

Education Achievement Authority

Financial Report

June 30, 2012

Education Achievement Authority

Contents

Independent Auditor's Report	1-2
Report Letter on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Basic Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	3-4
Management's Discussion and Analysis	5-10
Basic Financial Statements	
Government-wide Financial Statements:	
Statement of Net Assets	11
Statement of Activities	12
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	13
Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets	14
Statement of Revenue, Expenditures, and Changes in Fund Balances	15
Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	16
Notes to Financial Statements	17-25
Schedule of Audit Findings	26-30

Independent Auditor's Report

To the Board of Education
Education Achievement Authority

We have audited the accompanying financial statements of the governmental activities and each major fund of the Education Achievement Authority (the "School District," the "Authority," or the "EAA") as of and for the 11-month period ended June 30, 2012, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Education Achievement Authority'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 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 respective financial position of the governmental activities and each major fund of the Education Achievement Authority as of June 30, 2012 and the respective changes in financial position for the 11-month period then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis, as identified in the table of contents, is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Board of Education
Education Achievement Authority

In accordance with *Government Auditing Standards*, we have also issued a report dated June 10, 2013 on our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. 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.

Plante & Morse, PLLC

June 10, 2013

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*

Independent Auditor's Report

To the Board of Education
Education Achievement Authority

We have audited the financial statements of the governmental activities and each major fund of the Education Achievement Authority (the "School District," the "Authority," or the "EAA") as of and for the 11-month period ended June 30, 2012, which collectively comprise the School District's basic financial statements, and have issued our report thereon dated June 10, 2013. We have 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 Education Achievement Authority'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 entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph 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 deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of audit findings, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 accompanying schedule of audit findings as Findings 2012-1, 2012-2, and 2012-3 to be material weaknesses.

To the Board of Education
Education Achievement Authority

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. We consider the deficiencies described in the accompanying schedule of audit findings as Findings 2012-4 and 2012-5 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Education Achievement Authority'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*.

The Education Achievement Authority's responses to the findings identified in our audit are described in the accompanying schedule of audit findings. We did not audit the Education Achievement Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Morse, PLLC

June 10, 2013

Education Achievement Authority

Management's Discussion and Analysis

This section of the Education Achievement Authority's (the "EAA," the "Authority," or the "School District") annual financial report presents our discussion and analysis of the EAA's financial performance during the year ended June 30, 2012. Please read it in conjunction with the EAA's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand the EAA financially as a whole. The government-wide financial statements provide information about the activities of the whole district, presenting both an aggregate view of the EAA's finances and a longer-term view of those finances. The fund financial statements provide the next level of detail. For governmental activities, these statements tell how services were financed in the short-term as well as what remains for future spending. The fund financial statements look at the EAA's operations in more detail than the government-wide financial statements by providing information about the EAA's most significant funds - the General Fund and the Capital Projects Fund.

*Management's Discussion and Analysis (MD&A)
(Required Supplemental Information)*

Basic Financial Statements

Government-wide Financial Statements Fund Financial Statements

Notes to the Basic Financial Statements

Reporting the Authority as a Whole - Government-wide Financial Statements

One of the most important questions asked about the School District is "As a whole, what is the EAA's financial condition as a result of the year's activities?" The statement of net assets and the statement of activities, which appear first in the EAA's financial statements, report information on the School District as a whole and its activities in a way that helps you answer this question. We prepare these statements to include all assets and liabilities, using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. These two statements report the EAA's net assets - the difference between assets and liabilities, as reported in the statement of net assets - as one way to measure the EAA's financial health or financial position. Over time, increases or decreases in the EAA's net assets - as reported in the statement of activities - are indicators of whether its financial health is improving or deteriorating. The relationship between revenues and expenses is the EAA's operating results.

Education Achievement Authority

Management's Discussion and Analysis (Continued)

However, the EAA's goal is to provide services to our students, not to generate profits as commercial entities do. One must consider many other nonfinancial factors, such as the quality of the education provided and the safety of the schools, to assess the overall health of the Authority. The statement of net assets and the statement of activities report the governmental activities for the Authority, which encompass all of the EAA's services, including instruction, support services, community services, athletics, and food services. Unrestricted state aid (foundation allowance revenue) and state and federal grants finance most of these activities.

