

# LarsonAllen<sup>LLP</sup>

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September 7, 2009

Members of the Board of Education  
Charter School No. 4194  
Cannon River STEM School  
Faribault, Minnesota

This Executive Audit Summary and Management Report presents information which we believe is important to you as members of the school board. We encourage you to review the sections of this report, the audited financial statements and the auditors' reports.

We would be pleased to furnish additional information with respect to these suggestions and discuss this memorandum with you at your convenience. We wish to express our appreciation to the School for the courtesies, cooperation and assistance extended to us during the course of our work.

**LarsonAllen LLP**



Dennis Hoogeveen, CPA  
Principal

**CANNON RIVER STEM SCHOOL  
CHARTER SCHOOL NO. 4194**

**EXECUTIVE AUDIT SUMMARY (EAS)**

**JUNE 30, 2009**



**CANNON RIVER STEM SCHOOL  
CHARTER SCHOOL NO. 4194  
EXECUTIVE AUDIT SUMMARY (EAS)  
TABLE OF CONTENTS  
JUNE 30, 2009**

**EXECUTIVE AUDIT SUMMARY**

AUDIT FINDINGS AND RESULTS 1

OTHER AUDIT AND ACCOUNTING MATTERS 2

**APPENDIX A**

LEGISLATIVE ACTIVITY 4

**APPENDIX B**

OTHER COMMENTS 7

**APPENDIX C**

FORMAL REQUIRED COMMUNICATIONS 16



**EXECUTIVE AUDIT SUMMARY (EAS)  
FOR  
CANNON RIVER STEM SCHOOL  
YEAR ENDED JUNE 30, 2009**

**AUDIT FINDINGS AND RESULTS**

**Audit Opinion** – The financial statements are fairly stated. We issued what is known as a “clean” audit report.

**Compliance** – No compliance issues were noted in our review of laws, regulations, contracts, grant agreements or other matters that could have significant financial implications to the School.

**Internal Controls** – A “material weakness” in internal controls was noted regarding the School having a lack of segregation of duties for business office job functions during much of the start-up period. This is common in a small start-up environment. Our audit is designed to take this into consideration. We expect that once operational and the service provider was providing support for the accounting function that this was no longer an issue. The School should continue the process of identifying opportunities to segregate job functions to ensure adequate controls are in place for fiscal 2010.

**Legal Compliance** – One compliance issue is reported with respect to Minnesota Statutes related to charter schools. The required corrective action plan related to this finding is included in the schedule of findings which will be filed with the Minnesota Department of Education.

**Fund Balance** – The fund balance of the School’s General Fund ended at a balance of \$3,079 at June 30, 2009. Because this was a start-up year and the revenue received thus far was limited primarily to federal start-up grant funds, it is expected that fund balance would not be significant. In terms of thinking more long-term, if the Board has not already done so, it should consider establishing a fund balance policy which establishes a target fund balance percentage. We typically recommend that an operating charter school develop a plan that will eventually result in a target fund balance that is 20% to 25% of annual expenditures. Fund balance is an important aspect in the School’s financial well being since a healthy fund balance represents things such as cash flow, as a cushion against unanticipated expenditures, enrollment declines, funding deficiencies, state aid metering changes, and aid prorations at the state level and similar problems.

**Budget** – Total General Fund revenues on a net basis were \$6,031 (or 10.2%) more than the budgeted amount while total expenditures were \$2,952 (or 5.0%) higher than had been budgeted. As part of any budget initiated for fiscal 2009-10, the Board will want to take these variances into consideration in order to limit budget differences to every extent possible. We recommend that budget variances in a charter school environment (which is more volatile than in a traditional school environment but on a much smaller scale) be limited to no more than 1% to 2% on either side of zero once the School is operational and the program has matured.

**Management Comment** - As a part of our audit procedures, we selected 25 general disbursements and reviewed them for proper support, approval and expenditure coding. During our testing, it was noted that 17 disbursements lacked evidence of proper approval. It is our recommendation that the school review the policies and procedures related to general disbursements and ensure that they are being followed.

## **OTHER AUDIT AND ACCOUNTING MATTERS**

**Keeping the Charter School in Sound Financial Condition** – LarsonAllen works with a number of Minnesota charter schools and we often provide training opportunities for charter school staff which are aimed at helping charter schools to stay on top of business and financial management issues that, if not handled correctly, may result in a charter school that is not viable in the long-term. In response to the question of what it takes to keep a charter school in sound financial condition, we'd like you to discuss the following characteristics as a school board and rate your school on each.

