Great Hearts America – Texas

Financial and Compliance Report

June 30, 2015 and 2014

Great Hearts America – Texas

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PS&Co.

Great Hearts America – Texas

Federal Employer Identification Number: 43-1973126

Certificate of Board

We, the undersigned, certify that the attached Financial and Compliance Report of Great Hearts America – Texas was reviewed and (check one) ___X___ approved _______ disapproved for the year ended June 30, 2015 at a meeting of the governing body of the charter holder on the 30th day of September, 2015.

____
Ward Huseth, Board Secretary

____
Jay Heiler, Board President

If the governing body of the charter holder disapproved the independent auditor's report, the reason(s) for disapproving it is (are): (attach list as necessary)

PS&Co.

Padgett Stratemann

Independent Auditor's Report

To the Board of Directors
Great Hearts America – Texas
San Antonio, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of Great Hearts America – Texas (the "Organization"), which comprise the statements of financial position as of June 30, 2015 and 2014, and the related statements of activities and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*; issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of June 30, 2015 and 2014, and the changes in its net assets and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Other Supplemental Information, as listed in the table of contents, and the Schedule of Expenditures of Federal Awards, as required by the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Other Supplemental Information and Schedule of Expenditures of Federal Awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2015 on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

Padgett, Stratemann + Co., L.L.P.

San Antonio, Texas
September 30, 2015

Financial Statements

Great Hearts America – Texas

Statements of Financial Position

Exhibit A-1

June 30, 2015 and 2014

	2015	2014
Current Assets		
Cash and cash equivalents	**$ 319,056**	$ 411,883
Due from government agencies	**629,877**	75,935
Prepaid expenses	**29,508**	282,172
Unconditional promises to give – current portion	**783,000**	100,000
Other current assets	**45,111**	7,413
Total current assets	**1,806,552**	877,403
Noncurrent Assets		
Property and equipment – net	**9,005,997**	180,497
Land held for sale	**267,878**	-
Cash – restricted	**-**	1,780,000
Lease deposits	**140,640**	60,000
Loan issuance costs – net of amortization of $82,359 ($0 in 2013)	**284,854**	-
Unconditional promises to give – net	**1,680,295**	360,037
Total noncurrent assets	**11,379,664**	2,380,534
Total assets	**$ 13,186,216**	$ 3,257,937
Current Liabilities		
Accounts payable	**$ 1,084,065**	$ 60,716
Due to related party	**102,742**	-
Retainage payable	**528,988**	-
Accrued expenses	**44,530**	-
Deferred revenue	**607,371**	1,584,000
Total current liabilities	**2,367,696**	1,644,716
Long-Term Liabilities – notes payable	**8,280,222**	1,780,000
Total liabilities	**10,647,918**	3,424,716
Net Assets (Deficit)		
Unrestricted (deficit)	**1,680,789**	(166,779)
Temporarily restricted	**857,509**	-
Total net assets (deficit)	**2,538,298**	(166,779)
Total liabilities and net assets (deficit)	**$ 13,186,216**	$ 3,257,937

Notes to the financial statements form an integral part of these statements.

Great Hearts America – Texas

Statement of Activities

Exhibit A-2

Year Ended June 30, 2015

	Unrestricted	Temporarily Restricted	Total
Revenues and Other Support			
Local support:			
Contributions	$ 3,881,086	$ 500,000	$ 4,381,086
Food service	-	28,008	28,008
Other revenue	252,786	-	252,786
Total local support	4,133,872	528,008	4,661,880
State program revenues:			
Foundation School Program – State of Texas	-	3,963,412	3,963,412
Other state aid	-	14	14
Total state program revenues	-	3,963,426	3,963,426
Federal program revenues:			
PCS start-up grant	-	608,962	608,962
IDEA B cluster	-	53,125	53,125
Child Nutrition cluster	-	28,239	28,239
Total federal program revenues	-	690,326	690,326
Net assets released from restrictions – restrictions satisfied by payments	4,324,251	(4,324,251)	-
Total revenues and other support	8,458,123	857,509	9,315,632
Expenses			
11 Instructional	2,762,791	-	2,762,791
13 Curriculum development and instructional staff development	48,995	-	48,995
21 Instructional leadership	29,352	-	29,352
23 School leadership	584,535	-	584,535
31 Guidance, counseling, and evaluation services	6,208	-	6,208
33 Health services	43,739	-	43,739
35 Food services	148,594	-	148,594
36 Extracurricular activities	99,482	-	99,482
41 General administration	1,291,911	-	1,291,911
51 Plant maintenance and operations	663,448	-	663,448
53 Data processing services	149,538	-	149,538
61 Community services	54,955	-	54,955
71 Debt service	326,685	-	326,685
81 Fund Raising	400,322	-	400,322
Total expenses	6,610,555	-	6,610,555
Change in net assets	1,847,568	857,509	2,705,077
Net deficit at beginning of year	(166,779)	-	(166,779)
Net assets at end of year	$ 1,680,789	$ 857,509	$ 2,538,298

