

DAVID Y. IGE
GOVERNOR



CATHERINE PAYNE
CHAIRPERSON

STATE OF HAWAII
STATE PUBLIC CHARTER SCHOOL COMMISSION
(‘AHA KULA HO‘ĀMANA)

1111 Bishop Street, Suite 516, Honolulu, Hawaii 96813
Tel: (808) 586-3775 Fax: (808) 586-3776

SUBMITTAL FOR PRESENTATION AND ACTION

DATE OF SUBMITTAL: November 24, 2017

DATE OF MEETING: November 28, 2017

TO: Catherine Payne, Chairperson

FROM: Sione Thompson, Executive Director

AGENDA ITEM: III. Presentation and Action on Ka‘u Learning Academy’s Financial Audit for Fiscal Year 2017

I. DESCRIPTION

Update and action on the Financial Audit for Fiscal Year 2017 for Ka‘u Learning Academy (KLA).

II. AUTHORITY

Pursuant to Hawaii Revised Statutes (“HRS”) §302D-17(a), “An authorizer shall continually monitor the performance and legal compliance of the public charter school it oversees, including collecting and analyzing data to support ongoing evaluation according to the charter contract. Every authorizer shall have the authority to conduct or require oversight activities that enable the authorizer to fulfill its responsibilities under this chapter, including conducting appropriate inquiries and investigations, so long as those activities are consistent with the intent of this chapter and adhere to the terms of the charter contract.”

Section 12.1 of KLA’s State Public School Charter Contract provides that “the Commission continually monitor the performance and legal compliance of the School. The Commission shall have the authority to conduct or require oversight activities that enable the Commission to fulfill its responsibilities under Ch. 302D, HRS, including conducting appropriate inquiries and investigations, so long as those activities are consistent with the intent of Ch. 302D, HRS, and adhere to the terms of this Contract.”

III. BACKGROUND

Section 302D-32, Hawaii Revised Statutes (HRS), requires that “each charter school shall annually complete an independent financial audit that complies with the requirements of its authorizer.” In addition, the Charter Contract for KLA, in Section 11.3.4, states “Each fiscal year, the School shall provide for an independent annual financial audit conducted in accordance with Generally Accepted Auditing Standards and Governmental Auditing Standards and performed by a certified public accountant (CPA) ...”

On November 15, 2017, Commission staff received KLA’s Independent Financial Audit for Fiscal Year 2016-17, provided as **Exhibit 1** of this submittal. A review of the audit found that the school had been cited for several material weaknesses and incidents of non-compliance. The audit report defined a material weakness as “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.”

The audit reported the following findings:

- **Finding 2017-001: Lack of Internal Controls and Additional Oversight - continuation of 2016-001**
 - A lack of separation of duties in school financial procedures was noted as a material weakness. Specific instances noted included:
 - Funds for bill payments were disbursed with no approval by an appropriate level of authority;
 - Reimbursements for personal travel costs and payment for a utility bill for school management were made to KLA following the close of the fiscal year; and
 - A lack of documentation for 12 charges made on the school debit account could not provide support for the disbursement of school funds.
 - This finding was previously reported in KLA’s 2015-2016 financial audit and continued into the current audit.

- **Finding 2017-002: Accounting does not follow Generally Accepted Accounting Principles (GAAP)**
 - It was reported that school management did not utilize accrual accounting which resulted in significant adjustments to the school’s financial reports at the end of the fiscal year.
 - Financial reports completed during the school year were not an accurate representation of the school’s financial status.

- **Finding 2017-003: Non-compliance with Department of Labor Laws and Regulations**
 - Employee compensation, specifically bonuses, were not run through payroll.
 - Educational Assistants were paid as independent contractors.

IV. INFORMATION FOR CONSIDERATION

Each reported audit finding potentially violates the provisions of the school’s Charter Contract with the Commission and could require oversight and corrective actions. The following chart provides the section(s) of the Charter Contract that each finding may potentially violate:

FINDING	SECTION OF THE CHARTER CONTRACT
Finding 2017-001	Section 9.4: <u>Management and Financial Controls</u> . At all times, the School shall maintain appropriate governance and management procedures and financial controls which shall include, but not be limited to: (a) budgets, (b) accounting policies and procedures, (c) payroll procedures, (d) financial reporting and (e) internal control procedures for receipts, disbursements, purchases, payroll, and fixed assets.
Finding 2017-002	Section 9.1: The School shall maintain accurate and comprehensive financial records, operate in accordance with Generally Accepted Accounting Principles, and use public funds in a fiscally responsible manner.
<p>Finding 2017-003*</p> <p>* In addition, Finding 2017-003 raises concerns regarding KLA’s compliance with state collective bargaining requirements as determined by Charter 89, HRS.</p>	<p>Section 10.1: <u>Collective Bargaining</u>. The School shall be subject to collective bargaining under Ch. 89, HRS, and shall comply with the master agreements as negotiated by the State.</p> <p>Section 11.6: <u>Personnel Data</u>. The School shall maintain accurate and complete personnel and payroll information and shall provide such information to the Commission, in the format and timeframe prescribed by the Commission, as required for the Legislature or any State agency including but not limited to the Department of Budget & Finance, Employees' Retirement System, and the Hawaii Employer-Union Health Benefits Trust Fund. The School shall ensure each employee receiving State benefits qualifies for benefits.</p>