Below is a partial list of criteria that will help to assess if a charter school is in sound financial condition:

- Having enough cash on hand to pay current bills and those that are due shortly
- Having sufficient revenues to support expenditures on an ongoing basis with minimum reliance on the school's savings/fund equity
- Has demonstrated that it can meet long-term debt obligations and maintain a good credit rating
- Has demonstrated that it can provide education services at a level that meets the needs of all students demonstrated by student results that meet or exceed State standards
- Has an administrative staff that has demonstrated a commitment to professional development and continuing education
- Has a long-range fiscal plan that is compared frequently to actual progress and adjusted to meet dynamic environmental conditions
- Has maintained its buildings in a condition that avoids unexpected major renovation costs or has worked with the building owner to ensure an environment that provides a safe and educationally appropriate setting
- Has filed all state and federal reports and aid claims in a timely and accurate manner and has few or no major post-filing adjustments
- Has engaged an experienced auditing firm that encourages business staff to discuss changes in school accounting requirements as they arise, throughout the year
- Has frequent interaction that occurs between the school board and the administration relating to discussions of the school's fiscal status and trends

At least one board member should be considered "financially literate". This person understands financial statements and financial risks, understands the impact of business decisions on financial statements and can identify balance sheet risks while also understanding revenue recognition issues on the operating statement. This person should also serve as a liaison with the auditor.

**Responsibilities of Charter School Board Members** – Because of the changing oversight environment that has resulted from the failure of some boards of directors of public-held companies to properly exercise their responsibilities to the organization and to the shareholders, we felt it was appropriate to review the responsibilities of charter school board members. This information has been summarized based on materials prepared by PCPS, the AICPA's Alliance for CPA Firms.

There are four "duties" of charter school board members that we'd like to review.

**Duty of Care:** The care that "an ordinary prudent person would exercise in a like position and under similar circumstances". Characteristics that demonstrate such duty of care include:

- ✓ Attending board meetings regularly
- ✓ Showing independent judgment
- ✓ Being informed about organizational resources
- ✓ Delegating only to responsible individuals
- ✓ Following up regularly

**Duty of Loyalty:** Keeping in mind that by agreeing to participate in a charter school board that the interests of the school are of the utmost importance. Duty of loyalty manifests itself when:

- ✓ Members give undivided allegiance to the organization when making decisions that affect the organization
- ✓ Personal, family or business interests are not put above the organization's interests
- ✓ Conflicts of interest are avoided in both fact and in appearance

**Duty to Manage Accounts:** A major component of the Board's responsibility is to oversee financial management, including financial planning, budgeting, accounting, payroll, taxes and annual government filings. These are often accomplished through delegation but the ultimate responsibility remains with the Board, therefore, it is the Board's duty to manage accounts by:

- ✓ Overseeing the organization's executive director or equivalent position
- ✓ Checking that resources are used prudently
- ✓ Implementing procedures to ensure accurate records
- ✓ Ensuring that no one person has control over finance
- ✓ Accurate decision making is documented using board meeting minutes

**Duty of Obedience:** The State relies on this conceptual "duty of obedience" to know that state aids (as well as donors with their gifts) will be used appropriately and to ensure that the organization remains obedient to its central purpose. This is accomplished by establishing accountabilities which are also tools to keep the organization focused on its purpose. Central purposes are spelled out in articles of incorporation, by-laws, adopted mission statements, charter school sponsorship agreements and other governing documents. The school board demonstrates a duty of obedience through:

- ✓ Policies
- ✓ Programs
- ✓ Performance
- ✓ Process
- ✓ Value
- ✓ Outcomes and Effectiveness
- ✓ Efficiency and Economy
- ✓ Planning, Allocating and Managing



# APPENDIX A

## LEGISLATIVE ACTIVITY

What follows are some education-related highlights of recent legislative sessions as summarized from information made available by the Minnesota Department of Education, the Minnesota School Boards Association and the Minnesota House of Representatives.

### GENERAL EDUCATION REVENUE

#### Formula Allowance

The 2009 Legislature did not change the basic formula allowance, therefore, it will remain at \$5,124 per pupil unit for fiscal year 2010 and later.

