**PACE PREPARATORY ACADEMY, INC.**

**FINANCIAL STATEMENTS AND**
**INDEPENDENT AUDITOR'S REPORTS**

**YEARS ENDED JUNE 30, 2019 AND 2018**

**PACE PREPARATORY ACADEMY, INC.**
**TABLE OF CONTENTS**
**JUNE 30, 2019 AND 2018**

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# Independent Auditor's Report

The Board of Directors
PACE Preparatory Academy, Inc.

**Report on the Financial Statements**
We have audited the accompanying financial statements of PACE Preparatory Academy, Inc. (a nonprofit organization), which comprise the statements of financial position as of June 30, 2019 and 2018, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

***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 audits 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 PACE Preparatory Academy, Inc. as of June 30, 2019 and 2018, and the changes in its net assets and its cash flows for the years ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis-of-Matter**

As discussed in Note 1 to the financial statements, in the year ended June 30, 2019, the School adopted new accounting guidance Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profits (Topic 958) - Presentation of Financial Statements of Not-for-Profit Entities*, which requires various presentation changes to not-for-profit financial statements. Our Opinion is not modified with respect to this matter.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2019, on our consideration of PACE Preparatory Academy, Inc.'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of PACE Preparatory Academy, Inc.'s 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 PACE Preparatory Academy, Inc.'s internal control over financial reporting and compliance.

Brett V. Backlund, CPA, PC

Brett V. Backlund, CPA, PC
Gilbert, Arizona
November 7, 2019

**PACE PREPARATORY ACADEMY, INC.**
**STATEMENTS OF FINANCIAL POSITION**
**JUNE 30, 2019 AND 2018**

| | 2019 | 2018 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 145,838 | $ 76,761 |
| Accounts receivable, net | 96,900 | 66,900 |
| Due from governmental agencies | 13,415 | 32,010 |
| Prepaid expenses | 2,181 | 5,866 |
| Total Current Assets | 258,334 | 181,537 |
| Non-Current Assets: | | |
| Refundable deposits | 5,763 | 5,000 |
| Property and equipment, net | 1,548,866 | 1,598,424 |
| Total Non-Current Assets | 1,554,629 | 1,603,424 |
| TOTAL ASSETS | $ 1,812,963 | $ 1,784,961 |
| LIABILITIES AND NET ASSETS | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | $ 67,962 | $ 27,725 |
| Accrued payroll and related benefits | 23,973 | 16,403 |
| Accrued interest payable to related parties | 2,415 | 2,415 |
| Deferred/unearned revenues | 21,056 | - |
| Capital leases payable, current portion | 31,331 | 25,127 |
| Notes payable, current portion | 56,628 | 53,679 |
| Notes payable to related parties, current portion | 85,000 | - |
| Total Current Liabilities | 356,327 | 125,349 |
| Long-Term Liabilities: | | |
| Capital leases payable, less current portion | 19,835 | 7,516 |
| Notes payable, less current portion | 1,697,877 | 1,754,690 |
| Total Long-Term Liabilities | 1,717,712 | 1,762,206 |
| TOTAL LIABILITIES | 2,006,077 | 1,887,555 |
| NET ASSETS | | |
| Without donor restrictions: | | |
| Undesignated | (196,584) | (106,973) |
| With donor restrictions: | | |
| Extracurricular activities fees tax credit | 3,470 | 4,379 |
| TOTAL NET ASSETS/(DEFICIT) | (193,114) | (102,594) |
| TOTAL LIABILITIES AND NET ASSETS | $ 1,812,963 | $ 1,784,961 |

