Aloma D. Johnson Fruit Belt
Community Charter School
Financial Statements
June 30, 2011

CONWAY PORTER, C.P.A., P.C.

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CERTIFIED PUBLIC ACCOUNTANTS

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Independent Auditor's Report

To the Board of Trustees
Aloma D. Johnson Fruit Belt
Community Charter School
Buffalo, New York

We have audited the accompanying statement of financial position of Aloma D. Johnson Fruit Belt Community Charter School (the School) as of June 30, 2011, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Aloma D. Johnson Fruit Belt Community Charter School as of June 30, 2011, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2011 on our consideration of Aloma D. Johnson Fruit Belt Community Charter School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

Conway Porter, C.P.A., P.C.

Conway Porter III
President

Williamsville, New York
December 21, 2011

Aloma D. Johnson Fruit Belt
Community Charter School
Statement of Financial Condition
June 30, 2011

Assets		
Current Assets:		
Cash and Cash Equivalents	$	213,807
Receivables - Grants		65,180
Receivables - Other		2,490
Prepaid Expenses		7,040
Total Current Assets		288,517
Property and Equipment, at Cost		436,196
Less: Accumulated Depreciation and Amortization		(69,558)
Net Property and Equipment		366,638
Total Assets	$	655,155
Liabilities and Net Assets		
Current Liabilities:		
Accounts Payable	$	81,270
Accrued Expenses:		
Payroll and Payroll Taxes		9,394
Pension		113,589
Other		6,250
Total Accrued Expenses		129,233
Current Installments of Capital Lease Obligation		9,881
Total Current Liabilities		220,384
Long-Term Liabilities:		
Capital Lease Obligation, Excluding Current Installments		13,209
Commitments and Contingencies (Note 6)		
Total Liabilities		233,593
Unrestricted Net Assets		421,562
Total Liabilities and Net Assets	$	655,155

See notes to financial statements.

Aloma D. Johnson Fruit Belt
Community Charter School
Statement of Activities
Year Ended June 30, 2011

Unrestricted Revenue:		
Public School Districts:		
Resident Student Enrollment	$	3,608,395
Students with Disabilities		60,165
Contributions		200
Grant Income		345,324
Other		13,572
Total Unrestricted Revenue		4,027,656
Unrestricted Expenses:		
Program Services:		
Regular Education		2,717,669
Special Education		49,367
Total Program Services		2,767,036
Management and General		514,575
Total Unrestricted Expenses		3,281,611
Increase in Unrestricted Net Assets		746,045
Unrestricted Net Assets (Deficit) at Beginning of Year		(324,483)
Unrestricted Net Assets at End of Year	$	421,562

See notes to financial statements.

Aloma D. Johnson Fruit Belt
Community Charter School
Statement of Functional Expenses
Year Ended June 30, 2011

	Program Services				
	Regular Education	Special Education	Total	Management and General	Total
Unrestricted Expenses					
Salaries	$ 1,306,635	$ 23,570	$ 1,330,205	$ 251,678	$ 1,581,883
Payroll Taxes	115,309	2,080	117,389	22,210	139,599
Employee Benefits	235,414	4,247	239,661	45,344	285,005
Office Expense	18,763	338	19,101	3,614	22,715
Printing and Production	4,042	73	4,115	778	4,893
Telephone	6,952	125	7,077	1,339	8,416
Meetings and Travel	13,528	244	13,772	2,606	16,378
Consulting Fees	180,792	3,262	184,054	34,823	218,877
Repairs and Maintenance	2,978	53	3,031	574	3,605
Supplies	147,963	2,669	150,632	28,500	179,132
Interest Expense	11,687	211	11,898	2,251	14,149
Professional Fees	11,614	210	11,824	2,237	14,061
Advertising	12,146	219	12,365	2,340	14,705
Dues and Subscriptions	6,092	110	6,202	1,173	7,375
Insurance	15,773	285	16,058	3,038	19,096
Legal Fees	1,111	20	1,131	214	1,345
Occupancy	433,650	7,822	441,472	83,528	525,000
Staff Development	12,778	231	13,009	2,461	15,470
Program Expense	99,939	2,040	101,979	-	101,979
Health Center Costs	1,458	26	1,484	281	1,765
Security	88	1	89	17	106
Student Transportation	44,786	914	45,700	-	45,700
Depreciation and Amortization	24,977	450	25,427	4,811	30,238
Bad Debt Expense	-	-	-	19,063	19,063
Extracurricular Activities	392	8	400	-	400
Miscellaneous	8,802	159	8,961	1,695	10,656
Total Unrestricted Expenses	$ 2,717,669	$ 49,367	$ 2,767,036	$ 514,575	$ 3,281,611

See Accompanying Notes to Financial Statements.