Reporting the EAA's Most Significant Funds - Fund Financial Statements

The EAA's fund financial statements provide detailed information about the most significant funds - not the Authority as a whole. Some funds are required to be established by state law. However, the Authority establishes many other funds to help it control and manage money for particular purposes (the Capital Projects Fund is an example) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The governmental funds of the Authority use the following accounting approach:

Governmental funds - All of the EAA's services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year end that are available for spending. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the operations of the Authority and the services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the EAA's programs. We describe the relationship (or differences) between governmental activities (reported in the statement of net assets and the statement of activities) and governmental funds in a reconciliation.

Education Achievement Authority

Management's Discussion and Analysis (Continued)

The Authority as a Whole

Recall that the statement of net assets provides the perspective of the Authority as a whole. Table I provides a summary of the EAA's net assets as of June 30, 2012:

Table I

	Governmental Activities
	(in thousands)
Assets	
Current and other assets	\$ 11,257.9
Capital assets	<u>18.6</u>
Total assets	11,276.5
Liabilities	
Current liabilities	253.9
Long-term liabilities	<u>101.8</u>
Total liabilities	<u>355.7</u>
Net Assets	
Invested in capital assets - Net of related debt	18.5
Unrestricted	<u>10,902.3</u>
Total net assets	<u>\$ 10,920.8</u>

The above analysis focuses on the net assets (see Table I). As the EAA did not have any schools in its district during the year ended June 30, 2012, which was the EAA's first year of existence, net assets were primarily affected by start-up activities only. The change in net assets (see Table 2) of the EAA's governmental activities is discussed below. The EAA's net assets were approximately \$10.9 million at 2012. Invested in capital assets net of related debt totaled approximately \$18,500 which was for the purchase of a vehicle. The remaining amount of net assets (\$10.9 million) was unrestricted.

The \$10.9 million in unrestricted net assets of governmental activities represents the accumulated results of all past years' operations, which is equal to the current year's results, since this was the first year of the EAA's existence. The unrestricted net assets balance enables the Authority to meet working capital and cash flow requirements, as well as to provide for future uncertainties. The operating results of the General Fund will have a significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations for the Authority as a whole are reported in the statement of activities (Table 2), which shows the changes in net assets for fiscal year 2012. Since this is the first year the Authority has prepared financial statements, the portion of GASB Statement No. 34, revenue and expense comparison to the prior fiscal year, is not applicable.

Education Achievement Authority

Management's Discussion and Analysis (Continued)

Table 2	Governmental Activities 2012
	(in thousands)
Revenue	
General revenue:	
State aid	\$ 10,000.0
Local revenue	<u>3,877.4</u>
Total revenue	13,877.4
Functions/Program Expenses	
Support services	2,950.0
Athletics	4.5
Depreciaton (unallocated)	<u>2.1</u>
Total functions/program expenses	<u>2,956.6</u>
Increase in Net Assets	10,920.8
Net Assets - Beginning of period	<u>-</u>
Net Assets - End of period	<u>\$ 10,920.8</u>

As reported in the statement of activities, the cost of all of our governmental activities this year was approximately \$2.96 million. Certain activities were partially funded by other governments and organizations that subsidized certain programs with grants and contributions (\$10.0 million). We paid for the remaining "public benefit" portion of our governmental activities with approximately \$3.87 million of grants from not-for-profit organizations.

The Authority experienced an increase in net assets of approximately \$10.92 million. This is primarily due to \$10.0 million of revenue from the State of Michigan that the EAA intends to use for capital improvements of its schools needed to bring the buildings up to current occupancy codes prior to classes commencing.

As discussed above, the net cost shows the financial burden that was placed on the State by each of these functions. Since unrestricted state aid will constitute the vast majority of district operating revenue sources, the Board of Education and administration must annually evaluate the needs of the Authority and balance those needs with State-prescribed available unrestricted resources.

Education Achievement Authority

Management's Discussion and Analysis (Continued)

The EAA's Funds

As we noted earlier, the Authority uses funds to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the Authority is being accountable for the resources taxpayers and others provide to it and may provide more insight into the EAA's overall financial health.

As the Authority completed this year, the governmental funds reported a combined fund balance of approximately \$11.0 million, which is an increase of \$11.0 million from last year. This is primarily due to \$10.0 million of revenue from the State of Michigan that the EAA intends to use for capital improvements of its schools needed to bring the buildings up to current occupancy codes prior to classes commencing.

In the General Fund, our principal operating fund, the fund balance increased \$1.0 million to approximately \$1.0 million. The primary driver of this change is the money received by local not-for-profit organizations.

General Fund balance is available to fund costs related to allowable school operating purposes.

