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November 26, 2007

Members of the Board of Education  
Charter School No. 4159  
Seven Hills Classical Academy  
Bloomington, Minnesota

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

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

## LarsonAllen LLP



Dennis Hoogeveen, CPA  
Principal



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**SEVEN HILLS CLASSICAL ACADEMY  
CHARTER SCHOOL NO. 4159**

**EXECUTIVE AUDIT SUMMARY (EAS)**

**JUNE 30, 2007**



**SEVEN HILLS CLASSICAL ACADEMY  
CHARTER SCHOOL NO. 4159  
EXECUTIVE AUDIT SUMMARY (EAS)  
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**EXECUTIVE AUDIT SUMMARY (EAS)  
FOR  
SEVEN HILLS CLASSICAL ACADEMY  
YEAR ENDED JUNE 30, 2007**

**AUDIT FINDINGS AND RESULTS**

We prepared this Executive Audit Summary and Management Report in conjunction with our audit of the School's financial records for the year ended June 30, 2007. We appreciated the time that staff took to work with us to complete the engagement.

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

**Yellow Book Opinion** – No compliance issues were noted in our review of laws, regulations, contracts and grants that could have significant financial implications to the School.

**Internal Controls** – No “material weakness” in internal controls was noted.

**Legal Compliance** – No significant compliance issues were reported with respect to Minnesota Statutes, except related to collateral. The School technically was required to have higher levels of available collateral in order to cover the highest available deposit balance during any given day. At times during fiscal year 2007, deposits exceeded the amount of required collateral coverage.

**Fund Balance** – The School's General Fund increase fund balance during fiscal 2006-07 by \$5,697 ending at \$6,143 as of June 30, 2007. We recommend that a charter school develop a long-range plan which develops and maintains a target fund balance that is 20 percent to 25 percent of annual expenditures. The ending fund balance at June 30, 2007 for Seven Hills Classical Academy represents 0.3 percent of expenditures incurred for the year and is an important aspect in the School's financial well being since a healthy fund balance represents things such as cashflow, as a cushion against unanticipated expenditures, enrollment declines, state aid metering changes, funding deficiencies and aid prorations at the state level and similar problems. It is our understanding that the school board has adopted a fund balance policy that eventually calls for a 25 percent ending fund balance with an additional 3 percent being available for specific purposes such as capital items.

**Budget** – Total revenues on a net basis were \$21,455 (or 1.0%) lower than the final amended budget amount while total expenditures were \$22,556 (or 1.1%) higher than had been budgeted. As part of any budget update initiated for fiscal 2007-08, the Board will want to take these minor variances into consideration in order to limit budget differences to every extent possible. We recommend that budget variances in a charter school environment (which is more volatile than in a traditional school environment but on a much smaller scale) be limited to 1 percent to 2 percent on either side of zero. We encourage you to continue the practice of undertaking mid-year budget reviews resulting in the adoption of a revised General Fund budget when updated information becomes available.

**Policies and Procedures Related to General Disbursements** – As part of our audit testing, we select a random sample of transactions to test for certain attributes related to those transactions. The attributes we evaluated include proper preparation, proper approval, and proper recording. We noted the following issue during testing:

- One invoice lacked physical evidence of approval on the supporting documentation.

**Food Service Fund** – The School's food service program operated at a deficit of \$7,549 for fiscal year 2007. Under UFARS (Uniform Financial Accounting Reporting Standards) the School is required to eliminate the deficit either through operations during the next fiscal year or through an operating transfer from the General Fund. The School approved the transfer of \$7,549 from the General Fund to the Food Service Fund to eliminate the year-end deficit. It is not uncommon for charter schools to operate a subsidized food service program in which a portion of general education funds are utilized (via an annual operating transfer from the General Fund to the Food Service Fund) to ensure that all students have access to a nutritious meal as part of a healthy learning environment. It is basically a board-level decision as to whether or not the intent of the School is to run a food service program on a break-even basis (which may necessitate higher meal prices for students that pay for full-price meals) or on a subsidized basis (where the conclusion is that it is not practical to operate the type of program you want to have without a subsidy). We recommend that the Board indicate in the budget the extent to which it is willing to subsidize the food service program.

**Community Service Fund** – The School's community service program operated at a deficit of \$18,024 for fiscal year 2007. The School approved the transfer of \$18,024 from the General Fund to the Community Service Fund to eliminate the year-end deficit. We recommend that the Board develop a plan to minimize the likelihood of future deficits in the Community Service Fund to avoid using General Fund resources to subsidize this program, which should operate on a self-sustaining basis.

