

ASU Preparatory Academy

**Financial Statements,
Supplementary Information
and
Single Audit Reports**

Year Ended June 30, 2019

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Independent Auditors' Report

To the Board of Directors of
ASU Preparatory Academy
Tempe, Arizona

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of ASU Preparatory Academy (ASU Prep, a nonprofit organization), which comprise the consolidated statement of financial position as of June 30, 2019, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of ASU Prep as of June 30, 2019, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 to the financial statements, in the year ended June 30, 2019, ASU Prep adopted new accounting guidance Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities*, which requires various presentation changes to not-for-profit financial statements. Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the financial statements, in the year ended June 30, 2019, ASU Prep adopted new accounting guidance Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2018-18, *Not-for-Profit Entities (Topic 958) – Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which clarifies and improves the scope and the accounting guidance for contributions received and made by not-for-profit organizations. Our opinion is not modified with respect to this matter.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated August 30, 2019 on our consideration of ASU Prep's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 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 ASU Prep's internal control over financial reporting and compliance.

Fester & Chapman, PLLC

August 30, 2019

ASU Preparatory Academy

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2019

ASSETS

| | |
|---------------------------------------|-----------------------------|
| Current assets: | |
| Cash | \$ 2,707,029 |
| Restricted cash, current portion | 123,169 |
| Due from government | 1,052,452 |
| Pledges receivable | 5,092,627 |
| Prepaid expenses and other assets | <u>292,432</u> |
| Total current assets | 9,267,709 |
| Property and equipment: | |
| Land and improvements | 1,530,092 |
| Buildings and improvements | 4,240,872 |
| Curriculum software | 5,509,768 |
| Furniture, fixtures and equipment | 1,467,212 |
| Leasehold improvements | 1,033,357 |
| Curriculum software under development | 2,115,390 |
| Less accumulated depreciation | <u>(4,326,590)</u> |
| | 11,570,101 |
| Restricted cash, noncurrent portion | <u>392,770</u> |
| Total assets | <u><u>\$ 21,230,580</u></u> |

LIABILITIES AND NET ASSETS

| | |
|------------------------------------|-----------------------------|
| Current liabilities: | |
| Accounts payable | \$ 3,773,773 |
| Accrued payroll and related | 1,473,903 |
| Deferred revenue | 800,073 |
| Long-term debt, current portion | 105,000 |
| Line-of-credit | <u>800,000</u> |
| Total current liabilities | 6,952,749 |
| Long-term debt, noncurrent portion | <u>4,658,760</u> |
| Total liabilities | 11,611,509 |
| Net assets: | |
| Without donor restrictions | 3,505,927 |
| With donor restrictions | <u>6,113,144</u> |
| Total net assets | <u><u>9,619,071</u></u> |
| Total liabilities and net assets | <u><u>\$ 21,230,580</u></u> |

The accompanying notes are an integral part of these statements.

ASU Preparatory Academy

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended June 30, 2019

| | Without Donor <u>Restrictions</u> | With Donor <u>Restrictions</u> | <u>Total</u> |
|---|---|-----------------------------------|---------------------|
| Revenue and support: | | | |
| State aid | \$ 24,384,058 | \$ 1,838,574 | \$ 26,222,632 |
| Tuition | 1,940,995 | | 1,940,995 |
| Grants | 3,322,297 | | 3,322,297 |
| Content licensing | 668,499 | | 668,499 |
| Contributions | 8,392,504 | 5,000,000 | 13,392,504 |
| Tax credit contributions | | 122,137 | 122,137 |
| Student activities | 340,695 | | 340,695 |
| In-kind donations | 3,388,006 | | 3,388,006 |
| Miscellaneous | 202,283 | | 202,283 |
| Net assets released from restrictions: | | | |
| Satisfaction of donor requirements | <u>3,265,588</u> | <u>(3,265,588)</u> | |
| Total revenue and support | 45,904,925 | 3,695,123 | 49,600,048 |
| Expenses: | | | |
| Program services: | | | |
| Instruction | 25,392,307 | | 25,392,307 |
| Instructional support | 8,070,380 | | 8,070,380 |
| Supporting services: | | | |
| Management and general | 9,287,483 | | 9,287,483 |
| Operation and maintenance | 4,161,321 | | 4,161,321 |
| Transportation | 414,094 | | 414,094 |
| Operation of noninstructional services | <u>588,490</u> | | <u>588,490</u> |
| Total expenses | <u>47,914,075</u> | | <u>47,914,075</u> |
| Revenue and support less expenses | (2,009,150) | 3,695,123 | 1,685,973 |
| Nonoperating gains (losses): | | | |
| Excess of assets acquired over liabilities assumed in acquisition | 3,334,359 | | 3,334,359 |
| Loss on pledges receivable | | <u>(4,711,840)</u> | <u>(4,711,840)</u> |
| Total nonoperating gains (losses) | <u>3,334,359</u> | <u>(4,711,840)</u> | <u>(1,377,481)</u> |
| Change in net assets | 1,325,209 | (1,016,717) | 308,492 |
| Net assets, beginning of year (as restated) | <u>2,180,718</u> | <u>7,129,861</u> | <u>9,310,579</u> |
| Net assets, end of year | <u>\$ 3,505,927</u> | <u>\$ 6,113,144</u> | <u>\$ 9,619,071</u> |

