

**ISLAND CITY ACADEMY**  
**REPORT ON FINANCIAL STATEMENTS**  
**(with required supplementary and additional information)**  
**YEAR ENDED JUNE 30, 2011**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Island City Academy

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Island City Academy (the Academy), as of and for the year ended June 30, 2011, which collectively comprise the Academy's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Academy's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Island City Academy as of June 30, 2011, and the respective changes in financial position, thereof, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Academy implemented Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2011, on our consideration of Island City Academy'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages v through xi and 23, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Manes Costeiran PC*

September 23, 2011

## MANAGEMENT’S DISCUSSION AND ANALYSIS

This section of Island City Academy’s (the Academy) annual financial report presents our discussion and analysis of the Academy’s financial performance during the fiscal year that ended on June 30, 2011.

### **FINANCIAL HIGHLIGHTS**

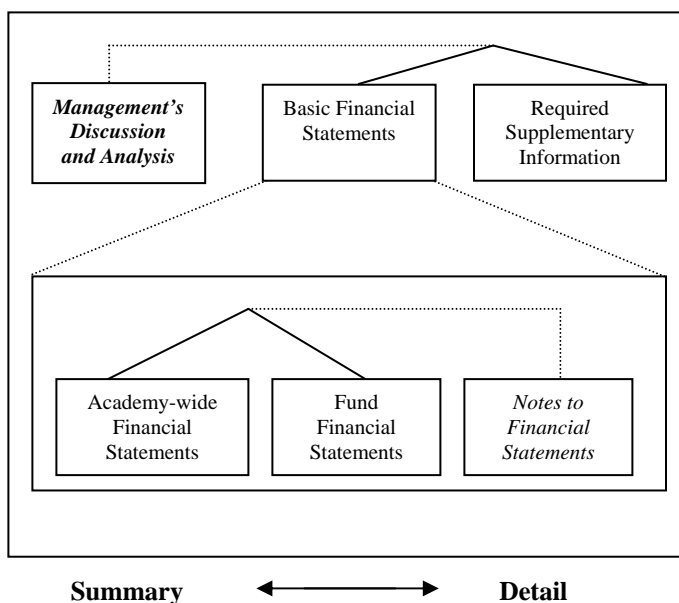
- The Academy’s financial status remained stable for the fifth year in a row. Total net assets increased by \$9,542.
- Overall revenues were \$1,605,320.
- The total cost of instruction programs decreased approximately \$30,700.
- Total revenues decreased approximately \$13,400, while total expenses increased approximately \$3,900.
- Enrollment increased by approximately 6 students from the prior year.
- The Academy reduced its outstanding long-term debt by \$35,000.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts - management’s discussion and analysis (this section), the basic financial statements and required supplementary information. The basic financial statements include two kinds of statements that present different views of the Academy:

- The first two statements are *academy-wide financial statements* that provide both *short-term* and *long-term* information about the Academy’s *overall* financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the Academy, reporting the Academy’s operations *in more detail* than the academy-wide statements.
- The *governmental funds* statements tell how *basic* services like regular and special education were financed in the *short-term* as well as what remains for future spending.
- *Fiduciary funds* statements provide information about the financial relationships in which the Academy acts solely as a *trustee or agent* for the benefit of others.

**Figure A-1  
Organization of Island City’s Annual  
Financial Report**



The financial statements also include *notes* that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the financial statements with a comparison of the Academy’s budget for the year. Figure A-1 shows how the various parts of this annual report are arranged and related to one another.

<b>Figure A-2 Major Features of Academy-wide and Fund Financial Statements</b>			
	Academy-wide Statements	Fund Financial Statements	
		Governmental Funds	Fiduciary Funds
Scope	Entire school (except fiduciary funds)	The activities of the school that are not proprietary or fiduciary, such as special education and building maintenance.	Instances in which the school administers resources on behalf of someone else, such as scholarship programs and student activities monies
Required financial statements	* Statement of net assets * Statement of activities	* Balance sheet * Statement of revenues, expenditures and changes in fund balances	* Statement of fiduciary assets and liabilities
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term liabilities included	All assets and liabilities, both short-term and long-term, Island City's funds do not currently contain capital assets, although they can.
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and the related liability is due and payable	All additions and deductions during the year, regardless of when cash is received or paid

Figure A-2 summarizes the major features of the Academy’s financial statements, including the portion of the Academy’s activities they cover and the types of information they contain. The remainder of this overview section of management’s discussion and analysis highlights the structure and contents of each of the statements.

## ACADEMY-WIDE STATEMENTS

The academy-wide statements report information about the Academy as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes *all* of the Academy's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two academy-wide statements report the Academy's *net assets* and how they have changed. Net assets - the difference between the Academy's assets and liabilities - are one way to measure the Academy's financial health or *position*.

- Over time, increases or decreases in the Academy's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- To assess the overall health of the Academy, you need to consider additional nonfinancial factors such as changes in the Academy's revenue streams and the condition of school buildings and other facilities. Currently the Academy is near capacity student enrollment and any variation from that may reflect negatively on the overall financial health of the Academy.

In the academy-wide financial statements, the Academy's activities:

- Governmental activities - Most of the Academy's basic services are included here, such as regular and special education, administration and operations and maintenance. State formula aid finances most of these activities.

## FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the Academy's *funds*, focusing on its most significant or "major" funds - not the Academy as a whole. Funds are accounting devices the Academy uses to keep track of specific sources of funding and spending on particular programs:

- Some funds are required by State law and by loan covenants.
- The Academy establishes other funds to control and manage money for particular purposes (like repaying its long-term debts) or to show that it is properly using certain revenues.
- The Academy maintains a School Lunch Fund and a Capital Projects Fund to properly account for these activities.