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

**PACE PREPARATORY ACADEMY, INC.**
**STATEMENTS OF ACTIVITIES**
**YEARS ENDED JUNE 30, 2019 AND 2018**

| | 2019 | 2018 |
|---|---|---|
| NET ASSETS WITHOUT DONOR RESTRICTIONS | | |
| Revenue, Support, and Gains: | | |
| Revenue from local sources | $ 117,906 | $ 107,891 |
| Revenue from state sources | 740,121 | 845,120 |
| Revenue from federal sources | 21,913 | 23,940 |
| Total Revenue, Support, and Gains | 879,940 | 976,951 |
| Net Assets Released from Restrictions: | | |
| Satisfaction of program restrictions | 2,409 | 60 |
| Total Revenue, Support, Gains, and Other Support | 882,349 | 977,011 |
| Expenses and Losses: | | |
| Personal services - salaries | 407,056 | 388,764 |
| Personal services - benefits | 102,809 | 68,534 |
| Purchased professional and technical services | 133,969 | 105,710 |
| Purchased property services | 69,511 | 65,614 |
| Other purchased services | 18,769 | 45,065 |
| Supplies | 35,955 | 27,620 |
| Depreciation and amortization | 79,406 | 93,449 |
| Interest | 110,262 | 117,849 |
| Other expenses and losses | 14,223 | 23,669 |
| Total Expenses and Losses | 971,960 | 936,274 |
| CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS | (89,611) | 40,737 |
| NET ASSETS WITH DONOR RESTRICTIONS | | |
| Contributions: | | |
| Extracurricular activities fees tax credit | 1,500 | 600 |
| Net assets released from restrictions: | | |
| Extracurricular activities fees tax credit | (2,409) | (60) |
| CHANGES IN NET ASSETS WITH DONOR RESTRICTIONS | (909) | 540 |
| CHANGES IN NET ASSETS | (90,520) | 41,277 |
| NET ASSETS/(DEFICIT), BEGINNING OF YEAR | (102,594) | (143,871) |
| NET ASSETS/(DEFICIT), ENDING OF YEAR | $ (193,114) | $ (102,594) |

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

**PACE PREPARATORY ACADEMY, INC.**
**STATEMENT OF FUNCTIONAL EXPENSES**
**YEAR ENDED JUNE 30, 2019**

| Expense Type | Charter School | Management and General | Fundraising | Total Expenses |
|---|---|---|---|---|
| Compensation to employees | $ 268,846 | $ 138,210 | $ - | $ 407,056 |
| Employee benefit programs | 57,461 | 29,540 | - | 87,001 |
| Federal, state, and local payroll taxes | 7,378 | 8,430 | - | 15,808 |
| *Fees for services paid to non-employees:* | | | | |
| Legal fees | - | 1,781 | - | 1,781 |
| Accounting and auditing fees | - | 45,990 | - | 45,990 |
| *Other fees for services:* | | | | |
| Professional and technical services | 73,975 | 12,223 | - | 86,198 |
| *Total other fees for services* | 73,975 | 12,223 | - | 86,198 |
| *Total fees for services paid to non-employees* | 73,975 | 59,994 | - | 133,969 |
| Advertising and promotion | - | 3,129 | - | 3,129 |
| *Office expenses:* | | | | |
| Classroom, office, and other supplies | 18,626 | 6,210 | - | 24,836 |
| Postage and delivery | 283 | - | - | 283 |
| Dues and fees | - | 1,691 | - | 1,691 |
| *Total office expenses* | 18,909 | 7,901 | - | 26,810 |
| *Occupancy:* | | | | |
| Rent | 34,754 | 15,231 | - | 49,985 |
| Utilities | 5,426 | 1,357 | - | 6,783 |
| Property taxes | 9,887 | 2,472 | - | 12,359 |
| Repairs and maintainance | 15,620 | 3,905 | - | 19,525 |
| *Total occupancy* | 65,687 | 22,965 | - | 88,652 |
| Travel, transportation, and meals and lodging | - | 53 | - | 53 |
| Interest | 88,210 | 22,052 | - | 110,262 |
| Depreciation, depletion, and amortization | 63,525 | 15,881 | - | 79,406 |
| Insurance | 12,243 | 3,061 | - | 15,304 |
| *Other expenses:* | | | | |
| Food | 4,336 | - | - | 4,336 |
| Miscellaneous other expenses | - | 174 | - | 174 |
| *Total other expenses* | 4,336 | 174 | - | 4,510 |
| Total expenses | $ 660,570 | $ 311,390 | $ - | $ 971,960 |