The accompanying notes are an integral part of these statements.

ASU Preparatory Academy

CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended June 30, 2019

| | |
|---|----------------------------|
| Cash flows from operating activities: | |
| Cash received from services, grants, and contributions | \$ 41,537,095 |
| Cash received from interest | 28,640 |
| Cash payments to employees for services | (29,287,687) |
| Cash payments to suppliers for goods and services | (11,221,117) |
| Cash payments for interest | <u>(359,406)</u> |
| Net cash provided by operating activities | 697,525 |
| Cash flows from investing activities: | |
| Proceeds from sale of investments | 1,479,955 |
| Net deposits to restricted cash accounts | (66,400) |
| Proceeds from acquisition | 2,049,268 |
| Payments for purchases of property and equipment | <u>(1,954,434)</u> |
| Net cash provided by investing activities | 1,508,389 |
| Cash flows from financing activities: | |
| Principal payments on long-term debt | (100,000) |
| Net payments on line-of-credit | <u>(1,250,366)</u> |
| Net cash used by financing activities | <u>(1,350,366)</u> |
| Net increase in cash | 855,548 |
| Cash, beginning of year | <u>1,851,481</u> |
| Cash, end of year | <u><u>\$ 2,707,029</u></u> |
| Cash flows from operating activities: | |
| Change in net assets | \$ 308,492 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | |
| Depreciation | 2,228,021 |
| Amortization of loan issuance costs | 12,207 |
| Loss on pledges receivable | 4,711,840 |
| Excess of assets acquired over liabilities assumed in acquisition | (3,334,359) |
| Changes in: | |
| Due from government | (357,661) |
| Pledges receivable | (5,011,450) |
| Prepaid expenses and other assets | 36,427 |
| Accounts payable | 626,415 |
| Accrued payroll and related | 748,600 |
| Deferred revenue | <u>728,993</u> |
| Net cash provided by operating activities | <u><u>\$ 697,525</u></u> |

The accompanying notes are an integral part of these statements.

ASU Preparatory Academy

CONSOLIDATED STATEMENT OF CASH FLOWS - CONTINUED

Year Ended June 30, 2019

Supplemental disclosures:

| | |
|------------------------|------------|
| Cash paid for interest | \$ 359,406 |
|------------------------|------------|

Noncash investing and financing activity in acquisition:

| | |
|------------------------|--------------|
| Property and equipment | \$ 5,506,839 |
| Short-term investments | \$ 1,461,604 |
| Restricted cash | \$ 449,539 |
| Long-term debt | \$ 4,851,553 |
| Line-of-credit | \$ 1,350,366 |

The accompanying notes are an integral part of these statements.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

University Public Schools, Inc. (UPSI) was formed in July 2007 to operate a public school under the laws of the State of Arizona applicable to charter schools. In July 2013, UPSI changed its name from University Public Schools, Inc. to ASU Preparatory Academy (ASU Prep). ASU Prep derives program funding primarily from state educational aid, government grants and contributions.

