

Management Report

for

Cyber Village Academy
St. Paul, Minnesota

June 30, 2017

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To the Boards and Management of
Cyber Village Academy and Virtual Properties
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, 2017. We have organized this report into the following sections:

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

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.

The purpose of this report is solely to provide those charged with governance of the Academy, management, and those who have responsibility for oversight of the financial reporting process comments resulting from our audit process and information relevant to school district and charter school financing in Minnesota. Accordingly, this report is not suitable for any other purpose.

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

Minneapolis, Minnesota
October 23, 2017

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the Academy's Board, the Board of the Academy's affiliated building company Virtual Properties (the Building Company), 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, each major fund, and aggregate remaining fund information of the Academy as of and for the year ended June 30, 2017, and the related notes to the financial statements. 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 engagement letter. 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

Based on our audit of the Academy's financial statements for the year ended June 30, 2017:

- We have issued an unmodified opinion on the Academy's annual financial statements.
- We reported no deficiencies in the Academy's internal control over financial reporting that we considered to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported no findings based on our testing of the Academy's compliance with Minnesota laws and regulations.

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 fiscal year ended June 30, 2017. However, the Academy implemented the following governmental accounting standard during the fiscal year ending June 30, 2017:

- Governmental Accounting Standards Board (GASB) Statement No. 82, *Pension Issues, an amendment of GASB Statements, No. 67, No. 68, and No. 73*, which addressed certain issues related to pension reporting and disclosures.

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.

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. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 the current fiscal year is not finalized until after the Academy has closed its financial records for the fiscal period. 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. Because of the timing of the calculations, this adjustment for the current fiscal year 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.

The Academy has recorded activity for pension benefits. This obligation is calculated using actuarial methodologies described in GASB Statement No. 68. This actuarial calculation includes significant assumptions, including projected changes, investment returns, retirement ages, proportionate share, and employee turnover.

The depreciation of capital assets involves estimates pertaining to useful lives.

We evaluated the key factors and assumptions used by management to develop the estimates discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

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 REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated October 23, 2017.

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.

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis and pension-related required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplemental information and Uniform Financial Accounting and Reporting Standards Compliance Table accompanying the financial statements, which are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section which accompanies the financial statements but is not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide and assurance on it.

FUNDING 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. A summary of legislative changes affecting school districts and charter schools included later in this report gives an indication of how complicated the funding system is. This section provides some state-wide funding and financial trend information.

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. Pupil units are calculated using a legislatively determined weighting system applied to average daily membership (ADM). Over the years, various modifications have been made to this calculation, including changes in weighting and special consideration for declining enrollment schools.

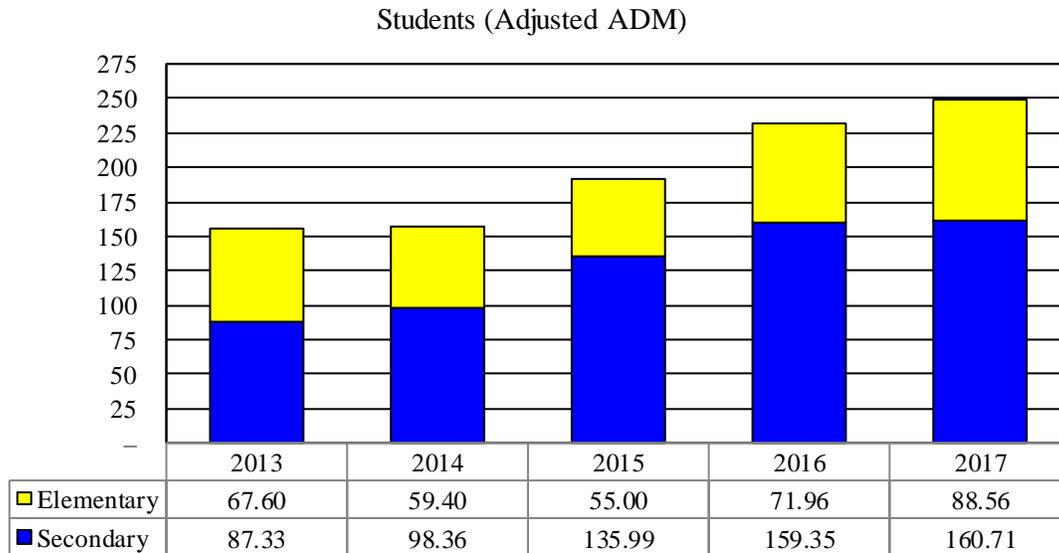
The table below presents a summary of the formula allowance for the past decade and as approved for the 2018 and 2019 fiscal years. The amount of the formula allowance and the percentage change from year to year excludes temporary funding changes, the “roll-in” of aids that were previously funded separately, and changes that may vary dependent on actions taken by individual schools. The \$529 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that resulted in an increase equivalent to approximately \$105, or 2.0 percent, state-wide.

