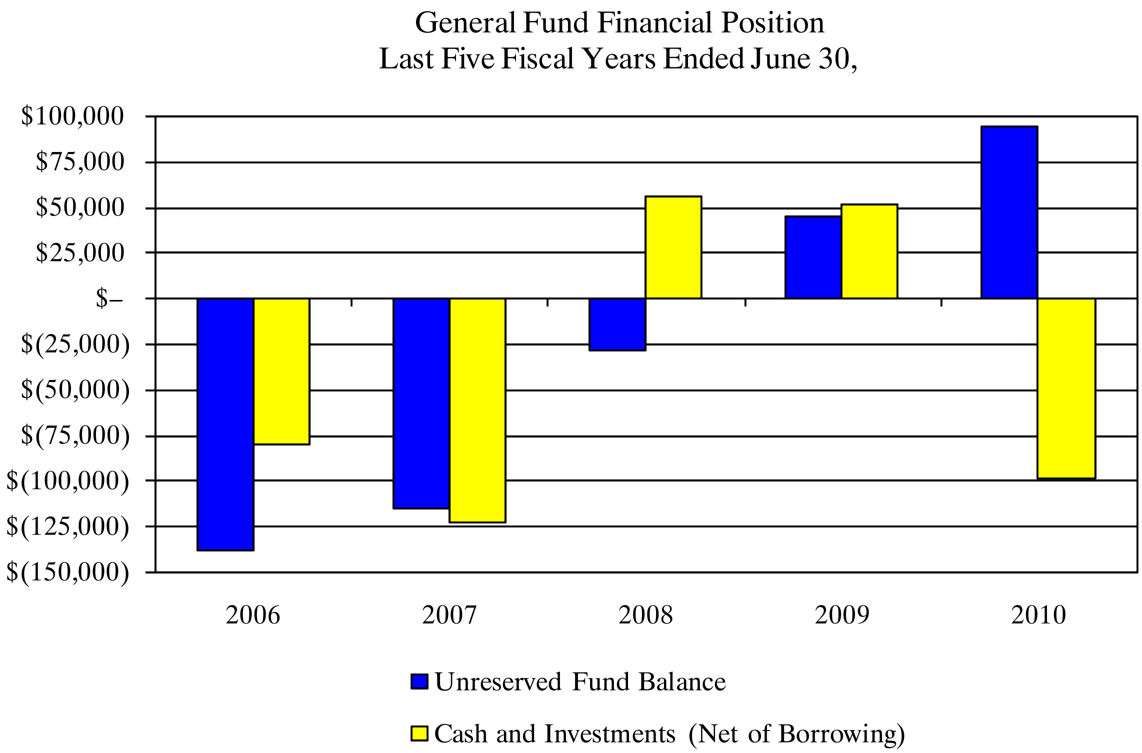
The Academy's ADM served for 2010 is estimated to be 114, an increase of about 5 ADM from the prior year. The following graph shows the rate of ADM change from year to year, and the relationship of the resulting pupil units:



ADM is a measure of students enrolled at the Academy, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts are not finalized until around January of the following year. When viewing revenue budget variances, one needs to consider these ADM changes, the impact of the prior year final adjustments which affect this year's revenue. After decreasing by more than 7 percent in 2009, the Academy's student population increased approximately 5 percent.

GENERAL FUND OPERATIONS AND FINANCIAL POSITION

The following graph displays the Academy's General Fund financial position over the last five years:

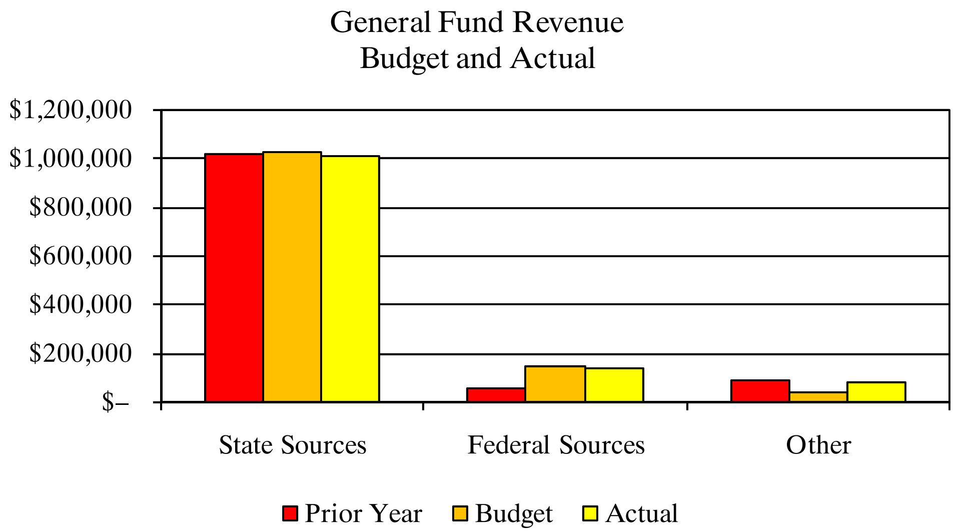


The Academy's General Fund ended 2010 with an unreserved fund balance of $94,244, an improvement of $50,101 from the prior year, and $44,168 higher than projected in the Academy's final budget. The General Fund cash and investment balance (net of borrowing) at year-end was a deficit of ($98,671), a decrease of $149,840 from the prior year. The significant decline in the Academy's cash flow this year was due to the change in the state metering of aid payments, as described earlier.

