Management Report

for

Cyber Village Academy
St. Paul, Minnesota
June 30, 2014

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To the Board and Management 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, 2014. 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 General Education Revenue
- 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 3, 2014

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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 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, major fund, and the aggregate remaining fund information of the Academy as of and for the year ended June 30, 2014, 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, 2014:

- We have issued an unmodified opinion on the Academy's annual financial statements.
- The results of our procedures did not disclose any material weaknesses involving the Academy's internal control over financial reporting.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards.*
- We reported one finding based on our testing of the Academy's compliance with Minnesota laws and regulations. One of twenty-five disbursements tested was not paid within 35 days of the receipt of goods or services, or the invoice for goods or services, as required by Minnesota Statutes.

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, 2014.

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.

We evaluated the key factors and assumptions used by management in the areas 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 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 3, 2014.

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 Management's Discussion and Analysis, which is 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. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

BASIC GENERAL EDUCATION REVENUE

The largest single funding source for Minnesota school districts and charter 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 district 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.

The table below presents a summary of the formula allowance for the past decade and as approved for the 2015 fiscal year. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the "roll-in" of aids that were previously funded separately, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

Fiscal Year Ended June 30,	Formula Allowance	Percent Increase
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
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 % *

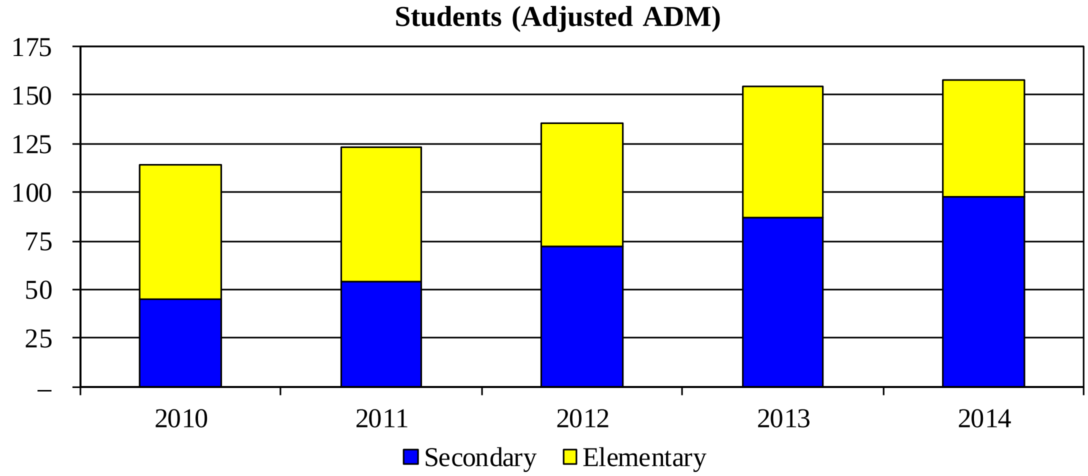
* The $529 increase in 2015 is offset by changes to pupil weightings and the general education aid formula that reduced the increase to the equivalent of $105, or 2.0 percent, state-wide.

In recent years, the limited increases in the formula allowance have forced many charter schools to cut expenditure budgets in order to maintain programs.