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

**PACE PREPARATORY ACADEMY, INC.**
**STATEMENT OF FUNCTIONAL EXPENSES**
**YEAR ENDED JUNE 30, 2018**

| **Expense Type** | **Charter School** | **Management and General** | **Fundraising** | **Total Expenses** |
|---|---|---|---|---|
| Compensation to employees | $ 261,177 | $ 130,587 | $ - | $ 391,764 |
| Federal, state, and local payroll taxes | 59,448 | 9,086 | - | 68,534 |
| *Fees for services paid to non-employees:* | | | | |
| Legal fees | - | 1,138 | - | 1,138 |
| Accounting and auditing fees | - | 33,024 | - | 33,024 |
| *Other fees for services:* | | | | |
| Professional and technical services | 51,233 | 9,007 | - | 60,240 |
| Professional education services | 6,082 | 2,226 | - | 8,308 |
| *Total other fees for services* | 57,315 | 11,233 | - | 68,548 |
| *Total fees for services paid to non-employees* | 57,315 | 45,395 | - | 102,710 |
| Advertising and promotion | - | 824 | - | 824 |
| *Office expenses:* | | | | |
| Classroom, office, and other supplies | 17,482 | 7,095 | - | 24,577 |
| Postage and delivery | 118 | - | - | 118 |
| Dues and fees | 199 | 2,406 | - | 2,605 |
| *Total office expenses* | 17,799 | 9,501 | - | 27,300 |
| *Occupancy:* | | | | |
| Rent | 31,581 | 13,535 | - | 45,116 |
| Utilities | 5,154 | 2,209 | - | 7,363 |
| Repairs and maintainance | 11,325 | 4,853 | - | 16,178 |
| *Total occupancy* | 48,060 | 20,597 | - | 68,657 |
| Travel, transportation, and meals and lodging | - | 892 | - | 892 |
| Interest | 82,494 | 35,355 | - | 117,849 |
| Depreciation, depletion, and amortization | 65,414 | 28,035 | - | 93,449 |
| Insurance | 30,262 | 12,969 | - | 43,231 |
| *Other expenses:* | | | | |
| Miscellaneous other expenses | 653 | 20,411 | - | 21,064 |
| *Total other expenses* | 653 | 20,411 | - | 21,064 |
| Total expenses | $ 622,622 | $ 313,652 | $ - | $ 936,274 |

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

**PACE PREPARATORY ACADEMY, INC.**
**STATEMENTS OF CASH FLOWS**
**YEARS ENDED JUNE 30, 2019 AND 2018**

| | 2019 | 2018 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Changes in net assets | $ (90,520) | $ 41,277 |
| Adjustments to reconcile changes in net assets to net cash from/(used in) operating activities: | | |
| Depreciation and amortization | 79,406 | 93,449 |
| (Increase)/decrease in operating assets: | | |
| Accounts receivable | (30,000) | (47,900) |
| Due from governmental agencies | 18,596 | (16,970) |
| Prepaid expenses | 3,685 | 8,846 |
| Refundable deposits | (763) | - |
| Increase/(Decrease) in operating liabilities: | | |
| Accounts payable and accrued expenses | 40,237 | (19,848) |
| Accrued payroll and related benefits | 7,570 | (1,004) |
| Accrued interest payable | - | (5,548) |
| Due to related parties | - | (21,657) |
| Unearned revenues | 21,056 | (16,201) |
| NET CASH FROM/(USED IN) OPERATING ACTIVITIES | 49,267 | 14,444 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of property and equipment | (3,712) | (8,920) |
| NET CASH FROM/(USED IN) INVESTING ACTIVITIES | (3,712) | (8,920) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Payments on capital lease obligations | (7,614) | (25,390) |
| Proceeds from notes and loans payable | 85,000 | - |
| Payments on notes and loans payable | (53,864) | (23,475) |
| NET CASH FROM/(USED IN) FINANCING ACTIVITIES | 23,522 | (48,865) |
| NET CHANGES IN CASH AND CASH EQUIVALENTS | 69,077 | (43,341) |
| CASH AND CASH EQUIVALENTS, BEGINNING | 76,761 | 120,102 |
| CASH AND CASH EQUIVALENTS, ENDING | $ 145,838 | $ 76,761 |
| SUPPLEMENTAL DISCLOSURES | | |
| Noncash investing and financing activities: | | |
| Acquisition of facilities through notes payable | $ 26,900 | $ - |
| Payments of notes payable through new notes payable | - | 1,830,000 |
| Cash flow information: | | |
| Cash paid for interest | $ 110,262 | $ 123,397 |

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

## NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Organization*

PACE Preparatory Academy, Inc. (School) is an Arizona not-for-profit organization established on February 28, 2000 to manage, operate, guide, direct, and promote the School and such other educational activities as the Board of Directors may define from time to time. The mission of the School is to enable students to become self-motivated, competent, lifelong learners equipped with the reading, writing, technological, and problem solving skills necessary to become contributing members of society in the 21st century. PACE's intent is to provide a totally innovative, non-traditional approach to educating high school students by providing a completely computer driven educational environment. Special needs students, non-traditional learners will work in a self-paced arena to obtain their high school diploma as well as training for future employment in the computer industry. The School operates under a charter contract with the Arizona State Board for Charter Schools (Sponsor), which mandates policy and operational guidelines. The School provides educational services to approximately 80 students in ninth through twelfth grades, and is funded primarily through its sponsor, based on student membership.