The Commission has the authority to act to address a charter school’s failure to meet the contractual requirements and non-compliance with laws and regulations. Pursuant to HRS §302D-5, the Commission as an authorizer is responsible for monitoring, in accordance with charter contract terms, the performance and legal compliance of public charter schools; and determining whether each charter contract merits renewal, nonrenewal, or revocation. Additionally, it requires the Commission to be responsible for and ensure the compliance of a public charter school it authorizes with all applicable state and federal laws, including reporting requirements.

Under state law, specifically Section 302D-17, HRS, the Commission’s oversight and corrective actions include:

1. Requiring a school to develop and execute a corrective action plan within a specified time frame;
2. Reconstituting the governing board of the charter school; and
3. Revocation of a Charter Contract.

Lastly, an analysis of KLA’s financial information, as reported in the audit, found that the school would receive a Rating of “Does Not Meet Target” for the Financial Performance Framework for the 2016-2017 school year. KLA’s results overall and for each indicator are represented in the chart below. Areas highlighted in red represent fiscal indicators that the school received a rating of “Does Not Meet Target”.

Current Ratio Greater than or equal to 1.1	Enrollment Variance equals or exceeds 95% in the most recent year	Days Cash on Hand \geq 60 days or 30-60 days trending upward	Total Margin is positive	Debt to Assets Ratio is less than 50%	Cash Flow is positive	Unrestricted Fund Balance Percentage greater than 25%	Change in Total Fund Balance is positive	Overall Annual Rating
2.4	124.7%	15	3.4%	23.3%	-\$38,070	14.3%	\$33,389	DOES NOT MEET

Exhibit 1

Ka'u Learning Academy Annual Audit for Fiscal Year 2016 -2017

KA‘U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

(A State of Hawai‘i Charter School)

AUDITED FINANCIAL STATEMENTS
WITH REQUIRED SUPPLEMENTARY INFORMATION

FOR THE YEARS ENDED JUNE 30, 2017 AND 2016

KA‘U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Table of Contents

Independent Auditor’s Report	1
Management Discussion and Analysis	3
Financial Statements:	
Statements of Net Position	6
Statements of Revenue and Expenses	7
Statements of Change in Net Position	8
Statements of Cash Flows	9
Notes to the Financial Statements	10
Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	15
Schedule of Findings and Questioned Costs	17
Management’s Response and Corrective Action Plan	19

INDEPENDENT AUDITOR'S REPORT

To Management and the Governing Board of
Ka'u Learning Academy Public Charter School
Na'alehu, Hawai'i 96772

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities of the Ka'u Learning Academy Public Charter School (the School), as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Ka'u Learning Academy Public Charter School's basic financial statements. These financial statements include the statements of net position as of June 30, 2017 and 2016, and the related statement of revenue and expenses, changes in net position, and cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Ka'u Learning Academy Public Charter School as of June 30, 2017 and 2016, and the changes in its net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Governing Board and Management of
The Ka‘u Learning Academy Public Charter School

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis and budgetary comparison information on pages 3-5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2017, on our consideration of the School’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School’s internal control over financial reporting and compliance.



Hilo, Hawai‘i
October 30, 2017

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Management Discussion and Analysis

(Unaudited Required Supplementary Information)

June 30, 2017 and 2016

The following discussion and analysis of the Ka'u Learning Academy Public Charter School's (the School) financial performance provides an overview of the School's financial activities for the fiscal year ended June 30, 2017 and 2016. Please read it in conjunction with the School's general purpose financial statements and the related notes to the financial statements, which begin on page 6.

The School as a Whole

Ka'u Learning Academy Public Charter School was established in July 2015, under a charter granted by the State of Hawai'i and operates as part of the State of Hawai'i and is therefore generally exempt from income taxes under *Section 115* of the Internal Revenue Code. The charter is awarded in three year increments and is subject to renewal at the discretion of the State of Hawai'i Public Charter School commission. The charter for the School was recently granted for the period of July 1, 2015 through June 30, 2021. The School currently serves 99 students in grades three through seven.