<u>Fiscal Year</u> <u>Ended June 30,</u>	<u>Formula Allowance</u>	
	<u>Amount</u>	<u>Percent</u> <u>Increase</u>
2008	\$ 5,074	2.0 %
2009	\$ 5,124	1.0 %
2010	\$ 5,124	– %
2011	\$ 5,124	– %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 %
2016	\$ 5,948	2.0 %
2017	\$ 6,067	2.0 %
2018	\$ 6,188	2.0 %
2019	\$ 6,312	2.0 %

FINANCIAL TRENDS OF YOUR ACADEMY

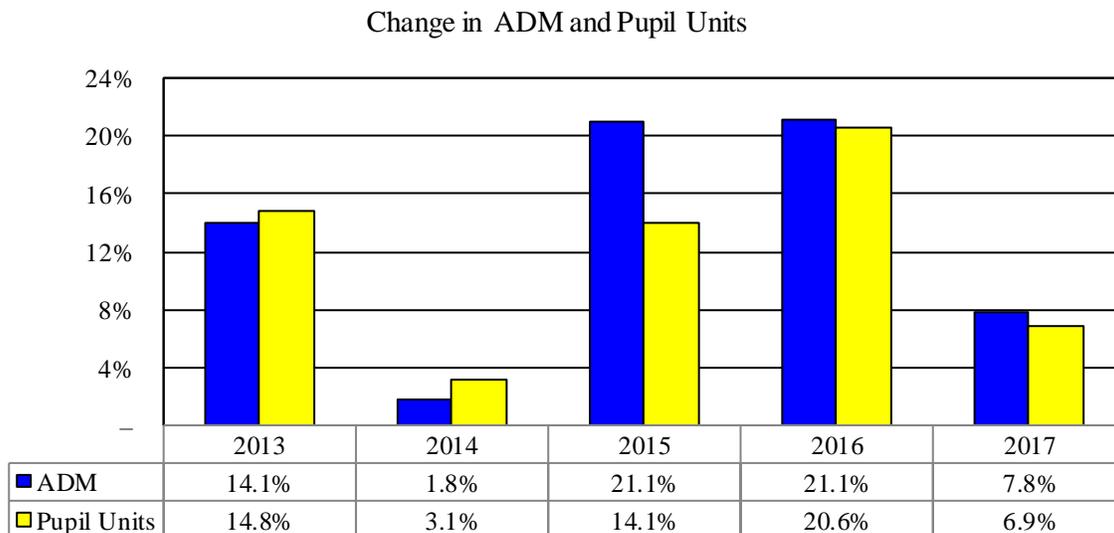
AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

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



The Academy's overall ADM increased about 18 from the prior year.