*Significant Accounting Policies*

The School prepares its financial statements in accordance with generally accepted accounting principles promulgated in the United States of America (U.S. GAAP) for not-for-profit organizations. The significant accounting and reporting policies used by the School are described below to enhance the usefulness and understandability of the financial statements.

<u>Cash and Cash Equivalents</u> – The School's cash consists of cash in demand deposit accounts as well as cash on hand. Cash equivalents can be money market funds or short term, interest bearing, highly liquid investments with original maturities of three months or less from the date of purchase, unless the investments are held for meeting restrictions of a capital nature.

<u>Gifts-in-Kind Contributions</u> – The School periodically receives contributions in a form other than cash or investments. If the School receives a contribution of property and equipment, the contributed asset is recognized as an asset at its estimated fair value at the date of gift, provided that the value of the asset and its estimated useful life meets the School's capitalization policy. Donated use of facilities is reported as contributions and as expenses at the estimated fair value of similar space for rent under similar conditions. If the use of the space is promised unconditionally for a period greater than one year, the contribution is reported as a contribution and an unconditional promise to give at the date of gift, and the expense is reported over the term of use. Donated supplies are recorded as contributions at the date of gift and as expenses when the donated items are placed into service or distributed.

The School may benefit from personal services provided by a substantial number of volunteers. Those volunteers have donated significant amounts of time and services in the School's program operations. However, the majority of the contributed services do not meet the criteria for recognition in the financial statements. GAAP allows recognition of contributed services only if (a) the services create or enhance non-financial assets, or (b) the services would have been purchased if not provided by contribution, require specialized skills, and are provided by individuals possessing those skills. No amounts have been reflected in the financial statements for donated services since they do not meet the criteria for recognition.

Grant Revenue – Grant revenue is recognized when the qualifying costs are incurred for cost-reimbursement grants or contracts or when a unit of service is provided for performance grants. Grant revenue from federal agencies is subject to independent audit under the Office of Management and Budget Circular A-133 and review by grantor agencies. The review could result in the disallowance of expenditures under the terms of the grant or reductions of future grant funds. Based on prior experience, the School's management believes that costs ultimately disallowed, if any, would not materially affect the financial position of the School.

Property and Equipment – Land, buildings, and improvements with a cost of $3,000 or more and vehicles, furniture, and equipment with both a cost of $500 or more and an estimated useful life of one year or more are capitalized. Assets are stated at cost. Assets donated are recorded at their estimated fair market value as of the date received. Repairs and maintenance that does not significantly increase the useful life of the asset are expensed as incurred. Amortization of buildings and improvements and depreciation of furniture and equipment are provided on a straight–line basis over the useful life of the respective assets, which ranges from 2 to 30 years. Property and equipment are reviewed for impairment when a significant change in the asset's use or another indicator of possible impairment is present. No impairment losses were recognized in the financial statements during the current period.

Net Assets – The financial statements can report net assets and changes in net assets in two classes that are based upon the existence or absence of restrictions on use that are placed by its donors (or certain grantors), as follows:

> Net Assets Without Donor Restrictions – Net assets available for use in general operations and not subject to donor- (or certain grantor) imposed restrictions. The governing board may designate, from net assets without donor restrictions, net assets for an operating reserve and board-designated endowment.
>
> Net Asset With Donor Restrictions – Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where by the donor has stipulated the funds be maintained in perpetuity.

All revenues and net gains are reported as increases in net assets without donor restrictions in the statement of activities unless the use of the related resources is subject to donor restrictions. All expenses and net losses are reported as decreases in net assets without donor restrictions.

Accounting for Contributions – Contributions are recognized when received. All contributions are reported as increases in net assets without donor restrictions unless use of the contributed asset is specifically restricted by the donor. Amounts received that are restricted by the donor to use in future periods or for specific purposes are reported as increases in nets assets with donor restrictions, consistent with the nature of the restriction. However, if a restriction is fulfilled in the same time period in which the contribution is received, the School reports that support as increases in net assets without donor restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and are reported in the statements of activities as net assets released from restrictions.

Classroom Site Fund – In June of 2000, the Arizona Legislature created a Classroom Site Fund (CSF) to be administered by the Arizona Department of Education (ADE). CSF was created to provide funding to school districts and charter schools for designated purposes. ADE administers and allocates CSF funds to the School based on student count and other factors specified by statute The School must allocate funding from CSF according to the following statutory parameters:

> Project 1011 – 20% of the funds must be used for teacher base salary increases and employment related expenses.
>
> Project 1012 – 40% of the funds must be used for performance based teacher compensation increases and teacher employment related expenses.
>
> Project 1013 – 40% of the funds must be used for maintenance and operations purposes including class-size reduction, teacher compensation increases, intervention programs, teacher development, dropout prevention programs, and teacher liability insurance premiums.