Using This Annual Report

This annual report consists of a series of financial statements. In accordance with *Governmental Accounting Standards Board Statement No. 34 Basic Financial Statement – Management's Discussion and Analysis - for State and Local Governments (GASB 34)*, the School is considered special purpose government entities that engages in only business-type activities. All of the financial activity of the School is recorded in an enterprise fund within the proprietary fund group. In accordance with *GASB No. 34* and *GASB No. 63 Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, the School issues a *Statement of Net Position*, *Statement of Revenue and Expenses*, *Change in Net Position* and a *Statement of Cash Flows*. These statements provide information about the financial activities of the School, as a whole. This annual report also contains notes to the financial statements which provide additional information that is essential to a full understanding of the information provided in the basic financial statements.

Financial Statements

The *Statement of Net Position* presents the assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position of the School as a whole, as of the end of the fiscal year. The *Statement of Net Position* is a point-in-time financial statement. The purpose of this statement is to present a fiscal snapshot of the School to the readers of the financial statements. Assets are resources with present service capacity that the School presently controls. Liabilities are present obligations to sacrifice resources that the School has little or no discretion to avoid. Net position represents the difference between all other elements in a statement of financial position and is displayed in three components—*net investment in capital assets*; *restricted* (distinguishing between major categories of restrictions), and *unrestricted*.

The *net investment in capital assets* component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

The *restricted* component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability, or if the liability will be liquidated with the restricted assets reported.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Management Discussion and Analysis - *Continued*

(Unaudited Required Supplementary Information)

June 30, 2017 and 2016

Financial Statements - Continued

The *unrestricted* component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

Over time readers of the financial statements will be able to evaluate the School's fiscal health (liquidity and solvency) or financial position by analyzing the increases and decreases in net position to determine if the School's financial health is improving or deteriorating. The reader will also need to consider other non-financial factors such as changes in economic conditions and new or amended charter school legislation when evaluating the overall financial health of the School. This statement is also a good source for readers to determine how much the School owes to vendors and creditors, and the available assets that can be used to satisfy those liabilities.

The *Statement of Revenue and Expenses* reports the financial (revenue and expenses) activities of the School and divides it into two categories: *Operating activities* and *Non-operating activities*. Operating activities include all financial activities associated with the operation of the School and its related programs. Consequently, all non-operating activities include all financial activities not related to the operation of a Charter School. The statement also helps to determine whether the School had sufficient revenues to cover expenses during the year and its net increase or decrease in net position based on current year operations.

The *Statements of Cash Flows* provides information about the School's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from *operations*, *investing*, and *capital and noncapital financing activities* and provides answers to such questions as "from where did cash come?," "for what was cash used?," and "what was the change in the cash balance during the reporting period?" This statement also is an important tool in helping users assess the School's ability to generate future net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Notes to the financial statements provide additional information that is essential to a full understanding of the information provided in the School's financial statements.

Financial Highlights

The following financial highlights are for the fiscal year 2017 and 2016:

- The School held total assets of \$179,795 at June 30, 2017 and \$137,272 at June 30, 2016, of which \$78,948 and \$20,299 were net capital assets, respectively, and the remaining assets consisted of cash and accounts receivable.
- The School held total liabilities of \$41,858 as of June 30, 2017 and \$32,724 as of June 30, 2016, all of which were current.
- Total net position for the School was \$137,937 and \$104,548, at June 30, 2017 and 2016, respectively, of which \$59,989 and \$84,249 was unrestricted, respectively, and \$78,948 and \$20,299, was for investments in capital assets, respectively.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Management Discussion and Analysis - *Continued*

(Unaudited Required Supplementary Information)

June 30, 2017 and 2016

Financial Highlights *(continued)*

- The School earned total revenues of \$966,531 and \$911,259 for the year ended June 30, 2017 and 2016, respectively, of which 100% was operating revenues.
- The School had total expenses of \$963,142 and \$806,761 for the year ended June 30, 2017 and 2016, respectively.
- The School earned net income of \$33,389 and \$104,498 for the year ending June 30, 2017 and 2016, respectively.