## NEW AUDITING STANDARDS

There are two key new auditing standards which became effective for the June 30, 2007, audit of the School. All public accounting firms must comply with these standards, as issued by the American Institute of CPAs, when performing audits. In an effort to serve you better and continue to gain efficiency and understanding in the audit process, we have outlined some of the changes.

### STATEMENT OF AUDITING STANDARDS (SAS) 103: AUDIT DOCUMENTATION

This standard addresses the format and content of the auditors' workpapers, documentation procedures and results.

- First, the standard tells us that: ***“The auditor’s report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion.”*** On the surface, this requirement does not seem much different from existing requirements; however, it has practical implications. A delay between the end of audit fieldwork and approval of draft financial statements can result in a change in the report date and require additional audit steps, such as updating attorney letters, reviewing additional board minutes and interim financial statements, extending subsequent receipts and disbursements testing, etc. for the intervening period. These additional steps would also be required if a significant adjustment were to be made to the financial statements, or information required in the footnotes were to be provided, after the initial fieldwork date.
- Second, we must now ***“lock down” audit files within 60 days of the issuance*** of the audit report. This will make workpapers inaccessible for changes. Practically, this means that late management responses can also cause the report date to change when they are incorporated into Single Audit findings or management letter comments, with similar implications for additional audit procedures and billings.

The audit documentation requirements of SAS 103 may reinforce the common perception that auditors ask the same questions and make the same requests multiple times over the course of an annual audit engagement. The purpose of follow-up requests, however, are designed to affirm representations and ensure the completeness of the audit evidence documentation through our report date.

SAS 103 encourages the auditor to corroborate oral representations by client management. Auditors will obtain audit evidence through inquiries of additional personnel and/or written documentation. Therefore, accessibility and responsiveness of all staff to auditor inquiries will be necessary to have an efficient audit. Corroborating information often resides outside the accounting office. For example, information obtained through direct inquiry of non-Business Office department staff such as food service.

## SAS 112: COMMUNICATING INTERNAL CONTROL RELATED MATTERS NOTED IN THE AUDIT

This standard includes new language and definitions. The standard replaces “reportable conditions” and “management points” with new terms as follows:

- **Control Deficiency**—“A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.”

Items that would fall under this new definition include:

- Lack of sufficient expertise to properly apply accounting principles to the financial statements;
- Lack of control over non-routine and nonsystematic transactions such as journal entries;
- Lack of antifraud programs;
- Lack of timely financial statements, or
- Errors uncovered in testing of controls during the audit.

- **Significant Deficiency**—“A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity’s financial statements, that is more than inconsequential, will not be prevented or detected by the entity’s internal control.”

In other words, judging the impact of items like those above, singularly or collectively, could rise to such a level that, in the auditor’s judgment, possible misstatements could occur in the financial statements. Strong indicators of this would be:

- Ineffective oversight of reporting or internal control by those responsible for governance;
- Restatement of prior period financials due to errors;
- Material adjustments to financial statements uncovered in the audit process, including the assessment of the reasonableness of estimates; or
- Lack of serious response to prior year control deficiency.

- **Material Weakness** — “A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.”

In other words, depending upon the qualitative analysis of the significant deficiencies above on the financial statements, as well as the number of such items encountered, any or all of the above could rise to the level of material weakness.

**For example**, an entity with an active audit committee that follows up on items, holds management accountable for previously identified lack of controls, but estimates an overstatement of the valuation of accounts receivable for one year. This may be assessed as a control deficiency. However, if the same estimate error occurs a second year, and the school board hasn’t held management to a corrective action on their approach to the estimate, the control deficiency could rise to a material weakness.

You will note that these new definitions are broader and more inclusive than the previous “reportable conditions” and “material weakness” that were reported to you under SAS 60.

- Additionally, and perhaps most importantly to you, our communication of significant deficiencies and material weaknesses must be in writing. Verbal communications of deficiencies will not be acceptable. This means, these items must be included in our “management letter” (formerly SAS 60 report), which state agencies and other constituents often request.

Nothing in the new standards precludes the auditor from orally communicating additional items that he/she believes to be of potential benefit to management, such as recommendations for operational or administrative efficiency or improvement in internal controls. If management responses are included in a management letter, we add a disclaimer according to the appropriateness or accuracy of the response.