Great Hearts America – Texas

Statement of Activities

Exhibit A-2

Year Ended June 30, 2014

	Unrestricted	Temporarily Restricted	Total
Revenues and Other Support			
Local support – contributions	$ 521,287	$ 11,180	$ 532,467
Federal program revenues – PCS start-up grant	-	191,038	191,038
Net assets released from restrictions – restrictions satisfied by payments	351,233	(351,233)	-
Total revenues and other support	872,520	(149,015)	723,505
Expenses			
Support services – administrative support services	1,039,299	-	1,039,299
Total expenses	1,039,299	-	1,039,299
Change in net assets	(166,779)	(149,015)	(315,794)
Net assets at beginning of year	-	149,015	149,015
Net deficit at end of year	$ (166,779)	$ -	$ (166,779)

Great Hearts America – Texas

Statements of Cash Flows

Exhibit A-3

Years Ended June 30, 2015 and 2014

	2015	2014
Cash Flows From Operating Activities		
Change in net assets	**$ 2,705,077**	$ (315,794)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	**28,454**	9,534
Amortization of loan issuance cost	**123,975**	-
Changes in:		
Due from governmental agencies	**(553,942)**	(75,935)
Prepaid expenses	**252,664**	(281,084)
Lease deposits	**(79,840)**	(65,570)
Unconditional promises to give	**(2,003,258)**	(460,037)
Other current assets	**(38,498)**	(1,843)
Accounts payable	**205,074**	52,119
Due to related party	**102,742**	(99,726)
Accrued expenses	**44,530**	-
Deferred revenue	**(976,629)**	1,459,000
Net cash provided by (used) operating activities	**(189,651)**	220,664
Cash Flows From Investing Activities		
Purchase of property and equipment	**(7,506,691)**	(190,031)
Purchase of land held for sale	**(267,878)**	-
Net cash used in investing activities	**(7,774,569)**	(190,031)
Cash Flows From Financing Activities		
Payments on loans	**(1,780,000)**	-
Proceeds from loans	**8,280,222**	1,780,000
Loan issuance costs	**(408,829)**	-
Net cash provided by financing activities	**6,091,393**	1,780,000
Net increase (decrease) in cash and cash equivalents	**(1,872,827)**	1,810,633
Cash and cash equivalents at beginning of year	**2,191,883**	381,250
Cash and cash equivalents at end of year	**$ 319,056**	$ 2,191,883
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	**$ 202,709**	$ -
Proceeds from loan deposited in escrow	**$ 1,800,000**	$ -

Notes to the financial statements form an integral part of these statements.

1. Organization and Significant Accounting Policies

Reporting Entity, Operations, and Nature of Activities

Great Hearts America – Texas (the "Organization") is a not-for-profit 501(c)(3) corporation established in the state of Texas to operate public charter schools with open admissions policies in Texas. The Organization was originally established in 2002 for the purpose of providing education under the name of Sister Creek Center for Liberal Arts. A Restated Certificate of Formation with New Amendments was filed on February 17, 2012 to change the Organization's name to Great Hearts America – Texas and amend its purpose to develop each student's academic potential, personal character, and leadership qualities through an academically rigorous and content-rich educational program grounded in the classical liberal arts tradition and to strive to give every student the education he or she deserves and needs. The primary goal of the Organization is to graduate thoughtful leaders of character who will contribute to a more philosophical, humane, and just society. No assets were transferred in the reformation process.