The following graph shows the rate of ADM changes from year to year and the relationship of the resulting pupil units:

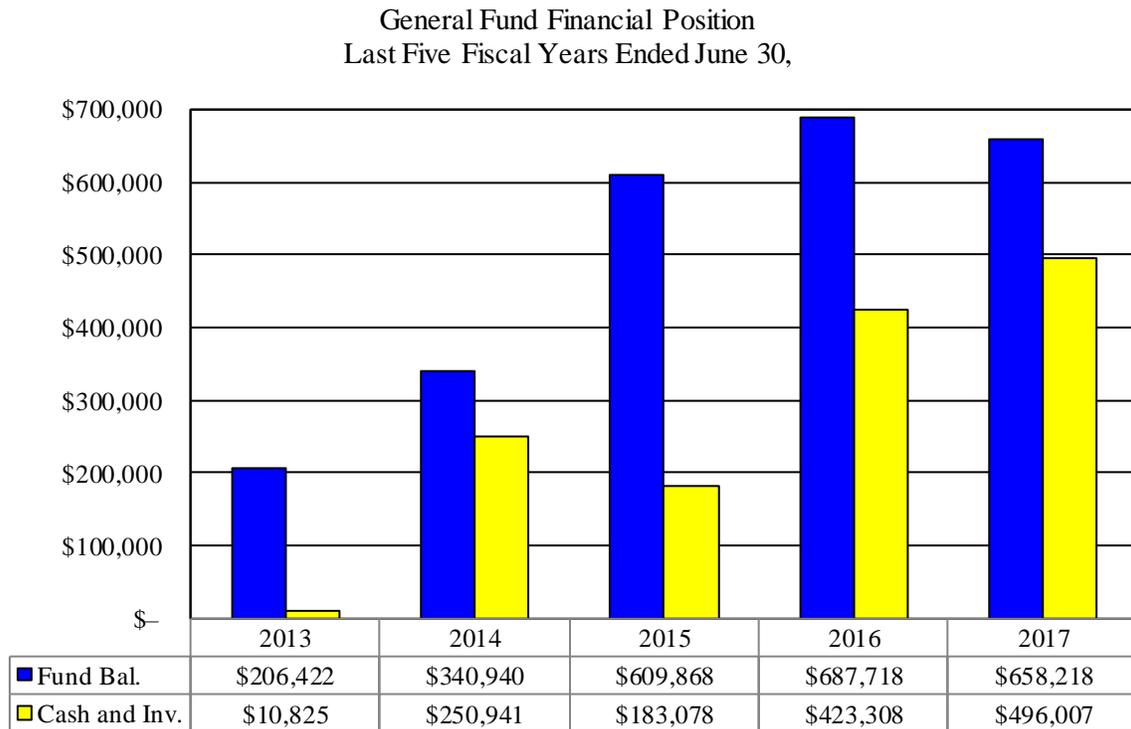


The Academy served approximately 281 pupil units for 2017, an increase of 18 from the previous year.

ADM is a measure of students attending class, 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 and the impact of the prior year final adjustments which affect this year's revenue.

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 total fund balance decreased \$29,500 from the prior year, compared to a decrease of \$119,092 projected in the final budget. Of the \$658,218 fund balance at year-end, \$101,518 was classified as nonspendable for prepaid items, another \$42,267 was classified as assigned to finance the Academy's fiscal 2018 budget, and the remaining \$514,433 was unassigned.

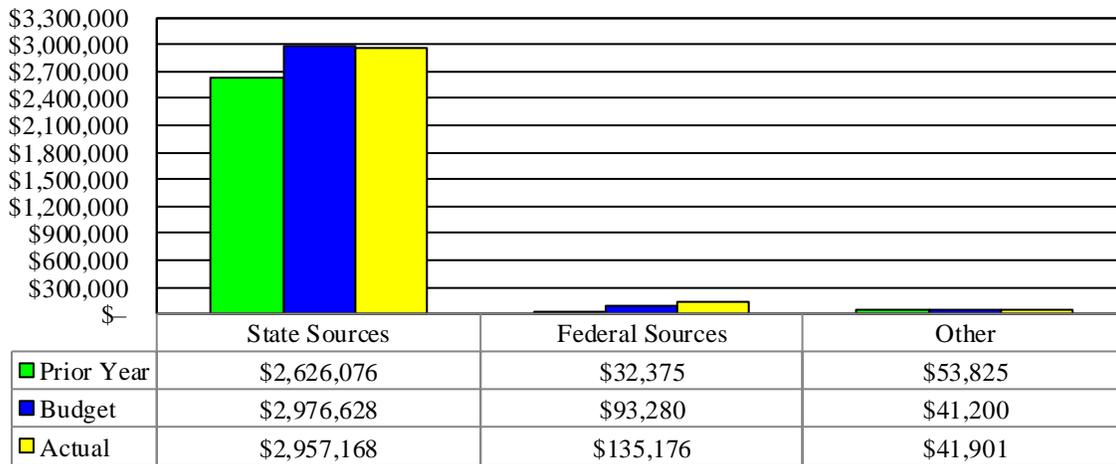
The General Fund cash and investments balance (adjusted for interfund borrowing) at year-end was \$496,007.