Remember, auditor awareness of control deficiencies varies with each audit and is influenced by the nature, timing, and extent of audit procedures performed, as well as other factors from one year to the next. Therefore, taking corrective action for all of one year's findings does not guarantee that new exceptions will not present themselves the following year, even though financial procedures and controls may not have changed.

## **ADDITIONAL ITEMS**

The Auditing Standards Board of the American Institute of CPA's has issued eight new auditing standards that significantly impact the required level of audit documentation, risk assessment and manner of reporting audit findings to audit committees, or their equivalents, by financial auditors. These audit standards, 104 through 111, will impact the audit process, including the approach, predictability of audit steps, and the overall scope of work to be performed. These standards are effective for the audit of the School's financial statements for the fiscal year ending June 30, 2008. We bring this to your attention as a matter of information to consider in planning and executing your plans for future audits.

- SAS No. 104, Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures ("Due Professional Care in the Performance of Work")
- SAS No. 105, Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards
- SAS No. 106, Audit Evidence
- SAS No. 107, Audit Risk and Materiality in Conducting an Audit
- SAS No. 108, Planning and Supervision
- SAS No. 109, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- SAS No. 110, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained
- SAS No. 111, Amendment to Statement on Auditing Standards No. 39, Audit Sampling

These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the Statements establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit.

The primary objective of these Statements is to enhance auditors' application of the audit risk model in practice by specifying, among other things:

- More in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them
- More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding
- Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks

# APPENDIX A

## LEGISLATIVE ACTIVITY

The outcome of the 2007 Legislative session was somewhat surprising in that going into the session there had been indications that agreement could be reached to provide meaningful improvement to the basic formula. In the end, the basic formula was increased by only modest amounts but much needed relief was provided for special education costs. But even that was not without a dark cloud since the changes implemented mean that districts are entitled to more funding for special education, but the inadequate appropriation will result in ever lower proration factors since the funding provided does not cover what the new calculations show is owed.

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

## GENERAL EDUCATION

### **Formula Allowance**

The 2007 Legislature increased the basic formula allowance by 2 percent (a \$100 increase to \$5,074 per pupil unit) for fiscal year 2008, and an additional 1 percent (a \$50 increase to \$5,124 per pupil unit) for fiscal year 2009 and later.

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

No changes were made in the linkage of other formulas to the general education formula: compensatory, operating sparsity, transportation sparsity, PSEO, shared time, contract alternative, nonpublic pupil, and tribal contract aids all continue to be calculated using the current formula allowance, and thereby receive a 2 percent increase in fiscal 2008 and a 1 percent increase in fiscal 2009. Extended time revenue, which is not linked to the formula, does not receive an inflationary increase, and continues to be calculated using a formula allowance of \$4,601.

### **Kindergarten Pupil Unit Weight**

Beginning in fiscal 2008, the kindergarten pupil unit weight was increased from .557 to .612. The increase of .055 in the weight is about 10 percent of what would be required to weight kindergarten students at the same level as students in grade 1. The additional revenue generated by the pupil unit weight increase is unrestricted general fund revenue, which may be used for any general education purpose, including partial funding for full-day kindergarten programs.

### **Gifted and Talented Revenue**

The 2005 Legislature had created a new component of general education revenue called "gifted and talented revenue." The revenue was set equal to \$4 times a district's adjusted marginal cost pupil units for fiscal year 2006 and \$9 times a district's adjusted marginal cost pupil units for fiscal year 2007 and later. Beginning in fiscal 2008, gifted and talented revenue was increased from \$9 to \$12 times a district's adjusted marginal cost pupil units (AMCPU). Included was a provision requiring school districts to adopt procedures for the academic acceleration of gifted and talented students.

### **Alternative Teacher Compensation (Q Comp) Revenue**

The 2005 Legislature initiated the Quality Compensation for Teachers program (Q-comp). The Q Comp program has five components: career ladders for teachers, job-embedded professional development, instructional observations and standards-based assessments, measures to determine student growth, and alternative teacher compensation or performance pay. Beginning in fiscal year 2006, school districts, charter schools, and intermediate districts that had fully implemented an alternative teacher professional pay system by October 1 of that school year were eligible for alternative teacher compensation revenue.