The Organization is the charter holder for all Great Hearts academies operated in Texas. The Organization has a sole corporate member, Great Hearts America, an Arizona not-for-profit 501(c)(3) corporation, as permitted by the Texas Business Organizations Code. This nonprofit corporate structure is intended to maintain the integrity of the national Great Hearts academic and programmatic model, while also allowing for local input and control.

Pursuant to the bylaws of the Organization, the Board of Directors (the "Board") will be comprised of not less than three and not more than seven members. Each director will serve a one-year term or until his or her successor is appointed, and a director whose term has expired may be appointed to succeed him or herself. The Board is responsible for the adoption and implementation of policy for the Organization and for the management, operation, and accountability of the charter school in all locations. At June 30, 2015, there are four directors.

In November 2012, the Texas State Board of Education approved the Organization's first charter authorizing the opening of at least two K-12 campuses in and around San Antonio, Texas. According to the terms of the charter, the charter shall be in effect from the date of execution through July 31, 2018, unless renewed or terminated. The charter may be renewed for an additional period of ten years. Under the terms of the charter, the Organization was authorized to open and hold classes beginning with the 2013-2014 school year; however, the Organization submitted for review and approval an amendment to the charter to delay opening its first schools, Great Hearts Academy – Monte Vista (North and South campuses), by one year (i.e., to August 2014 for the 2014-2015 school year), which was granted by the Texas Education Agency ("TEA"). The Organization opened Great Hearts Academy – Monte Vista (North and South campuses) on August 18, 2014.

In June 2014, the TEA also approved an expansion amendment to the charter, allowing the Organization to open up to two additional campuses (Great Hearts Academy – Dallas and Great Hearts Academy – Irving) to serve families in those additional geographic territories effective July 1, 2015. The TEA also approved an amendment in June to increase the charter's maximum enrollment of the Organization from 1,965 to 3,930 effective July 1, 2015. In January 2015, TEA approved a non-expansion amendment for Great Hearts to open a third campus in San Antonio (Great Hearts Academy – Northern Oaks), in place of the previously approved campus Great Hearts Academy – Dallas. As a result of these amendments, the

Organization operates four campuses as of July 1, 2015: Great Hearts Academy – Monte Vista North; Great Hearts Academy – Monte Vista South; Great Hearts Academy - Northern Oaks; and Great Hearts Academy – Irving. The Organization does not conduct any other charter or noncharter activities.

Basis of Accounting
The accompanying financial statements were prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Financial Accounting Standards Board is the accepted standard setting body for establishing not-for-profit accounting and financial reporting principles. Accordingly, revenues are recognized when earned and expenses are recognized when they are incurred.

Support and revenue are reported as an increase in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (e.g., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

Basis of Presentation
Net assets and revenues, expenses, gains, and losses are classified as unrestricted, temporarily restricted, and permanently restricted based upon the following criteria.

Unrestricted Net Assets (Deficit) – Unrestricted net assets consist of net assets that are not subject to donor-imposed stipulations. Unrestricted net assets result from operating revenues, unrestricted contributions, and unrestricted dividend and interest income. Unrestricted net assets may be designated for specific purposes by action of the Board. The Organization had unrestricted net assets (deficit) of $1,680,789 and ($166,779) at June 30, 2015 and 2014, respectively.

Temporarily Restricted Net Assets – Temporarily restricted net assets consist of assets that are subject to grantor or donor-imposed stipulations that require the passage of time or the occurrence of a specified event (actions by the Organization). When the donor restriction expires, the temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. The temporarily restricted description requires the Organization to use state funding for the benefit of educating students enrolled in the Organization's schools. Compliance with this requirement allows the Organization to use these funds for any allowable school purpose to further educate its students. The Organization had $857,509 and $0 of temporarily restricted net asset at June 30, 2015 and 2014, respectively.

Permanently Restricted Net Assets – Permanently restricted net assets consist of net assets required to be maintained in perpetuity with only the income to be used for the Organization's charter school activities due to grantor donor-imposed restrictions. The Organization had no permanently restricted net assets at June 30, 2015 and 2014.

Cash and Cash Equivalents
For financial statement purposes, the Organization considers all highly liquid investment instruments with an original maturity of three months or less to be cash and cash equivalents. The Organization maintains a balance at a bank in excess of the federally insured limits. The Organization has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on cash deposits and investment holdings. At June 2015 and 2014, cash and cash equivalents, including restricted cash, are comprised of bank accounts with a balance of $319,056 and $2,191,883; respectively. Restricted cash in the prior year represented note payable proceeds restricted for the purchase of land.