The Capital Projects Fund fund balance increased by \$10.0 million, due to the reason enumerated above.

General Fund Budgetary Highlights

Over the course of the year, the Authority revises its budget as it attempts to deal with unexpected changes in revenues and expenditures. State law requires that the budget be amended to ensure that expenditures do not exceed appropriations. In future years, the final amendment to the budget will be adopted just before year end. However, the EAA was not required to do this during the current year as no schools had been added to the district before year end.

Capital Assets and Debt Administration

Capital Assets

As of June 30, 2012, the Authority had approximately \$18,566 invested in capital assets. This amount represents a net increase (including additions, disposals, and depreciation) of \$18,566 from last year.

Buses and other vehicles	\$ 20,629
Less accumulated depreciation	<u>2,063</u>
Net capital assets	<u><u>\$ 18,566</u></u>

Education Achievement Authority

Management's Discussion and Analysis (Continued)

This year's additions of \$20,629 consisted of one vehicle. No debt was issued for this addition.

Several major capital projects are planned for the 2012-2013 fiscal year. We anticipate capital additions will be approximately \$9.0 million greater than the 2011-2012 fiscal year. We present more detailed information about our capital assets in the notes to the financial statements.

Debt

At the end of this year, the Authority had no bonds outstanding.

Other obligations include accrued payroll-related liabilities and employee compensated absences.

Economic Factors and Next Year's Budgets and Rates

Our appointed officials and administration consider many factors when setting the EAA's 2013 fiscal year budget. One of the most important factors affecting the budget is our student count. The state foundation revenue is determined by multiplying the blended student count by the foundation allowance per pupil. The blended count for the 2013 fiscal year is based on an average of the February 2013 and September 2012 student counts. The fiscal year 2013 budget was adopted in June 2012, based on an estimate of students that will be enrolled in September 2012. Approximately 98 percent of total General Fund revenue is from the foundation allowance. Under State law, the Authority cannot access additional property tax revenue for general operations. As a result, district funding is heavily dependent on the State's ability to fund local school operations. Based on early enrollment data at the start of the 2012-2013 school year, we anticipate that the fall student count will be close to the estimates used in creating the fiscal year 2013 budget. Once the final student count and related per pupil funding is validated, State law requires the Authority to amend the budget if actual district resources are not sufficient to fund original appropriations.

Since the EAA's revenue is heavily dependent on state funding and the health of the State's School Aid Fund, the actual revenue received depends on the State's ability to collect revenues to fund its appropriation to the Authority. The State periodically holds a revenue-estimating conference to estimate revenues. Based on the results of the most recent conference, the State estimates funds are sufficient to fund the appropriation.

Contacting the School District's Management

This financial report is intended to provide our taxpayers, parents, and investors with a general overview of the School District's finances and to show the School District's accountability for the money it receives. If you have any questions about this report or need additional information, we welcome you to contact the Business Office.

Education Achievement Authority

Statement of Net Assets June 30, 2012

	<u>Governmental Activities</u>
Assets	
Cash	\$ 1,239,292
Receivables (Note 4)	10,000,000
Prepaid assets	18,665
Capital assets - Net (Note 5)	<u>18,566</u>
Total assets	11,276,523
Liabilities	
Accounts payable	241,019
Accrued payroll-related liabilities	12,881
Noncurrent liabilities - Employee compensated absences	<u>101,756</u>
Total liabilities	<u>355,656</u>
Net Assets	
Invested in capital assets - Net of related debt	18,566
Unrestricted	<u>10,902,301</u>
Total net assets	<u>\$ 10,920,867</u>

Education Achievement Authority

Statement of Activities 11-month Period Ended June 30, 2012

Functions/Programs	<u>Expenses</u>	<u>Governmental Activities Net (Expense) Revenue and Changes in Net Assets</u>
Primary government -		
Governmental activities:		
Support services:		
Instructional staff	\$ 906,617	\$ (906,617)
General administration	972,708	(972,708)
School administration	8,177	(8,177)
Business	238,698	(238,698)
Operations and maintenance	62,054	(62,054)
Central	761,741	(761,741)
Athletics	4,520	(4,520)
Depreciation expense (unallocated) (Note 5)	<u>2,063</u>	<u>(2,063)</u>
Total primary government	<u>\$ 2,956,578</u>	(2,956,578)
General revenue:		
State aid not restricted to specific purposes (Note 4)		10,000,000
Private grants (Note 6)		<u>3,877,445</u>
Total general revenue		<u>13,877,445</u>
Change in Net Assets		10,920,867
Net Assets - Beginning of period		<u>-</u>
Net Assets - End of period		<u>\$ 10,920,867</u>

