Arizona School for the Arts

Financial Statements
and
Auditors' Reports

Year Ended June 30, 2009

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Independent Auditors' Report

To the Board of Directors
of Arizona School for the Arts
Phoenix, Arizona

We have audited the accompanying statement of financial position of Arizona School for the Arts (the School, a non-profit organization) as of June 30, 2009, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arizona School for the Arts as of June 30, 2009, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2009, on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

Fester & Chapman P.C.
September 18, 2009

Arizona School for the Arts

STATEMENT OF FINANCIAL POSITION

June 30, 2009

ASSETS

Current assets:	
Cash and cash equivalents	$ 381,153
Cash, restricted	2,668,272
Other receivables	44,331
Due from government	15,647
Prepaid expenses	1,768
Prepaid interest	150,000
Total current assets	3,261,171
Property and equipment:	
Land	3,447,520
Buildings and improvements	3,615,999
Furniture, fixtures, and equipment	192,490
Vehicles	18,500
Less: accumulated depreciation	(314,867)
	6,959,642
Deposits	23,805
Prepaid interest, net of current portion	279,081
Deferred charges, net of accumulated amortization of $8,787	342,692
Total assets	$ 10,866,391

LIABILITIES AND NET ASSETS

Current liabilities:	
Accrued payroll and related	$ 173,686
Refundable deposits	24,062
Accrued interest	31,719
Total current liabilities	229,467
Long-term debt	10,500,000
Total liabilities	10,729,467
Unrestricted net assets	136,924
Total liabilities and net assets	$ 10,866,391

The accompanying notes are an integral part of this statement.

Arizona School for the Arts

STATEMENT OF ACTIVITIES

Year Ended June 30, 2009

Revenue and support:	
State Equalization	$ 2,531,594
Classroom Site funds	146,890
Instructional Improvement fund	16,141
Tax credit	126,480
Special events	76,850
Student activities	162,958
Rental	484,625
Grants	31,766
Interest income	1,651
Miscellaneous revenue	14,227
Total revenue and support	3,593,182
Expenses:	
Salaries	1,672,607
Payroll taxes and benefits	353,415
Professional services	420,624
Instructional supplies	45,990
General supplies	21,785
Printing and postage	11,608
Dues and fees	11,461
Rent	285,395
Equipment rental	36,039
Repairs and maintenance	61,922
Administrative fees	1,247
Dues and fees	1,501
Insurance	74,380
Travel, training and related	898
Advertising	7,838
Utilities	79,477
Taxes	24,258
Student activities	65,759
Depreciation	85,648
Amortization of deferred charges	8,787
Interest expense	541,789
Miscellaneous expense	31,949
Total expenses	3,844,377
Change in net assets	(251,195)
Net assets, beginning of year	388,119
Net assets, end of year	$ 136,924

The accompanying notes are an integral part of this statement.

Arizona School for the Arts

STATEMENT OF CASH FLOWS

Year Ended June 30, 2009

Cash flows from operating activities:	
Change in net assets	$ (251,195)
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Depreciation	85,648
Amortization of deferred charges	8,787
Changes in:	
Other receivables	(16,515)
Due from government	(15,647)
Prepaid expenses	9,230
Prepaid interest	(150,000)
Deposits	(12,296)
Prepaid interest, net of current portion	(279,081)
Accounts payable	(7,555)
Accrued payroll and related	13,587
Refundable deposits	24,062
Accrued interest	31,719
Net cash used in operating activities	(559,256)
Cash flows from investing activities:	
Deposits into restricted cash	(2,668,272)
Purchases of land, buildings and equipment	(6,879,436)
Net cash used in investing activities	(9,547,708)
Cash flows from financing activities:	
Proceeds from long-term debt	10,500,000
Principal payments on long-term debt	(71,934)
Payments made for loan issuance costs	(351,479)
Net cash provided by by financing activities	10,076,587
Net decrease in cash	(30,377)
Cash and cash equivalents, beginning of year	411,530
Cash and cash equivalents, end of year	$ 381,153
Supplemental disclosure of cash flow information	
Cash paid for interest	$ 510,070

The accompanying notes are an integral part of this statement.