Aloma D. Johnson Fruit Belt
Community Charter School
Statement of Cash Flows
Year Ended June 30, 2011

Cash Flows from Operating Activities:			
Increase in Unrestricted Net Assets		$	746,045
Adjustments to Reconcile Decrease in Unrestricted Net Assets to Net Cash Used in Operating Activities:			
Depreciation and Amortization			30,238
Changes in:			
Receivables			5,431
Prepaid Expenses			(3,612)
Accounts Payable			(141,529)
Accrued Expenses			(16,064)
Deferred Revenue			-
	Net Cash Provided by Operating Activities		620,509
Cash Flows from Financing Activities:			
Additions to Property and Equipment			(4,550)
Cash Flows from Financing Activities:			
Repayment of Notes Payable			(413,869)
Repayment of Capital Lease Obligation			(9,310)
	Net Cash (Used) in Financing Activities		(423,179)
Net Increase in Cash			192,780
Cash at Beginning of Year			21,027
Cash at End of Year	**Cash at end of Period**	$	213,807

Supplemental Schedule of Cash Flow Information:

Cash Paid During the Year for Interest	$	14,149

See Accompanying Notes to Financial Statements.

Note 1 – Summary of Significant Accounting Policies

Nature of Activities: The Aloma D. Johnson Fruit Belt Community Charter School (the School) was chartered by the Board of Regents of the State University of New York on February 12, 2008 for a term of five years pursuant to Article 56 of the New York State Education Law. The School is a K-4 public school primarily funded through the Board of Education of the City School District of the City of Buffalo.

Basis of Accounting – The accompanying financial statements have been prepared on the accrued basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Basis of Presentation – The School reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. The School had only unrestricted net assets in 2011.

Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash – For the purpose of the statement of cash flows, the School considers all highly liquid debt investments purchased with maturity of three months or less to be cash equivalents.

Receivables – Receivables are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements. Bad debt expense for the year ending June 30, 2011 was $19,063.

Capitalization, Depreciation and Amortization – Property and equipment are recorded at cost or fair market value at the date of the gift in the case of donated equipment. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, contributions of equipment are recorded as unrestricted support. Depreciation and amortization is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line method. Improvements in excess of $500 are capitalized, while expenditures for maintenance and repairs are charged to expense as incurred. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related costs and accumulated depreciation and amortization. The resulting gains and losses are reflected in the statement of activities.

Deferred Revenue and Revenue Recognition – Grant awards accounted for as exchange transactions are recorded as revenue when expenditures have been incurred in compliance with the grant restrictions. Amounts unspent are recorded in the statement of financial position as deferred revenue.

Note 1 – Summary of Significant Accounting Policies – Cont'd.

Donated Equipment, Materials, Supplies and Personal Services – Donated equipment, materials and supplies are reflected in the financial statements based on the fair market value at the time of donation.

Donated personal services meeting the requirements for recognition in the financial statements was not material and has not been recorded. However, many individuals volunteer their time and perform a variety of tasks that assist the School.

Promises to Give – Contributions are recognized when the donor makes an unconditional promise to give to the School. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Expense Allocation – The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Recent Accounting Pronouncements – In June 2009, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Codification (Codification). Effective July 1, 2009, the Codification is the single source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP). The Codification is intended to reorganize, rather than change, existing GAAP. Accordingly, all references to currently existing GAAP have been removed and have been replaced with plain English explanations of the School's accounting policies. The adoption of the Codification did not have a material impact on the School's financial position or results of operations.

Subsequent Events – The School has evaluated events after June 30, 2011 and through December 21, 2011, which is the date the financial statements were available to be issued, and determined that any events or transactions occurring during this period that would require recognition or disclosure are properly addressed in these financial statements.

Income Taxes – The School is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code, therefore, no provision for income taxes is reflected in the financial statements.

Note 2 – Property and Equipment

Property and equipment as of June 30, 2011 is summarized as follows:

Leasehold Improvements	$ 351,050
Equipment	62,819
Books	22,327
	436,196
Less Accumulated Depreciation and Amortization	(69,558)
Net Property and Equipment	$ 366,638

Notes to Financial Statements – Cont'd.