Budgetary Highlights

The School's annual budget was amended as the year progressed. For the fiscal year ended June 30, 2017, actual revenue for the School was \$966,531 compared to budgeted revenue of \$946,000. The School incurred \$963,142 in actual expenditures (exclusive of capitalized purchases) compared to budgeted expenditures of \$869,093. The main reason actual expenses exceeded budget was the school was required to build ADA compliant restrooms that cost considerably more than anticipated. The School was also required to lease ADA compliant porta-toilets for the entire year while the permanent bathrooms were being built. The school spent a considerable amount of money on architects and engineers in order to keep the school compliant with county building codes. Additionally, the school purchased curriculum and training from the 2016-2017 budget that is being used in the 2017-2018 school year. This was a substantial cost that could have been put off until the next fiscal year, but the school received a significant discount for purchasing the curriculum, hardware, software and training in advance. Though this negatively affected the 2016-2017 bottom line, the school will benefit in the 2017-2018 fiscal year, because their curriculum and technology has already been purchased. Additionally, the school leaders and staff were required to make several trips to Oahu to speak at the charter commission meetings in order to represent the school's interest as it pertained to their proposed 8th grade expansion.

School's Financial Activities

The majority of the School's funding is received from the State of Hawai'i Public Charter School Commission and is based on a standard rate per pupil. The School received \$761,065 and \$677,754 in per pupil funding which represents 78% and 77% of the School's revenue for the years ended June 30, 2017 and 2016, respectively. In addition, the School received various Federal grants which totaled \$154,819 and \$152,709 for the years ended June 30, 2017 and 2016, respectively.

Contacting the School's Financial Management

This financial report is designed to provide the reader with a general overview of the School's finances and to show the accountability for the funds received. If you have questions about this report or need additional financial information contact the Business Office of the School.

Executive Director – Kathryn Tydlacka, 498-0761 or kaulearning@gmail.com

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Statements of Net Position
As of June 30, 2017 and 2016

ASSETS

	<u>2017</u>	<u>2016</u>
CURRENT ASSETS		
Cash and Cash Equivalents (Note 2)	\$ 39,172	\$ 77,242
Accounts Receivable (Note 2)	61,675	39,731
Total Current Assets	<u>100,847</u>	<u>116,973</u>
CAPITAL ASSETS		
Net Capital Assets (Note 2)	<u>78,948</u>	<u>20,299</u>
TOTAL ASSETS	<u>\$ 179,795</u>	<u>\$ 137,272</u>

LIABILITIES AND NET POSITION

CURRENT LIABILITIES		
Accounts Payable	\$ 15,939	\$ 3,647
Accrued Payroll	19,134	22,292
Accrued Vacation Payable	6,785	6,785
Total Current Liabilities	<u>41,858</u>	<u>32,724</u>
NET POSITION (Note 2)		
Investment in Capital Assets, Net of Related Debt	78,948	20,299
Unrestricted Net Position	58,989	84,249
Total Net Position	<u>137,937</u>	<u>104,548</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 179,795</u>	<u>\$ 137,272</u>

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Statements of Revenue and Expenses
For the Year Ended June 30, 2017 and 2016

	2017	2016
OPERATING REVENUE		
State Per Pupil	\$ 761,065	\$ 677,754
Food Service	69,159	70,127
Federal Impact Aid	51,870	35,689
In Kind Revenue (Note 9)	40,602	34,789
Title I	33,790	40,051
FICA Reimbursements (Note 7)	30,206	25,806
Miscellaneous Income	9,409	14,201
Other State Income	430	6,000
SPED	-	6,842
Total Revenue	996,531	911,259
OPERATING EXPENSES		
Salaries, Wages and Benefits	514,643	450,176
Student Expenses	160,548	64,012
Food Services	73,560	64,338
Travel	60,760	13,685
In Kind Expense (Note 9)	40,602	34,789
Professional Services	25,251	5,389
Utilities	22,390	19,230
Repairs and Maintenance	19,308	6,556
Transportation	17,982	60,495
Building and Grounds Expenses	13,599	39,818
Depreciation Expense	7,765	811
Equipment Rental	6,734	289
Equipment and Furniture	-	27,568
Other Expense	-	18,349
Administration Expenses	-	1,256
Total Expenses	963,142	806,761
Operating Income	\$ 33,389	\$ 104,498
NON-OPERATING REVENUE AND EXPENSES		
	-	-
CHANGE IN NET POSITION	\$ 33,389	\$ 104,498

The accompanying notes are an integral part of these financial statements.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Statements of Changes in Net Position
For the Years Ended June 30, 2017 and 2016

	<u>Net Position</u>		
	<u>Capital and Unrestricted</u>	<u>Restricted</u>	<u>Total</u>
Net Position, June 30, 2015	\$ 50	\$ -	\$ 50
Change in Net Position	<u>104,498</u>	<u>-</u>	<u>104,498</u>
Net Position, June 30, 2016	104,548	-	104,548
Change in Net Position	<u>33,389</u>	<u>-</u>	<u>33,389</u>
Net Position, June 30, 2017	<u>\$ 137,937</u>	<u>\$ -</u>	<u>\$ 137,937</u>