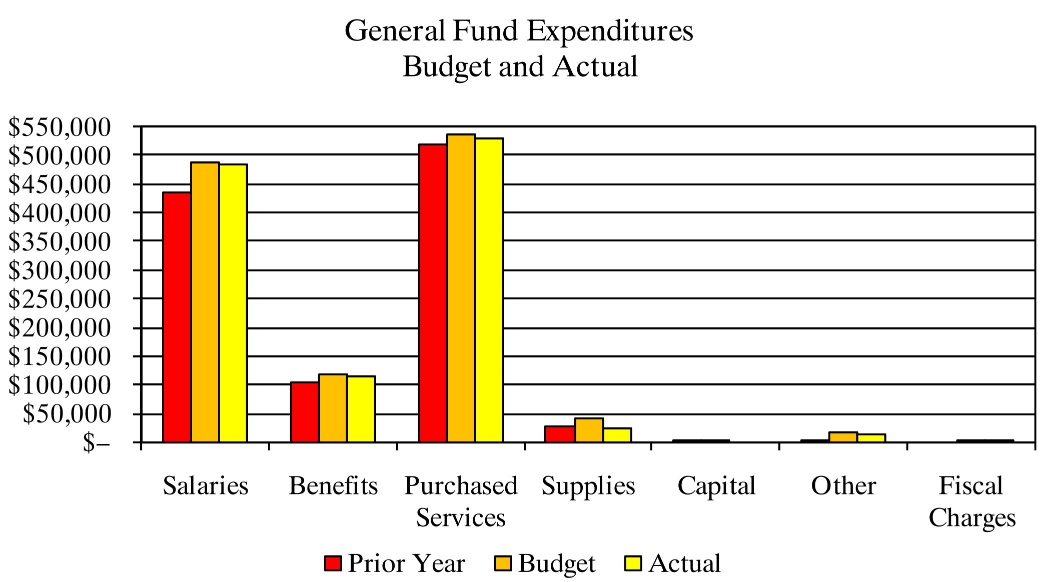
Unreserved fund balance as a percentage of expenditures is one key measure of a school's financial health. The resources represented by this fund balance are critical to a school's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. For the Academy, this ratio was 8.0 percent at the end of 2010, as compared to 4.0 percent at the end of 2009. The Academy has been able to steadily improve its financial condition over the last three years, despite the lack of funding increases.

GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the Academy's General Fund revenue and expenditures for 2010:



Total General Fund revenues for 2010 were $1,224,855, an increase of $61,456 from the prior year, and $12,562 over budget. State aid revenue was $15,035 less than last year and $6,383 under budget, despite the increase in students served by the Academy. Conversely, the Academy earned $76,109 more federal aid than the prior year. These two changes primarily reflect the one-time reduction to state general education aid of $67,622 that was replaced by federal fiscal stabilization funds. The Academy also earned an additional $33,459 in federal American Recovery and Reinvestment Act (ARRA) funds in its Title I and special education areas. Revenue from other sources also exceeded budget by $35,726 due to the Academy receiving more revenue from student fees and admissions than anticipated.



Total General Fund expenditures for 2010 were $1,174,754, an increase of $84,512 from the prior year, but $31,606 less than budget. Most of the increase was in salaries and benefits, which were $61,092 higher than last year as the Academy added staff in the regular and special education instruction areas. Expenditures were under budget in all categories, with the largest variances in supplies ($14,897) and purchased services ($6,861).