Education Achievement Authority

Governmental Funds Balance Sheet June 30, 2012

	General Fund	Capital Projects Fund	Total Governmental Funds
Assets			
Cash	\$ 1,239,292	\$ -	\$ 1,239,292
Receivables - Due from other governmental units	-	10,000,000	10,000,000
Prepaid assets	18,665	-	18,665
Total assets	<u>\$ 1,257,957</u>	<u>\$ 10,000,000</u>	<u>\$ 11,257,957</u>
Liabilities and Fund Balances			
Liabilities			
Accounts payable	\$ 241,019	\$ -	\$ 241,019
Accrued payroll-related liabilities	12,881	-	12,881
Total liabilities	253,900	-	253,900
Fund Balances			
Nonspendable - Prepaid assets	18,665	-	18,665
Assigned - Capital projects	-	10,000,000	10,000,000
Unassigned	985,392	-	985,392
Total fund balances	1,004,057	10,000,000	11,004,057
Total liabilities and fund balances	<u>\$ 1,257,957</u>	<u>\$ 10,000,000</u>	<u>\$ 11,257,957</u>

Education Achievement Authority

Governmental Funds Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets 11-month Period Ended June 30, 2012

Fund Balance Reported in Governmental Funds \$ 11,004,057

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in the funds:

Cost of capital assets	\$ 20,629	
Accumulated depreciation	<u>(2,063)</u>	<u>18,566</u>

Long-term liabilities are not due and payable in the current period and are not reported in the governmental funds - Employee compensated absences

(101,756)

Net Assets of Governmental Activities

\$ 10,920,867

Education Achievement Authority

Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances 11-month Period Ended June 30, 2012

	<u>General Fund</u>	<u>Capital Projects Fund</u>	<u>Total Governmental Funds</u>
Revenue			
Local sources (Note 6)	\$ 3,877,445	\$ -	\$ 3,877,445
State sources (Note 4)	<u>-</u>	<u>10,000,000</u>	<u>10,000,000</u>
Total revenue	3,877,445	10,000,000	13,877,445
Expenditures			
Current:			
Support services:			
Instructional staff	879,934	-	879,934
General administration	906,571	-	906,571
Business	223,010	-	223,010
Operations and maintenance	62,054	-	62,054
Central	738,618	-	738,618
Athletics	4,520	-	4,520
Capital outlay	<u>58,681</u>	<u>-</u>	<u>58,681</u>
Total expenditures	<u>2,873,388</u>	<u>-</u>	<u>2,873,388</u>
Net Change in Fund Balances	1,004,057	10,000,000	11,004,057
Fund Balances - Beginning of period	<u>-</u>	<u>-</u>	<u>-</u>
Fund Balances - End of period	<u>\$ 1,004,057</u>	<u>\$ 10,000,000</u>	<u>\$ 11,004,057</u>

Education Achievement Authority

Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities 11-month Period Ended June 30, 2012

Net Change in Fund Balances - Total Governmental Funds \$ 11,004,057

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures; however, in the statement of activities, these costs are allocated over their estimated useful lives as depreciation:

Depreciation expense	\$ (2,063)	
Capitalized capital outlay	<u>20,629</u>	18,566

Compensated absences are recorded when earned in the statement of activities. In the current year, more was earned than paid out. (101,756)

Change in Net Assets of Governmental Activities **\$ 10,920,867**

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 1 - Nature of Business and Significant Accounting Policies

The Education Achievement Authority (the "School District," the "Authority," or the "EAA") is a public school district formed by an interlocal agreement between Detroit Public Schools (DPS) and Eastern Michigan University. Its purpose is to assume the operations and assets of the lowest performing schools within the city of Detroit. The State has granted legal authority to the Authority to operate as a school district.

The Authority was formed in August 2011; however, the Authority only began actively operating and managing the 15 selected schools and receiving state foundation allowance during the fiscal year beginning July 1, 2012.