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Statements of Cash Flows
For the Year Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash from Government Funding	\$ 924,576	\$ 822,538
Other Cash Receipts	9,409	14,201
Cash Paid to Employees	(517,801)	(421,099)
Cash Paid to Vendors	<u>(387,840)</u>	<u>(317,338)</u>
Net Cash Provided by Operating Activities (Note 6)	28,344	98,302
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	-	-
CASH FLOWS FROM CAPITAL AND RELATED FINANCING		
Cash Used to Purchase Capital Assets	(66,414)	(21,110)
CASH FLOWS FROM FINANCING ACTIVITIES	<u>-</u>	<u>-</u>
Net Increase in Cash for the Year	(38,070)	77,192
CASH BALANCE, BEGINNING OF YEAR	<u>77,242</u>	<u>50</u>
CASH BALANCE, END OF YEAR	<u><u>\$ 39,172</u></u>	<u><u>\$ 77,242</u></u>
Non-cash Investing Activity:		
Donation of vehicles	\$ -	\$ 17,050

THE KA‘U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Notes to the Financial Statements June 30, 2017 and 2016

Note 1. ORGANIZATION

The Ka‘u Learning Academy Public Charter School (the School) was established in July 2015, as a Hawai‘i Public Charter School via State of Hawai‘i legislation. The Ka‘u Learning Academy Public Charter School is part of the State of Hawai‘i’s public school system and functions with a governing board as a public charter school. This structure implements an alternative framework with regards to curriculum, facilities management, instructional approach, length of school periods, and personnel management.

The School operates in the town of Na‘alehu and provides instruction for students in grades three through seven.

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the School conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the School’s significant accounting policies:

a) *Financial Statement Presentation*

The School, in accordance with *Governmental Accounting Standards Board (GASB) Statement No. 34 – Basic Financial Statement – Management’s Discussion and Analysis – for State and Local Governments* engages in only business-type activities and is not a component unit of another governmental entity. Therefore, the financial statements are prepared using the accrual basis of accounting and all of the activity is recorded in the enterprise fund.

b) *Basis of Accounting*

The accrual method of accounting is used for all governmental entities that operate as business-type entities. Accordingly, revenue is recognized when earned, and capital assets and expenditures are recorded when received and incurred. Grants and contributions are recognized when all eligible requirements are met.

Pursuant to *GASB Statements No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the School has elected to apply the provisions of all relevant pronouncements of *Financial Accounting Standards Board (FASB)* that do not conflict with or contradict *GASB* pronouncements.

c) *Deferred Revenue*

Revenue is recognized when earned; however, funds received that are not earned as of year-end are recorded as a liability under deferred revenue. There were no deferred funds as of June 30, 2017.

THE KA‘U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Notes to the Financial Statements
June 30, 2017 and 2016

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

d) *Tax Status*

The School was established under a charter granted by the State of Hawai‘i and operates as part of the State of Hawai‘i and is therefore generally exempt from income taxes under *Section 115* of the Internal Revenue Code.

e) *Cash and Cash Equivalents*

For the purpose of the *Statement of Net Position* and the *Statement of Cash Flows*, the School considers all checking, savings and short-term investments with an original maturity of three months or less to be cash equivalents.

f) *Accounts Receivable*

Accounts receivable are presented net of the allowance for doubtful accounts. Management’s periodic evaluation of the adequacy of the allowance is based on its past experience. Accounts receivable are written off when deemed uncollectible. No allowance for doubtful accounts has been recorded as of June 30, 2017 as management considers all accounts receivable to be collectible.

g) *Operating Revenue and Expenses*

Operating revenue and expenses generally result from providing educational and instructional services in connection with the School’s principal ongoing operations. The principal operating revenues include Federal, State and Private grants, Program Fees, and other revenue. Operating expenses include educational costs, administrative expenses, and depreciation on capital position. All other revenue and expenses not meeting this definition are reported as non-operating revenues and expenses.

h) *Capital Assets*

Property and equipment are recorded at a cost or at fair market value at the date of donation. Generally, capital assets purchased with a cost or value greater than \$5,000 and a useful life greater than one year are capitalized. Depreciation is computed using the straight-line method over the assets’ estimated useful lives of three to ten years. The following details the Capital Assets as of June 30, 2017 and 2016:

	2017	2016
Work in Progress	\$ -	\$ 4,896
Leasehold Improvements	57,049	16,214
Accumulated Depreciation	(2,105)	(811)
Net Leasehold Improvements	<u>54,944</u>	<u>15,403</u>
Furniture and Equipment	14,925	-
Accumulated Depreciation	(1,891)	-
Net Furniture and Equipment	<u>13,034</u>	<u>-</u>
Vehicles	15,550	-
Accumulated Depreciation	(4,580)	-
Net Vehicles	<u>10,970</u>	<u>-</u>
Net Capital Assets	<u>\$ 78,948</u>	<u>\$ 20,299</u>