No changes were made in the calculation of adjusted marginal cost pupil units--grade level pupil unit weightings and the 77% current year / 23% prior year marginal cost pupil unit calculations for declining enrollment districts remain unchanged.

#### One-Time General Education Aid Reduction Offset by Federal Fiscal Stabilization Funds in Fiscal 2010

Total state aid appropriations for E-12 education were reduced by \$500 million for the 2010–2011 biennium, and replaced with an equal amount of federal state fiscal stabilization funds under the American Recovery and Reinvestment Act of 2009 (ARRA). There was virtually no change in school district property tax levies for taxes payable in 2010 or 2011 (fiscal years 2011 and 2012).

The reduction is allocated among school districts and charter schools based on the district's fiscal 2008 general education revenue from state aid and levy, excluding referendum revenue. The reduction amount equals 7.82% of this revenue. This one-time reduction in general education aid is offset on a dollar-for-dollar basis by federal funds from the fiscal stabilization account created in the state treasury to hold the federal stimulus money. The federal funds are appropriated in fiscal 2010 and are available for obligation until September 30, 2011.

School districts and charter schools must apply to MDE to receive the federal fiscal stabilization funds. The federal fiscal stabilization funds may be used for any activity that is authorized under the following federal education acts:

- The Elementary and Secondary Education Act of 1965 (ESEA);
- The Individuals with Disabilities Education Act (IDEA);
- The Adult Education and Family Literacy Act (AEFLA); or
- The Carl D. Perkins Career and Technical Education Act of 2006 (Perkins)

The ARRA also provides that, to the extent consistent with state law, a school may use fiscal stabilization funds for modernization, renovation or repair of public school facilities, including modernization, renovation, and repairs that are consistent with a recognized green building rating system.

#### Q Comp Aid/Levy Breakdown

Statutes clarified that the change in the Q Comp formula enacted in 2007 which reduced the basic Q Comp aid from 73.1% to 65% of the revenue was effective for fiscal 2010 and later. This results in a decrease in the basic aid from \$190 to \$169 per pupil, with a corresponding increase in the equalized levy revenue (from \$70 to \$91 per pupil).

## **Access to Student Records; School Conferences**

A child's parent or guardian is allowed to designate a "significant individual" to participate in a school conference involving that child. The parent or guardian is required to give prior written consent to allow the individual to participate in the conference and have access to data on the child that is needed for and relevant to the conference. This section is effective for the 2009-2010 school year and later.

## **Legitimate Exemptions**

A student is allowed to be excused from school for mental health reasons with a note from a mental health professional.

## **District-Created Site-Governed Schools**

A school board is allowed to approve site-governed schools by requesting site governing school proposals from groups of licensed professionals and parents from one or more school districts. For an approved proposal, a district and the site council is required to enter into an agreement identifying the powers and duties, roles and responsibilities, revenue, and education performance standards to be delegated to the site.

Roles and responsibilities of site-governed schools – To the extent a self-governed school is supervised by a principal, the principal is required to be licensed.

Revenue to site-governed schools – The school district is allowed to retain an agreed-upon administrative fee for management services. The school district is allowed to provide and charge for agreed upon services to the school site. The site is allowed to carry forward unspent revenue.

Exemption from statutes and rules – Site-governed schools are exempted from the same laws and rules as charter schools, except that site-governed schools are subject to government data practices laws, the open meeting law, Public Employee Labor Relations Act (PELRA), teacher continuing contract and tenure laws, and teacher prep time and lunch requirements.

Performance standards – The school board and the site council are directed to agree to performance standards and expectations that include student achievement targets premised on multiple indicators, criteria and process addressing school sites that fail to meet accountability requirements, and other agreed-upon performance terms. Requires agreements to be filed with the commissioner. Establishes initial three-year agreements and annual reviews and allows subsequent agreements of up to five years based on school performance.

Board termination of self-governed school authority – A school board is allowed to terminate an agreement for cause. Site-governed schools terminated or not renewed for reasons other than for cause are allowed to seek charter school status and to become owners of all resources the school purchased as a site governed school.