The Education Achievement Authority conforms to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the School District:

Reporting Entity

The School District is governed by an 11-member Board of Education appointed by the governor of Michigan, Eastern Michigan University, and DPS. The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational financial relationships that determine which of the governmental organizations are a part of the School District's reporting entity, and which organizations are legally separate, component units of the School District. Based on the application of the criteria, the School District does not contain any component units.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. All of the School District's government-wide activities are considered governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Intergovernmental payments, unrestricted grants, and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note I - Nature of Business and Significant Accounting Policies (Continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide Financial Statements - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants, categorical aid, and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

When an expense is incurred for purposes for which both restricted and unrestricted net assets or fund balance are available, the School District's policy is to first apply restricted resources. When an expense is incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used, it is the School District's policy to spend funds in this order: committed, assigned, and unassigned.

Amounts reported as program revenue include operating grants and contributions. Internally dedicated resources are reported as general revenue rather than as program revenue.

Fund Financial Statements - Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Unrestricted state aid, intergovernmental and local grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when cash is received by the School District.

All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note I - Nature of Business and Significant Accounting Policies (Continued)

The School District reports the following major governmental funds:

General Fund - The General Fund is the School District's primary operating fund. It accounts for all financial resources of the School District, except those required to be accounted for in another fund.

Capital Projects Fund - The Capital Projects Fund is used to record the State appropriation of \$10,000,000 and the disbursement of monies designated for upgrading facilities and ensuring they are in compliance with state guidelines.

Assets, Liabilities, and Net Assets or Equity

Cash and Investments - Cash and investments include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Prepaid Assets - Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid assets in both government-wide and fund financial statements.

Capital Assets - Capital assets, which include one vehicle, are reported in the applicable governmental activities column in the government-wide financial statements. Capital assets are defined by the School District as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost. Costs of normal repair and maintenance that do not add to the value or materially extend asset life are not capitalized. The School District does not have infrastructure-type assets.

The only capital asset purchased during the period was one vehicle. The vehicle is depreciated using the straight-line method over five years.

Compensated Absences (Vacation and Sick Leave) - The liability for compensated absences reported in the government-wide statements consists of earned but unused accumulated vacation and sick leave benefits. A liability for these amounts is reported in governmental funds as it comes due for payment. At June 30, 2012, \$101,756 is accrued on the government-wide statements for this purpose.

Taxes - The Authority does not have the ability or authority to levy taxes on the residents of the state or of the district.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Fund Balance - In the fund financial statements, governmental funds report the following components of fund balance:

- **Nonspendable:** Amounts that are not in spendable form or are legally or contractually required to be maintained intact
- **Restricted:** Amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for use for a specific purpose
- **Committed:** Amounts that have been formally set aside by the Board of Education for use for specific purposes. Commitments are made and can be rescinded only via resolution of the Board of Education.
- **Assigned:** Intent to spend resources on specific purposes expressed by the Board of Education
- **Unassigned:** Amounts that do not fall into any other category above. This is the residual classification for amounts in the General Fund and represents fund balance that has not been assigned to other funds and has not been restricted, committed, or assigned to specific purposes in the General Fund.

The board has not adopted a minimum fund balance policy.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 2 - Stewardship, Compliance, and Accountability

Budgetary Information - An annual budget was not adopted for the General Fund because it is not legally required and, therefore, presentation of budgetary comparison information is not required. A budget was adopted for the year ending June 30, 2013.

Note 3 - Deposits and Investments

State statutes authorize the School District to make deposits in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The School District is allowed to invest in U.S. Treasury or agency obligations, U.S. government repurchase agreements, bankers' acceptances, commercial paper rated prime at the time of purchase that matures not more than 270 days after the date of purchase, mutual funds, and investment pools that are composed of authorized investment vehicles. The School District's deposits are in accordance with statutory authority.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 3 - Deposits and Investments (Continued)

The School District has designated one bank for the deposit of its funds.

The School District's cash and investments are subject to risk, which is examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. The School District does not have a deposit policy for custodial credit risk. At year end, the School District's deposit balance of \$1,262,277 was fully insured under the Dodd-Frank Act expiring on December 31, 2012 that gives full FDIC insurance coverage for money deposited in noninterest-bearing checking accounts. The School District evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Note 4 - Receivables

The receivable in the Capital Projects Fund is for a \$10,000,000 appropriation from the State of Michigan to the Authority from Senate Bill No. 871 effective June 29, 2012 and was received within 60 days of year end.