THE KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Notes to the Financial Statements June 30, 2017 and 2016

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) *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. Estimates also affect the reported amounts of revenue and expenditures during the reporting period. Actual results could differ from those estimates.

j) *Classification of Net Position*

Unrestricted Net Position – portion of funds to support operations

Investment in Capital Assets, Net – book value of capital assets net of any related debt

Restricted – funds received or committed to specific uses or programs

Note 3. RELATED PARTY TRANSACTIONS

The Fournier Center for Empowerment (the Center) is a business established in Chicago, Illinois. During the year ending June 30, 2016, the Center provided \$47,818 of funding to cover the start-up costs for the School, which was subsequently reimbursed by the School. The founder of the Center was compensated for professional development services provided to the School in the amount of \$4,724. The Operations Director for the School is the registered agent for the Center in the State of Hawai'i.

The School leases its facilities under an annual lease with an option to renew for an additional year. The Fournier Center for Empowerment is a co-tenant under the lease. The total rent expense for the School was \$120 for the fiscal years ending June 30, 2017 and 2016, which is considered below-market (see Note 9). The School is required to compensate the landlord for other costs for the utilization of the property. Total expense to the School for these expenses was \$6,000 for the years ending June 30, 2017 and 2016.

Note 4. CONCENTRATIONS

The Ka'u Learning Academy Public Charter School receives a substantial amount of its support from governmental funding. As of June 30, 2017 and 2016, the School received 99% and 98% of its revenues from government funding, respectively. Significant reduction of funding from this legislation could adversely affect the operations of the School.

Note 5. SUBSEQUENT EVENTS

In preparing these financial statements management has evaluated events and transactions for potential recognition or disclosure through October 30, 2017, the date the financial statements were issued.

THE KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Notes to the Financial Statements
June 30, 2017 and 2016

Note 6. RECONCILIATION OF OPERATING INCOME WITH NET CASH PROVIDED BY OPERATING ACTIVITIES

	<u>2017</u>	<u>2016</u>
Operating Income	\$ 33,389	\$ 104,498
Adjustments to Reconcile:		
Add Depreciation Expense	7,765	811
Change in Accounts Receivable	(21,944)	(39,731)
Change in Accounts Payable	12,292	3,647
Change in Accrued Expenses	(3,158)	29,077
Net Cash Provided by Operating Activities	<u>\$ 28,344</u>	<u>\$ 98,302</u>

Note 7. REIMBURSED PAYROLL EXPENSES

The Ka'u Learning Academy Public Charter School received reimbursements from the Hawai'i Public Charter School Commission for the employer FICA expenses for all employees not enrolled in the Department of Education's FMS payroll system. For the fiscal years ending June 30, 2017 and 2016, this amount was \$30,206 and \$25,806, respectively.

Note 8. DEPOSITS WITH FINANCIAL INSTITUTIONS

The School maintains its cash balances in two financial institutions located in Hawai'i. The balances at times may exceed the Federal Deposit Insurance Corporation (FDIC) insured limit per financial institution. Management acknowledges the possibility of risk in this arrangement; however the size and longevity of the depository institution minimizes such risk. As required by *GASB Statement No. 40, Deposits and Investment Risk Disclosures*, the following represents a summary of deposits as of June 30:

	<u>2017</u>	<u>2016</u>
Fully Insured Deposits	\$ 39,172	\$ 77,242
Uninsured and Uncollateralized	-	-
	<u>\$ 39,172</u>	<u>\$ 77,242</u>

Note 9. IN-KIND REVENUE

During the year ending June 30, 2016, the School received two donated vans for their transportation program with an approximate combined value of \$17,050. In addition, a member of the Governing Board provided skilled contractor services at no charge with an estimated value of \$1,850. The School maintains an administrative office on a separate property at no charge to the School, the approximate value of which is \$4,950. The School leases its facilities for a quarterly fee which is considered below fair market value by an amount of \$10,939. The School provides additional educational opportunities for Special Education students. The Department of Education (DOE) of the State of Hawai'i pays for these services directly. In-Kind revenues are hereby noted for \$40,602 and \$34,789, respectively, for the years ending June 30, 2017 and 2016.