The Academy has two kinds of funds:

- Governmental funds - Most of the Academy's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out, and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Academy's programs. Because this information does not encompass the additional long-term focus of the academy-wide statements, we provide additional information with the governmental funds statements that explain the relationship (or differences) between them.

- Fiduciary funds - The Academy is the trustee, or fiduciary, for assets that belong to others, such as student activities funds. The Academy is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the academy-wide financial statements because the Academy cannot use these assets to finance its operations.

### FINANCIAL ANALYSIS OF THE ACADEMY AS A WHOLE

**Net assets** - The Academy's *combined* net assets were higher on June 30, 2011, than they were the year before - decreasing by \$9,542.

The Academy's financial position is the product of many factors.

<b>Table A-3</b>		
<b>Island City's Net Assets</b>		
	2011	2010
Current and other assets	\$ 963,330	\$ 916,347
Capital assets	1,677,188	1,740,255
Total assets	2,640,518	2,656,602
Long-term debt outstanding	1,465,000	1,505,000
Other liabilities	266,048	251,674
Total liabilities	1,731,048	1,756,674
Net assets:		
Invested in capital assets, net of related debt	172,188	200,255
Restricted for debt service	271,040	212,873
Restricted for food service	11,069	-
Unrestricted	455,173	486,800
Total net assets	\$ 909,470	\$ 899,928

	2011	2010
<b>Revenues:</b>		
Charges for services	\$ 61,122	\$ 56,822
Operating grants	24,963	102,297
<b>General revenues:</b>		
State sources - unrestricted	1,475,353	1,388,214
Federal sources - unrestricted	23,018	54,899
Intermediate sources - Act 18	13,188	12,414
Local sources	6,373	2,279
Other	1,303	1,829
Total revenues	1,605,320	1,618,754
<b>Expenses:</b>		
Instruction	829,978	860,630
Support services	475,005	482,544
Community services	50,642	18,087
Food services	48,584	47,928
Interest on long-term debt	109,323	111,861
Unallocated depreciation	82,246	70,863
Total expenses	1,595,778	1,591,913
Change in net assets	\$ 9,542	\$ 26,841

### **FINANCIAL ANALYSIS OF THE ACADEMY'S FUNDS**

The financial performance of the Academy as a whole is reflected in its governmental funds as well. As the Academy completed the year, its governmental funds reported *combined* fund balances of \$759,728; \$13,534 above last year's ending fund balances of \$746,194.

The Academy's general fund had more revenues and transfers in than expenditures in 2011 by \$20,135. The debt service fund had more revenues and transfers in than expenditures and transfers out by \$3,485. The capital projects fund - building and site had more expenditures and transfers out than revenues in 2011 of \$11,302. Overall, the Academy had an increase in total fund balance.

#### **General Fund Budgetary Highlights**

Over the course of the year, the Academy revised the annual operating budget several times. These budget amendments are:

- Changes made in the first and fourth quarters to account for changes in assumptions since the original budget was adopted.

While the Academy’s final budget for the general fund anticipated that revenues and transfers in would be higher than revenues by roughly \$8,266, the actual results for the year show a \$20,135 increase for the year.

- Actual revenues were \$17,809 higher than expected.
- The actual expenditures were \$19,437 above budget.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital Assets**

By the end of 2011, the Academy had invested \$1,677,188 in a broad range of capital assets, including school building, computer and audiovisual equipment and other school furniture. This amount represents a net decrease of \$63,067, from last year. (More detailed information about capital assets can be found in Note 5 to the financial statements.) Total depreciation expense for the year was \$82,246.

<b>Table A-5</b>		
<b>Island City's Capital Assets</b>		
<i>(net of depreciation)</i>		
	2011	2010
Land	\$ 96,082	\$ 96,082
Buildings	1,393,219	1,416,339
Computer equipment	80,694	103,953
Land improvements	29,813	31,705
Furniture and fixtures	77,380	92,176
Total	\$ 1,677,188	\$ 1,740,255

**Long-term Debt**

At year-end the Academy had \$1,505,000 in certificates of participation outstanding, a reduction of \$35,000 from last year. (More detailed information about the Academy’s long-term liabilities is presented in Note 6 to the financial statements.)

- The Academy continued to pay down its debt, retiring \$35,000.
- No new debt was issued during the year.

## **FACTORS BEARING ON THE ACADEMY'S FUTURE**

At the time these financial statements were prepared and audited, the Academy was aware of three existing circumstances that could significantly affect its financial health in the future:

- The Academy has adopted a general fund budget for 2011/2012 using up to \$26,989 in fund balance.
- A weak state economy could cause future pro-rating of state aid.

## **CONTACTING THE ACADEMY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our parents, customers, investors, and creditors with a general overview of the Academy's finances and to demonstrate the Academy's accountability for the money it receives. If you have questions about this report or need additional information, contact the Administrator's Office, Island City Academy, 6421 Clinton Trail, Eaton Rapids, MI 48827.

## **BASIC FINANCIAL STATEMENTS**

**ISLAND CITY ACADEMY  
STATEMENT OF NET ASSETS  
JUNE 30, 2011**

<b>ASSETS</b>	<b>Governmental activities</b>
<b>CURRENT ASSETS:</b>	
Cash	\$ 400,758
Investments	230,611
Receivables:	
Other governmental units	294,462
Prepaid expenditures	37,499
<b>TOTAL CURRENT ASSETS</b>	<b>963,330</b>
<b>NONCURRENT ASSETS:</b>	
Capital assets	2,299,577
Less accumulated depreciation	(622,389)
<b>TOTAL NONCURRENT ASSETS</b>	<b>1,677,188</b>
<b>TOTAL ASSETS</b>	<b>\$ 2,640,518</b>
<b>LIABILITIES AND NET ASSETS</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable	\$ 16,715
Accrued interest	45,464
Accrued salaries and related items	163,869
Current portion of long-term debt	40,000
<b>TOTAL CURRENT LIABILITIES</b>	<b>266,048</b>
<b>NONCURRENT LIABILITIES:</b>	
Noncurrent portion of long-term obligations	1,465,000
<b>TOTAL LIABILITIES</b>	<b>1,731,048</b>
<b>NET ASSETS:</b>	
Invested in capital assets, net of related debt	172,188
Restricted for debt service	271,040
Restricted for food service	11,069
Unrestricted	455,173
<b>TOTAL NET ASSETS</b>	<b>909,470</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 2,640,518</b>

See notes to financial statements.