For fiscal year 2006, the Q comp revenue and aid equaled \$260 times the October 1 enrollment for the previous fiscal year. For a district where only selected sites participated, the calculation was based on the enrollment at those sites on October 1 of the previous fiscal year. For fiscal year 2007 and later, the total alternative teacher compensation revenue remains \$260 times the October 1 enrollment for the previous fiscal year, but a portion of the revenue is funded with an equalized local levy. No changes to funding allocations were made by the 2007 Legislature for fiscal 2008-09. Beginning in fiscal 2010, the basic Q Comp aid will be reduced from 73.1 percent to 65 percent of the total Q Comp revenue (from \$190 per pupil to \$169 per pupil). Since the total Q comp revenue remains \$260 per pupil, the equalized levy portion of the revenue increases from \$70 to \$91 per pupil.

### **Equity Revenue**

The 2005 Legislature also added new components to equity revenue. For fiscal 2006 and later, districts with referendum revenue per Resident Marginal Cost Pupil Unit (RMCPU) less than 10 percent of the state average receive additional revenue to bring the district up to the 10 percent level. However, a district cannot receive more than \$100,000 under this provision. Since the estimated state averages are \$560 per RMCPU for fiscal 2006 and \$670 per RMCPU for fiscal 2007, a district with no referendum revenue received an increase of \$56 per RMCPU for fiscal 2006 and \$67 per RMCPU for fiscal 2007 (not to exceed \$100,000 per year).

For fiscal 2006 and later, the equity revenue for metro districts, (excluding the revenue under the \$46 / \$23 provision described below), was increased by 25 percent. For fiscal 2006 only, this component was funded entirely with state aid. For fiscal 2007 and later, districts with referendum revenue per adjusted marginal cost pupil unit (AMCPU) below the regional (metro or rural) 95th percentile received additional equity revenue equal to \$46 times the AMCPU, while districts with referendum revenue above the regional 95th percentile received additional equity revenue equal to \$23 times the AMCPU. Beginning in fiscal 2008, the equity revenue was increased for districts with referendum allowances at or above the 95th percentile from \$23 to \$46 per pupil unit, consistent with the amount that other districts receive per pupil unit from this component of equity revenue.

### **Alternative Attendance Adjustment**

Beginning in fiscal 2008, an additional alternative attendance adjustment was provided to districts where the net open enrollment pupil units exceed 20 percent of the district's resident pupil units, and 50 percent or fewer of open enrolled students are enrolled solely in on line learning. For qualifying districts, the additional aid equals the first tier referendum equalization limit (currently \$700) times the district's net open enrollment pupil units times the lesser of 1 or the difference between (a) the ratio of the district's net open enrollment pupil units to the district's resident pupil units and (b) .2. Under this formula, a district's additional aid per pupil unit gradually increases as the ratio of the district's net open enrollment pupil units to the district's resident pupil units increases from .2 to 1.2, and then levels off at \$700.

### **Uses of General Education Revenue**

The 2007 Legislature clarified that a district may spend general education revenue for kindergarten and prekindergarten programs. Since prekindergarten expenditures are accounted for in the Community Service fund, school districts electing to spend general education revenue for prekindergarten programs must transfer the amount to be expended for this purpose to the Community Service Fund.

## **Learning Year Programs**

Legislation clarified that learning year programs may provide instruction on an extended year calendar, and extended school day calendar, or both. Area learning centers are required to serve eligible students enrolled in a district served by the center or a charter school within the geographic boundaries of a district served by the center and a charter school can be a learning year site. Continual learning plans must specify learning experiences necessary for grade progression. Learning year programs are required to be approved biennially by the state to provide accelerated instruction that leads to early graduation.

## **School Finance Reform Task Force**

Establishes a new School Finance Reform Task Force with the following goals:

- (1) creating a standard and index to ensure that the formula remains adequate over time;
- (2) simplifying the remaining school formulas;
- (3) analyzing categorical funding formulas, including but not limited to pupil transportation, compensatory revenue, and limited English proficiency revenue;
- (4) establishing a schedule for implementation of the other new formulas; and
- (5) examining the role of the regional delivery structure including the functions performed by intermediate school districts, service cooperatives, education districts, and other cooperative organizations.

The task force consists of nine members, including the Commissioner of Education, four members of the Senate, and four members of the House. The task force must submit a report to the education committees of the Legislature by January 15, 2008, describing the formula recommendations according to the goals it has established. The \$75,000 that had been appropriated to hire an independent contractor to assist the task force was vetoed by the governor.