ASU Prep has an affiliation agreement with Arizona State University (ASU) where the agreement provides ASU with opportunities to promote innovative teaching methods, teacher training methods, curriculum, school administration, professional development and educational research. ASU Prep, through the affiliation may obtain certain services from ASU, including the participation of ASU faculty and staff and may use ASU's trademark in the conduct of school activities. ASU may from time-to-time provide an affiliation payment for consideration of the services provided by ASU Prep. In addition, ASU Prep's by-laws require that two members of the Board of Directors be appointed by the President of ASU and be either employed by or an independent contractor engaged by ASU.

The Gary K. Herberger Young Scholars Academy, LLC is a private school wholly owned by ASU Prep. The Gary K. Herberger Young Scholars Academy, LLC offers a learning environment designed for highly gifted middle school students. The Academy began offering classes in August 2011.

ASU Prep Global Academy is a not-for-profit 501(c)(3) organization incorporated in the State of Arizona. ASU Prep Global Academy offers online high school and college prep curriculum to students around the world. ASU Prep is the sole member of ASU Prep Global Academy.

The significant accounting policies of ASU Prep follow:

Principles of Consolidation: The consolidated financial statements represent the accounts of ASU Preparatory Academy, The Gary K. Herberger Young Scholars Academy, LLC, and ASU Prep Global Academy. All significant intercompany transactions and accounts have been eliminated. The consolidated financial statements are not those of a separate legal entity.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -
Continued

Basis of Presentation: Financial statement presentation follows the recommendations of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) topic of *Not-for-Profit Entities*. ASU Prep is required to report information regarding its financial position and activities according to two classes of net assets:

Net Assets Without Donor Restrictions – Net assets available for use in general operations and not subject to donor (or certain grantor) restrictions.

Net Assets With Donor Restrictions – Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the restricted stipulated purpose for which the resource was restricted has been fulfilled, or both.

Use of Estimates: In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributions: ASU Prep follows the FASB ASC subtopic of *Revenue Recognition for Not-for-Profit Entities*. Contributions received are recorded as unrestricted or restricted support based on the existence and/or nature of any donor restrictions. All donor restricted support is reported as an increase in net assets with donor restrictions. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statement of activities as net assets released from restrictions.

Due from Government: Due from government consists mainly of state approved payments to ASU Prep to operate the charter school. ASU Prep has never experienced any losses due to non-payment, and expects none from the June 30, 2019 balances, and therefore has not established an allowance for uncollectibility.

Pledges Receivable: Pledges receivable are recognized as revenue when an unconditional promise to give is received, and are stated at the net present value of expected cash flows, less an estimated allowance for doubtful accounts. During the year ended June 30, 2019, a major donor decided to cancel its commitment to ASU Prep and therefore a loss on pledges receivable totaling approximately \$4.7 million was recorded. However, at June 30, 2019, 98% of pledges receivable were due from ASU. ASU Prep has never experienced any losses due to non-payment from them, and expects none, and therefore has not established an allowance for uncollectibility.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -
Continued

Property and Equipment: All acquisitions of property and equipment with an initial cost of \$5,000 or more and an estimated life of one year or more are capitalized. Assets are stated at cost. Donations of property and equipment are recorded at estimated fair value as of the date of donation. Depreciation is provided on the straight-line basis over the following estimated useful lives of the respective assets:

| | |
|-----------------------------------|--|
| Buildings and improvements | 5-30 years |
| Furniture, fixtures and equipment | 3-10 years |
| Leasehold improvements | Lesser of the estimated useful life or remaining term of applicable lease |
| Curriculum software | 2-5 years |

Deferred Revenue: Deferred revenue consists of tuition fees for pre-kindergarten and kindergarten collected in advance for the next school year. Also, ASU Prep records funds received from grant awards classified as exchange transactions as deferred revenue until the related funds are expended and/or the services related to the awards are performed, at which time the funds are recognized as revenue.

Advertising: Advertising costs are expensed as incurred. During the year ended June 30, 2019, ASU Prep had \$92,452 in advertising costs.

In-Kind Donations: ASU Prep records revenue and a corresponding expense for in-kind rent at its estimated fair value and in-kind services that create or enhance non-financial assets or that require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided. The value of in-kind services is determined based on the estimated fair value of the services received or the increase in the fair value of the assets that are attributable to the in-kind services. Total in-kind rent for school sites and in-kind professional services received during the year ended June 30, 2019 was \$1,104,245 and \$2,283,761, respectively.