Due from Government Agencies
Due from government agencies is comprised of amounts due from state and due from pass-through grants from TEA. Due from state consists of underpayments for the foundation school program made to the School from TEA.

Any of the government funding sources may, at their discretion, request reimbursement for expenses or return of funds, or both, as a result of any noncompliance with the terms of the grant or contract.

Revenue Recognition
Capitation received, including base capitation, entitlements, and special services, is recognized in the period services are provided. Revenues from TEA are earned based on reported attendance. Public and private grants received are recognized in the period received and when the terms of the grant are met.

Functional Allocation of Expenses
The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Capital Assets
Capital assets, as defined by the Organization, are assets with individual cost of more than $5,000. Such assets are recorded at cost if purchased or fair value if donated. Depreciation is calculated on the straight-line method. The useful life of buildings and equipment is 3 to 3.5 years.

Impairment of Long-Lived Assets
The Organization reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an

amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, and the effects of obsolescence, demand, competition, and other economic factors. The Organization did not recognize an impairment loss during the years ended June 30, 2015 and 2014.

Property Held for Sale
Property held for sale represents land purchased by the Organization that it is actively pursuing a buyer for as of June 30, 2015. Management expects the land will be sold within the next year.

Loan Issuance Costs
Loan issuance costs are amortized over the term of the respective financing.

Federal Income Tax
The Organization is a not-for-profit organization and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, except to the extent it has unrelated business activities. As such, no provision for federal income taxes has been made in the accompanying financial statements. At June 30, 2015 and 2014, the Organization has no material unrelated business taxable income.

The Organization's policy is to record interest and penalty expense related to income taxes as interest and other expense, respectively. At June 30, 2015 and 2014, no interest or penalties have been or are required to be accrued. The Organization, generally, is no longer subject to income tax examinations by federal authorities for the years prior to June 30, 2011.

Public Support Revenue
Contributions from donors are recorded at fair value when the Organization is in possession of or receives an unconditional promise to give. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted support based on the existence and/or nature of any donor restrictions. Support that is restricted by the donor is reported as an increase in temporarily restricted net assets in the reporting period in which the support is recognized. When a donor restriction expires, that is, when a stipulated time restriction passes or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Unconditional promises to give, including contributions and pledges that are expected to be collected within one year, are recorded at their net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows based on the fair value option.

Conditional promises to give are not included as revenues in the financial statement until such time as the conditions are met.

Donated services are recognized only if the services received either create or enhance assets or require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. No material amount of donated services was received during the years ended June 30, 2015 and 2014.

In-kind contributions of goods and services are recorded at fair market value and recognized as revenue in the accounting period in which they are received. No in-kind contributions were received during the years ended June 30, 2015 and 2014.

State and Federal Program Revenues
The Organization considers all government grants and contracts as exchange transactions rather than contributions. The Organization recognizes revenue from fee-for-service transactions as services are rendered and, for grants, as eligible expenditures are incurred. Advances from government agencies are recorded as deferred revenue. Eligible expenditures incurred in excess of grant fund reimbursements are recorded as due from pass-through grants from TEA.

Allowance for Bad Debts
Management reviews accounts receivable (e.g., due from) and promises to give on a regular basis to determine if any receivable will potentially be uncollectible. Management uses its judgment, based on the best available facts and circumstances, and records a specific reserve for each receivable to reduce the receivable to the amount that is expected to be collected. Factors such as the third-party organization's ability to meet its financial obligations and historical experience are used to determine the amount which is likely to be collected. Management includes receivable balances that are determined to be uncollectible in its overall allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. The allowance for doubtful accounts totaled $0 as of June 30, 2015 and 2014.

Prepaid Items
Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. The cost of prepaid items is recorded as an expense when consumed rather than when purchased.

Lease Deposits
The Organization paid deposits for the lease of building space. The amounts will be refunded or expensed at the end of the lease term.

Deferred Revenue
Amounts received for conditional promises to give for which the condition has not been met are recorded as deferred revenue. When the condition is met, the revenue is recognized.