**ISLAND CITY ACADEMY  
STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2011**

<b>Functions/programs</b>	<b>Expenses</b>	<b>Program revenue</b>		<b>Governmental activities</b>
		<b>Charges for services</b>	<b>Operating grants</b>	<b>Net (expense) revenue and changes in net assets</b>
Governmental activities:				
Instruction	\$ 829,978	\$ -	\$ -	\$ (829,978)
Support services	475,005	-	-	(475,005)
Community services	50,642	40,668	-	(9,974)
Food services	48,584	20,454	24,963	(3,167)
Interest on long-term debt	109,323	-	-	(109,323)
Unallocated depreciation	82,246	-	-	(82,246)
Total governmental activities	<u>\$ 1,595,778</u>	<u>\$ 61,122</u>	<u>\$ 24,963</u>	<u>(1,509,693)</u>
General revenues:				
State source - unrestricted				1,475,353
Federal sources - unrestricted				23,018
Intermediate sources - Act 18				13,188
Local sources				6,373
Investment revenue				1,303
Total general revenues				<u>1,519,235</u>
<b>CHANGE IN NET ASSETS</b>				9,542
<b>NET ASSETS, beginning of year</b>				<u>899,928</u>
<b>NET ASSETS, end of year</b>				<u>\$ 909,470</u>

See notes to financial statements.

**ISLAND CITY ACADEMY  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
JUNE 30, 2011**

	<u>General fund</u>	<u>Debt service</u>	<u>Capital projects fund building &amp; site</u>	<u>Non-major governmental (special revenue) fund</u>	<u>Total governmental funds</u>
<b>ASSETS</b>					
<b>ASSETS:</b>					
Cash	\$ 261,690	\$ -	\$ 135,341	\$ 3,727	\$ 400,758
Investments	-	230,611	-	-	230,611
Receivables:					
Other governmental units	291,142	-	-	3,320	294,462
Due from other funds	-	32,268	-	4,022	36,290
Prepaid expenditures	37,499	-	-	-	37,499
<b>TOTAL ASSETS</b>	<u>\$ 590,331</u>	<u>\$ 262,879</u>	<u>\$ 135,341</u>	<u>\$ 11,069</u>	<u>\$ 999,620</u>
<b>LIABILITIES AND FUND BALANCES</b>					
<b>LIABILITIES:</b>					
Accounts payable	\$ 16,715	\$ -	\$ -	\$ -	\$ 16,715
Accrued salaries and related items	163,869	-	-	-	163,869
Deferred revenue	23,018	-	-	-	23,018
Due to other funds	36,290	-	-	-	36,290
<b>TOTAL LIABILITIES</b>	<u>239,892</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>239,892</u>

See notes to financial statements.

	<b>General fund</b>	<b>Debt service</b>	<b>Capital projects fund building &amp; site</b>	<b>Non-major governmental (special revenue) fund</b>	<b>Total governmental funds</b>
<b>FUND BALANCES:</b>					
Nonspendable:					
Prepaid expenditures	\$ 37,499	\$ -	\$ -	\$ -	37,499
Restricted					-
Debt service fund	-	262,879	-	-	262,879
Special revenue fund	-	-	-	11,069	11,069
Committed for capital projects	-	-	135,341	-	135,341
Assigned for subsequent year expenditures	26,989	-	-	-	26,989
Unassigned	285,951	-	-	-	285,951
<b>TOTAL FUND BALANCES</b>	<b>350,439</b>	<b>262,879</b>	<b>135,341</b>	<b>11,069</b>	<b>759,728</b>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<b>\$ 590,331</b>	<b>\$ 262,879</b>	<b>\$ 135,341</b>	<b>\$ 11,069</b>	<b>\$ 999,620</b>

**Total governmental fund balances** \$ 759,728

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

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

The cost of the capital assets is	\$ 2,299,577	
Accumulated depreciation is	<u>(622,389)</u>	1,677,188

Long-term liabilities are not due and payable from current resources and are not reported in the fund:

Certificates of participation	(1,505,000)
Accrued interest is not included as a liability in government funds, it is recorded when paid	(45,464)

Receivable expected to be collected after August 31, 2011

State of Michigan - federal sources	23,018
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**Net assets of governmental activities** \$ 909,470

See notes to financial statements.

**ISLAND CITY ACADEMY**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**  
**GOVERNMENTAL FUNDS**  
**YEAR ENDED JUNE 30, 2011**