Expense Allocation: The costs of providing various programs and other activities have been summarized on a functional basis in Note 9 to the consolidated financial statements. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income Taxes: ASU Prep and ASU Prep Global Academy are exempt from federal and state income taxes as an organization other than a private foundation under Section 501(c)(3) of the Internal Revenue Code and similar state provisions.

Gary K. Herberger Young Scholars Academy, LLC is single member LLC owned by ASU Prep, and therefore is considered a disregarded entity for income tax purposes. Accordingly, no provision for income taxes has been made.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -
Continued

Change in Accounting Principle: On August 18, 2016, FASB issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. A key change required by ASU 2016-14 is the net asset classes used in these financial statements. Amounts previously reported as unrestricted net assets are now reported as net assets without donor restrictions and amounts previously reported as temporarily restricted net assets are now reported as net assets with donor restrictions. A footnote on liquidity has also been added, see (Note 3).

On June 21, 2018, FASB issued Accounting Standards Update (ASU) 2018-18, *Not-for-Profit Entities (Topic 958) – Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The update provides a more robust framework for determining whether a transaction should be accounted for as a contribution or as an exchange transaction by clarifying how a not-for-profit organization determines whether a resource provider is participating in an exchange transaction.

NOTE 2 - BEGINNING NET ASSETS RESTATEMENT

During the year ended June 30, 2019, ASU Prep determined that unspent classroom site fund monies should be reclassified as net assets with donor restrictions as a result of implementing ASU 2018-18, *Not-for-Profit Entities (Topic 958) – Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The effect on net assets as of the beginning of the fiscal year is summarized below:

| | Without Donor <u>Restrictions</u> | With Donor <u>Restrictions</u> | <u>Total</u> |
|-----------------------------------|---|-----------------------------------|---------------------|
| Beginning net assets | \$ 2,517,497 | \$ 6,793,082 | \$ 9,310,579 |
| Restatement | (336,779) | 336,779 | |
| Beginning net assets, as restated | <u>\$ 2,180,718</u> | <u>\$ 7,129,861</u> | <u>\$ 9,310,579</u> |

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 3 - LIQUIDITY AND AVAILABILITY

ASU Prep monitors its liquidity so that it is able to meet its operating needs and other contractual commitments. ASU Prep has the following financial assets that could readily be made available within one year of each fiscal year end to fund expenses without limitations:

| | <u>2019</u> |
|--|---------------------|
| Financial assets included in current assets: | |
| Cash | \$ 2,707,029 |
| Restricted cash, current portion | 123,169 |
| Due from government | 1,052,452 |
| Pledges receivable | <u>5,092,627</u> |
| Total financial assets included in current assets | 8,975,277 |
| Less amounts unavailable for general expenditure within one year: | |
| Classroom Site Funds carryover | 711,665 |
| Restricted cash, current portion | 123,169 |
| Tax credit contributions restricted for extracurricular activities | <u>334,218</u> |
| Financial assets available to meet cash needs for general expenditures within one year | <u>\$ 7,806,225</u> |

In addition to financial assets available to meet general expenditures over the year, ASU Prep operates with a balanced budget and anticipates covering its general expenditures by collecting revenue from the State of Arizona, contributions, grants, and other revenues; and by utilizing donor-restricted resources from current and prior year gifts. Also, ASU Prep maintains a \$1,000,000 line-of-credit (see Note 5) with a financial institution that is drawn upon as needed to manage cash flow.

NOTE 4 - CONCENTRATION OF CREDIT RISK

ASU Prep maintains cash balances at a financial institution, which is insured by the Federal Deposit Insurance Corporation (FDIC). At times, such cash may be in excess of FDIC insurance limits. ASU Prep has not experienced any losses in such accounts and management believes it is not exposed to any significant risks related to these accounts.