THE KA‘U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Notes to the Financial Statements
June 30, 2017 and 2016

Note 10. RETIREMENT PLAN

Charter School employees are employees of the State of Hawai‘i and as such employees which meet certain conditions are required to become members of the State of Hawai‘i Employees’ Retirement System (ERS), a 401(a) defined benefit retirement plan, exempt under *Section 501(a)* of the Internal Revenue Code. Prior to June 30, 1984 employees participated in a noncontributory plan. As of July 1, 1984 a new, noncontributory plan was added for those ERS members also covered under Social Security. On July 1, 2006 pursuant to *Act 170, SLH of 2004*, a hybrid plan was adopted. All members of the non-contributory and certain members of the contributory plan are eligible to join the hybrid plan, and most new employees are required to join the hybrid plan. The School did not make any contributions to the retirement plan.

Independent Auditor's 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 Governing Board and Management of
The Ka'u Learning Academy Public Charter School
Na'alehu, Hawai'i 96772

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities of the Ka'u Learning Academy Public Charter School, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Ka'u Learning Academy Public Charter School's basic financial statements, and have issued our report thereon dated October 30, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Ka'u Learning Academy Public Charter School's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Ka'u Learning Academy Public Charter School's internal control. Accordingly, we do not express an opinion on the effectiveness of the Ka'u Learning Academy Public Charter School's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be material weaknesses as Findings 2017-001 and 2017-002.

To the Governing Board and Management of
The Ka'u Learning Academy Public Charter School

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Ka'u Learning Academy Public Charter School's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as Finding 2017-003.

Ka'u Learning Academy Public Charter School's Response to Findings

Ka'u Learning Academy Public Charter School's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Ka'u Learning Academy Public Charter School's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Caolonaro CPAs

Hilo, Hawai'i
October 30, 2017

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Schedule of Findings and Questioned Costs
June 30, 2017

Finding 2017-001: Lack of Internal Controls and Additional Oversight – continuation of 2016-001

Criteria: Segregation of duties means to separate certain accounting functions that serve as a check and balance for each other. Accounting and reconciling transactions should be separated from disbursing funds in any manner. Also, we noted lack of annotated oversight by the appropriate level of authority of bank statements, bank reconciliation reports, and payroll processing.

Cause of Condition: During our audit, we noted a lack of separation of duties in certain internal control procedures. The specific instances we encountered are as follows:

- We noted that the bookkeeper disbursed funds via on-line bill payments and there was no annotated approval by the appropriate level of authority.
- We noted School disbursements for management's personal travel costs and a utility bill which were reimbursed to the School. The reimbursements occurred after the fiscal year end.
- During our testing of 2 months of bank statement debit charges, supporting documents for 12 charges were not provided to us to support the disbursement.
- We noted one of the School's Directors solely responsible for processing payroll is included in payroll, and there was no annotated review or approval of payroll by the appropriate level of authority. Additionally, during our payroll testing, the timesheets for two hourly paid persons were not provided to us though they had been paid.
- We noted no documented perusal by a check signer of their review of the bank statements and bank reconciliation reports.

Effect: The lack of segregation of duties is a risk as it allows the School to be susceptible to fraud and misappropriation of the School's assets.

Recommendations: We recommend a member of the Governing Board review employee contracts and verify agreed upon wages to the processed payroll report. This review should be notated on the payroll report with the date and initials or signature of the reviewer. We also recommend that the bookkeeper not be able to disburse funds in any manner. Fiscal oversight should be added where a check signer reviews the bank statements and reconciliation reports and annotates their review. We recommend a local Governing Board member review bank statement for reasonableness and unusual items and document their review.

See Management's Response and Corrective Action Plan on page 19.

Finding 2017-002: Accounting does not follow Generally Accepted Accounting Principles (GAAP)

Criteria: The School, in accordance with *Governmental Accounting Standards Board (GASB) Statement No. 34 – Basic Financial Statement – Management's Discussion and Analysis – for State and Local Governments* engages in only business-type activities and is not a component unit of another governmental entity. Therefore, the financial statements are required to be prepared accurately using the accrual basis of accounting, and all of the activity is recorded in the enterprise fund.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Schedule of Findings and Questioned Costs
June 30, 2017

Finding 2017-002: Accounting not following GAAP (continued)

Cause of Condition: During our audit, it was noted that management does not fully utilize the accrual system of accounting. The specific instances we encountered are as follows:

- Many closing entries were not made at year end and the Statement of Net Position accounts were not properly reconciled to subsidiary journals.
- A material amount of earned revenues were not reported as of year end and expenses were not accurately classed by funding source.
- Fixed asset purchases were not properly capitalized.
- We noted verbal or the absence of documented pay rates agreed to in several individual contractor contract agreements.