	General fund	Debt service	Capital projects fund building & site	Non-major governmental (special revenue) fund	Total governmental funds
<b>REVENUES:</b>					
Local sources	\$ 47,768	\$ -	\$ 576	\$ 20,454	\$ 68,798
State sources	1,475,353	-	-	775	1,476,128
Federal sources	-	-	-	24,188	24,188
Intermediate sources	13,188	-	-	-	13,188
Total revenues	<u>1,536,309</u>	<u>-</u>	<u>576</u>	<u>45,417</u>	<u>1,582,302</u>
<b>EXPENDITURES:</b>					
Current:					
Instruction:					
Basic instruction	760,159	-	-	-	760,159
Added needs	77,120	-	-	-	77,120
Total instruction	<u>837,279</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>837,279</u>
Support services:					
Pupil	2,081	-	-	-	2,081
Library	15,739	-	-	-	15,739
General administration	114,264	-	-	-	114,264
School administration	215,518	-	-	-	215,518
Business	10,200	-	-	-	10,200
Operations and maintenance	129,081	-	-	-	129,081
Total support services	<u>486,883</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>486,883</u>
Community service	50,642	-	-	-	50,642
Food service	-	-	-	48,584	48,584
Debt service:					
Principal retirement	-	35,000	-	-	35,000
Interest and fiscal charges	-	110,380	-	-	110,380
Total expenditures	<u>1,374,804</u>	<u>145,380</u>	<u>-</u>	<u>48,584</u>	<u>1,568,768</u>
<b>EXCESS (DEFICIENCY) OF REVENUES UNDER (OVER) EXPENDITURES</b>	<u>161,505</u>	<u>(145,380)</u>	<u>576</u>	<u>(3,167)</u>	<u>13,534</u>
<b>OTHER FINANCING SOURCES (USES):</b>					
Transfers in	11,878	148,865	-	4,383	165,126
Transfers out	<u>(153,248)</u>	<u>-</u>	<u>(11,878)</u>	<u>-</u>	<u>(165,126)</u>
Total other financing sources (uses)	<u>(141,370)</u>	<u>148,865</u>	<u>(11,878)</u>	<u>4,383</u>	<u>-</u>
<b>NET CHANGE IN FUND BALANCES</b>	<u>20,135</u>	<u>3,485</u>	<u>(11,302)</u>	<u>1,216</u>	<u>13,534</u>
<b>FUND BALANCES:</b>					
Beginning of year	330,304	259,394	146,643	9,853	746,194
End of year	<u>\$ 350,439</u>	<u>\$ 262,879</u>	<u>\$ 135,341</u>	<u>\$ 11,069</u>	<u>\$ 759,728</u>

See notes to financial statements.

**ISLAND CITY ACADEMY  
RECONCILIATION OF THE STATEMENT OF REVENUES,  
EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2011**

<b>Net change in fund balances total governmental funds</b>	<b>\$ 13,534</b>
 Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. In the statement of activities, these costs are allocated over their estimated useful lives as depreciation.	
Depreciation expense	(82,246)
Capital outlay	19,179
 Accrued interest on certificates of participation is recorded in the statement of activities when incurred; it is not recorded in governmental funds until it is paid:	
Accrued interest payable, beginning of the year	46,521
Accrued interest payable, end of the year	(45,464)
 Proceeds and repayments of principal on long-term debt are other financing sources and expenditures in the governmental funds, but not in the statements of activities (where they are additions and reductions of liabilities)	
Principal repayment	35,000
 Revenue is recorded on the accrual method in the statement of activities; in the governmental funds it is recorded on the modified accrual method and not available:	
Revenue receivable at year end received after August 31, 2011 - Federal sources	23,018
<b>Change in net assets of governmental activities</b>	<b>\$ 9,542</b>

**ISLAND CITY ACADEMY  
STATEMENT OF FIDUCIARY ASSETS AND LIABILITES  
JUNE 30, 2011**

	<u>Agency fund</u>
<b>ASSETS</b>	
Cash	\$ 8,790
<b>LIABILITIES</b>	
Due to student groups	\$ 4,577
Due to parent/teacher groups	4,213
	<u>\$ 8,790</u>

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The basic financial statements of the Island City Academy have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Academy's accounting policies are described below.

**A. Reporting Entity**

Island City Academy (the "Academy") is a public school academy as part of the Michigan Public School System under Public Act No. 362 of 1993. Central Michigan University is the authorizing body for the Academy. The Academy's board of directors is approved by the authorizing body and is authorized to manage the Academy and the property and affairs of the Academy. The Academy receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the Academy is not included in any other governmental reporting entity as defined by accounting principles generally accepted in the United States of America. In addition, the Academy's reporting entity does not contain any component units as defined in Governmental Accounting Standards Board Statements No. 14 and No. 39.

**B. Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the Academy. For the most part, the effect of interfund activity has been removed from these statements. The government-wide financial statements categorize primary activities as either governmental or business type. All of the Academy's activities are classified as governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid and other unrestricted items are not included as program revenues but instead as *general revenues*.

In the government-wide statement of net assets, the governmental activities column (a) is presented on a consolidated basis, and (b) is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The Academy's net assets are reported in three parts - invested in capital assets, net of related debt, restricted net assets; and unrestricted net assets.

The Academy first utilizes restricted resources to finance qualifying activities.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**B. Government-wide and Fund Financial Statements (Continued)**

The government-wide statement of activities reports both the gross and net cost of each of the Academy's functions. The functions are also supported by general government revenues (state revenue, certain intergovernmental revenues, investment income and other revenue). The statement of activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific (either operating or capital) grants.

The net costs (by function) are normally covered by general revenue (state sources, intergovernmental revenue, interest income and other revenues.)

The Academy does not allocate indirect costs.

This government-wide focus is more on the sustainability of the Academy as an entity and the change in the Academy's net assets resulting from the current year's activities.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

**Governmental Funds** - Governmental funds are those funds through which most Academy functions typically are financed. The acquisition, use and balances of the Academy's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The Academy reports the following major governmental funds:

The *general fund* is the Academy's primary operating fund. It accounts for all financial resources of the Academy, except those required to be accounted for in another fund.

The *debt service fund* accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

The *capital projects fund* accounts for the receipt of debt proceeds and the acquisition of fixed assets or construction of major capital projects.

**Other non-major funds**

The *school lunch fund* accounts for activity related to the preparation and service of food to children of the school.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**B. Government-wide and Fund Financial Statements (Concluded)**

**Fiduciary funds** account for assets held by the Academy in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the Academy under the terms of a formal trust agreement. Fiduciary funds are not included in the government-wide statements.