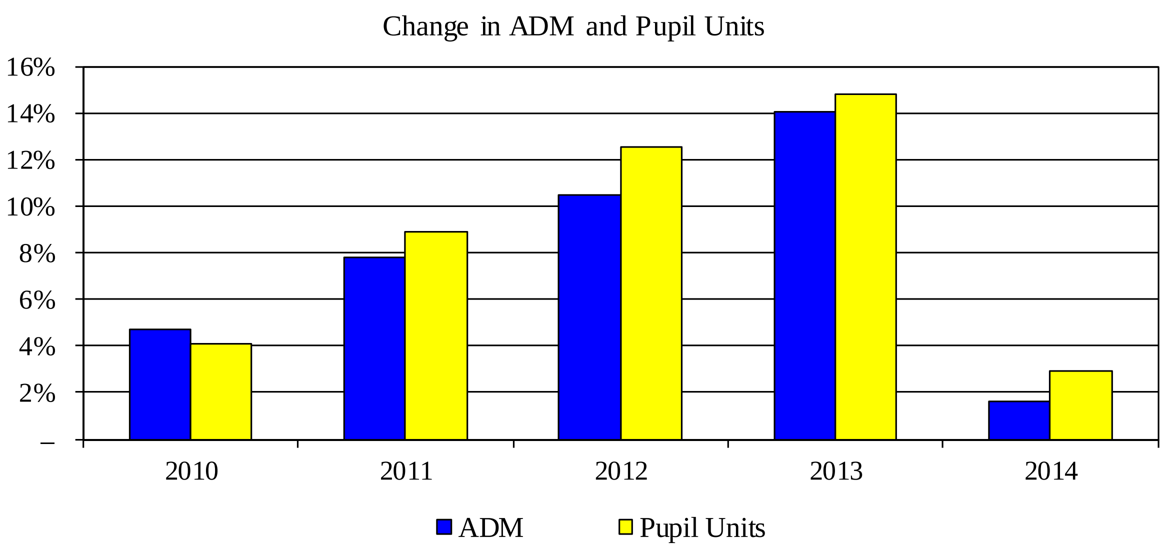
FINANCIAL TRENDS OF YOUR ACADEMY

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

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



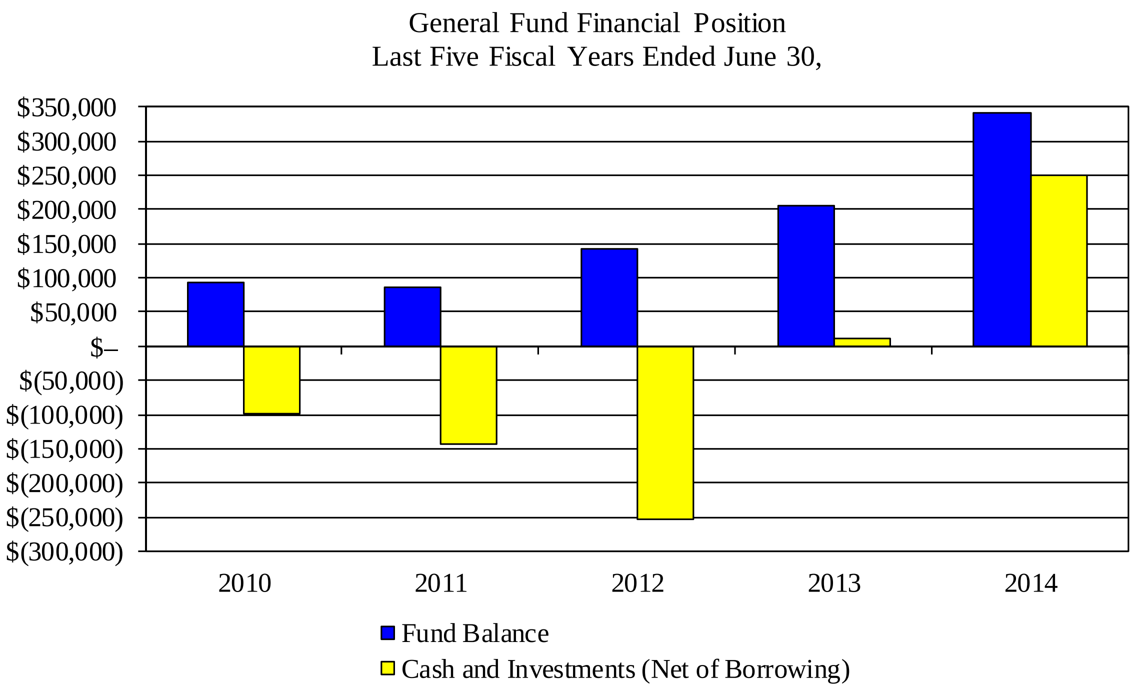
The Academy served an estimated ADM of 157 for 2014, an increase of about 2 ADM from the prior year. The following graph shows the rate of ADM change from year to year, and the relationship of the resulting pupil units:



ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. The number of pupil units served by the Academy for 2014 was estimated to be 191, an increase of about 5 pupil units from the prior year. 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:

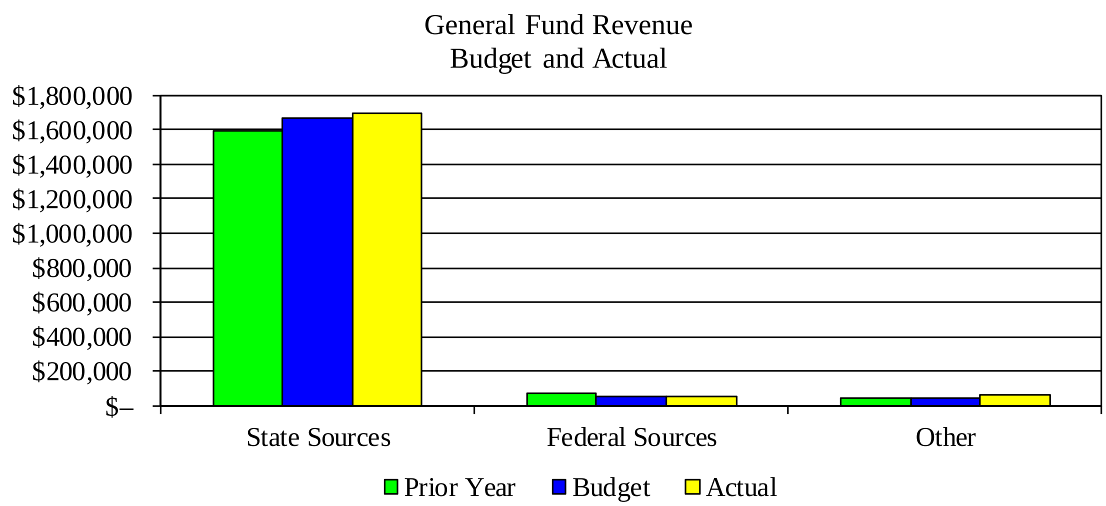


The Academy's General Fund ended 2014 with total fund balances of $340,940, an increase of $134,518 from the prior year. The General Fund cash and investments balance (net of borrowing) at year-end was $250,941, which represents an increase of $240,116 from the prior year. The significant improvement in the Academy's cash flow was mainly due to a change in the state metering of aid payments, as described later in this report.

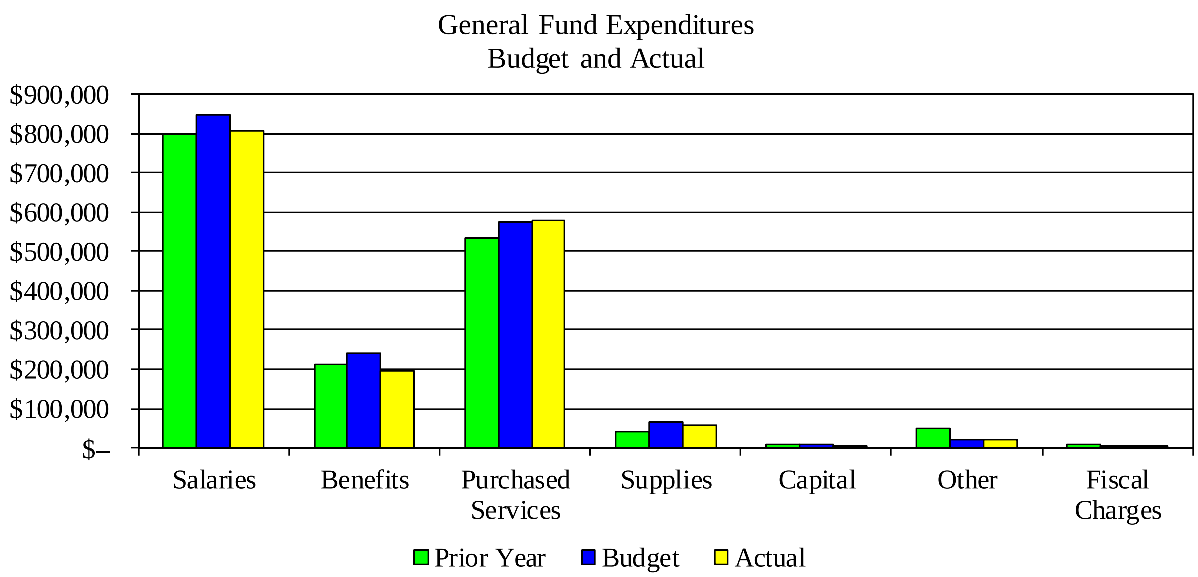
Fund balance as a percentage of expenditures is one key measure of the Academy's financial health. The resources represented by this fund balance are critical to the Academy's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. For the Academy, this ratio was 20.5 percent at the end of 2014, as compared to 12.5 percent at the end of 2013.

GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the Academy's General Fund revenue and expenditures for 2014:



Total General Fund revenues for 2014 were $1,797,145, an increase of $87,230 from the prior year, and $27,443 over budget. State aid revenue was $96,638 more than the prior year, mainly due to the Academy earning more general education revenue aid due to serving more students, and more charter school lease aid due incurring more reimbursable lease expenditures by leasing additional space in the current year.



Total General Fund expenditures for 2014 were $1,662,627, an increase of $16,422 from the prior year. The increase was mainly in purchased service costs, which were $48,128 higher than last year due to a $45,898 increase in building lease expenditures.

Expenditures were under budget by $91,648 in total. Salaries and benefits were under budget by $85,863, mainly in the regular and special education instruction program areas, due to lower than anticipated costs for teacher bonuses and Q Comp, staff turnover, and employees opting out of health insurance.

FOOD SERVICE SPECIAL REVENUE FUND

In the Food Service Special Revenue Fund, revenues exceeded expenditures by $254 during the year in the Academy's school milk program.

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
	2014	2013	(Decrease)
Total net position – governmental activities			
Total fund balances – governmental funds	$ 341,620	$ 206,848	$ 134,772
Capital assets	82,567	80,863	1,704
Accumulated depreciation	(73,352)	(72,581)	(771)
Total net position – governmental activities	$ 350,835	$ 215,130	$ 135,705
Net position			
Net investment in capital assets	$ 9,215	$ 8,282	$ 933
Restricted for food service	680	426	254
Unrestricted	340,940	206,422	134,518
Total net position	$ 350,835	$ 215,130	$ 135,705

The Academy's total net position at June 30, 2014 was $135,705 higher than the previous year. The Academy's net investment in capital assets increased $933 due to a new server purchased during the year and a disposal of a software program. Unrestricted net position increased $134,518 due to the operating results in the Academy's General Fund.

LEGISLATIVE SUMMARY

The 2014 legislative session began with a projected budget excess for the remainder of the biennium of $1.09 billion, later revised upward to a projected excess of $1.23 billion in the February 2014 economic forecast. In addition to the bonding bill and supplemental budget typically addressed during an even-year short session, the projected excess enabled the legislature to repay $246 million of K–12 education finance shifts and to replenish the state "Rainy Day Fund" budget reserve with the addition of $150 million. The supplemental budget adopted by the 2014 legislature contained $54.0 million in additional state aid appropriations for K–12 education for fiscal year 2015, including a $25 increase to the basic general education formula allowance. The 2014 legislature also adopted a number of technical corrections and modifications to the significant education funding changes adopted by the 2013 legislature.

The following is a brief summary of recent legislative changes and issues affecting the future funding of Minnesota school districts and charters schools.