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Arizona School for the Arts (the School) is an Arizona not-for profit corporation incorporated on March 29, 1995. The School's purpose is to provide quality education in academics and the arts to students in the sixth through twelfth grades. The School operates under a charter contract with the Arizona State Board for Charter Schools, which mandates policy and operational guidelines.

The significant accounting policies of the School follow:

Basis of Presentation: Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not-for-Profit Organizations. Under SFAS No. 117, the School is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The School does not have any temporarily or permanently restricted net assets at June 30, 2009.

Use of Estimates: In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributions: The School follows SFAS No. 116, *Accounting for Contributions Received and Contributions Made*. Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support based on the existence and/or nature of any donor restrictions. All donor restricted support is reported as an increase in temporarily restricted or permanently restricted net assets depending on the nature of the restriction. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activity as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

Other Receivables: Other receivables consist mainly of rental payments receivable and other fees related to lease agreements. The School has not experienced any losses, nor expects any losses; therefore, no allowance has been established.

Due from Government: Due from government consists of mainly state approved payments to the School to operate the charter school. The School has never experienced any losses due to non-payment, and therefore has not established an allowance.

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Prepaid Interest: Prepaid interest consists of bond funds disbursed to the bond trustee to partially pay interest due through the year ended June 30, 2012.

Deferred Charges: Loan issuance costs and origination fees are being amortized on a straight-line method over the term of related debt (note 4). Amortization expense for the year ended June 30, 2009 was $8,787.

Property and Equipment: Land, Buildings and improvements and vehicles with a cost of $3,000 or more and furniture, fixtures and equipment of $300 or more are recorded at cost if purchased, or at their estimated fair market value if donated. Assets are stated at cost. Depreciation and amortization is provided on a straight-line basis over the estimated useful lives of the respective assets. The estimated lives used in determining depreciation and amortization are:

Building and improvements	40 years
Furniture, fixtures and equipment	3-10 years
Vehicles	7 years

Income Taxes: The School is exempt from Federal income taxes as an organization other than a private foundation under Section 501(c)(3) of the Internal Revenue Code, and from Arizona income taxes under Section 43-147(a)(4) of the Arizona Revised Statutes.

Expense Allocation: The costs of providing various programs and other activities have been summarized on a functional basis in note 7. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Cash and Cash Equivalents: Cash and cash equivalents consist of checking, savings and money market accounts.

Advertising: Advertising costs are expensed as incurred.

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

NOTE 2 - RESTRICTED CASH

Restricted cash consists of required deposits associated with the long-term debt (see note 4). The project funds may be used for improvements to School buildings. The initial operating reserve funds are kept in trust in the event the School is not able to make debt service payments on the IDA loan, and any unused amounts would be used to extinguish the debt at the maturity date of the bonds. The accounts are held by U.S. Bancorp as trustee. Restricted cash as of June 30, 2009 consisted of the following:

Current portion:	
Project funds	$ 2,518,250
Initial operating reserve funds	150,022
Total	$ 2,668,272

NOTE 3 - CONCENTRATION OF CREDIT RISK

The School's cash and cash equivalents were fully insured by the Federal Deposit Insurance Corporation at June 30, 2009. The School has not experienced any losses and believes it is not exposed to any significant risk; therefore, the School has not developed any polices related to collateral.

Restricted cash is in the custody of U.S. Bancorp as trustee. The funds were not insured or collateralized at the year end June 30, 2009.