The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the accrual basis of accounting. This fund is used to account for assets that the Academy holds for others in an agency capacity (primarily student activities).

**C. Measurement Focus, Basis of Accounting and Basis of Presentation**

**Accrual Method**

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

**Modified Accrual Method**

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

State and federal aid and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Academy.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Measurement Focus, Basis of Accounting and Basis of Presentation (Concluded)**

**State Revenue**

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to the Academy based on information supplied by the Academy. For the year ended June 30, 2011, the foundation allowance was based on pupil membership counts taken in February and September of 2010.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The State revenue is recognized during the foundation period and is funded through payments from October 2010 to August 2011. Thus, the unpaid portion at June 30th is reported as due from other governmental units.

The Academy also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Categorical funds received, which are not expended by the close of the fiscal year are recorded as deferred revenue.

**D. Other Accounting Policies**

1. Cash and equivalents include amounts in demand deposit accounts.

The Academy reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* and No. 40, *Deposits and Investment Risk Disclosures*. Under these standards, certain investments are valued at fair value as determined by quoted market prices, or by estimated fair values when quoted market prices are not available. The standards also provide that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the Academy intends to hold the investment until maturity.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**D. Other Accounting Policies (Continued)**

State statutes authorize the Academy to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The Academy is also authorized to invest in U.S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above.

2. Prepaid expenditures

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenditures.

3. Receivables and payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

All receivables are shown net of an allowance for uncollectible amounts, if any.

4. Capital assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**D. Other Accounting Policies (Continued)**

Depreciation on all assets is provided on the straight-line basis over the estimated useful lives as follows:

Buildings and additions	50 years
Computer equipment	5 years
Furniture and other equipment	5 - 20 years

The Academy's capitalization policy is to capitalize individual amounts exceeding \$1,000.

5. Long-term obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities on the statement of net assets. Certificates of participation premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight line method over the term of the related debt.

In the fund financial statements, governmental fund types recognize certificates of participation premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

6. Use of estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**D. Other Accounting Policies (Concluded)**

7. Fund balance

Beginning with fiscal year 2011, the Academy implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on a government's fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

Nonspendable fund balance - amounts that are in nonspendable form (such as inventory or prepaid expenditures) or are either legally or contractually required to be maintained intact.

Restricted fund balance - amounts constrained to specific purposes by their providers (such as taxpayers, grantors, bondholders, and higher levels of government), through constitutional provisions, or by enabling legislation.

Committed fund balance - amounts constrained to specific purposes by the Academy itself, using its highest level of decision-making authority (Board of Directors). To be reported as committed, amounts cannot be used for any other purpose unless the Academy takes the same highest level action to remove or change the constraint.

Assigned fund balance - amounts the Academy intends to use for a specific purpose. Intent can be expressed by the Board of Directors or by an official or body to which the Board of Directors delegates the authority.

Unassigned fund balance - amounts that are available for any purpose. Positive amounts are reported only in the general fund.

The Academy would typically use restricted fund balance first, followed by committed resources, and then assigned resources as appropriate opportunities arise, but reserves the right to selectively spend unassigned resources first to defer the use of these classified funds.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the general and special revenue funds.

The Academy follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The School Administrator submits to the Board of Directors a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Prior to July 1, the budget is legally adopted by Board of Directors resolution pursuant to the Uniform Budgeting and Accounting Act (1968 PA 2). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, in the general fund are noted in the required supplementary information section.
3. The School Administrator is authorized to transfer budgeted amounts between major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the Board.
4. Formal budgetary integration is employed as a management control device during the year for the general fund.
5. The budget was amended during the year with supplemental appropriations, the last one approved prior to June 30, 2011.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 3 - DEPOSITS, INVESTMENTS AND CREDIT RISK**

As of June 30, 2011, the Academy had the following investments.

<u>Investment Type</u>	<u>Fair value</u>	<u>Weighted average maturity (years)</u>	<u>Standard &amp; Poor's Rating</u>	<u>%</u>
First American Treasury Obligation Fund - class D	<u>\$ 230,611</u>	<u>0.0027</u>	AAAm	<u>100%</u>
Portfolio weighted average maturity		<u>0.0027</u>		

1 day maturity equals 0.0027, one year equals 1.00

The Academy voluntarily invests certain excess funds in external pooled investment funds which included treasury obligations. The treasury obligation reports as of June 30, 2011, the fair value of the Academy's investments is the same as the value of the pool shares. The above investments are restricted for payment of debt service.

The Academy does not currently have an investment policy.

**Interest rate risk.** The Academy will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the Academy's cash requirements.

**Credit risk.** State law limits investments in commercial paper and corporate bonds to a prime or better rating issued by nationally recognized statistical rating organizations (NRSROs).

**Concentration of credit risk.** The Academy will minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the Academy's investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

**Custodial credit risk - deposits.** In the case of deposits, this is the risk that in the event of a bank failure, the Academy's deposits may not be returned to it. As of June 30, 2011, \$123,103 of the Academy's bank balance of \$401,829 was exposed to custodial credit risk because it was uninsured and uncollateralized.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 3 - DEPOSITS, INVESTMENTS AND CREDIT RISK (Concluded)**

**Custodial credit risk - investments.** For an investment, this is the risk that, in the event of the failure of the counterparty, the Academy will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The Academy will minimize custodial credit risk, which is the risk of loss due to the failure of the security issuer or backer, by; limiting investments to the types of securities allowed by law; and pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the Academy will do business.