CSF funds are non-reverting. Therefore, unspent monies at fiscal year-end may be used in future years with the restrictions originally placed on the revenue still applicable. In accordance with statutory requirements, unexpended balances must be carried forward in each of the three projects (1011, 1012, and 1013).

Advertising Costs – All costs associated with advertising and promotion are expensed in the period incurred. Advertising costs consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Advertising costs | $ 3,129 | $ 824 |

*Retirement Plan*

Plan Description – Employees of the School participate in the Arizona State Retirement System (ASRS). The ASRS administers a cost-sharing, multiple-employer defined benefit pension plan; a cost-sharing, multiple-employer defined benefit health insurance premium benefit plan; and a cost-sharing, multiple-employer defined benefit long-term disability plan. The ASRS through its Retirement Fund provides retirement, death, and survivor benefits; its Health Benefit Supplement Fund provides health insurance premium benefits; and its Long-Term Disability Fund provides long-term disability benefits. The Arizona State Retirement System Board governs the ASRS according to the provisions of A.R.S. Title 38, Chapter 5, Article 2 and 2.1.

The ASRS issues a publicly available financial report that includes its financial statements and required supplementary information. The report is available on their Web site (www.azasrs.gov).

Funding Policy – The Arizona State Legislature establishes and may amend active plan members' and the School's contribution rate. Active plan members and the School were each required by statute to contribute at the actuarially determined rate of 11.80% (11.64% retirement and 0.16% long-term disability) for the year ended June 30, 2019, 11.50% (11.34% retirement and 0.16% long-term disability) for the year ended June 30, 2018 of the members' annual covered payroll.

Use of Estimates – The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities at the date of the financial statements. On an ongoing basis, the School's management evaluates the estimates and assumptions based upon historical experience and various other factors and circumstances. The School's management believes that the estimates and assumptions are reasonable in the circumstances; however, the actual results could differ from those estimates.

Tax Status – The School is incorporated exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code and state income taxation under Arizona Revised Statute (A.R.S.) §43-1201, though it would be subject to tax on income unrelated to its exempt purposes (unless that income is otherwise excluded by the Code or A.R.S.). Contributions to the School are tax deductible to donors under section 170 of the Code. The School is not classified as a private foundation. The School's Form 990, *Return of Organization Exempt from Income Tax*, is generally subject to examination by the Internal Revenue Service for three years after the date filed. As of June 30, 2019, the returns for 2018, 2017, 2016, and 2015 remain subject to examination. Lastly, the School has not taken any uncertain tax positions, and, therefore, has no policy for evaluating them.

Fair Value Measurements – The School reports its fair value measures using a three-level hierarchy that prioritizes the inputs used to measure fair value. This hierarchy, established by GAAP, requires that entities maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs used to measure fair value are as follows:

Level 1 – Quoted prices for identical assets or liabilities in active markets to which the organization has access at the measurement date.

Level 2 – Inputs other than quoted prices included in level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets in markets that are not active;
- observable inputs other than quoted prices for the asset or liability (for example, interest rates and yield curves); and
- inputs derived principally from, or corroborated by, observable market data by correlation or by other means.

Level 3 – Unobservable inputs for the asset or liability. Unobservable inputs should be used to measure the fair value to the extent that observable inputs are not available.

When available, the organization measures fair value using level 1 inputs because they generally provide the most reliable evidence of fair value. However, level 1 inputs are not available for many of the assets and liabilities that the organization is required to measure at fair value (for example, unconditional promises to give and in-kind contributions).

The School's primary uses of fair value measures in the financial statements are cash and cash equivalents, due from governmental agencies, and other current assets and liabilities. The recorded values for these financial instruments approximate their fair values based on their short-term nature.

Expense Recognition and Allocation – The cost of providing the School's programs and other activities is summarized on a functional basis in the statements of functional expenses. Expenses that can be identified with a specific program or support service are charged directly to that program or support service.

Costs common to multiple functions have been allocated among the various functions benefited. The expenses that are allocated include the following:

| Expense | Method of Allocation |
|---|---|
| Grants | Time and Effort |
| Salaries and benefits | Time and Effort |
| Occupancy | Square Footage |
| Depreciation | Square Footage |
| Insurance | Square Footage |

General and administrative expenses include those costs that are not directly identifiable with any specific program, but which provide for the overall support and direction of the School.