NOTE 5 - LINE-OF-CREDIT

ASU Prep has a \$1,000,000 line-of-credit with a financial institution. Interest of 5.74% is payable monthly, with all outstanding principal and interest due in August 2019. As of June 30, 2019, the outstanding balance was \$800,000.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 6 - LONG-TERM DEBT

\$5,500,000 Education Facility Revenue Bonds (Phoenix Collegiate Academy Project) Series 2012, issued by the Industrial Development Authority of the City of Phoenix, Arizona. The proceeds from the bonds were loaned to Phoenix Collegiate Academy, Inc. pursuant to a loan agreement dated November 1, 2012. The loan matures over 30 years with an interest rate of 5.00% to 5.625%. Principal is due July 1 each year, beginning July 1, 2015, and interest is due semiannually on January 1 and July 1, beginning July 1, 2013. The note is secured by a deed of trust on real property. ASU Prep assumed the loan on July 1, 2018. Under the loan agreement, ASU Prep is required to comply with certain financial covenants. At June 30, 2019, ASU Prep was in compliance with these covenants and a calculation of them is shown on the following page. \$ 5,049,583

| | |
|--------------------------------------|---------------------|
| Less current maturities | 105,000 |
| Less unamortized loan issuance costs | 285,823 |
| | <u>\$ 4,658,760</u> |

The future minimum payments on long-term debt are as follows:

| | |
|--------------------------------------|---------------------|
| Year ending June 30: | |
| 2020 | \$ 105,000 |
| 2021 | 110,000 |
| 2022 | 115,000 |
| 2023 | 120,000 |
| 2024 | 130,000 |
| Thereafter | 4,469,583 |
| | 5,049,583 |
| Less unamortized loan issuance costs | 285,823 |
| Total | <u>\$ 4,763,760</u> |

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 6 - LONG-TERM DEBT - Continued

The debt service coverage ratio compliance covenant is calculated by dividing the Net Income Available for Debt Service of the pledged school sites by the Maximum Annual Debt Service for the bonds for the pledged school sites, as defined in the bonds. For the year ended June 30, 2019, the debt service coverage ratio is calculated as follows:

| | |
|--|---------------------|
| Change in net assets | \$ 2,312,035 |
| Add: | |
| Amortization of loan issuance costs | 12,207 |
| Depreciation expense | 177,118 |
| Interest expense related to the 2012 Bonds | <u>275,750</u> |
| Net income available for debt service | <u>\$ 2,777,110</u> |
| Maximum annual debt service under the 2012 Bonds | <u>\$ 381,094</u> |
| Debt service coverage ratio | <u><u>7.29</u></u> |

The liquidity coverage compliance covenant is calculated by dividing the Net Current Assets of the pledged school sites by the Operating Expenses for the pledged school sites, as defined in the bonds. For the year ended June 30, 2019, the liquidity coverage is calculated as follows:

| | |
|-------------------------------------|---------------------|
| Net current assets | \$ 4,214,169 |
| Operating expenses | 8,427,092 |
| Less: | |
| Amortization of loan issuance costs | (12,207) |
| Depreciation expense | (177,118) |
| Total operating expenses | <u>\$ 8,237,767</u> |
| Liquidity coverage | <u>51%</u> |

NOTE 7 - COLLABORATION AGREEMENT AND OPERATING LEASES

ASU Prep pays an annual administrative fee for its use of a school facility as part of a collaboration agreement. ASU Prep also leases office space under the provisions of long-term lease agreements classified as operating leases. Rental expenses under these agreements for the year ended June 30, 2019 totaled \$2,517,496, of which approximately \$1,100,000 of this amount was donated by ASU and is recorded as in-kind rent. Future minimum commitments are as follows:

| | |
|----------------------|----------------------------|
| Year ending June 30: | |
| 2020 | \$ 733,562 |
| 2021 | <u>595,390</u> |
| | <u><u>\$ 1,328,952</u></u> |

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 8 - NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions released from restrictions for the year ending June 30, 2019 consisted of the following:

| | |
|----------------------|---------------------|
| Academic programs | \$ 1,801,900 |
| Classroom Site Funds | <u>1,463,688</u> |
| | <u>\$ 3,265,588</u> |

Net assets with donor restrictions consisted of the following at June 30, 2019:

| | |
|---|---------------------|
| Time restricted donor pledges | \$ 5,000,000 |
| Classroom Site Funds | 711,665 |
| Tax credit contributions restricted for extracurricular activities | 334,218 |
| Academic programs | <u>67,261</u> |
| | <u>\$ 6,113,144</u> |

NOTE 9 - CONDITIONAL CONTRIBUTIONS

ASU Prep received conditional contributions during the fiscal year ending June 30, 2019. Conditional contributions are recorded when the donor-imposed conditions are substantially met. Certain conditions are required to be met by ASU Prep in the subsequent years in order to earn and receive these amounts. As of June 30, 2019, amounts awarded but not yet earned totaled \$1,633,766. While management believes that ASU Prep will meet these conditions, they had not been met as of the year ended June 30, 2019. Accordingly, no amount has been recorded for these conditional contributions as a receivable in these consolidated financial statements.