## **Special Education**

A significant share of the available funding that legislators added to K-12 public education as part of the 2007 legislative session was put into special education funding. The more significant of those changes are as follows:

### **Regular and Transition-Disabled Aid**

- Beginning in fiscal 2008, the special education-regular and transition-disabled aid formulas were changed to calculate the aid using current year expenditures, instead of second prior year expenditures adjusted for ADM change.
- Beginning in fiscal 2008, the statewide funding caps for special education-regular and transition-disabled will be combined into one overall cap to ensure a uniform level of funding for expenditures in both programs.
- Beginning in fiscal 2008, funding for expansion of Part C services is included in the special education-regular and excess cost aid formulas.
- The combined statewide cap for special education-regular and transition-disabled aid were set at \$694,063,000 for fiscal 2008, \$719,470,000 for fiscal 2009, \$735,693,000 for fiscal 2010, and \$786,586,000 for fiscal 2011. After adjusting for the roll-in of transition-disabled aid and categorical funding for expanded Part C services and ADM changes from year to year, the imputed growth factors are 27.5 percent for fiscal 2008, 3.8 percent for fiscal 2009, 1.9 percent for fiscal 2010, and 6.6 percent for fiscal 2011. Beginning in fiscal 2012, the growth factor for the statewide special education-regular/transition disabled funding cap was set at 4.6 percent per year.
- Assuming a state average 4.5 percent annual increase in special education costs and a state average 7.8 percent annual increase in special transportation costs, the statewide adjustment/proration factors for special education-regular funding are projected to be 89 percent for fiscal 2008 and 88 percent for fiscal 2009.

- The deduction for other revenue used in calculating aid was updated for contracted placements. The deduction is calculated using the resident district's average general education revenue, excluding basic skills and Q Comp revenue, and referendum equalization aid per adjusted pupil unit attributable to the pupil. This calculation was clarified to include students receiving special education services who are residents of the state and are placed in a care and treatment facility by court action in a state that does not have a reciprocity agreement with Minnesota (those who also qualify for out-of-state tuition aid).

### **Special Education Tuition Billing**

- The portions of general education revenue that are included in special education tuition billing calculations was clarified as follows:
  - Referendum equalization aid is included, but not tax base replacement aid, because the equalization aid follows the student while the tax base replacement aid stays with the resident district.
  - For students served under an agreement between boards, basic skills revenue and sparsity revenue is excluded from the amount charged to the resident district, since these components are paid directly to the serving district.
  - For students served under an agreement between boards, outside of the regular classroom more than 60 percent of the school day, the portion of general education revenue which offsets special education costs is calculated using the serving district's average basic skills and sparsity revenue per pupil, and the resident district's average for other general education revenue components.
  - For students served by a coop without a fiscal agent school district, the general education revenue and referendum equalization aid attributable to the student are calculated using the resident district's average general education revenue and referendum equalization aid excluding sparsity revenue.
- Intermediate districts and cooperatives that received an exemption from uniform tuition billing in fiscal 2007 are allowed to apply for a one-year extension of the exemption for fiscal 2008.
- Districts are allowed to apply for a waiver to cover any remaining unreimbursed costs of serving pupils with a disability in programs operated at residential facilities licensed by the Department of Human Services or the Department of Corrections.
- For fiscal 2007 only, a district or charter school not otherwise eligible for a waiver was allowed to apply for a waiver to cover any remaining unreimbursed costs of serving pupils with a disability.

### **Litigation Costs; Annual Report**

Districts are required to report their special education litigation costs to the Department annually through UFARS; and the Department is required to report on school district special education litigation costs to the legislative education committees by January 15 of each year.

### **School Technology and Operating Capital Aid**

All school districts qualify for one-time technology and operating capital aid equal to \$40 for fiscal year 2008 and \$55 for fiscal year 2009 per adjusted marginal cost pupil unit. The aid must be used only for the purposes authorized for operating capital revenue in statute.

### **Equity in Telecommunications Access Aid**

A one-time increase of \$3.9 million in fiscal 2008 and \$5.0 million in fiscal 2009 was provided over the \$3.75 million permanent funding base for the program to fully fund the estimated cost of the current telecommunications access formula for the next two years. In the event that this increase is not sufficient to fully fund the formula, the aid will be prorated.

### **School Lunch Aid**

Beginning in fiscal 2008, state school lunch aid was increased by 1.5 cents per meal served, from 10.5 cents to 12 cents.