Note 5 - Capital Assets

Capital asset activity of the School District's activities was as follows:

Governmental Activities	<u>Balance July 1, 2011</u>	<u>Additions/ Transfers</u>	<u>Balance June 30, 2012</u>
Capital assets being depreciated - Vehicles	\$ -	\$ 20,629	\$ 20,629
Accumulated depreciation - Vehicles	-	2,063	2,063
Net capital assets	<u>\$ -</u>	<u>\$ 18,566</u>	<u>\$ 18,566</u>

Depreciation expense was not charged to activities as the School District considers its assets to impact multiple activities and allocation is not practical. Depreciation expense for the 11-month period ended June 30, 2012 totaled \$2,063.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 6 - Local Revenue

In addition to the State appropriation as mentioned in Note 4, the Authority also received substantially all of its funding from three private, local sources for the 11-month period ended June 30, 2012. The private sources were as follows:

The Kellogg Grant - A \$1,000,000 grant was received from the W.K. Kellogg Foundation. The grant is to be used to achieve the mission of the Authority by redesigning public education in Michigan's persistently low achieving schools by providing general operating support.

Next Generation Learning Challenges (aka the Gates Grant) - A total of \$150,000 was received from Next Generation Learning Challenges. The money is to be used for the implementation of a student-centered system of education. As of June 30, 2012, no money had been spent.

The Michigan Educational Excellence Foundation (MEEF) - A total of \$2,705,000 was received from MEEF to provide operating funds for the School District's primary mission.

Note 7 - Related Party Transactions

DPS - The Authority has a related party relationship with DPS due to the interlocal agreement signed between the board of regents of Eastern Michigan University and the School District for the City of Detroit creating the Education Achievement Authority signed on July 14, 2011. During the 11-month period ended June 30, 2012, the Authority contracted with DPS for help during the start-up phase of the Authority. The total amount expended and paid to DPS for the 11-month period ended June 30, 2012 was \$60,956.

Subsequent to year end, the Authority continued to contract with DPS for IT management and other services provided on behalf of the Authority.

Note 8 - Subsequent Events

Commencing in fall of 2012, the Authority assumed control of 15 schools and their operations, which is legal through the charter agreement. Upon assumption of the operations, the Authority employed approximately 400 teachers and building administrators and contracted substantially all non-instruction related functions to third parties as described below. The Authority also began receiving state aid and federal grant revenue and implementing processes designed to achieve the purpose of the Authority.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 8 - Subsequent Events (Continued)

State Aid Anticipation Note - On September 1, 2012, the School District entered into an agreement with DPS to borrow up to \$5,912,000 as an advance of state aid. The note is to be repaid in three installments, including interest (variable interest rate based on LIBOR), with the last payment due January 21, 2013. The payment was made on January 31, 2013 and there are no amounts outstanding as of the report date related to this note.

On February 1, 2013, the Authority entered into a second agreement with DPS to borrow up to \$6,000,000 as an advance of state aid. The note is to be repaid with four installments, including interest (variable interest rate based on LIBOR), with the last payment due July 22, 2013.

Title I Funding - On April 10, 2013, the Authority received an official letter from the State that they are now eligible to receive Title I, Part A and Title II, Part A funds based on the proportional amount of students at the Authority and at the applicable districts. This will provide the EAA with a share of DPS' total allocation proportionate to the number of students enrolled in the schools operated by the EAA, resulting in measurably increased allocations to the EAA for the 2013-2014 school year for Title I, Part A and Title II, Part A.

Lease and Asset Transfer for Schools - Subsequent to June 30, 2012, the Authority began operating 15 schools that were operated as Authority schools for the fiscal year ending June 30, 2013. The authority is leasing the buildings from the original district at a rate of \$1 per annum plus the number of Detroit resident students attending each school multiplied by \$910 per year for the period of three years from the commencement date of the signed lease agreement with the tenant having annual options to renew the term for successive one-year periods.

Rent will also be charged for non-Detroit resident students at the lesser of (a) two and a half percent (2.5 percent) of the Academy's total annual State aid revenue for students attending school or (b) an amount equal to ten percent (10 percent) of the square footage of the building times \$1 times 12 months.

The Authority assumes all responsibility to manage all of the assets leased according to all applicable federal and state program rules and regulations.

The lease also provides a provision that any money expended by the Authority to make alterations, improvements, or additions to the buildings necessary to enable the Authority to utilize them will be deducted from the lease payment amount. Normal repairs and maintenance are paid for by the Authority.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 8 - Subsequent Events (Continued)

Capital Lease - Subsequent to June 30, 2012, the Authority entered into two different leases with Hewlett-Packard Financial Services Company on August 7, 2012. The first lease was for student netbooks and teacher laptops for a total cost of \$2,999,532, which is amortized over 36 months with an annual rate of interest at 2.56 percent. The second lease was for laptop carts that had a total cost of \$531,118, which is amortized over 36 months with an annual rate of interest at 3.11 percent.