**Foreign currency risk.** The Academy is not authorized to invest in investments which have this type of risk.

**NOTE 4 - RECEIVABLES**

Amounts due from other governmental units include the July and August state aid payments due from the State of Michigan and ARRA funds from the federal government.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 5 - CAPITAL ASSETS**

A summary of changes in the Academy's capital assets follows:

	<u>July 1, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2011</u>
Assets not being depreciated:				
Land	\$ 96,082	\$ -	\$ -	\$ 96,082
Capital assets, being depreciated:				
Building	1,742,138	11,878	-	1,754,016
Computer equipment	148,337	7,301	-	155,638
Land improvements	37,856	-	-	37,856
Furniture and fixtures	255,985	-	-	255,985
Subtotal	<u>2,184,316</u>	<u>19,179</u>	<u>-</u>	<u>2,203,495</u>
Accumulated depreciation:				
Building	325,799	34,998	-	360,797
Computer equipment	44,384	30,560	-	74,944
Land improvements	6,151	1,892	-	8,043
Furniture and fixtures	163,809	14,796	-	178,605
Total accumulated depreciation	<u>540,143</u>	<u>82,246</u>	<u>-</u>	<u>622,389</u>
Net capital assets being depreciated	<u>1,644,173</u>	<u>(63,067)</u>	<u>-</u>	<u>1,581,106</u>
Net capital assets	<u>\$ 1,740,255</u>	<u>\$ (63,067)</u>	<u>\$ -</u>	<u>\$ 1,677,188</u>

Depreciation for the fiscal year ended June 30, 2011 amounted to \$82,246. The Academy determined that it was impractical to allocate depreciation to the various governmental activities as the assets serve multiple functions.

**NOTE 6 - LONG-TERM DEBT**

The Academy issued certificates of participation for the acquisition, construction and improvement of major capital facilities, as well as, the purchase of equipment. These certificates of participation are direct obligations and pledge the full faith and credit of the Academy. Long-term debt currently outstanding at June 30 is as follows:

August 1999 certificates of participation - due in annual installments of \$30,000 to \$140,000 through August 2029; interest at 7.25%. Secured by pledged state aid, first mortgage on the property security interest in specific equipment and debt service reserve fund.	<u>\$ 1,505,000</u>
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**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 6 - LONG-TERM DEBT (Concluded)**

The annual requirements to amortize long-term debt outstanding as of June 30, 2011, including interest of \$1,325,611 are as follows:

Year ending June 30,	Principal	Interest	Total
2012	40,000	106,503	146,503
2013	40,000	103,603	143,603
2014	45,000	100,376	145,376
2015	50,000	96,788	146,788
2016 - 2020	300,000	422,676	722,676
2021 - 2025	425,000	287,644	712,644
2026 - 2030	605,000	98,655	703,655
	<u>\$ 1,505,000</u>	<u>\$ 1,216,245</u>	<u>\$ 2,721,245</u>

An amount of \$262,879 is available in the debt service funds to service the debt.

The following is a summary of long-term debt transactions of the Academy for the year ended June 30, 2011:

Long-term debt, July 1, 2010	\$ 1,540,000
Deletions	<u>(35,000)</u>
Long-term debt, June 30, 2011	<u>\$ 1,505,000</u>

Interest expense (government-wide) for the year ended June 30, 2011 was \$109,323.

**ISLAND CITY ACADEMY  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 7 - INTERFUND RECEIVABLES AND PAYABLES**

Individual fund due to and from other funds at June 30, 2011 are as follows:

Fund	Due from other funds	Due to other funds
General fund	\$ -	\$ 36,290
Debt service fund	32,268	-
Special revenue fund - school lunch fund	4,022	-
Total	<u>\$ 36,290</u>	<u>\$ 36,290</u>

Outstanding balances between funds represent July and August State Aid payments to be paid by the General Fund to the Debt Service Fund and Special Revenue Fund.

**NOTE 8 - INTERFUND TRANSFERS**

Operating transfers between the governmental funds were as follows:

Operating transfers out		Operating transfers in	
General fund	\$ 153,248	Debt service fund	\$ 148,865
Capital projects fund	11,878	Food service fund	4,383
	<u>          </u>	General fund	11,878
	<u>\$ 165,126</u>		<u>\$ 165,126</u>

The operating transfers to the debt service fund from the general fund were to pay the debt service principal and interest payments. Transfers from the general fund to the food service fund were to subsidize operations. Transfers from the capital projects fund to the general fund were to reimbursement the general fund for the purchase of capital assets.

**NOTE 9 - RISK MANAGEMENT**

The Academy is exposed to various risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. To minimize the risk, the Academy carries commercial insurance.

**REQUIRED SUPPLEMENTARY INFORMATION**

**ISLAND CITY ACADEMY  
REQUIRED SUPPLEMENTAL INFORMATION  
BUDGETARY COMPARISON SCHEDULE  
GENERAL FUND  
YEAR ENDED JUNE 30, 2011**

	<b>Original budget</b>	<b>Final budget</b>	<b>Actual</b>	<b>Variance with final budget positive (negative)</b>
<b>REVENUES:</b>				
Local sources	\$ 35,500	\$ 31,900	\$ 47,768	\$ 15,868
State sources	1,414,000	1,460,900	1,475,353	14,453
Federal sources	22,000	20,000	-	(20,000)
Intermediate sources	5,000	5,700	13,188	7,488
Total revenues	<u>1,476,500</u>	<u>1,518,500</u>	<u>1,536,309</u>	<u>17,809</u>
<b>EXPENDITURES:</b>				
Instruction:				
Basic programs	776,854	743,896	760,159	(16,263)
Added needs	78,913	75,787	77,120	(1,333)
Total instruction	<u>855,767</u>	<u>819,683</u>	<u>837,279</u>	<u>(17,596)</u>
Support services:				
Pupil	20,445	8,500	2,081	6,419
Library	17,480	16,830	15,739	1,091
General administration	99,180	104,750	114,264	(9,514)
School administration	216,408	216,216	215,518	698
Business	13,260	18,700	10,200	8,500
Operations and maintenance	133,450	129,650	129,081	569
Total support services	<u>500,223</u>	<u>494,646</u>	<u>486,883</u>	<u>7,763</u>
Community services	-	41,038	50,642	(9,604)
Total expenditures	<u>1,355,990</u>	<u>1,355,367</u>	<u>1,374,804</u>	<u>(19,437)</u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES</b>	<u>120,510</u>	<u>163,133</u>	<u>161,505</u>	<u>(1,628)</u>
<b>OTHER FINANCING SOURCES (USES):</b>				
Operating transfers in	-	-	11,878	11,878
Transfers out	(148,867)	(154,867)	(153,248)	1,619
<b>NET CHANGE IN FUND BALANCE</b>	<u>\$ (28,357)</u>	<u>\$ 8,266</u>	<u>20,135</u>	<u>\$ 11,869</u>
<b>FUND BALANCE:</b>				
Beginning of year			<u>330,304</u>	
End of year			<u>\$ 350,439</u>	