Fundraising costs are expensed as incurred, even though they may result in contributions received in future years. The School generally does not conduct its fundraising activities in conjunction with its other activities. In the few cases in which it does, joint costs have been allocated between fundraising and management and general expenses in accordance with standards for accounting for costs of activities that include fundraising.

Subsequent Events – The School has reviewed all subsequent events through November 7, 2019, which was the date the financial statements were available to be issued. Events occurring after that date have not been evaluated to determine whether a change in the financial statements would be required.

Prior Year Amounts – Certain prior year amounts have been reclassified to conform to current year presentation.

New Accounting Pronouncement - On August 18, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment returns. The School has adjusted the presentation of its financial statements accordingly, applying the changes retrospectively to the comparative period presented. The new standard changes the following aspects of the School's financial statements:

- The temporarily restricted and permanently restricted net assets classes have been combined into a single net asset class called *net assets with donor restrictions*
- The unrestricted net asseets class has been renamed net assets without restrictions.
- The financial statements include a new Statement of Functional Expenses.
- The financial statements include a new disclosure about liquidity and availability of resources.

## NOTE 2 – CASH AND CASH EQUIVALENTS

The School maintains all of its cash with one financial institution. The carrying amount of deposits and bank balances consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Carrying amount of deposits | $ 145,838 | $ 76,761 |
| Bank balances | $ 158,201 | $ 80,491 |

The entire bank balances were covered by federal depository insurance.

Restricted Cash – Monies received from the Classroom Site Fund are restricted solely for use at school sites. Unspent monies at fiscal year-end may be used in future years with the restrictions originally placed on the revenue still applicable. In accordance with statutory requirements, unexpended balances must be carried forward in each of the three projects (1011, 1012, and 1013). Restricted cash related to the Classroom Site Fund consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Restricted cash for Classroom Site Fund: | | |
| Project 1011 | $ 8,524 | $ 3,032 |
| Project 1012 | 59,295 | 67,152 |
| Total restricted cash for Classroom Site Fund | $ 67,819 | $ 70,184 |

## NOTE 3 – AVAILABILITY AND LIQUIDITY OF FINANCIAL ASSETS

Expenses by function consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Financial statements at year end: | | |
| Cash and cash equivalents | $ 145,838 | $ 76,761 |
| Accounts receivable | 96,900 | 66,900 |
| Due from governmental agencies | 13,415 | 32,010 |
| Prepaid expenses | 2,181 | 5,866 |
| Total financial assets | 258,334 | 181,537 |
| Less amounts not available to be used within one year: | | |
| Net assets with donor restrictions | (3,470) | (4,379) |
| Restricted cash for classroom site fund | (67,819) | (70,184) |
| Total amounts not available to be used within one year | (71,289) | (74,563) |
| Financial assets available to meet general expenditures over the next year | $ 187,045 | $ 106,974 |

The School's goal is generally to maintain financial assets to meet 30 to 60 days of operating expenses, which is approximately $80,000 to $160,000. In addition, the School operates annually on a balanced budget.

## NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Property and equipment: | | |
| Land and improvements | $ 211,665 | $ 211,665 |
| Building and improvements | 1,628,199 | 1,628,199 |
| Equipment | 259,727 | 229,879 |
| Total property and equipment | 2,099,591 | 2,069,743 |
| Accumulated depreciation and amortization | (550,725) | (471,319) |
| Property and equipment, net | $ 1,548,866 | $ 1,598,424 |

Depreciation and amortization expense consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Depreciation and amortization expense | $ 79,406 | $ 93,449 |

## NOTE 5 - CAPITAL LEASE OBLIGATIONS

The School acquired equipment under the provisions of various long-term lease agreements classified as capital leases for accounting purposes. Accordingly, the original cost of the leased assets, together with the accumulated amortization, consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Original cost of the leased assets | $ 207,925 | $ 181,788 |
| Accumulated amortization | $ 183,966 | $ 172,502 |

The amount of amortization of the leased assets which was part of depreciation and amortization on the statements of activities, consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Amortization expense | $ 11,464 | $ 23,215 |

Capital lease obligations consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Capital lease obligations | $ 51,166 | $ 32,643 |

The future minimum lease payments under the capital lease obligations, together with the present value of the net minimum lease payments, as of June 30, 2019 are as follows:

| | |
|---|---|
| Fiscal year ending June 30: | |
| 2020 | $ 35,373 |
| 2021 | 9,156 |
| 2022 | 9,156 |
| 2023 | 6,867 |
| Total future minimum capital lease payments | 60,552 |
| Less implicit interest | (9,386) |
| Present value of net minimum lease payments | $ 51,166 |