Basic General Education Revenue – The per pupil basic general education formula allowance for fiscal year (FY) 2015 was set to increase $504 to $5,806, with simultaneous changes to pupil weights and the general education formula structure reducing the increase to the equivalent of a $80 per pupil state-wide. The 2014 legislature approved an additional $25 increase, bringing the FY 2015 formula allowance to $5,831. It was also clarified that declining enrollment revenue for charter schools is based on its decline in pupil units and not the state average.

Pupil Unit Weights – Pupil unit weights for FY 2015 will change as follows:

	FY 2014	FY 2015
Pre-Kindergarten and Disabled Kindergarten	1.25	1.0
Part-Time Kindergarten (under 850 instruction hours)	0.612	0.55
All-Day Kindergarten (at least 850 instruction hours)	0.612	1.0
Grades 1–3	1.115	1.0
Grades 4–6	1.06	1.0
Grades 7–12	1.30	1.2

Other Changes to the General Education Formula – A number of other changes were made to general education formula for FY 2015, including:

- Marginal cost pupil units are eliminated and a new declining enrollment revenue component of general education aid is established equal to the decline in adjusted pupil units between the prior year and current year times 28 percent of the basic general education aid allowance.
- The extended time allowance increases from $4,601 to $5,017.
- The equity revenue allowance increases; from $75 to $80 for sliding scale, and from $46 to $50 for flat rate.
- The pension adjustment reduction to general education aid is eliminated, with districts or charter schools having a below average pension adjustment guaranteed to receive a minimum of the state average gain from the elimination of the pension adjustment.
- Q-Comp revenue is rolled out of the general education formula and established as a separate categorical aid, and the transition revenue calculation is amended to adjust for the roll-out.

Special Education Funding Reform – State funding for special education is being transitioned to new funding formulas that will be effective beginning in FY 2016.

The funding formula for state special education aid remains the same through FY 2015. For FY 2016, special education will be the lesser of: 62 percent of old formula special education expenditures for the prior year; 50 percent of nonfederal special education expenditures for the prior year; or 56 percent of the amount calculated using a new pupil driven formula based on prior year data.

Beginning in FY 2015, special education tuition billing is changed so that the resident district is responsible for 90 percent of unfunded costs (vs. 100 percent currently) and the serving district or charter school is responsible for 10 percent of unfunded costs for open-enrolled students. This does not apply to students placed by tuition agreement, or served by a charter school with at least 70 percent special education students.

Beginning in FY 2016, special education aid will be paid directly to cooperatives and intermediate districts, rather than flowing through the resident districts. Tuition bills will be reduced by the aid paid directly to these entities.

A new special education cross subsidy reduction aid was added for FY 2014 and FY 2015 only. Aid for FY 2015 will equal the lesser of $48 per ADM served or 2.27 percent of the amount generated for the district under the new pupil-based formula, with a statewide limit of $30 million.

The formula for special education excess cost aid was simplified beginning in FY 2014 by basing the calculation on prior year data and excluding special education tuition receipts and expenditures. For FY 2016, excess cost aid will be the greater of: 56 percent of the difference between the district's unreimbursed nonfederal special education costs and 7 percent of the district's general education revenue; or 62 percent of the difference between the district's unreimbursed old formula special education costs and 2.5 percent of the district's general education revenue.

Teacher Development and Evaluation Aid – For FY 2015 only, school districts, intermediate districts, and charter schools not receiving Q-comp revenue are eligible for teacher development and evaluation aid equal to $302 times the number of full-time equivalent teachers employed on October 1 of the previous school year. The entitlement is limited to $10 million state-wide.

Child Nutrition Program Aids – Beginning in FY 2015, state school lunch aid for reduced price lunch students increases from 12.5 cents per lunch to 52.5 cents, making lunches free for those students. State aid for school breakfasts for kindergarten students increases from 55 cents to $1.30, making school breakfasts free for all kindergarten students.

State Aid Final Payment Schedule – Beginning with FY 2015 final payments, the final payment schedule for charter schools is adjusted to be consistent with school districts as long as the metering of aid payments remain on a 90–10 schedule. Charter schools will go back to an accelerated final payment schedule if the current aid payment schedule drops below 90 percent in the future.