NOTE 4 - LONG-TERM NOTE PAYABLE

Long-term debt consists of the following at June 30, 2009:

Education Revenue Bonds (Series 2008 Bonds) were issued by the Industrial Development Authority of the City of Phoenix, Arizona, (IDA) in the aggregate principal amount of $10,500,000. The proceeds of the bonds were loaned to the School pursuant to a loan agreement dated October 1, 2008. The loan matures over a 40-year period, with an effective interest rate of approximately 8.99%. Monthly principal and interest payments vary, and range from a minimum of $63,702 to a maximum of $76,226. The bonds are secured by land and the building renovated with loan proceeds, and through assignment of State Equalization revenue.	$ 10,500,000

Repayment of the outstanding principal commences during the fiscal year ended June 30, 2014. The amount of principal due during the fiscal year ended June 30, 2014 totals $10,000.

NOTE 5 - OPERATING LEASES

The School has two leases for education and administration space. Rental expense for those leases was $285,395 for the year ended June 30, 2009. Future minimum operating lease commitments are as follows:

Year ending June 30:	
2009	$ 279,703
2010	288,446
2011	297,190
2012	12,118
	$ 877,457

NOTE 6 - OPERATING LEASES AS LESSOR

As part of the purchase of the building described in note 4, the School assumed four leases with tenants occupying the building. All leases expired during the year ended June 30, 2009, per terms of the agreement. The School received rental payments totalling $484,625 during the year ended June 30, 2009.

NOTE 7 - FUNCTIONAL EXPENSE CLASSIFICATION

The following is a summary of the School's expenses by function for the year ended June 30, 2009:

Junior high and high school education	$ 3,542,632
General and administrative	211,503
Fund-raising	90,242
Total	$ 3,844,377

NOTE 8 - COMMITMENTS AND CONTINGENT LIABILITIES

Compliance: The School's compliance with certain laws and regulations is subject to review by the State of Arizona, Office of the Auditor General and Department of Education. Such reviews could result in adjustments or withholding of State Equalization assistance.

NOTE 9 - ECONOMIC DEPENDENCY

Approximately 75% of the School's revenue for the year ended June 30, 2009 was derived from the State of Arizona through payments of State Equalization and Classroom Site (Proposition 301) funds for charter school and State of Arizona grants. Funds that are paid from the State of Arizona are subject to funding approval from the state legislature. Changes in state funding levels for charter schools could have a significant impact on the School's ability to operate.

NOTE 10 - PENSION PLAN

Plan Description: Permanent full-time and certain part-time employees of the School participate in a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes financial statements and required supplementary information. A recent report may be obtained by writing the ASRS, 3300 North Central Avenue, PO Box 33910, Phoenix, AZ 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

NOTE 10 - PENSION PLAN - Continued

Funding Policy: The Arizona State Legislature establishes and may amend active plan members' and the School's contribution rates. For the year ended June 30, 2009, active plan members and the School were each required by statute to contribute at the actuarially determined rate of 9.45 percent (8.95 percent retirement and 0.50 percent long-term disability). The School's contributions to the System for the years ended June 30, 2009, 2008 and 2007 were $123,646, $115,870 and $112,835, respectively, which were equal to the required contributions for each year.

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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 of
Arizona School for the Arts
Phoenix, Arizona

We have audited the financial statements of Arizona School for the Arts (the School, a nonprofit organization), as of and for the year ended June 30, 2009, and have issued our report thereon dated September 18, 2009. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School'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 weakness have been identified. However, as described in the accompanying schedule of finding and response, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operational of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect or correct misstatements on a timely basis. A *material weakness* is a deficiency, or 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 finding and response as 2009-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School'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 a certain other matter that was reported to management in a separate letter dated September 18, 2009.

The School's response to the finding identified in our audit is described in the accompanying schedule of finding and response. We did not audit the School's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, management, the Arizona State Board for Charter Schools, and the Auditor General of the State of Arizona, and is not intended and should not be used by anyone other than these specified parties.

Foster & Chapman P.C.

September 18, 2009

Arizona School for the Arts

SCHEDULE OF FINDING AND RESPONSE

June 30, 2009

2009 – 1 Controls Over Financial Reporting

Criteria: Arizona Revised Statutes 15-914(C) requires that a charter school not subject to a single audit have an audit conducted annually in accordance with generally accepted governmental auditing standards (GAGAS). Financial statements audited under GAGAS must be presented in accordance with generally accepted accounting principles (GAAP). In addition, proper risk management, as detailed by the Committee of Sponsoring Organization's framework should include the monitoring of internal control activities sufficient to report financial data reliably in accordance with GAAP.