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Directors  
Island City Academy

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Island City Academy as of and for the year ended June 30, 2011, which collectively comprise Island City Academy's basic financial statements and have issued our report thereon dated September 23, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

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

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses to be a material weakness. 2011-01.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency. 2011-02.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Island City Academy's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Island City Academy's in a separate letter dated September 23, 2011.

Island City Academy's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Island City Academy's response and, accordingly, we express no opinion on it.

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

A handwritten signature in black ink that reads "Manes Costeiran PC". The signature is written in a cursive style and is centered on the page.

September 23, 2011

**ISLAND CITY ACADEMY  
SCHEDULE OF FINDINGS AND RESPONSES**

Finding 2011-01

Finding considered a material weakness

Criteria:

An audit adjustment in an amount meeting the definition of a material weakness was proposed by the auditor and accepted by management in order to record a new cash account established during the year for the daycare program.

Condition

The new cash account was not recorded in the Academy's accounting records on timely basis to accurately reflect the appropriate balance of the asset and the related revenues associated with the account.

Cause

Account balances were not recorded or reconciled on a timely basis and internal controls over financial reporting did not detect and correct the misstatements.

Effect

Inaccurate financial information may have been used for management decisions and reporting.

Recommendation

When new cash accounts are opened they should be communicated to the Academy's bookkeeper in a timely basis in order to allow for recording and regular reconciliation.

Client Response

In the future when new cash accounts are opened they will be communicated to the Academy's bookkeeper to ensure proper recording and regular reconciling.

**ISLAND CITY ACADEMY  
SCHEDULE OF FINDINGS AND RESPONSES**

Finding 2011-02

Finding considered a significant deficiency

Criteria:

Statement on Auditing Standards requires us to communicate in writing when a client requires assistance to prepare the financial statements and footnotes required in the annual audit report in accordance with accounting principles generally accepted in the United States of America.

Condition

Currently, the Academy's staff and bookkeeper requests the external auditor's assistance in the preparation of the annual financial statements and related footnotes.

Cause

The staff and bookkeeper of the Academy does understand all information included in the annual financial statements; however, assistance of the external auditor was utilized in preparing the financial statements and footnotes to the financial statements.

Effect

Utilization of the external auditor in preparing the financial statements and related footnotes assists management with the external financial reporting responsibility, to ensure their financial statements are accurate.

Recommendation

At this time, we recommend no changes to this situation and communicate this as required by professional standards. The current process meets the definition of a significant deficiency as defined in Statement on Auditing Standards.

Client Response

The Academy is aware of this deficiency and believes it is not cost beneficial to develop this expertise. The Academy will continue to use the external auditors for this technical assistance and would expect this situation to be ongoing.

**ISLAND CITY ACADEMY  
SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES**

Finding 2010-01

Finding considered a significant deficiency

Criteria:

Statement on Auditing Standards #112 titled *Communicating Internal Control Related Matters Identified in an Audit* (issued May 2006), requires communication in writing when an entity requires assistance to prepare the financial statements, including the footnotes, in accordance with accounting principles generally accepted in the United States of America.

Condition

The Academy's bookkeeper prepared the interim financial reports and assisted the external auditor in the preparation of the annual financial statements.

Cause

The staff and bookkeeper of the Academy understood all the information included in the annual financial statements; however, assistance of the external auditor was utilized in preparing the footnotes to the financial statements and certain reconciliations required by Governmental Accounting Standards Board Statement #34.

Effect

Utilization of the external auditor in preparing the footnotes and certain reconciliations to the financial statements assisted management with the external financial reporting responsibility. The process met the definition of a significant deficiency as defined in Statement on Auditing Standards #112.

Recommendation

No changes were recommended, as this finding was only communicated as required by professional standards.

Client Response

The Academy was aware of this deficiency and believed it to not be cost beneficial to develop this expertise. The Academy will continue to use the external auditors for this technical assistance and would expect this situation to be ongoing.

September 23, 2011

To the Board of Directors  
Island City Academy

In planning and performing our audit of the financial statements of Island City Academy as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered Island City Academy's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Academy's internal control. Accordingly, we do not express an opinion on the effectiveness of the Academy's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

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

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Academy's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Academy's financial statements that is more than inconsequential will not be prevented or detected by the Academy's internal control. We consider the following deficiency in Island City Academy's internal control to be a significant deficiency:

**Financial Statement Preparation**

Auditing standards require communication in writing when an entity requires assistance to prepare the financial statements, including the footnotes, in accordance with accounting principles generally accepted in the United States of America. The staff and bookkeeper of the Academy understand all the information included in the annual financial statements; however, assistance of the external auditor was utilized in preparing the footnotes to the financial statements and certain reconciliations required by Governmental Accounting Standards Board Statement #34. Utilization of the external auditor in preparing the footnotes and certain reconciliations to the financial statements assists management with the external financial reporting responsibility. The current process meets the definition of a significant deficiency.