Fund balance as a percentage of expenditures is one key measure of the Academy's financial health. The resources represented by this fund balance are critical to the Academy'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 20.0 percent at the end of 2017, as compared to 26.1 percent at the end of 2016. The unassigned portion of the Academy's fund balance at year-end was equal to 15.6 percent of fiscal 2017 expenditures.

GENERAL FUND REVENUE AND EXPENDITURES

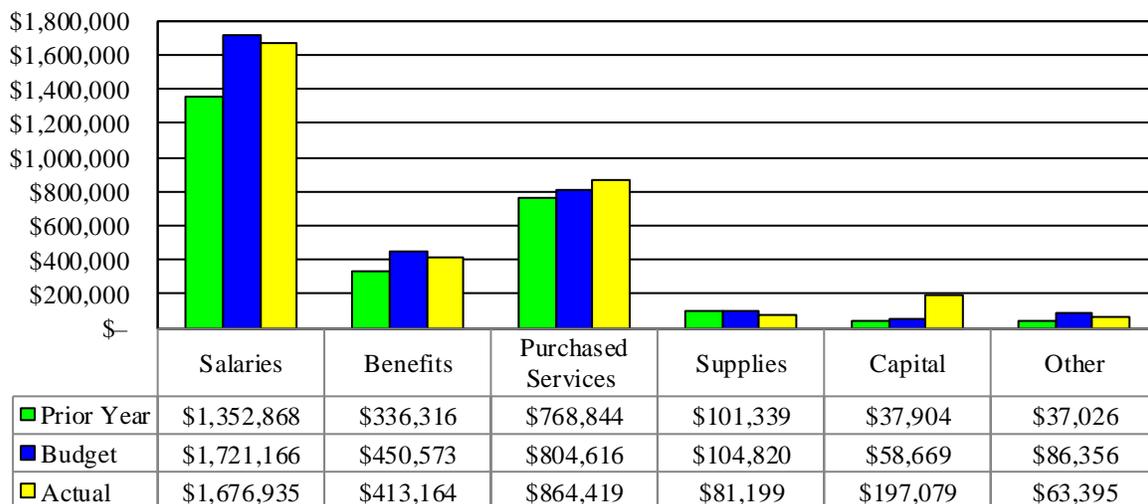
The following graphs summarize the Academy's General Fund revenue and expenditures for 2017:

General Fund Revenue
Budget and Actual



General Fund revenues increased \$421,969 from the prior year, and were \$23,137 over budget. State revenue sources were \$331,092 more than the prior year, as the Academy earned more general education and special education state aids than last year, mainly due to serving more students. Federal revenues were \$102,801 higher than last year and \$41,896 over budget, as the Academy earned more federal special education and Title I program revenue than in the past year, due to serving more students and paying a special education director with federal funds.

General Fund Expenditures
Budget and Actual



General Fund expenditures increased \$661,894 (25.1 percent) from the prior year, and were \$69,991 over budget. The increase was mainly in salaries and benefits (up \$400,915), capital expenditures (up \$159,175), and purchased services (up \$95,575), due to hiring multiple new employees and contracting for additional services to serve the growing student population. Capital expenditures were \$159,175 higher than last year and \$138,410 over budget, due to the Academy purchasing two school buses that were partially financed with a \$150,000 capital lease.