ENTITY-WIDE FINANCIAL STATEMENTS

The Academy's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the Academy's current assets to finance its current liabilities. The Governmental Accounting Standards Board (GASB) Statement No. 34 reporting model also requires the inclusion of two entity-wide financial statements designed to present a clear picture of the Academy as a single, unified entity. These entity-wide statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net assets represent the resources the Academy has leftover to use for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how resources can be used. Therefore, the statement divides net assets into three components: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The following table presents a summarized conversion of the Academy's governmental fund balances (as individually discussed earlier) to net assets and separate components for the last three years:

	June 30,		
	2008	2009	2010
Total net assets – governmental activities			
Total fund balances – governmental funds	$ (29,014)	$ 44,143	$ 94,244
Capital assets	69,996	71,636	71,636
Accumulated depreciation	(66,221)	(67,973)	(69,231)
Total net assets – governmental activities	$ (25,239)	$ 47,806	$ 96,649
Net assets			
Invested in capital assets	$ 3,775	$ 3,663	$ 2,405
Unrestricted	(29,014)	44,143	94,244
Total net assets	$ (25,239)	$ 47,806	$ 96,649

The Academy's total net assets at June 30, 2010 were $48,843 higher than the previous year. Of the increase, $50,101 was in the unrestricted portion of net assets, which corresponds to the change in the General Fund unreserved fund balance. The Academy's investment in capital assets decreased by $1,258 due to depreciation.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 54 – FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications (nonspendable, restricted, committed, assigned, and unassigned) that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The definitions of the General Fund, special revenue, capital projects, debt service, and permanent fund types are clarified by the provisions in this statement. Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010.

GASB STATEMENT NO. 59 – FINANCIAL INSTRUMENTS OMNIBUS

The objective of this statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of this statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. Applying the reporting provisions of Statement No. 31 for interest-earning investment contracts to unallocated insurance contracts improves consistency of investment measurements that are reported by pension and other post-employment benefit (OPEB) plans. Emphasizing the applicability of SEC requirements to 2a7-like external investment pools provides practitioners with improved guidance. Limiting interest rate risk disclosures for investments in mutual funds, external investment pools, and other pooled investments to debt investment pools provides better guidance regarding the applicability of interest rate risk disclosures. Finally, addressing the applicability of Statement No. 53 to certain financial instruments refines which financial instruments are within the scope of that statement. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010.

LEGISLATIVE SUMMARY

The following is a brief summary of current legislative changes and issues affecting the funding of Minnesota charter schools. More detailed and extensive summaries are available from the MDE.

Basic General Education Revenue – The basic general education formula allowance for fiscal year (FY) 2010 and FY 2011 is $5,124, reflecting no increase from the FY 2009 level.

FY 2010 One-Time General Education Aid Reduction Offset by Federal Fiscal Stabilization Funds – Reduced the FY 2010 general education aid entitlement by $500 million. The reduction is allocated among school districts and charter schools. This one-time reduction is offset on a dollar-for-dollar basis by federal fiscal stabilization funds.

Alternative Teacher Compensation Revenue (Q Comp) – Clarification of change made reducing the basic Q Comp aid from 73.1 percent to 65 percent effective for FY 2010 and later. This results in a decrease in the basic aid, with a corresponding increase in the equalized levy revenue.

State Aid Payment Deferral – All state aids normally paid on a 90–10 schedule are changed to a 73–27 schedule for FY 2010 and 70–30 for FY 2011. The 90–10 schedule is reinstated for FY 2012; however, that is considered unlikely.

Accounting for Separation and Retirement Benefits – Clarifies accounting requirements for reserved and designated for separation and retirement benefits with the following:

- Designated for separation and retirement benefit account includes compensated absences, termination benefits, pension benefits, and OPEB not accounted for elsewhere.
- Designated account will no longer be limited to 50 percent of the amount necessary to meet obligations for the portion of severance pay that constitutes compensation for accumulated sick leave.
- MDE eliminated the reserve for severance account beginning with FY 2010 reporting.

PERA and TRA Rates – Contribution rates for employers and employees for the PERA Coordinated Plan increases by 0.25 percent effective January 1, 2011. Contribution rates for employers and employees for both the TRA Basic and Coordinated Plans increase by 0.5 percent each year through FY 2015. There is no additional aid to help fund these increases.

Minnesota Department of Education Budget – The MDE budget has been reduced by 3.8 percent for FY 2010 and 5.4 percent for FY 2011.

Statutory Operating Debt – Authorizes an advance final payment for school districts and charter schools in statutory operating debt. Sets the aid payment schedule at 90 percent of the aid entitlement for these schools for fiscal years 2010 and later.

Charter School Payment Modifications – Provides that the board of directors of any charter school serving fewer than 150 students where 100 percent of the students are eligible for special education services to request that MDE accelerate the school's cash flow.

Leased Property – Provides that properties leased or rented to charter schools formed and operated under Minnesota Statutes, Section 124D.52 are exempt from taxation if the lease term is for a period of at least 12 months and is owned by (i) a nonprofit corporation; (ii) a public school district, college, or university; (iii) a private school, college, or university; (iv) a church; or (v) the state or a subdivision of the state. Similar to the language that exempts school districts from taxation for rented or leased property, the new language requires that the charter school use the property to provide direct instruction for K–12, special education, or administrative services directly related to the educational program at that site. Finally, the lease must provide that the charter school has the exclusive right to use the property during the lease period.