## **Charter Schools**

Numerous revisions to state charter school laws were made, including those recommended by the Office of the Legislative Auditor in its 2008 report. Major changes include:

- State statute was clarified that the purpose of a charter school is not to reestablish a district school that that would otherwise close or has been closed.
- Makes ineligible to authorize charter schools those nonprofit organizations that are sectarian or religious institutions or are not incorporated in Minnesota.
- Allows the commissioner to approve up to three nonprofit organizations to be "single-purpose sponsors" whose sole purpose is to authorize charter schools and sets criteria for approval.

- Establishes the process by which an eligible authorizer must apply to the commissioner for approval to be an authorizer and sets criteria the commissioner must consider. (Sets a deadline of June 30, 2011, for current authorizers to receive approval to continue authorizing schools.)
- Directs the commissioner to review an authorizer's performance at least every five years and subject an authorizer that has not performed satisfactorily to corrective action.
- Requires charter school board members to begin attending MDE-approved training in four areas within six months of being seated on the board and complete the training within twelve months of being seated.
- Requires an ongoing board to be elected by the end of the third year of operation and that the board shall be composed of at least five non-related members, including at least one licensed teacher, one parent of an enrolled student and one community member. Allows a majority of a charter school's board members to be teachers, but does not require it.
- Prohibits an authorizer from requiring a charter school to enter into a service contract with the authorizer as a condition of granting the charter contract. Requires disclosure of any service contracts to the commissioner.
- Strengthens prohibitions on conflicts of interest for charter school board members.
- Allows authorizers to renew a contract with a charter school for up to five years after the initial three-year contract.
- Requires a charter school's board to establish qualifications for persons that hold leadership roles in the school.
- Allows an increase in the fees that an authorizer may charge for the monitoring and evaluation of the fiscal, operational and academic performance of a school it authorizes.
- Establishes a process and criteria for a charter school to organize an affiliated nonprofit building corporation to renovate or purchase an existing facility or construct a new school facility after approval by the commissioner.
- Establishes requirements for paying and withholding state aid after a charter school ceases to operate.
- Allows the commissioner to withhold aid from a charter school to satisfy a directive to return federal or state funds.

# APPENDIX B

## FORM 990 CHANGES

### **Prepare for the New Form 990**

The Internal Revenue Service has completely redesigned Form 990—the information return filed by charities and other tax exempt organizations. We want to review the basics of the new requirements to make sure you understand the new form, including new policy disclosures and reporting requirements.

The 2008 Form 990 consists of an 11-page core form and 16 related schedules. All tax-exempt organizations must complete the core form, which contains questions intended to increase the transparency of tax-exempt organizations and present the IRS and stakeholders with a realistic picture of entities and their operations. The 16 schedules are required only if your organization participates in certain activities. For example, Schedule C will only be completed by those organizations participating in political and lobbying activities.

The 2008 form requires exempt organizations to report information never requested before. It also requires greater accounting detail than the current form. Here are some of the highlights.

### **Governance**

The form asks questions about organizational policies such as conflicts of interest, whistleblowers, document retention, and joint ventures. The form also requests information about the composition and independence of the governing body and unrelated business income, documentation of board and committee actions, compensation practices for key individuals, and the board's review of the Form 990 itself.

### **Compensation**

The form requests information about compensation of directors, officers, key employees, highly compensated employees, and independent contractors. A significant change is that compensation—including that from related organizations—will now be reported on a calendar-year basis through W-2s and 1099s.

Schedule J requires a description of specific types of compensation, including first-class travel, companion travel, gross-up payments to cover taxes, housing allowances, club dues, and personal services, such as maid or chauffeur services. Organizations must describe the process of approving executive compensation, including specific information about nontaxable benefits and deferred, incentive, and other compensation.

### **Revenue and Expense Reporting**

The revenue and expense reporting format has changed. Organizations will now be required to disclose amounts paid for services such as management, legal, accounting, lobbying, professional fundraising, and investment management.

### **Public Charity Status**

Schedule A is now limited to information concerning 501(c)(3) public charity status and details regarding supporting organizations. In addition, the public support calculation method must be the same method used within the tax filing. For example, an accrual-basis organization will complete the public support schedule on an accrual basis. And, for publicly supported organizations that are not meeting the 33 $\frac{1}{3}$ % public support test, the form requires an explanation of how the organization meets the 10% facts and circumstances test.

### **Schedule of Contributors**

Schedule B remains unchanged from the current version; however, the instructions clarify the method of reporting contributions and the definition of “contributor.”