BUILDING COMPANY SPECIAL REVENUE FUND

The Building Company Special Revenue Fund was established to account for the activity of Virtual Properties, the Academy's affiliated building company. The fund incurred expenditures of \$2,100 for the administrative and legal costs of establishing the Building Company, which were financed by a temporary interfund loan from the General Fund.

FOOD SERVICE SPECIAL REVENUE FUND

In the Food Service Special Revenue Fund, expenditures exceeded revenues by \$17,554 during the year. A transfer of \$17,554 was made from the General Fund to eliminate this operating deficit.

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 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 financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net position represents 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 position into three components: net investment in capital assets, restricted, and unrestricted. The following table presents a summarized conversion of the Academy's governmental fund balances (as individually discussed earlier) to net position, and separate components of net position for the last two years:

	June 30,		Increase (Decrease)
	2017	2016	
Total net position – governmental activities			
Total fund balances – governmental funds	\$ 656,118	\$ 687,718	\$ (31,600)
Capital assets, net of depreciation	264,769	82,679	182,090
Capital lease	(124,535)	–	(124,535)
PERA and TRA pensions	<u>(1,604,807)</u>	<u>(922,467)</u>	<u>(682,340)</u>
Total net position – governmental activities	<u>\$ (808,455)</u>	<u>\$ (152,070)</u>	<u>\$ (656,385)</u>
Net position			
Net investment in capital assets	\$ 140,234	\$ 82,679	\$ 57,555
Unrestricted	<u>(948,689)</u>	<u>(234,749)</u>	<u>(713,940)</u>
Total net position	<u>\$ (808,455)</u>	<u>\$ (152,070)</u>	<u>\$ (656,385)</u>

The Academy's total net position at June 30, 2017 was a deficit of (\$808,455), a decrease of \$656,385 from the previous year.

The Academy's net investment in capital assets increased \$57,555 due to various equipment additions.

The unrestricted portion of net position decreased \$713,940, mainly due to increases in the net pension liabilities reported on the Academy's entity-wide financial statements related to the state-wide Public Employees Retirement Association (PERA) and the Teachers Retirement Association (TRA) pension plans.

LEGISLATIVE SUMMARY

The 2017 legislative session established public education funding appropriations for the 2018–2019 fiscal biennium totaling \$483.3 million. The following is a brief summary of specific legislative changes from the 2017 session or previous legislative sessions impacting Minnesota charter schools in future years.

Basic General Education Revenue – The 2017 Legislature approved annual increases of 2 percent to the basic general education formula allowance for the 2018–2019 biennium. The per pupil allowance will increase \$121 to \$6,188 for fiscal year (FY) 2018, and another \$124 to \$6,312 for FY 2019.

Compensatory Revenue – The \$5 million allocation for compensatory pilot grants in FY 2017 was permanently added to the allocation for regular compensatory revenue beginning in FY 2018. Beginning in FY 2018, a portion of compensatory revenue will be required to be used for extended time activities. The requirement will be 1.7 percent of total compensatory revenue for FY 2018, and 3.5 percent in FY 2019 and beyond.

Transportation Sparsity Revenue – Beginning in FY 2018, transportation sparsity revenue increases annually by 18.20 percent of the difference between 1) the lessor of a school district’s actual regular and excess transportation costs for the previous fiscal year or 105.00 percent of those costs for the preceding year, and 2) the sum of 4.66 percent of a school district’s basic transportation revenue, transportation sparsity revenue, and charter school transportation adjustment for the previous year. For charter schools, the adjustment to transportation sparsity is equal to the applicable school district’s per pupil adjustment.