Condition: There was an adjustment needed to properly state other receivables and accrued payroll.

Cause: Unknown.

Effect: Financial statements prior to the audit adjustments were materially misstated.

Recommendation: Whenever possible, the Chief Financial Officer should compare material revenue recorded to agreements or similar documentation to evaluate if revenue and the related receivable balances are accurately stated. Also, accrued expenses should be evaluated to determine if they appear reasonable.

Response: Accruals from June 2008 (for FY 08) were recorded by a temporary finance consultant and appeared in the books for the next fiscal year. Immediately following last year's audit, ASA had a personnel transition, the consultant was replaced by a full-time permanent Director of Finance. The error was not discovered until immediately prior to the audit for FY 09. Personnel are now aware of the accrual process and GAAP will continue to be followed moving forward.

Arizona School for the Arts

Financial Statements
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Year Ended June 30, 2008

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Independent Auditors' Report

To the Board of Directors
of Arizona School for the Arts
Phoenix, Arizona

We have audited the accompanying statement of financial position of Arizona School for the Arts (the School, a non-profit organization) as of June 30, 2008, and the related statement of activities and cash flows for the year then ended. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arizona School for the Arts as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 4, 2008, on our consideration of the School's internal control over financial reporting and 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 important in assessing the results of our audit.

Fester & Chapman P.C.

November 4, 2008

Arizona School for the Arts

STATEMENT OF FINANCIAL POSITION

June 30, 2008

ASSETS

Current assets:	
Cash and cash equivalents	$ 411,530
Accounts receivable	27,815
Prepaid expenses	10,998
Total current assets	450,343
Property and equipment:	
Buildings and improvements	205,855
Furniture, fixtures, and equipment	189,159
Accumulated depreciation	(229,159)
	165,855
Deposits receivable - noncurrent	11,509
Total assets	$ 627,707

LIABILITIES AND NET ASSETS

Current liabilities:	
Accounts payable	$ 7,555
Accrued payroll and related	160,099
Current portion of long-term debt	12,752
Total current liabilities	180,406
Long-term debt, net of current portion	59,182
Total liabilities	239,588
Unrestricted net assets	388,119
Total liabilities and net assets	$ 627,707

The accompanying notes are an integral part of this statement.

Arizona School for the Arts

STATEMENT OF ACTIVITIES

Year Ended June 30, 2008

Revenue and support:	
State Equalization	$ 2,333,536
Classroom site fund	212,075
Instructional improvement fund	17,325
Grants	34,700
Special events	162,629
Tax credit	91,489
Contributions	58,279
Student activities	88,835
Interest income	7,531
Miscellaneous revenue	28,697
Total revenue and support	3,035,096
Expenses:	
Salaries	1,538,191
Payroll taxes and benefits	369,074
Professional services	385,236
Instructional supplies	67,003
Printing and postage	5,321
Dues and fees	10,406
Rent	277,155
Special event expenses	76,726
Repairs and maintenance	29,320
Student transportation	4,153
Administrative fees	9,006
Insurance	17,440
Travel, training and related	2,333
Advertising	919
Depreciation	26,744
Interest expense	3,214
Student activities	82,575
Utilities	11,644
Taxes	2,331
Miscellaneous expense	5,867
Loss on disposal of assets	25,017
Total expenses	2,949,675
Change in net assets	85,421
Net assets, beginning of year	302,698
Net assets, end of year	$ 388,119

The accompanying notes are an integral part of this statement.