NOTE 10 - RELATED PARTY TRANSACTIONS

ASU Prep has an affiliation agreement with ASU. ASU Prep recorded in-kind rent and professional services of \$3,388,006 received from ASU during the year ended June 30, 2019. In addition, ASU made cash contributions to ASU Prep totaling 13,317,656 during the year ended June 30, 2019.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 11 - FUNCTIONAL EXPENSE ALLOCATIONS

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. Expenses are allocated on the basis of estimates of proportional use or time and effort.

The following is a summary of ASU Prep's expenses by function for the year ended June 30, 2019:

| | Program Services | Supporting Services | Total |
|-----------------------------------|----------------------|------------------------|----------------------|
| Wages and salaries | \$ 18,170,537 | \$ 4,925,935 | \$ 23,096,472 |
| Payroll taxes and fringe benefits | 5,896,968 | 1,042,847 | 6,939,815 |
| Professional services | 1,682,874 | 3,621,832 | 5,304,706 |
| Supplies and instructional aids | 2,233,724 | 435,770 | 2,669,494 |
| Food service | 754,996 | | 754,996 |
| Travel and training | 365,932 | 185,612 | 551,544 |
| Repairs and maintenance | 27,492 | 740,916 | 768,408 |
| Transportation | 9,879 | 413,554 | 423,433 |
| Depreciation | 1,752,836 | 475,185 | 2,228,021 |
| Advertising | | 92,452 | 92,452 |
| Dues and fees | 34,745 | 318,460 | 353,205 |
| Insurance | | 94,746 | 94,746 |
| Office and administration | 65,020 | 234,304 | 299,324 |
| Information technology | 134,552 | 227,718 | 362,270 |
| Utilities | 234 | 539,174 | 539,408 |
| Rent | 1,980,573 | 536,923 | 2,517,496 |
| Interest expense | 92,313 | 267,093 | 359,406 |
| Other | 260,012 | 298,867 | 558,879 |
| Total expenses | <u>\$ 33,462,687</u> | <u>\$ 14,451,388</u> | <u>\$ 47,914,075</u> |

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 12 - RETIREMENT PLAN

Plan Description: Permanent full-time and certain part-time employees of ASU Prep participate in a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes financial statements and required supplementary information. The report is available on its website at www.azasrs.gov.

Funding Policy: The Arizona State Legislature establishes and may amend active plan members' and ASU Prep's contribution rates. For the year ended June 30, 2019, active plan members and ASU Prep were each required by statute to contribute at the actuarially determined rate of 11.80 percent (11.64 percent retirement and 0.16 percent long-term disability). ASU Prep's contributions to ASRS for the year ended June 30, 2019 were \$2,540,445, which was equal to the required contributions.

NOTE 13 - COMMITMENTS AND CONTINGENT LIABILITIES

Compliance: ASU Prep's compliance with certain laws and regulations is subject to review by the State of Arizona, Office of the Auditor General and Department of Education. While ASU Prep believes its schools are in compliance with all laws and regulations, such reviews could result in adjustments or withholding of the school's State Equalization or Classroom Site Funds. Management is not aware of any such adjustments or withholdings as of June 30, 2019.

NOTE 14 - ECONOMIC DEPENDENCY

For the year ended June 30, 2019, approximately 58% of ASU Prep's revenue was derived from the State of Arizona through payments of State Equalization, Classroom Site Funds (Proposition 301), Instructional Improvement Funds, State of Arizona grants, and federal grants passed through the State of Arizona. Non-federal funds that are paid from the State of Arizona are subject to funding approval from the state legislature. Changes in state funding levels for charter schools could have a significant impact on ASU Prep's future revenues.

For the year ended June 30, 2019, 34% of ASU Prep's revenue received as cash and in-kind donations was from ASU, and 98% of pledges receivable were due from ASU as of June 30, 2019.