### **Supplemental Financial Statements**

Schedule D requires detailed information concerning donor-advised funds, conservation easements, art, historical treasures, trust, escrow and custodial arrangements, endowments, and investments. Organizations also must report footnotes to the organization’s financial statements that describe potential liability for uncertain tax positions.

### **Fundraising and Gaming**

Schedule G is required for reporting fundraising and gaming revenue, expenses, and activities. It also requires information about payments to professional fundraisers and a list of the states in which the organization solicits contributions.

### **Tax-Exempt Bonds**

Schedule K requests information regarding identification of bond issues, proceeds, private use, and arbitrage.

### **Transactions with Interested Persons**

Schedule L requires organizations to report excess benefit transactions, loans, grants, and business transactions with directors, officers, and key employees.

### **Noncash Contributions**

Schedule M requests information about noncash gifts, gift acceptance policies, the number of Form 8283 filed, and the use of third parties or related organizations to process noncash gifts.

### **Related Organizations**

Schedule R requires organizations to identify and provide information about “disregarded” entities, such as single-member LLCs, related tax-exempt organizations, partnerships, and taxable entities.

## **Weathering the Recession as a Charter School**

### **Weathering the Recession**

Within the past year our consultants have written a white paper and offered complimentary training sessions on how charter schools can weather the recession. We'd like to present a summarized version of that information here. If you would like the full white paper or would like to discuss training opportunities for your administrative team or school board in the areas of charter school finance, governance, roles and responsibilities, strategic planning or similar areas please don't hesitate to contact us to discuss your needs.

### **Meeting Challenges Head On**

Most charter school leaders are weary of waking up every morning braced for what the day will bring. Government funding will be different in three or six months than it is today. How big will the change be, and which of your programs will it affect? Private giving will change as foundations, corporations, and individuals adjust to dramatic changes in investment values, personal income, and general business conditions. What will the impact be on your school?

While you may not yet know the answers to these questions, by now it's no doubt clear that:

- Business as usual won't do it anymore. It's time to adapt and transform.
- Active engagement with today's challenges increases your likelihood of emerging from the recession with important educational programs intact.
- Going it alone won't work. It is in working with others that leaders find the best ways to generate solutions and hope for the future.

It's time to adopt new tools and approaches for responding proactively and nimbly to changes in income. Such tools will be critical to your ability to continue delivering as much mission-related benefit to your students as possible within available resources, and adapt to the future as it unfolds.

### **Make the Most of What You Have**

You may already have organizational assets (financial and non-financial) that you can make more productive. Use this approach as you look for ways to increase revenue and decrease costs.

1. Examine the balance sheet. What assets might produce income if better activated or directed to a different purpose?
  - Are existing assets appropriately protected? Are your investments appropriately diversified and insured? Are other assets appropriately insured?
  - Are you making the best possible use of physical space and equipment? Is there a way to make this fixed investment available to others and earn some income or expense relief from it? Is occupancy expense an appropriate share of the budget you expect to be able to fund in the next few years?

2. Move to your activities. What is the bigger story told by your statement of revenue and expense?
  - Are you obtaining every possible dollar from entitlement-based revenue streams? Are your state and federal aid rates as high as those of similar schools with comparable student populations? If not, what can you do to raise them?
  - Do your school's leaders know which programs operate at a surplus, which operate near breakeven, and which require varying levels of subsidy? How recently has the board discussed the implications of this "portfolio" of activities, and whether the mix of subsidies appropriately reflects and carries out your school's mission?
3. Don't forget your non-financial assets. Are the right people doing the right things? Talented, motivated, productive staff and volunteers are the most essential asset of all. Without them it is not possible to do good work. Are you applying the best human capital to all aspects of your mission?

### **Contingency Plans**

Prepare or revise your operating budget in a way that acknowledges uncertainty in the funding environment and builds in processes that will allow you to respond quickly and wisely through the year.

1. Identify trigger points. Develop a contingency planning tool that allows each program to envision and model multiple income scenarios and adjust spending to live within the income projected in each scenario. Then articulate the "trigger points" or conditions under which your school must implement one or more programs' contingency plans. It can be helpful to define — in objective terms — what a financial crisis would look like for your school, in order to come up with these conditions.
2. Cautiously consider an intentional deficit. Determine whether your school has sufficient net assets and cash that you can afford to incur an intentional deficit.