The leases can be considered capital as the title to the equipment will be transferred at the end of the lease.

The Skillman Grant - Subsequent to June 30, 2012, a \$500,000 grant was awarded from the Skillman Foundation. The funding period of the grant was from July 1, 2012 to June 30, 2014 and no funds were received until July 2012. The grant is to be used to fund the general operations of the Authority.

State Appropriation - Subsequent to June 30, 2012, the \$10,000,000 received as part of a one-time state appropriation to the Authority had been partially spent. As of the date of this report, \$7,300,000 had been spent.

The appropriation was originally recorded as part of the Capital Projects Fund; however, there are no legal restrictions on the appropriation and it has been classified as unrestricted fund balance. Subsequent to year end, an allowable transfer of \$2,000,000 was made from the Capital Projects Fund to the General Fund.

Significant Contracts - Subsequent to June 30, 2012, the Authority entered into a significant contract with Aramark Management Services for approximately \$470,000 per month for custodial, grounds, maintenance, waste management, and pest control services. The Authority also entered into contracts with Jenkins Construction to help with the capital improvements paid for by the State appropriation as well as Teach for America for teacher selections.

Charters - Subsequent to June 30, 2012, the Authority granted charters to three charter schools and acts as their fiscal agent and is accountable for providing oversight and compliance monitoring.

Expansion - Subsequent to June 30, 2012, the Authority has sought to expand its services to schools outside of DPS that meet the requirements as set forth in the interlocal agreement. As of the date of this report, the expansion has not yet been fully legally approved.

Education Achievement Authority

Notes to Financial Statements June 30, 2012

Note 9 - Defined Contribution Pension Plan

The School District provides pension benefits to all of its full-time employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The plan provisions and contribution requirements were established through a resolution by the Board of Education, and may be amended by future board actions. Employees are eligible to participate from the date of employment and are fully vested after two years of service. The School District matched contributions up to 7.5 percent of the employee's salary during the 11-month period ended June 30, 2012.

During the 11 months ended June 30, 2012, employees earned \$28,696 of matching contributions from the Authority, of which \$10,764 remains payable as of June 30, 2012.

Note 10 - Upcoming Accounting Pronouncements

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, was issued by the GASB in June 2011 and will be effective for the School District's 2012-2013 fiscal year. The statement incorporates deferred outflows of resources and deferred inflows of resources, as defined by GASB Concepts Statement No. 4, into the definitions of the required components of the residual measure of net position, formerly net assets. This statement also provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Once implemented, this statement will impact the format and reporting of the balance sheet at the government-wide level and also at the fund level.

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented for financial statements for periods beginning after December 15, 2012. Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows and inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources. Statement No. 65 will be implemented by the School District as of June 30, 2013.

Education Achievement Authority

Schedule of Audit Findings I 1-Month Period Ended June 30, 2012

Reference Number	Finding
2012-1	<p>Finding Type - Material weakness</p> <p>Criteria - Segregation of duties is an important part of internal control that reduces the risk of fraudulent transactions or accounting errors by limiting the access that individuals have to only segments of a transaction and providing for appropriate review and approval of accounting records.</p> <p>Condition - The staff accountant, business, finance, and operations generalist, and CFO have the ability to initiate and approve wire transfers directly with the bank without approval of another individual prior to the bank releasing the funds. Additionally, these individuals have full administrative access to the finance system including the ability to post journal entries, write grants, post cash receipts, add vendors, enter invoices, and enter cash disbursements.</p> <p>Context - The lack of segregation of duties affects all transactions recorded in the finance system.</p> <p>Cause - The lack of segregation of duties is the result of process design.</p> <p>Effect - The lack of segregation of duties limits the Authority's ability to reliably prevent or detect fraudulent activity, including missappropriation of cash, in a timely manner.</p> <p>Recommendation - We recommend that policies and procedures be implemented to increase the segregation of duties in the finance function.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The EAA has recently hired both a CFO, who is a CPA, and a controller, who has 19+ years of school finance and accounting experience. These two individuals have already begun to implement several process improvements, including that proper internal controls and segregation of duties are being observed.</p>