Arizona School for the Arts

STATEMENT OF CASH FLOWS

Year Ended June 30, 2008

Cash flows from operating activities:	
Change in net assets	$ 85,421
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	26,744
Loss on sale of asset	25,017
Changes in:	
Accounts receivable	23,915
Prepaid expenses	(10,998)
Deposits	500
Accounts payable	3,105
Accrued payroll and related	18,798
Net cash provided by operating activities	172,502
Cash flows from investing activities:	
Purchase of furniture, fixture, and equipment	(75,741)
Net cash used in investing activities	(75,741)
Cash flows from financing activities:	
Proceeds from long-term debt	73,000
Principal payments on long-term debt	(19,044)
Net cash provided by by financing activities	53,956
Net increase in cash	150,717
Cash, beginning of year	260,813
Cash, end of year	$ 411,530

Supplemental disclosure of cash flow information	
Cash paid for interest	$ 3,214

The accompanying notes are an integral part of this statement.

Arizona School for the Arts

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Arizona School for the Arts (the School) is an Arizona not-for profit corporation incorporated on March 29, 1995. The School's purpose is to provide a quality education to students in the sixth through twelfth grades in academics and the arts. The School operates under a charter contract with the Arizona State Board for Charter Schools, which mandates policy and operational guidelines.

The significant accounting policies of the School follow:

Basis of Presentation: Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, Financial Statements of Not-for-Profit Organizations. Under SFAS No. 117, the School is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The School does not have any temporarily or permanently restricted net assets at June 30, 2008.

Use of Estimates: In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributions: The School follows SFAS No. 116, *Accounting for Contributions Received and Contributions Made.* Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support based on the existence and/or nature of any donor restrictions. All donor restricted support is reported as an increase in temporarily restricted or permanently restricted net assets depending on the nature of the restriction. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activity as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

NOTE 1 - BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Property and Equipment: Leasehold improvements with a cost of $3,000 or more and furniture and equipment of $300 or more are recorded at cost if purchased or at their estimated fair market value if donated. Assets are stated at cost. Depreciation and amortization is provided on a straight-line basis over the estimated useful lives of the respective assets. The estimated lives used in determining depreciation and amortization are:

Building and improvements	30 years
Furniture, fixtures and equipment	3-10 years

Income Taxes: The School is exempt from Federal income taxes as an organization other than a private foundation under Section 501(c)(3) of the Internal Revenue Code, and from Arizona income taxes under Section 43-147(a)(4) of the Arizona Revised Statutes.

Expense Allocation: The costs of providing various programs and other activities have been summarized on a functional basis in note 5. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Cash and Cash Equivalents: Cash and cash equivalents consist of checking, savings and money market accounts.

Advertising: Advertising costs are expensed as incurred.

NOTE 2 - CONCENTRATION OF CREDIT RISK

The School maintains its unrestricted cash with with one financial institute. At June 30, 2008, deposits exceeded Federal Deposit Insurance Corporation limits by $344,583. The School has not experienced any losses in such accounts and believes it is not exposed to any significant risk, therefore, the School has not developed any polices related to collateral.

NOTE 3 - LONG-TERM NOTE PAYABLE

Long-term debt consists of the following at June 30, 2008:

$73,000 note payable for the purchase of pianos. Note is due in 60 installments of $1,449, which includes interest at 7.00%. The note is secured by a security agreement for the pianos purchased, and matures in May of 2013.	$ 71,934
Less current portion	12,752
	$ 59,182

The aggregate future minimum payments on long-term debt as of June 30, 2008, were as follows:

Year ending June 30:	
2009	$ 12,752
2010	13,674
2011	14,663
2012	15,723
2013	15,122
	$ 71,934

NOTE 4 - OPERATING LEASE

The School has two leases for education and administration space. Rental expense for those leases was $268,009 for the year ended June 30, 2008. Future minimum operating lease commitments are as follows:

Year ending June 30:	
2009	$ 279,703
2010	288,446
2011	297,190
2012	12,118
	$ 877,457

NOTE 5 - FUNCTIONAL EXPENSE CLASSIFICATION

The following is a summary of the School's expenses by function for the year ended June 30, 2008:

Program activities	$ 2,662,664
General and administrative	210,285
Fund raising	76,726
Total	$ 2,949,675

NOTE 6 - COMMITMENTS AND CONTINGENT LIABILITIES

Compliance: The School's compliance with certain laws and regulations is subject to review by the State of Arizona, Office of the Auditor General and Department of Education. Such reviews could result in adjustments or withholding of state equalization assistance.