This is a risky departure from good financial management practice and should only be considered by schools that a) have strong cash and net assets positions, and b) have committed to making whatever fundamental changes they must in order to get back to balanced budgets in subsequent years. It is an interim strategy that buys your school and those it serves some time, and it must never be used to deny the reality of a need to adapt to the external environment.

Put smart, clear boundaries around the amount of deficit to be budgeted, and monitor actual financial results against the detailed budget even more carefully than in balanced-budget times.

## **Restructure, Reorganize, Engage**

Many schools have already spent several years cutting expenses in response to funding cuts. For these organizations it will be impossible to continue producing the current level of services in the same way with less revenue. In these settings leaders need to find new ways of operating; waiting it out until things get back to normal is not an option. Consider the full continuum of options, including:

1. **Restructure.** Consider spinning off activities that don't truly fit the mission or that require a level of subsidy your school can no longer afford. This could start out as a "foster care" arrangement of sorts with another organization picking up the program for a period of time before final arrangements are agreed upon.
2. **Reorganize.** Merge programs with an organization that has a vision, mission and values similar to your school's. Often seen as the very last resort, this strategy must be viewed through students' eyes. Merger may be the best way to keep vital services in place for the students you were founded to serve — to maintain your mission.
3. **Engage with Others.** Identify peer schools or other organizations that are more efficient than your school in certain aspects of service delivery; explore how to restructure and combine forces so that students get the best of all efforts within the resources available. This might mean combining forces with another school to accomplish portions of the administrative work load or facility operations. Carefully analyze and compare the costs and benefits of all of these options before proceeding.

## **Communicate, Communicate**

Develop an active "intelligence" function to keep leaders informed about internal and external changes.

1. **Funders and Legislators.** Keep your key funders and legislative representatives informed about the impact and quality of your school's programs; monitor developments in government aid levels, grant guidelines, and funder priorities. Participate in advocacy efforts as appropriate to the funding stream.
2. **Staff.** Keep employees informed about your school's economic realities and what you as leaders are doing about it. Fear can be your worst enemy in difficult times. It saps the energy of even the most talented staff and diverts their time and talent into unproductive speculation. Share good news and even small successes with staff; find ways to help them remain hopeful about the future.
3. **Board of directors.** Keep your board informed, engage members wherever possible in contingency and communications plans, and be specific with them about what you need them to do. Tap board members' financial savvy and their ability to think strategically about your school's short- and long-term success. A board that actively partners with staff leaders is an important asset when the school must make difficult choices.
4. **Others in the charter school sector.** Learn about strategies that do and don't work from the leaders of schools similar to yours, as well as from other parts of the sector.



## How Do You Minimize the Risk Of Fraud?

With the downturn in the economy we felt it was important to reemphasize the importance of maintaining vigilance against opportunities to take advantage of charter schools. These are not based on specific concerns we have about your particular school. They are intended as general, thought-provoking things to keep in mind as board members to help protect against unwelcome news coverage. If you are serious about protecting your school, consider some or all of the following steps:

- Implement control policies and procedures and monitor them (segregation of duties, proper approvals, documentation requirements for purchases, cash receipts, review of bank statements, etc.).
- Conduct periodic internal audits.
- Accept the idea that fraud is commonplace and can happen in any school.
- Assure the message coming from top management is one of integrity and low tolerance for fraud. Create work environments that encourage honesty (don't put employees in situations that encourage them to lie or deceive).
- Set a high standard for moral and ethical conduct and job performance which includes treating employees with respect and fairness, including fair pay.
- Use due care in hiring practices with thorough background checks. Try to hire people of integrity.
- Invest in proper training of staff.
- Consistently enforce standards through appropriate discipline ranging from reprimand to dismissal.
- Utilize and work closely with a qualified external auditor who is familiar with charter school finance and accounting and internal control procedures. Realize that the cheapest audit is not always the most effective. Follow through on implementing their management recommendations.
- Consider a finance committee (there may be certain members of your board that are more interested in school finances than others.)
- Have a fidelity bond for employees.
- Ask your employees to identify ways in which someone could commit fraud at your school and the ways to avoid it.
- Have periodic reviews of the effectiveness of internal controls. Adopt a "trust, but verify" code.
- Consider surprise fraud audits which are beyond a typical audit and include reviews of "high risk" areas.
- Investigate unexplained financial variances or other "red flags" (altered or missing documents, large or out-of-the-ordinary adjustments, excessive refunds or credits, employees not taking vacations, reduction in income, no addresses for vendors or employees, etc.). If something seems odd, whether it is a disbursement to an unfamiliar vendor or unexpected costs, consider the possibility of fraud.
- Establish realistic expectations for periodic reporting of financial results both in terms of timeliness as well as completeness. Ensure that budgets are adhered to. Investigate variances and seek out satisfactory explanations.