Leases – Beginning in FY 2015, Charter school lease agreements for space must include a clause that the charter school may exercise to break the lease if its charter is terminated or not renewed. Leases must also include a sum certain annual cost.

Preschool program – Charter school law language was amended to authorize charter schools to provide a free preschool or pre-kindergarten program; however, the primary focus of charter schools must remain on students aged 5–18.

Affiliated Building Corporation (ABC) – The requirements for a charter school to form an ABC have been updated as follows:

- The same requirements apply for all types of projects, whether building a new facility or renovating an existing one.
- The charter school forming the ABC must have been in existence for at least six consecutive years and have had a net positive unreserved general fund balance for the last three.
- ABCs are required to comply with IRS regulations for "supporting organizations," which allows for overlap of boardmembers between the charter school and supporting nonprofit companies.

ACCOUNTING AND AUDITING UPDATES

GASB Statement No. 68, Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statements No. 27 and No. 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB Statements No. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this statement.

This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a nonemployer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

Included in this statement are major changes in how employers that participate in cost-sharing pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting (government-wide and proprietary funds), a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability of all employers with benefits provided through the pension plan. A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions. In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all active and inactive employees that are provided with pensions through the pension plan.

Changes to Federal Grant Audit Requirements

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The "Super Circular" includes a number of significant changes to the federal Single Audit process, including: an increase in dollar threshold for requiring a Single Audit from $500,000 to $750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high risk auditees and from 25 percent to 20 percent for low risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from $10,000 to $25,000. Auditees are required to implement the administrative requirements of the new Super Circular by December 26, 2014. The revised audit requirements will be effective for fiscal year 2016 charter school audits.

COSO INTERNAL CONTROL FRAMEWORK

The clarified auditing standards applicable to governmental audits incorporate a definition of internal control that is based on the internal control integrated framework developed and issued in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May, 2013 COSO issued an updated framework which supersedes the original after December 15, 2014. The new COSO framework retains the basic definition of internal control and its five components established in its original framework, along with the fundamental requirements to consider these five components and to use judgment when assessing and evaluating the effectiveness of a system of internal controls. The new COSO framework enhances and clarifies a number of concepts from the original framework to make it easier to use and apply. One of the more significant enhancements was the establishment of 17 principles, associated with the five components of internal control, intended to assist users in understanding the requirements of effective internal control and designing effective systems of internal control.

The five components of internal control and 17 underlying principles are as follows:

Control Environment –

1. Organization demonstrates a commitment to integrity and ethical values.
2. Governing body is independent from management and exercises oversight control.
3. Management establishes structure, reporting lines, authority, and responsibilities.
4. Organization demonstrates a commitment to the competence of individuals involved with internal control.
5. Organization holds individuals accountable for internal control responsibilities.

Risk Assessment –

6. Organization specifies clear objectives for the identification and assessment of risks.
7. Organization identifies and analyzes risk.
8. Organization assesses the potential for fraud risks.
9. Organization identifies and assesses significant changes that could impact internal control.

Control Activities –

10. Organization selects and develops control activities to mitigate risks.
11. Organization selects and develops general information technology (IT) controls.
12. Organization establishes and implements control policies and procedures.

Information and Communication –

13. Organization uses relevant, quality information to support internal control.
14. Organization communicates internal control information internally.
15. Organization communicates internal control information externally.

Monitoring –

16. Organization conducts ongoing and/or separate internal control evaluations.
17. Organization evaluates and communicates deficiencies to responsible parties for corrective action.

COSO defines an effective system of internal control as one that reduces to an acceptable level the risk of failing to achieve an organizational objective in the areas of operations, compliance, or reporting. According to the new framework, an organization can achieve effective internal control by applying all of the principles listed above. To achieve this, each of these five components and the relevant principles must be present and functioning, and the five components must operate in an integrated manner. Local governments should be reviewing their internal control systems to assure these principles have been incorporated and implemented.