ASU Preparatory Academy

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2019

NOTE 15 - ACQUISITION OF PHOENIX COLLEGIATE ACADEMY, INC.

Effective July 1, 2018, ASU Prep completed an acquisition of the assets and assumed the liabilities of Phoenix Collegiate Academy, Inc (PCA), an Arizona nonprofit organization. There was no cash consideration involved in this acquisition. ASU Prep's primary reason for the acquisition of PCA was to further its mission of providing K-12 instruction. ASU Prep assumed the rights, title, and interest of all PCA's assets. As a result of the acquisition, PCA was incorporated into ASU Prep's operations and is no longer a separate, stand-alone 501(c)(3) organization.

Fair values of PCA's major classes of assets acquired and liabilities assumed by ASU Prep were as follows:

| | |
|--|---------------------|
| Assets: | |
| Cash | \$ 2,049,268 |
| Short-term investments | 1,461,604 |
| Restricted cash | 449,539 |
| Due from government | 533,124 |
| Property and equipment | 5,536,388 |
| Other assets | <u>13,350</u> |
| Total assets | <u>10,043,273</u> |
| Liabilities: | |
| Long-term debt | 4,851,553 |
| Line-of-credit | 1,350,366 |
| Other liabilities | <u>506,995</u> |
| Total liabilities | <u>6,708,914</u> |
| Excess of assets acquired over liabilities assumed in acquisition | <u>\$ 3,334,359</u> |

NOTE 16 - SUBSEQUENT EVENTS

ASU Prep has evaluated subsequent events through August 30, 2019, the date which the financial statements were available to be issued, and has concluded that no events have occurred since the year ended June 30, 2019 that would require adjustment to the financial statements. However, ASU Prep did note the following event that occurred subsequent to the year end that should be disclosed:

In July 2019, the Gary K. Herberger Young Scholars Academy, LLC converted to a separate 501(c)(3) nonprofit organization, and ASU Prep no longer has any membership interest in it.

ASU Preparatory Academy

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2019

| <u>Federal Grantor/Pass-Through Grantor/ Program Title</u> | <u>Pass-Through Grantor's Number</u> | <u>CFDA Number</u> | <u>Program Expenditures</u> | <u>Passed Through to Subrecipients</u> |
|--|--|------------------------|---------------------------------|--|
| <u>U.S. Department of Agriculture</u> | | | | |
| Passed through Arizona Department of Education | | | | |
| Child Nutrition Cluster: | | | | |
| School Breakfast Program | ED09-0001 | 10.553 | \$ 122,929 | |
| National School Lunch Program | ED09-0001 | 10.555 | 446,325 | |
| <i>Total Child Nutrition Cluster</i> | | | <u>569,254</u> | |
| Child and Adult Care Food Program | KR02-1170-ALS | 10.558 | <u>140,592</u> | |
| Total U.S. Department of Agriculture | | | <u>709,846</u> | |
| <u>U.S. Department of Education</u> | | | | |
| Education Innovation and Research | N/A | 84.411 | 545,474 | |
| Passed through Arizona Department of Education | | | | |
| Title I Grants to Local Educational Agencies | S010A040003 | 84.010 | 853,574 | |
| Special Education Cluster (IDEA): | | | | |
| Special Education Grants to States | H027A0090007 | 84.027 | 324,126 | |
| Charter Schools | 18FCSP73-810658-01A, 18FCSP19-810646-01A | 84.282 | 443,016 | |
| Twenty-First Century Community Learning Centers | 18FCCLC2-810646-16C, 19FCCLC3-910646-16C | 84.287 | 114,545 | |
| English Language Acquisition State Grants | 18FELENG-810161-66A, 19FELENG-910161-66A | 84.365 | 30,847 | |
| Student Support and Academic Enrichment Program | 18FT4TIV-810646-01A | 84.424 | <u>3,000</u> | |
| Total U.S. Department of Education | | | <u>2,314,582</u> | |
| Total Expenditures of Federal Awards | | | <u>\$ 3,024,428</u> | |

See accompanying notes to this schedule.