### **Formation of a Charter School**

The statute language allowing: a charter school applicant to apply to the education commissioner if a school board fails to vote on a charter school application within 90 days was deleted; the commissioner is to assist the applicant in finding an eligible sponsor if a school board elects not to sponsor the charter school.

### **Related Party Lease Costs**

The conflict of interest provisions applicable to charter schools in statute were made applicable generally, not just limited to lease agreements.

### **Pupil Enrollment Upon Nonrenewal or Termination of a Charter School Contract**

A closed charter school is required to transmit students' education records to the student's resident school districts within 10 business days after the school's closure, where the records must be retained subject to the student transferring elsewhere.

### **World Languages Resources**

The education commissioner is directed, after consulting with the quality teaching network, to employ a full-time state world languages coordinator by July 1, 2007, to: assist charter schools and school districts in developing and enhancing world languages courses and programs; collaborate with professionals and charter schools and school districts in developing world languages programs; survey 20 charter schools and school districts to determine the types of existing world languages programs, identify exemplary world languages programs, and address staff development needs; identify successful world languages programs in other states; report to the commissioner on the feasibility and structure of a world languages graduation requirement; and annually report to the legislature on the status and needs of world languages programs in Minnesota.

The commissioner is directed to recommend an assessment tool for charter schools and school districts to use in measuring students' proficiency in world languages by July 1, 2009.

The commissioner is also directed, upon request, to evaluate the plans of charter schools and school districts in developing and enhancing their world languages programs. The department is directed to assist school districts in monitoring local assessment results.

## APPENDIX B

### FORMAL REQUIRED COMMUNICATIONS

Board of Education  
Charter School No. 4159  
Seven Hills Classical Academy  
Bloomington, Minnesota

We have audited the financial statements of Seven Hills Classical Academy (the School) as of and for the year ended June 30, 2007, and have issued our report thereon dated November 26, 2007. Professional standards require that we provide you with the following information related to our audit.

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

As stated in our engagement letter dated May 7, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principals. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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

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

#### **Significant Accounting Policies**

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the School are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year audited. We noted no transactions entered into by the School during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

### **Accounting Estimates**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financials statements were:

- Due from Minnesota Department of Education
- Due from Federal through the Minnesota Department of Education
- Estimated Useful Lives of Depreciable Capital Assets

Management's estimate of Due from Minnesota Department of Education (MDE) is based on amounts anticipated to be received from the state for various aid entitlements for fiscal 2006-07. The most significant of these is the aid portion of General education revenue. General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the School. Student attendance is accumulated in a statewide database – MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for fiscal year 2007 is not finalized until well into fiscal year 2008. Beginning in fiscal 2007, MDE began calculating amounts owed to the School for special education excess cost tuition billing and adding the amount to the School's special education aid. In prior years, individual charter schools handled the tuition billing calculation and process. Because the tuition amounts are based on estimated information, final entitlements are not expected to be known until well into the following fiscal year. Management expects any differences between estimated and actual data will be insignificant.

Management's estimate of Due from Federal through the Minnesota Department of Education is based on amounts anticipated to be received through the state for various federal aid entitlements for fiscal 2006-07. Many federal entitlements require that supporting financial reporting information be provided both in the UFARS accounting system and also the EDRS reporting system. To the extent that these two separate systems are not in agreement and reported in a timely manner, the estimated aid entitlement may be adversely affected. Management expects any differences between estimated and actual data will be insignificant.

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

We reviewed and tested management's procedures and underlying supporting documentation in the areas discussed above and evaluated the key factors and assumptions used to develop the estimates noted above in determining that they are reasonable in relation to the financial statements taken as a whole. We concluded that the accounting estimates and management judgments appeared to consider all significant factors and resulted in appropriate accounting recognition.

### **Audit Adjustments**

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the School's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the School, either individually or in the aggregate, indicate matters that could have a significant effect on the School's financial reporting process. Management did not identify and we did not notify them of any uncorrected financial statement misstatements. We recognize that for management purposes, the School maintains its accounting records primarily using the cash basis during the year. There may be adjustments which we propose while assisting your finance staff in the closing of the year-end accounting records. These types of adjustments, if any, are not considered to be "audit adjustments" for purposes of this communication.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### **Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the School's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### **Issues Discussed Prior to Retention of Independent Auditors**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the School's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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

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

This report is intended solely for the information and use of the Board of Education and the management of the School, and is not intended to be and should not be used by anyone other than these specified parties.

  
LarsonAllen LLP

Minneapolis, Minnesota  
November 26, 2007