Note 3 – Notes Payable

During the year ending June 30, 2011 the School paid the entire balance of the notes payable in full. Notes paid during the year ended June 30, 2011 are summarized as follows:

Note payable to M&T Bank, secured by the assets of the School, St. John Fruit Belt Community Development Corporation and St. John Baptist Church of Buffalo, due on demand and absent demand, due monthly through October 12, 2012, with interest at prime plus 1.0% (4.25 at June 30, 2010)	$253,869
Line of credit of $150,000 to M&T Bank, secured by the assets of the School, St. John Fruit Belt Community Development Corporation and St. John Baptist Church of Buffalo, due on demand, with interest at prime plus 0.5% (3.75% at June 30, 2010)	150,000
Notes payable, non-interest, unsecured, due on demand	10,000
Total Notes Payable, June 30, 2010	413,869
Less payments during the year ended June 30, 2011	(413,869)
Total Notes Payable, June 30, 2011	$ -

Note 4 – Capital Lease Obligation

The School leased copy machines under the terms of a capital lease agreement at an interest rate of 6.0%. The lease obligation and the related equipment have been capitalized for financial reporting purposes. The following is a summary of equipment under the capital lease obligation as of June 30, 2011:

Cost of Equipment	$ 47,416
Less Accumulated Depreciation	(22,127)
Net Capitalized Equipment	$ 25,289

Note 4 – Capital Lease Obligation – Cont'd.

Depreciation of leased equipment for the year ended June 30, 2011 amounted to $9,483. Future minimum lease payments under the operating lease are as follows:

2012	$ 11,047
2013	11,047
2014	2,763
Total Minimum Lease Payments	24,857
Less amount representing interest on capital lease obligation	(1,767)
Net Capital Lease Obligation	23,090
Less current portion of capital lease obligation	(9,881)
Capital Lease Obligation, Excluding Current Portion	$ 13,209

Note 5 – Pension Plans

The School participates in the New York State Teachers' Retirement System (TRS), which is a cost-sharing multiple employer, public employees' retirement system. The System offers a wide range of plans and benefits which are related to years of service and final average salary, vesting of retirement benefits, death and disability. All benefits generally vest after ten years of service.

TRS is administered by the New York State Teachers' Retirement Board and provides retirement, disability, withdrawal and death benefits to plan members and beneficiaries as authorized by the Education Law and the Retirement and Social Security Law of the State of New York. The TRS issues a publicly available financial report that contains financial statements and required supplementary information for the System. The report may be obtained by writing to the New York State Teachers' Retirement System, 10 Corporate Woods Drive, Albany, New York 12211.

The System requires Tiers 3 and 4 plan member contributions of 3% of their annual salary. Tier 5 plan members must contribute 3.5% of their annual salary. Pursuant to Article 11 of the Education law, employer rates are established annually for TRS by the New York State Teachers' Retirement Board at an actuarially determined rate. The employer rates for TRS were 8.62% of the annual covered payroll as of June 30, 2011. Required annual contributions by the School for the year ended June 30, 2011 amounted to $82,691.

Note 6 – Commitments and Contingencies

Commitments and contingencies at June 30, 2011 consist of the following:

a. Lease

The School leases its facility from St. John Baptist Church of Buffalo, under an operating lease expiring on May 31, 2012. Rent expense amounted to $525,000 for the year ended June 30, 2011. The rent increased from $304,000 at June 30, 2010 to $525,000 at June 30, 2011. The State Education Department approved the rent increase in a letter to the School in November 2010. Future minimum lease payments under the operating lease are as follows:

2012	$ 525,000
Total Minimum Lease Payments	$ 525,000

b. Government Grants

The School has received Federal and State Aid and various Grants, which are subject to audit by agencies of the Federal and State governments. Such audits may result in disallowances and a request for a return of funds to the Federal and State governments. The School believes disallowances, if any, would not be material.

c. Litigation

The School is involved in various cases of litigation arising in the ordinary course of business. In the opinion of management, no loss will be incurred as a result of this litigation.

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CERTIFIED PUBLIC ACCOUNTANTS

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Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees
Aloma D. Johnson Fruit Belt
Community Charter School
Buffalo, New York

We have audited the financial statements of Aloma D. Johnson Fruit Belt Community Charter School (the School) as of and for the year ended June 30, 2011, and have issued our report thereon dated December 21 2011. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all significant deficiencies or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we have identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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. We consider the deficiencies described in the accompany schedule of findings and questioned costs to be material weaknesses.

Compliance and other Matters

As part of obtaining reasonable assurance about whether Aloma D. Johnson Fruit Belt Community Charter School's financial statements are free of 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*.

As part of the audit, management requested us to prepare a draft of the financial statements, including the related notes to financial statements. Management reviewed, approved, and accepted responsibility for those financial statements prior to their issuance.