Early Learning – The Legislature made a number a number of changes to early learning programs, including appropriating funding of \$71.75 million for the 2018–2019 biennium. Other changes include:

- The creation of a new School Readiness Plus (SR+) program for FY 2018 and FY 2019 only, with the following student eligibility requirements:
 - A child who is four years of age as of September 1 and who demonstrates one or more risk factors is eligible to participate in the program free of charge,
 - A child who is four years of age as of September 1 and who does not demonstrate any risk factors is eligible to participate on a fee-for-service basis, and
 - A sliding fee schedule must be adopted for students not demonstrating risk factors, but the fee must be waived for students unable to pay.
- Changing the Voluntary Pre-Kindergarten (VPK) cap from a limit on the total state aid entitlement to a limit on the number of participants, as follows:
 - A combined cap of 6,160 participants for VPK and SR+ for FY 2018,
 - A combined cap of 7,160 participants for VPK and SR+ for FY 2019, and
 - A cap of 3,160 participants for VPK for FY 2020 and later (SR+ program sunsets).
- All applications submitted in January to renew an existing FY 2017 VPK program will be funded first (3,160 slots). Applications for expanded VPK programs, and new VPK or SR+ programs will be ranked and approved based on various criteria. The number of new participants allowed in each new or expanded program will depend on how the programs are ranked.

Procedural Changes or Clarifications Related to Funding

Charter schools are allowed to include students participating in postsecondary enrollment options in their pupil count for generating building lease aid.

Nutrition Contracts – The Legislature amended the law governing contracts to provide for an exception to the requirement limiting school contracts to two years with an option for an additional two years. A contract between a school board and a food service management company that complies with Code of Federal Regulations, Title 7, Section 210.16, may be renewed annually after its initial term for not more than four years.

Lead in School Drinking Water –

- Requires the commissioner of health and education to develop a model plan to test for lead in school drinking water.
- Requires charter schools to adopt the model plan or an alternative plan to test school water for lead at least every five years.
- Requires charter schools to make lead testing results available to the public and to notify parents that this information is available.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 83, *CERTAIN ASSET RETIREMENT OBLIGATIONS*

At times, state and local governments are required to take specific actions to retire certain tangible capital assets, such as the decommissioning of nuclear reactors, removal and disposal of wind turbines in wind farms, dismantling and removal of sewage treatment plants, and removal and disposal of x-ray machines. Obligations to retire certain tangible capital assets also arise from contracts or court judgments. Accounting and financial reporting standards exist for costs of the closure and post-closure care of municipal solid waste landfills, but those standards do not address retirement obligations associated with other types of tangible capital assets.

This statement addresses accounting and financial reporting for certain asset retirement obligations (AROs) that were not addressed in GASB standards by establishing uniform accounting and financial reporting requirements for these obligations. An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this statement. The requirements of this statement are effective for reporting periods beginning after June 15, 2018.

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

This statement is intended to enhance consistency and comparability of fiduciary activity reporting by state and local governments. It is also meant to improve the usefulness of fiduciary activity information primarily for assessing the accountability of governments in their roles as fiduciaries.

This statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. This statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. The requirements of this statement are effective for reporting periods beginning after December 15, 2018.

GASB STATEMENT NO. 85, *OMNIBUS 2017*

The objective of this statement is to address issues that have been identified during implementation and application of certain GASB statements. The statement addresses a variety of topics, including issues related to blending component units, goodwill, fair value measurement and application, and post-employment benefits (pensions and OPEB). The statement is meant to enhance consistency in the application of recent accounting and financial reporting standards. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

GASB STATEMENT NO. 86, *CERTAIN DEBT EXTINGUISHMENT ISSUES*

Current GASB guidance requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. This new standard establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt.

The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

GASB STATEMENT NO. 87, *LEASES*

A lease is a contract that transfers control of the right to use another entity's nonfinancial asset as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this statement.

Governments enter into leases for many types of assets. Under the previous guidance, leases were classified as either capital or operating depending on whether the lease met any of four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

The goal of this statement is to better meet the information needs of users by improving accounting and financial reporting for leases by governments. It establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. This statement increases the usefulness of financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract.

Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for reporting periods beginning after December 15, 2019.