Related Party Transactions
During the audit period, the Organization received donated administrative services from Great Hearts Academies ("GHA-AZ"), a fiscal sponsor of Great Hearts America. The amount of services received is minimal and, therefore, is not reflected in the financial statements. GHA-AZ is an Arizona not-for-profit 501(c)(3) corporation that manages a network of 19 academically rigorous classical liberal arts academies (serving grades K-12) in the Phoenix, Arizona metropolitan area. The Organization and GHA-AZ are considered affiliates as of June 30, 2015 and 2014, since the Board of the Organization is comprised of key management personnel of GHA-AZ and Great Hearts America.

Contingencies
Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Organization, but which will only be resolved when one or more future events occur or fail to occur. The Organization's management assesses such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Organization or unasserted claims that may result in such proceedings, the Organization's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Organization's financial statements. If the assessment indicates a potentially material loss contingency is not probable, but is reasonably possible, or is probable, but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, would be disclosed in the notes to the financial statements. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed in the notes to financial statements.

Subsequent Events
The Organization has evaluated subsequent events through September 30, 2015, the date the financial statements were available to be issued. The Organization opened Great Hearts Academy – Northern Oaks and Great Hearts Academy – Irving on August 17, 2015.

2. Fair Value Measurements and Disclosures

The requirements of *Fair Value Measurements and Disclosures* of the Accounting Standards Codification ("ASC") apply to all financial instruments and all nonfinancial assets and nonfinancial liabilities that are being measured and reported on a fair value basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Fair Value Measurements and Disclosures* also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Inputs – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

At June 30, 2015 and 2014, the Organization had no investments.

The fair value of the Organization's cash and cash equivalents, due from government agencies, prepaid expenses, and deposits approximates the carrying amounts of such instruments due to their short maturity. The fair value of the debt approximates the carrying amount because the rate and terms currently available to the Organization approximate the rate and terms on the existing debt.

3. Due from Government Agencies

Due from government agencies consists of the following:

	2015	2014
Due from state – settlement of current year underpayment	**$ 625,595**	$ -
Due from pass-through grants from TEA:		
PCS start-up grant	**-**	75,935
Child Nutrition cluster	**4,282**	-
Total due from government agencies	**$ 629,877**	$ 75,935

4. Promises to Give

On February 2, 2012, the Organization received a conditional promise to give of $1,000,000 payable in annual installments starting on January 1, 2013 through January 31, 2021. The Organization met the condition of opening a school in the San Antonio area during the fiscal year; thus, revenue discounted to the present value was recognized during the year ended June 30, 2015. The discount rate used to calculate the present value of long-term promises to give at June 30, 2015 is 2.13%.

On June 4, 2012, the Organization received a conditional promise to give of $2,000,000 payable in annual installments starting on July 1, 2013 through December 31, 2016. The Organization met the condition of opening a school in the San Antonio area during the fiscal year; thus, revenue discounted to the present value was recognized during the year ended June 30, 2015. The discount rate used to calculate the present value of long-term promises to give at June 30, 2015 is 0.64%.

On June 25, 2014, the Organization received an unconditional promise to give of $500,000 payable in five $100,000 annual installments starting on December 31, 2014 through December 31, 2018. The discount rate used to calculate the present value of long-term promises to give at June 30, 2015 is 1.68%.

On April 30, 2015, the Organization received a conditional promise to give of $500,000 payable between 2015 and 2022. The Organization met the condition by finding a match from another funder during the fiscal year; thus, revenue discounted to the present value was recognized during the year ended June 30, 2015. The discount rate used to calculate the present value of long-term promises to give at June 30, 2015 is 2.13%.

On June 10, 2015, the Organization received an unconditional promise to give of $500,000 payable in two installments over 12 months. The contribution is restricted for use to offset the costs of low-income students who qualify for Free and Reduced Lunch, including out-of-school time education programs, uniforms, school supplies, and athletic fees in the San Antonio area.