In addition, we noted other matters involving the internal control and its operations that we have reported to the management of Aloma D. Johnson Fruit Belt Community Charter School in a separate letter dated December 21, 2011.

Aloma D. Johnson Fruit Belt Community Charter School's response to our findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Aloma D. Johnson Fruit Belt Community Charter School's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management of Aloma D. Johnson Fruit Belt Community Charter School, others within the organization and the New York State Education Department, and is not intended to be, and should not be used by anyone other than these specified parties.

Conway Porter, C.P.A., P.C.

Conway Porter III
President

Williamsville, New York
December 21, 2011

Condition 2011-1: Internal Control System Design

During our consideration of internal control over the preparation of financial statements for the purpose of planning our audit, management was unable to provide documentation of the components of internal control. Thus we believe that the School has not adequately documented the internal control components and that this inadequacy is a deficiency in internal control over financial reporting.
Internal control over financial reporting consists of the following five components:

1. *Control environment* sets the tone of the company, influencing the control consciousness of personnel. It includes matters such as integrity and ethical values, commitment to competence, Board of Trustees participation, organization structure, management's philosophy and operating style, assignment of authority and responsibility, and human resource policies and participation.

2. *Risk assessment* includes the company's identification and analysis of external and internal risks relevant to the preparation of financial statements, such as changes in operating environment, new personnel, new or revamped information systems, rapid growth, new products, activities, or technology, etc.

3. *Control activities* are the policies and procedures that help ensure that management directives are carried out. They include segregation of duties, information, processing, reviews and approvals, physical controls, etc.

4. *Information and communication systems* include the accounting system and its manual or automated procedures and records used to initiate, record, process, and report the company's transactions, events, and conditions and to maintain accountability for the related assets, liabilities and net assets.

5. *Monitoring* is a process that assesses whether controls are operating as intended, takes corrective action for deficiencies noted, and modifies control as appropriate for changed conditions. Monitoring can be accomplished through ongoing activities by management personnel who have direct knowledge of the company's business activities, separate evaluations, or as a combination of the two. Also, some monitoring may be provided by controls built into information technology.

The Board of Trustees is responsible for ensuring that the School has a system in place to ensure the safeguarding of assets, recording of financial data and preparation of financial reports which reflect the transactions of the entity.

Recommendations: We recommend that the Board discuss, evaluate and establish a system of internal control over financial reporting and that this system be written, communicated with management and staff and monitored to ensure compliance. If the Board lacks the capacity to develop such a system, we recommend that the Board engage a consultant to educate and assist them in developing the required internal control system.

Employees should be instructed to perform appropriate control activities, and appropriate, timely investigations and corrective actions should be taken if errors are identified by the check and review process. The policies and procedures management develops, documents and communicates should include routine transactions processing and recording matters as well as nonroutine matters such as journal entries, valuation allowances, revenue recognition, etc. The policies and procedures should also include the reason for the policy; processes to which it applies; specific processing, approval, or review steps or procedures to be performed; and procedures for handling questions about, or exceptions to, the policy. The policies and procedures can be documented in a number of ways, including narratives, flowcharts, and checklists.

School Response: The Board agrees with the recommendation of the auditor. Action will be taken to discuss, evaluate and establish a system of internal control over financial reporting. The system will be written, communicated with management and staff, and monitored to ensure compliance.

Condition 11-2: Segregation of Duties

A control deficiency 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 misstatements on a timely basis. A deficiency in design exists when a control necessary to meet the control objective is missing. We believe that the internal control system of the School is marked by a lack of segregation of duties.

In reviewing the internal controls in place in the School, we noted that the accounting staff is limited to one individual. This employee is responsible for student fee billings and related accounts receivable, cash receipts, cash disbursements, bank and other reconciliations and control of all assets. There are no documented approvals of transactions, except for the purchase of educational supplies. This employee executes purchases, approves and distributes payroll and generally conducts all other financial activities of the School, with the exception of signing checks.