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 Academy's internal control. We consider the following deficiency in Island City Academy's internal control to be a material weakness:

### **Material Journal Entry**

During the course of the audit, it came to the auditor's attention that the bank account for the child care program at Island City Academy was not recorded on the general ledger. In order to reconcile cash, we posted an entry during the audit which is material to the financial statements. We recommend that Island City Academy record the proposed journal entry to reconcile cash. Additionally, if the Academy continues to use this bank account, we recommend that it be reconciled on a monthly basis.

In addition, during our audit, we noted certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated September 23, 2011 on the financial statements of Island City Academy. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:

### **Review of Internet Usage Policy**

Employee access to, and use of, the Academy's Internet resources has increased significantly. Thus, now is a good time to develop or review an official academy policy on acceptable use of the Internet. A sound policy can help limit misuse of the Internet and perhaps provide a basis for legal action, should that be necessary. The policy should be communicated to employees on a regular basis. The following are some matters the policy should cover:

- Internet access includes viewing websites, sending and receiving email, transmitting or receiving electronic files, running Internet applications such as games on the Academy-provided network or Internet, etc.

- Appropriate use of the Internet includes business-related communication with customers, vendors, and other employees; research; information retrieval; and other business-related tasks.
- Inappropriate, prohibited use of the Internet includes accessing or downloading obscene, sexually explicit, pornographic, or politically subversive material; sending or forwarding profane, obscene, sexually explicit, discriminatory, or harassing material; disseminating proprietary or confidential Academy information or trade secrets without authorization; downloading software subject to licensing restrictions in violation of intellectual property rights; or using the Internet for personal gain, illegal or unauthorized political activity, or to maliciously alter, damage, or destroy information.
- All electronic documents created or stored on, and all communications using, the Academy's computers are the Academy's property. Employees should not expect their communications using the Academy's systems to be private or confidential. The Academy may access those documents or communications when warranted by business needs or legal requirements. Also, the Academy can monitor its systems to ensure proper use and prevent security violations.
- Personal use of the Internet (such as for browsing, shopping, playing games, or sending personal email) should be deferred to nonbusiness hours if possible and be kept to a minimum when use is unavoidable during business hours. Personal use should at all times (during business or nonbusiness hours) conform to the above-stated Academy policies concerning inappropriate, prohibited use.

- Files transferred in should be checked for viruses before being opened.
- Violations of the Internet policy may result in restriction or loss of access, termination, and notification of appropriate authorities if there is evidence of illegal activity.

### **Consider Establishing a Fraud Hotline**

The Academy's code of ethics encourages employees to report any suspicions of fraud or misconduct, but it does not provide an effective, practical mechanism for doing so. We believe that as a result, employees would be hesitant to report knowledge or suspicions that could prevent or detect fraud or other misconduct that could be detrimental to the Academy. Studies show that most frauds are known to someone in the defrauded organization and are revealed after a tip is received from someone with knowledge about the fraud. However, an employee may not report suspicions or knowledge of fraud if he or she does not know to whom to report, especially if the perpetrator is someone high up in the Academy or someone to whom the employee reports. We recommend that management consider establishing a fraud hotline.

The very existence of a fraud hotline would serve as a deterrent to misconduct by creating among employees a perception that fraud would be detected and reported. It would also demonstrate the Academy's serious intent to prevent and detect fraud. In addition, the hotline could also be used to report incidents of harassment, unsafe working conditions, violence, or violations of laws or regulations. This would allow the Academy to address such situations in a timely manner and could help prevent or minimize fines, lawsuits, legal liability, or adverse publicity by demonstrating that the Academy has procedures for receiving and addressing complaints.

An effective fraud hotline should have the following features:

- It should be available 24/7. Studies show that 40% of calls to fraud hotlines are made at night or on weekends. Employees typically will not call during normal work hours to report on coworkers or supervisors, and they often will not call back if their first call is not answered.
- The hotline must allow anonymous calls to protect confidentiality so that employees will not fear possible retaliation if they are identified as the whistle-blower.
- Employees should be made aware of the hotline's availability and the reasons why they should use it. This could be done via informational posters, memos, or brochures.

This report is intended solely for the information and use of Island City Academy, management, and others within the Academy, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the cooperation we received from your staff during our engagement and the opportunity to be of service.

Very truly yours,

*Manes Costeiran PC*

September 23, 2011

To the Board of Directors  
Island City Academy

We have audited the financial statements of Island City Academy for the year ended June 30, 2011, and have issued our report thereon dated September 23, 2011. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of Island City Academy. 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 test of Island City Academy's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters.

## Significant Audit Findings

### *Qualitative Aspects of Accounting Practices*

Management is responsible for the 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 Island City Academy are described in Note 1 to the financial statements. In 2011, Island City Academy adopted new accounting policies in accordance with *Statement No. 54 of the Governmental Accounting Standards Board*. We noted no transactions entered into by the Academy during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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 estimate affecting the financial statements was:

Management's estimate of the depreciable lives of capital assets is based on management's estimate of the economic useful life of the asset. We evaluated the key factors and assumptions used to develop the depreciable lives of capital assets in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. We did not identify any sensitive disclosures.

### *Difficulties Encountered in Performing the Audit*

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

### *Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We proposed an adjusting journal entry that was material to the financial statements. This entry was made to record a cash account and related revenues in relation to the daycare program. Management has accepted the adjusting journal entry.

*Disagreements with Management*

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

*Management Representations*

We have requested certain representations from management that are included in the management representation letter dated September 23, 2011.

*Management 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 Island City Academy's financial statements or a determination of the type of auditors' 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.

*Other Audit Findings or Issues*

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 Island City Academy's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Directors and management of Island City Academy and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*Maney Costeiran PC*