Education Achievement Authority

Schedule of Audit Findings (Continued) 11-Month Period Ended June 30, 2012

Reference Number	Finding
2012-2	<p>Finding Type - Material weakness</p> <p>Criteria - Compensated absence liabilities recorded in the government-wide statements as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34 should be recorded based on the earned benefit reduced by amounts used.</p> <p>Condition - The Authority did not have access to records to calculate an accurate liability for compensated absences at June 30, 2012.</p> <p>Context - The maximum liability, based on the employees for the fiscal year ended June 30, 2012, was calculated to be \$101,756. The liability in future periods could be significantly larger due to the increase in employees in the fiscal year ending June 30, 2013.</p> <p>Cause - The records for compensated absences are maintained on a manual spreadsheet on a computer that was not backed up.</p> <p>Effect - This amount was accrued, but there is a possibility it is overstated as it was not reduced by any vacation or personal time off taken by employees.</p> <p>Recommendation - We recommend that all computers that have Authority data on them be subject to standard backup procedures.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The EAA will review its options and ensure (a) proper data backup is observed and (b) records for compensated absences are maintained appropriately.</p>

Education Achievement Authority

Schedule of Audit Findings (Continued) 11-Month Period Ended June 30, 2012

Reference Number	Finding
2012-3	<p>Finding Type - Material weakness</p> <p>Criteria - GASB Statement No. 33 prescribes that voluntary non-exchange transactions are to be recognized based on the timing and provisions of enabling legislation.</p> <p>Condition - The State of Michigan passed an appropriation on June 29, 2012 to appropriate \$10 million for the Authority. The appropriations bill did not specify any timing or purpose restrictions. Based on the provisions of the appropriations bill and the timing of the cash receipt, the \$10 million should have been recognized as revenue and a receivable at June 30, 2012.</p> <p>Context - The total appropriation was \$10 million.</p> <p>Cause - Inadequate review of grant agreements for application of relevant accounting guidance</p> <p>Effect - The Authority did not recognize \$10 million in revenue as of June 30, 2012. Management posted the transaction as revenue into the Capital Projects Fund after it was identified and proposed by the auditors.</p> <p>Recommendation - We recommend that all significant grants and revenue sources be analyzed for proper accounting treating in accordance with GASB Statement No. 33.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The EAA's new CFO and controller have already begun to implement several process improvements, including the proper accounting treatment of all items, including significant grants.</p>

Education Achievement Authority

Schedule of Audit Findings (Continued) 11-Month Period Ended June 30, 2012

Reference Number	Finding
2012-4	<p>Finding Type - Significant deficiency</p> <p>Criteria - Grant funds should be spent in accordance with the grant agreements.</p> <p>Condition - During the 11-month period ended June 30, 2012, the Authority wrote and received grants from several granting organizations that had specific purpose restrictions. Upon receipt, the Authority remitted the funds to the Michigan Educational Excellence Foundation, who then remitted the funds back to the Authority as a grant. The Authority recorded the transaction on a gross basis, including the revenue twice - once from the granting organization and once from the Michigan Educational Excellence Foundation.</p> <p>Context - For the 11-month period ended June 30, 2012, grant receipts that were remitted to the Michigan Educational Excellence Foundation totaled \$1,150,000.</p> <p>Cause - Unknown</p> <p>Effect - The results were that the funds received by the Authority from the granting entity were provided to MEEF on a short-term basis, which is not in accordance with the grant agreements. This could result in the granting entity rescinding the grant if the funds are not used for the stipulated purposes.</p> <p>Recommendation - We recommend that grant proceeds be tracked and used in accordance with the grant agreement.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The EAA's new CFO and controller have already begun to implement several process improvements, including the review of all grants to ensure that proceeds be tracked and used in accordance with the grant agreements.</p>

Education Achievement Authority

Schedule of Audit Findings (Continued) 11-Month Period Ended June 30, 2012

Reference Number	Finding
2012-5	<p>Finding Type - Significant deficiency</p> <p>Criteria - Financial information should be complete, accurate, and recorded timely.</p> <p>Condition - After year end, the Authority did not keep up with recording financial activity. The accounting was not completed timely or accurately.</p> <p>Context - This does not affect the 11-month period ended June 30, 2012.</p> <p>Cause - Unkown</p> <p>Effect - Information recorded subsequent to June 30, 2012 is not accurate or complete.</p> <p>Recommendation - We recommend that the Authority develop a system to accurately track and record financial information timely.</p> <p>Views of Responsible Officials and Planned Corrective Actions - The EAA's new CFO and controller have begun to implement several process improvements, including the utilization of a system to accurately track and record financial information in a timely manner.</p>