Accordingly, there is an over-reliance on the work of this individual which constitutes a lack of segregation of duties. An internal control system which is effective seeks to segregate functions with potential conflicts, such as those illustrated below:

1. Those responsible for accounting and physical control over assets such as cash or inventory do not have duties that are incompatible with maintaining effective internal controls such as control over distribution or oversight of assets
2. Revenues – Functions such as receipt of funds, recording revenues and reconciling cash are segregated
3. Purchasing and Cash Disbursements - Functions with potential conflicts, such as vendor approval, purchasing and payment processing, are segregated
4. Preparation, approval and payment of payroll are not entrusted to the same individual

Recommendations: As described more fully in Finding 2011-1, the Board of Trustees is responsible for establishing that a system of internal controls has been established and is being followed. The Board must institute policies to ensure that there is proper segregation of duties. The Board should consider the following:

1. Expand the role of Board members as part of the governance function. Board members currently sign checks. The role could be expanded so that the Board member approves the invoice at the same time as the checks are signed. This approval should be evidenced by

affixing a signature or initialing the invoice. Signed checks should be transmitted to other staff to be mailed.

2. Evaluate the role of the outside consultant who is currently preparing monthly budgetary reports to determine if the role could be expanded or whether the Board should hire another member of the accounting staff. This person should be responsible for preparing bank reconciliations and be independent of the purchasing, cash receipts and cash disbursement functions. This person should also periodically reconcile student attendance records, student billings, vouchers submitted and amounts received. All procedures performed should be evidenced by signed reconciliations, checklists, etc.

3. Bank statements should be delivered unopened to a designated person (even a Board member) who should review returned checks for improper signatures, unusual payees and status of bank balances. An independent supervisory person should also be responsible for reviewing bank reconciliations on a monthly basis.

4. Expand the role of the principal to require the pre-approval of all purchases, the approval of employee time records and resultant payroll payments.

5. Consider developing a simple inventory system to reconcile the cash sales of uniforms, etc. to purchases and unsold items on hand.

The policies and procedures developed by the Board should be documented in writing, communicated to staff and monitored periodically to ensure compliance.

School Response: The Board agrees with the recommendation of the auditor. Action will be taken to address each of the recommendations of Condition 11-2 as stated by the Auditor.

<u>Condition 11-3: Financial Reporting Objectives</u>

The year-end financial statements that management prepared and presented to us to audit contained a number of errors, inconsistencies, and omissions. Also, from our consideration of internal control over the preparation of financial statements for the purpose of planning our audit, we believe that the cause of the errors, inconsistencies, and omissions was inadequately designed control policies and procedures relate to the preparation of the financial statements. For instance, we noted that management has not developed and communicated a standardized format and instructions for the financial reporting activities to be performed by the accounting personnel.

Recommendations: We believe that this inadequacy is a deficiency in internal control over financial reporting. Management should assess the adequacy of the design of its policies and procedures related to preparation of financial statements and design appropriate controls as necessary to rectify inadequacies. When developing control policies and procedures for a process, management should consider where errors or fraud could occur that would cause a material misstatement in the financial statements and which policies or procedures, if operating properly, would prevent or detect the error or fraud on a timely basis.

School Response: The Board agrees with the recommendation of the auditor. Action will be taken to address the deficiency in internal control over financial reporting. The Board will assess the adequacy of the design of policies and procedures related to preparation of financial statements and design appropriate statements and design appropriate controls as necessary to rectify inadequacies.

Condition 11-4: Preparation of Financial Statements

Generally Accepted Accounting Principles (GAAP) require that financial statements be recorded on an accrual basis. In addition, financial statements prepared on an accrual basis more accurately reflect the relationship between current revenues and current expenses and allows management and the Board to better assess the condition of the School and the success of its operations.

During the performance of our audit engagement procedures, we noted the School had not adjusted all account balances to reflect appropriate accrual year-end balances. This is a necessary step to ensure the financial statements are fairly stated. The unrecorded amounts were, in our judgment, material to the financial statements. Since the School's internal control policies and procedures did not prevent or detect a material misstatement of the financial statements, we concluded there is a material weakness in the School's control policies and procedures required to be reported under professional standards.

Recommendations: We recommend that management design control policies and procedures to identify misstatements in the financial statements.

1. *Review of Account Balances Recorded in the Accounting Records* - At year-end the Accounts Receivable Account which records student billings had a negative balance of $7,500. At least on a monthly basis the general ledger accounts should be reviewed for reasonableness and discrepancies investigated and corrected on a timely basis.
2. *Preparation of Standard Journal Entries* – A set of monthly standard journal entries should be established so the accrual adjustments are not overlooked. GAAP adjustments should be prepared on an ongoing basis, particularly in the areas of Accounts Receivable, Accounts Payable, Prepaid Expenses, and Depreciation Expense.
3. *Preparation of Monthly Financial Statements* - We also recommend that the Board of Trustees require that monthly financial statements submitted to the Board be prepared on an accrual basis.

School Response: The Board agrees with the recommendation of the auditor. Action will be taken to design control policies and procedures to identify misstatements in the financial statements.