Effect: As a result of not using accrual accounting, the financial reports required significant adjustments at year end, many of which were material to the financial statements. Management maintains a general overall knowledge of the financial status of the School, however, the details are not being reflected accurately during the year. Thus the financial reports presented to and reviewed by the Governing Board at a particular given time were not an accurate representation of the financial position of the School. Federal and State funding requires adequate internal control over financial reporting to reasonably safeguard assets and provide management with accurate financial reporting.

Recommendation: We recommend that the Accountant continue to receive training in the purpose and use of accrual accounting and its application to the preparation of the financial statements. Procedures should be put into place to ensure the financial statements are being presented accurately. We further recommend the Accountant ensure the accounting is complete and the books are closed properly. Also, prior to closing the books, the Accountant should review the financials at year end and accurately class revenue and expenses by funding source.

See Management's Response and Corrective Action Plan on pages 19-20.

Finding 2017-003: Non-compliance with Department of Labor Laws and Regulations

Criteria: The School is subject to the laws and regulations of 29 CFR Subpart A—Service Contract Labor Standards Provisions and Procedures, Part 4, to accurately define and report compensation for employees and independent contractors.

Cause of Condition: We noted that not all compensation to employees, specifically bonuses, was run through payroll. Additionally, we noted Educational Assistants being paid as independent contractors.

Effect: Employee W-2s and the State and Federal Wage reports would be inaccurate if not amended.

Recommendation: We recommend following guidelines relating to defining independent contractors and employees based on the nature of the work and level of control the School has over the services they provide. All non-reimbursements to employees should be included in wages unless a documented reason within guidelines is noted. We also recommend reviewing all wage reports for 2017 to be sure that employee W-2s will be accurate.

See Management's Response and Corrective Action Plan on page 20.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Managements Response and Corrective Action Plan
June 30, 2017

Finding 2017-001: Lack of Internal Controls and Additional Oversight – continuation of 2016-001

We agree with the auditor's findings and the following actions will be taken to improve the situation:

An outside CPA, who has extensive experience with accounting for and complying with government contracts has been contracted to assist with corrections.

Policies and procedures will be implemented to ensure separation of duties and provide adequate internal controls. The employee responsible for accounting and reconciling transactions will have no access to cash disbursements. KLA director will review and notate approval bank statements and reconciliations. Governing board will review bank statements and document their review.

Policies regarding receipt collection and retention will be implemented with oversight by KLA director.

Controls will be implemented to ensure that only bona fide business expenses are paid for with school funds.

All aspects of the payroll process will be reviewed by the outside CPA, and recommendations regarding policies and procedures will be provided to KLA. These procedures will be written and implemented. Payroll documents will be reviewed prior to payroll processing to ensure completeness. Procedures to ensure adequate file retention will be followed. KLA Director will annotate approval of payroll prior to submission and will review reports after submission to ensure payroll was processed correctly. A member of the Governing Board will review employee contracts and verify agreed upon wages.

All policies and procedures created will be assembled into a manual that will be available to all pertinent staff, and staff will be required to sign acknowledgement of reading procedures. The manual will be completed and all employees will have reviewed prior to the fiscal year end.

Finding 2017-002: Accounting not following GAAP

We agree with the auditor's findings and the following actions will be taken to improve the situation:

The outside CPA will provide an assessment of the skill level of the accounting staff and make recommendations on training and/or replacing the current staff. The training plan will include instruction on accrual accounting and its application to the preparation of the financial statements. Checklists will be created for accounting staff to follow to ensure month/year end entries are correctly recorded.

KA'U LEARNING ACADEMY PUBLIC CHARTER SCHOOL

Managements Response and Corrective Action Plan
June 30, 2017

Finding 2017-002: Accounting not following GAAP (continued)

An outside CPA will review financials periodically, and prior to year-end in order to ensure that revenue and expenses have been recorded in accordance with GAAP. CPA will assist with audit preparation to ensure adherence to cost principles. CPA will also assist with reporting to funding sources to ensure compliance with contract requirements.

KLA director and CPA will work closely with the accounting staff to ensure that checklists are being followed and financial statements are being prepared in accordance with GAAP. Assessment and training will begin immediately. Financial statements will be in accordance with GAAP prior to the audit of the year ending June 30, 2018.

Finding 2017-003: Non-compliance with Department of Labor Laws and Regulations

We agree with the auditor's findings and the following actions will be taken to improve the situation:

The outside CPA will review all employees and independent contractors to ensure that they are correctly classified, and any anomalies will be corrected. Policies and procedures will be implemented to ensure compliance with the Department of Labor Laws and Regulations. KLA director will ensure that procedures are being followed.

Payroll shall be reviewed and corrected prior to issuance of W2's and 1099's in January, 2018.