ASU Preparatory Academy

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2019

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant transactions of ASU Preparatory Academy (ASU Prep) recorded on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

NOTE 2 - CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBERS

The program titles and CFDA numbers were obtained from the federal or pass-through grantors or the 2019 *Catalog of Federal Domestic Assistance*.

NOTE 3 - INDIRECT COST RATE

ASU Prep did not elect to use the 10 percent de minimis indirect cost rate as covered in 2 CFR §200.414.

NOTE 4 - SUBRECIPIENTS

ASU Prep did not pass any funds onto subrecipients during the year ended June 30, 2019.



**Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of the Consolidated Financial Statements
Performed in Accordance With *Government Auditing Standards***

To the Board of Directors of
ASU Preparatory Academy
Tempe, Arizona

We have audited, in accordance with the 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 consolidated financial statements of ASU Preparatory Academy (ASU Prep), which comprise the consolidated statement of financial position as of June 30, 2019, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated August 30, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ASU Prep'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ASU Prep's internal control. Accordingly, we do not express an opinion on the effectiveness of ASU Prep's internal control.

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. 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.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ASU Prep'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*.

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 ASU Prep's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ASU Prep's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Fester & Chapman, PLLC

August 30, 2019



**Independent Auditors' Report on Compliance For Each Major Federal Program
and Report on Internal Control Over Compliance Required by the Uniform Guidance**

To the Board of Directors of
ASU Preparatory Academy
Tempe, Arizona

Report on Compliance for Each Major Federal Program

We have audited ASU Preparatory Academy's (ASU Prep) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of ASU Prep's major federal programs for the year ended June 30, 2019. ASU Prep's major federal programs are identified in the summary of the auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of ASU Prep's major federal programs based on our audit of the types of compliance requirements referred to above. 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 audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about ASU Prep'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 on compliance for each major federal program. However, our audit does not provide a legal determination of ASU Prep's compliance.

Opinion on Each Major Federal Program

In our opinion, ASU Prep complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2019.

Report on Internal Control Over Compliance

Management of ASU Prep is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered ASU Prep's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 ASU Prep's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program 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 type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Fester & Chapman, PLLC

August 30, 2019

ASU Preparatory Academy

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year Ended June 30, 2019

SUMMARY OF AUDITORS' RESULTS

Financial Statements

| | | |
|---|------------|--------------------------------------|
| Type of Auditors' Report issued: | Unmodified | |
| | Yes | No |
| Material weaknesses identified in internal control over financial reporting? | _____ | _____ <u>X</u> _____ |
| Significant deficiencies identified not considered to be material weaknesses? | _____ | _____ <u>X</u> _____ (None reported) |
| Noncompliance material to the financial statements noted? | _____ | _____ <u>X</u> _____ |

Federal Awards

| | | |
|---|-------|--------------------------------------|
| Material weakness identified in internal control over major programs? | _____ | _____ <u>X</u> _____ |
| Significant deficiencies identified not considered to be material weaknesses? | _____ | _____ <u>X</u> _____ (None reported) |

Type of auditors' report issued on compliance for major programs: Unmodified

| | | |
|---|-------|----------------------|
| Any audit findings disclosed that are required to be reported in accordance with 2 CFR §200.516(a)? | _____ | _____ <u>X</u> _____ |
|---|-------|----------------------|

Identification of major programs:

| <u>CFDA Number</u> | <u>Name of Federal Program or Cluster</u> |
|--------------------|--|
| 84.010 | Title I Grants to Local Educational Agencies |
| 84.411 | Education Innovation and Research |

Dollar threshold used to distinguish between Type A and Type B programs: \$ 750,000

| | |
|--|----------------------|
| Auditee qualified as low-risk auditee? | _____ <u>X</u> _____ |
|--|----------------------|

Other Matters:

| | |
|--|----------------------|
| Auditee's Summary Schedule of Prior Findings required to be reported in accordance with 2 CFR §200.511(b)? | _____ <u>X</u> _____ |
|--|----------------------|

ASU Preparatory Academy

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year Ended June 30, 2019

FINANCIAL STATEMENT FINDINGS

None reported.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported.



SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Year Ended June 30, 2019

Status of Prior Year Financial Statement Findings

Finding No.: 2018-001 Cash
Status: Fully Corrected

Finding No.: 2018-002 Prepaid Expenses
Status: Fully Corrected