## NOTE 6 – NOTES PAYABLE

Notes payable consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Note payable to a financial institution with an original amount of $1,830,000, an interest rate of 5.36%, and payable monthly principle and interest payments of $12,442 through February 21, 2028. The note is secured by a Deed of Trust on the School's property. | $ 1,754,505 | $ 1,808,369 |
| Total notes payable | $ 1,754,505 | $ 1,808,369 |

Maturities of the notes payable as of June 30, 2019 are summarized as follows:

| | |
|---|---|
| Fiscal year ending June 30: | |
| 2020 | $ 56,628 |
| 2021 | 59,739 |
| 2022 | 63,021 |
| 2023 | 66,483 |
| 2024 | 70,135 |
| Thereafter | 1,438,499 |
| Total notes payable | $ 1,754,505 |

Interest expense on the notes payable consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Interest expense on notes payable | $ 95,436 | $ 117,639 |

## NOTE 7 – NOTES PAYABLE TO RELATED PARTIES

Notes payable to related parties consisted of the following as of the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Note payable to a related party with an original amount of $85,000, an interest rate of 6.00%, and payable in monthly interest only payments with all unpaid principal and interest due at maturity on June 30, 2020. The note is unsecured. | $ 85,000 | $ - |
| Total notes payable to related parties | $ 85,000 | $ - |

Maturities of the notes payable to related parties as of June 30, 2019 are summarized as follows:

| | |
|---|---|
| Fiscal year ending June 30: | |
| 2020 | $ 85,000 |
| Total notes payable to related party | $ 85,000 |

As of the years ended June 30, 2019 and 2018, the School owed the related party $2,415 and $2,415, respectively, for unpaid interest, which is listed as accrued interest payable to related parties on the statements of financial position.

## NOTE 8 – COMMITMENTS AND CONTINGENT LIABILITIES

Litigation – The School is contingently liable for claims, either asserted or unasserted, and judgments resulting from lawsuits incidental to the normal operation of a school. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these matters will have a material adverse effect on the School's financial position, results of operations, or liquidity. Accordingly, no provision for possible losses is reflected in the financial statements.

Compliance – The School's compliance with certain laws and regulations is subject to review by its Sponsor. Although such reviews could result in a reduction of state equalization assistance, any required reductions are not expected to be significant.

Commitments – As of the years ended June 30, 2019 and 2018, the School entered into annual agreements with W.A.S. Consulting, LLC, a related party, totaling $80,000 and $80,000, respectively, which covered the years ended June 30, 2020 and 2019, respectively. W.A.S. Consulting, LLC will perform the duties required as Principal/Administrator for the School.

Operating Leases – The School leases facilities with a related party under the provisions of a lease agreement classified as an operating lease for accounting purposes. Rent expense under the lease agreement consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Rent expense | $ 35,957 | $ 35,957 |

Future minimum lease payments under the leases as of June 30, 2019 are summarized as follows:

| | |
|---|---|
| Fiscal year ending June 30: | |
| 2020 | $ 30,000 |
| 2021 | 10,000 |
| Total minimum lease payments | $ 40,000 |

Operating Leases (Lessor) – During the year ended June 30, 2015, the School purchased a facility for operations. As part of the purchase, the School inherited a tenant through March 2019 for $9,000 per month. During the year ended June 30, 2019, the lease with the tennat expired, however the tennat continued to lease the property on a month-to-month basis while they negotiated a new lease. Rental income under the lease agreement consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Rental income | $ 108,000 | $ 108,000 |

## NOTE 9 - CONCENTRATIONS OF RISK

Amounts held in financial institutions can occasionally be in excess of the Federal Deposit Insurance Corporation and Securities Investor Protection Corporation limits. The School deposits its cash with high quality financial institutions, and management believes the School is not exposed to significant credit risk on those amounts.

A significant portion of the School's annual funding comes from agencies of the federal and state governments, including primarily the Arizona Department of Education. As such, the School's ability to generate resources via contributions and grants is dependent upon the economic health of the federal government and the state of Arizona. An economic downturn could cause a decrease in contributions and grants that coincides with an increase in demand for the School's services. In addition, if the state of Arizona and its agencies significantly reduced the level of support provided to the School it would have a material effect on the School's operations. The School's management is aware of the concentration and its potential impact on its programs, and would take appropriate action if any reduction did occur.