## Stabilization Funds and Single Audit for 2010

Stabilization funds under the American Recovery and Reinvestment Act of 2009 (ARRA) are federal dollars to schools. The increase in federal dollars to districts will result in more schools requiring a Single Audit in fiscal 2010 than in the past.

What is a Single Audit? A Single Audit is an audit of federal programs. This audit goes beyond the reconciliation of federal revenues, as has always been done as part of the annual audit. It is a more in-depth review of the compliance requirements related to specific federal programs.

Single Audits are triggered when an entity expends more than \$500,000 of federal funds in a fiscal year. For many schools, federal expenditures have historically been below the \$500,000 threshold. The increased federal expenditures, directly resulting from the ARRA stabilization funds, will put more schools over the threshold in fiscal 2010.

What can you expect as a result of a Single Audit?

- **More auditor time for engagements.** Single Audits require additional documentation and testing related to the federal programs. The additional time will result in additional costs for the audit, which will increase the audit fee for the fiscal year in which a Single Audit is required.
- **Auditors working with different district personnel.** In order to obtain the necessary documentation and information, auditors will be working with different district personnel. This depends on the specific grant that will be tested. For example, the Child Nutrition Program will require auditors to work with personnel that process the free and reduced meal applications.
- **Additional documentation requested from clients.** Depending on the grant program tested, additional documentation will be requested. This could include the grant agreement, grant budget, lists of students receiving services (Title I, Part A), and detailed expenditure summaries to name a few. The type of documentation requested depends on the federal grant that is tested.

One area that is significantly impacted by the Single Audit is payroll documentation related to federal programs. The Office of Management and Budget's (OMB) Circular A-87 specifically addresses payroll documentation. This is applicable to all federal programs, regardless if there is a Single Audit requirement.

The OMB's Circular A-87 separates payroll documentation into two categories:

- Employees paid from a single federal program (when 100% of an employee's payroll is charged to one federal program).
- Employees paid from multiple programs (when an employee's payroll is coded to more than one program).

For employees that are charged to a single federal program, the required documentation is a time certification. The time certification is to be completed semi-annually and must be completed after the period of time covered has elapsed. (It can only be completed at the end of the six-month period.) The certification can be signed by the employee or by a supervisor that has first-hand knowledge of the work performed by the employee.

Employees working with multiple programs must complete personnel activity reports (PAR). This includes employees that work in more than one federal program as well as employees that work in a federal program and a non-federal program. A PAR documents the time the employee spends working in programs and must be an after-the-fact distribution of actual activity. It must account for the total activity for which the employee was compensated, including any time coded to non-federal programs. PARs are to be completed monthly and must coincide with one or more pay periods. They must also be signed by the employee.

What can you do to prepare now?

- Keep grant agreements and other related documents together. This will help you pull together information at the end of the year as well have information available for the auditors.
- Know your grant agreements. Identify which grants are federal grants. For all federal grants, document the Catalog of Federal Domestic Assistance (CFDA) number. This is a number that is assigned to each federal grant. It is a required element for Single Audit reporting. If you are unable to identify the CFDA number, contact the grantor.
- Implement procedures for payroll documentation (use time certifications and personnel activity reports) for all employees coded to federal programs.

## Cashflow Concerns

The State of Minnesota is balancing its budget through the withholding of state aid payments to school districts and charter schools. For fiscal 2010, there will be 17% less state aid paid out by the end of the fiscal year. In addition, another approximate 8% reduction in metered state aid payments relates to the swapping of federal aid for state aid. Traditional school districts can borrow to meet cashflow needs through the issuance of aid anticipation certificates while charter schools do not possess that ability. As a result, we anticipate that there will be a number of charter schools experiencing significant cashflow difficulties during fiscal 2010 and continuing into future fiscal years.