NOTE 7 - ECONOMIC DEPENDENCY

Approximately 84% of the School's revenue for the year ended June 30, 2008 was derived from the State of Arizona through payments of state equalization and Classroom Site (Proposition 301) funds for charter school and State of Arizona grants. Funds that are paid from the State of Arizona are subject to funding approval from the state legislature. Changes in state funding levels for charter schools could have a significant impact on the School's ability to operate.

NOTE 8 - PENSION PLAN

Plan Description: Permanent full-time and certain part-time employees of the School participate in a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The ASRS issues a comprehensive annual financial report that includes financial statements and required supplementary information. A recent report may be obtained by writing the ASRS, 3300 North Central Avenue, PO Box 33910, Phoenix, AZ 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

NOTE 8 - PENSION PLAN - Continued

Funding Policy: The Arizona State Legislature establishes and may amend active plan members' and the School's contribution rates. For the year ended June 30, 2008, active plan members and the School were each required by statute to contribute at the actuarially determined rate of 9.10 percent (8.5 percent retirement and 0.51 percent long-term disability). The School's contributions to the System for the years ended June 30, 2008, 2007 and 2006 were $115,870, $112,835 and $82,600, respectively, which were equal to the required contributions for each year.

NOTE 9 - SUBSEQUENT EVENTS

During July 2008, the School deposited $100,000 into an escrow account for the purchase of a new building. The total contracted purchase price of the new building is $3,600,000, which the School plans to fund with loans from the Industrial Development Authority.

On September 29, 200,8 the School deposited $50,000 into an escrow account for the purchase of a building. The total contracted purchase price of the building is $3,175,000, which the School plans to fund with loans from the Industrial Development Authority.

Fester & Chapman P.C.

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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 of
Arizona School for the Arts
Phoenix, Arizona

We have audited the financial statements of Arizona School for the Arts (the School, a nonprofit organization), as of and for the year ended June 30, 2008, and have issued our report thereon dated November 4, 2008. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School'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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in the internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the School's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the School's financial statements that is more than inconsequential will not be prevented or detected by the School's internal control. We consider the deficiency described in the accompanying schedule of finding and response as 2008-1 to be a significant deficiency in internal control over financial reporting.

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 School's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

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

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

This report is intended solely for the information and use of the Board of Directors, management, the Arizona State Board for Charter Schools, and the Auditor General of the State of Arizona, and is not intended and should not be used by anyone other than these specified parties.

Fester & Chapman P.C.

November 4, 2008

Arizona School for the Arts

SCHEDULE OF FINDING AND RESPONSE

June 30, 2008

2008 – 1 Controls Over Financial Reporting

Criteria: Arizona Revised Statutes 15-914(C) requires that a charter school not subject to the single audit have an audit conducted annually in accordance with generally accepted governmental auditing standards (GAGAS). Financial statements audited under GAGAS must be presented in accordance with generally accepted accounting principles (GAAP). In addition, proper risk management, as detailed by the Committee of Sponsoring Organization's framework should include the monitoring of internal control activities sufficient to report financial data reliably in accordance with GAAP.

Condition: There was an adjustment needed to properly state accounts payable

Cause: Unknown

Effect: Financial statements prior to the audit adjustments were misstated.

Recommendation: The detail of any invoices received should be reviewed to determine when services were received or goods are obtained. Based on timing of the service and receipt of the goods, the School should record related accounts payable in the correct period. In addition, the School should designate a capable individual to review invoice detail to ensure accounts payable are being recorded properly

Response: The School concurs with the finding and will ensure accounts payable transactions are recorded in the correct period (fiscal year).