## NOTE 10 – RETIREMENT PLAN

The Arizona State Legislature establishes and may amend active plan members' and the School's contribution rate. Active plan members and the School were each required by statute to contribute at the actuarially determined rate of 11.80% (11.64% retirement and 0.16% long-term disability) for the year ended June 30, 2019, 11.50% (11.34% retirement and 0.16% long-term disability) for the year ended June 30, 2018 of the members' annual covered payroll. The School's contributions to the System, which were equal to the required contributions for each year, consisted of the following for the years ended June 30:

| | 2019 | 2018 |
|---|---|---|
| Contributions to employees accounts at ASRS | $ 45,033 | $ 33,999 |

## NOTE 11 - RELATED PARTY TRANSACTIONS

As of June 30, 2017, the School had unpaid invoices outstanding to Sterling Financial Services, LLC, now renamed Sterling Accounting and Tax, LLC (SAT), which is owned by a former member of the board of directors of the School, that totaled $1,225 for purchased professional services rendered to the School pursuant to the agreements entered into between the entities and for supplies and other miscellaneous items purchased on behalf of the School. During the years ended June 30, 2019 and 2018, SAT provided purchased professional services to the School and purchased supplies and other miscellaneous items on behalf of the School that totaled $19,035 and $15,095, respectively. As of the years ended June 30, 2019 and 2018, the School paid SAT $14,050 and $15,095, respectively, which left $6,210 and $1,225, respectively, outstanding as part of accounts payable and accrued expenses on the statements of financial position.

As of June 30, 2017, the School had upaid invoices outstanding to W.A.S. Consulting, L.L.C. (WAS), which is owned by a member of the board of directors, that totaled $20,432 for consulting services rendered to the School pursuant to the agreements entered into between the entities and for supplies and other miscellaneous items purchased on behalf of the School. During the years ended June 30, 2019 and 2018, WAS provided consulting services to the School and purchased supplies and other miscellaneous items on behalf of the School that totaled $107,505 and $24,763, respectively. As of the years ended June 30, 2019 and 2018, the School paid WAS $12,744 and $127,937, respectively, which left $12,019 and $0, respectively, outstanding as part of accounts payable and accrued expenses on the statements of financial position.

The School leased district offices in Cottonwood, Arizona from Enchanted Homes, L.L.C, which is owned by a former member of the board of directors of the School. The lease agreements obligates the School to pay $10,000 and $12,000, respectively, for the years ended June 30, 2019 and 2018. During the years ended June 30, 2019 and 2018, the School made payments totaling $7,000 and $11,000, respectively, which left $4,000 and $1,000, respectively, outstanding as part of accounts payable and accrued expenses on the statements of financial position.

During the year ended June 30, 2018, the School leased a vehicle from the former member of the board of directors for $496 per month, which totaled $5,952. As of June 30, 2018, the School made the required payments to the former member of the board of directors.

## NOTE 12 - SUBSEQUENT EVENTS

On July 1, 2019, the School repaid the outstanding notes payable to related parties totaling $85,000.

Effective October 29, 2019, the School entered into a new lease agreement with it's current tennant. The term of the new lease began on November 1, 2019 and terminates on October 31, 2022. The monthly rent payments shall be $9,000 per month. The tennant has the option to renew and extend the lease two (2) times for one (1) year each with a maximum of a 2.0% increase in the rental amount.

In addition, effective October 29, 2019, the School and tennant entered into a promissory note payable for past-due rent of $101,325. The note does not charge interest to the tennant over the life of the note. Minimum payments of $1,000 per month are due on the first day of every month until the outstanding principal is paid in full.

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# 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*

Board of Directors
PACE Preparatory Academy, Inc.

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 PACE Preparatory Academy, Inc. (a nonprofit organization), which comprise the statement of financial position as of and for the year ended June 30, 2019, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated November 7, 2019.

**Internal Control over Financial Reporting**
In planning and performing our audit of the financial statements, we considered the 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we do not express an opinion on the effectiveness of the School's internal control.

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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**
As part of obtaining reasonable assurance about whether the 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**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 School'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 School's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Brett V. Backlund, CPA, PC

Brett V. Backlund, CPA, PC
Gilbert, Arizona
November 7, 2019

**PACE PREPARATORY ACADEMY, INC.**
**STATUS OF PRIOR YEAR AUDIT FINDINGS**
**JUNE 30, 2019**

We have reviewed the School's prior year schedule of findings and responses contained in the prior year audit report dated November 8, 2018. The School did not have any deficiencies in internal control over financial reporting or instances of noncompliance or other matters, therefore, no corrective action was necessary.