Cash flow is considered the financial lifeblood of business – for-profit and nonprofit alike. It is a time-dependent term that means having sufficient resources when needed to meet costs as they are due. Technically, it's the difference between cash receipts and cash disbursements over a given period of time. But for all practical purposes, cash flow means that a school is able to stay solvent – that it is able to pay debts and claims as they come due. Schools need to anticipate, plan, and balance the flow of cash in and out of the organization. This allows schools to have enough cash when they need it and to make the most of excess cash.

Many schools have trouble distinguishing cash flow problems from operating deficits, though they are very different circumstances. Negative cash flow occurs when a school's demand for cash is higher than the amount of cash on hand – a situation that, although disruptive to smooth operations, shouldn't be confused with running a deficit. Negative cash flow assumes that, within the course of the year, there will be enough money to handle all budgeted financial obligations. The problem is that the receipt of funds will be slower than the time period in which bills must be paid. It's a timing issue.

A deficit, on the other hand, occurs when schools overspend their operating income. Naturally, when schools spend more annually than they receive, there will be cash flow problems. But in such cases, negative cash flow is a symptom of the deeper deficit problem.

By the time you are reading this, your school may already be dealing with the consequences of insufficient cashflow. However, to the extent your school has time to plan and implement its strategy we encourage you to consider the following:

1. Have a board-level discussion regarding the ending fund balance and the period of time over which you'd like to reach your goal. We have found that school's that have been able to attain an ending fund balance that is between 20% and 25% of expenditures are best equipped to deal with financial issues that come up including a slowdown in the metering of state aid payments.
2. Ensure that the school is maximizing all opportunities to generate cashflow—e.g. is the school's lease aid application is submitted timely and completely?, is the school claiming reimbursement for federal expenditures in a timely and complete manner?, is the best data available for enrollment being used by the Department to generate aid entitlements?, etc.
3. Is the School able to work with individual vendors to adjust the timing of amounts owed?

## APPENDIX C

### FORMAL REQUIRED COMMUNICATIONS

Members of the Board of Education  
Charter School No. 4194  
Cannon River STEM School  
Faribault, Minnesota

We have audited the financial statements of the governmental activities and each major fund of Cannon River STEM School for the year ended June 30, 2009, and have issued our report thereon dated September 7, 2009. Professional standards require that we provide you with the following information related to our audit.

#### **Our Responsibility under U.S. Generally Accepted Auditing Standards and *Government Auditing Standards***

As stated in our engagement letter dated April 27, 2009, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the School. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the School's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

1. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.
2. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.
3. We are also responsible for communicating Minnesota legal compliance issues.

#### **Other Information in Documents Containing Audited Financial Statements**

Our audit opinion, the audited financial statements, and the notes to financial statements should only be used in their entirety. Inclusion of the audited financial statements in a client prepared document, such as an annual report, should be done only with our prior approval and review of the document. Our responsibility for other information in documents containing the entity's financial statements and report does not extend beyond the financial information identified in the report. We do not have an obligation to perform any procedures to corroborate other information contained in such documents.

### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on July 22, 2009.

### **Significant Audit Findings**

#### ***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies established by Cannon River STEM School are described in Note 1 to the financial statements.

We noted no transactions entered into by the School during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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:

Management's estimate of federal revenue and receivable is based on amounts anticipated to be received from the federal government for various aid entitlements.

Management's estimate of the useful lives for depreciable assets is based on guidance recommended by the Minnesota Department of Education and other sources. The useful life of a depreciable asset determines the amount of depreciation that will be recorded in any given reporting period as well as the amount of accumulated depreciation that is reported at the end of a reporting period.

We evaluated the key factors and assumptions used to develop the above estimates in determining that it is reasonable in relation to the financial statements taken as a whole.

#### ***Difficulties Encountered in Performing the Audit***

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

#### ***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. Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

Members of the Board of Education  
Charter School No. 4194  
Cannon River STEM School

***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 auditors' 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 September 7, 2009.

***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 School's financial statements or a determination of the type of auditors' 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 School's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Members of the School Board and management of the Cannon River STEM School and is not intended to be and should not be used by anyone other than these specified parties.

  
LarsonAllen LLP

Minneapolis, Minnesota  
September 7, 2009