Unconditional promises to give consists of the following:

	June 30, 2015	June 30, 2014
Gross amounts due in:		
One year or less	**$ 783,000**	$ 100,000
One to five years	**1,883,015**	400,000
Total unconditional promises to give	**2,666,015**	500,000
Less discounts to net present value	**202,720**	39,963
Net unconditional promises to give	**$ 2,463,295**	$ 460,037

5. Property and Equipment

Property and equipment consist of the following:

	June 30, 2015	June 30, 2014
Equipment	**$ 127,627**	$ 92,011
Land	**2,404,878**	-
Construction in progress	**6,511,480**	98,020
	9,043,985	190,031
Less accumulated depreciation	**37,988**	9,534
Net property and equipment	**$ 9,005,997**	$ 180,497

Depreciation expense for the years ended June 30, 2015 and 2014 totaled $28,454 and $9,534, respectively.

6. Conditional Contributions

On September 5, 2014, the Organization received a conditional promise to give in the amount of $812,994. Payment is contingent upon the Organization meeting certain criteria specified by the donor. During the year, the Organization received a payment of $533,136 on this conditional promise to give; however, since the condition has not been met, this is recorded in deferred revenue. The future payment at June 30, 2015 is $278,858 and is payable within a year. The condition was satisfied in August 2015.

7. Deferred Revenues

Deferred revenues consist of the following:

	June 30, 2015	June 30, 2014
Conditional promises to give	**$ 533,136**	$ 1,584,000
After school program deposits	**74,235**	-
Total deferred revenues	**$ 607,371**	$ 1,584,000

8. Notes Payable

On June 30, 2014, the Organization entered into a note agreement in the amount of $1,780,000. The note had an interest rate of 3.75% and was scheduled to mature on October 31, 2014.

On June 30, 2014, the Organization entered into a loan commitment agreement to borrow $1,800,000. The loan had an interest rate of 6.5% and was scheduled to mature on October 31, 2014. On July 1, 2014, the lender funded the loan and deposited the loan proceeds into an escrow account for the Organization to purchase land.

The $1,780,000 and $1,800,000 notes payables described above were refinanced through the issuance of the long-term debt instruments described below.

On October 28, 2014, the Organization entered into a long-term debt instrument of up to $10,000,000 in principal. The long-term instrument bears an interest rate of 4.8% and matures on October 27, 2017.

On October 28, 2014, the Organization also entered into two subordinated notes, each with principal immediately outstanding of $1,000,000 and annual interest of 3.75%. The entire unpaid principal amount of the subordinated notes, together with all accrued unpaid interest, are payable on October 27, 2017.

	June 30, 2015	June 30, 2014
Promissory note payable to Jefferson Bank in the original maximum amount of $10,000,000, including interest at 4.8%; due October 2017; collateralized by property	**$ 6,280,222**	$ -
Term note payable to Charter School Growth Fund in the original amount of $1,000,000, including interest at 3.75%; due October 2017; collateralized by property	**1,000,000**	-
Term note payable to Ewing Halsell Foundation in the original amount of $1,000,000, including interest at 3.75%; due October 2017; collateralized by property	**1,000,000**	-
Term note payable to Charter School Growth Fund in the original amount of $1,780,000, including interest at 3.75%; due October 2014; collateralized by property	**-**	1,780,000
	$ 8,280,222	$ 1,780,000

Aggregate maturities required at June 30, 2015 were as follows:

Year ending June 30,	
2016	$ -
2017	-
2018	8,280,222
	$ 8,280,222

Interest expense totaled $202,709 and $0 for the years ended June 30, 2015 and 2014, respectively.

9. Leases

The Organization leases building space pursuant to noncancellable operating lease agreements expiring through 2025. Future minimum lease payments under noncancellable operating leases as of June 30, 2015 were as follows:

Year ending June 30,	
2016	$ 744,156
2017	884,807
2018	949,433
2019	1,026,770
2020	712,385
Thereafter	3,860,123
Future minimum lease payments	**$ 8,177,674**

Rent expense totaled $419,109 for the year ended June 30, 2015 ($21,430 in 2014).

10. Commitments and Contingencies

The Organization receives a portion of its funding from federal and state programs that are governed by various rules and regulations of the grantors. The ultimate determination of amounts received under these programs is generally based upon allowable costs reported to the government. Until such audits have been completed and final settlement reached, there exists a contingency to refund any amount received in excess of allowable costs. Management is of the opinion that no material liability will result from such audits.

During the year ended June 30, 2015, the Organization entered into contracts to perform construction on new schools. At June 30, 2015, the commitment balance and retainage payable totaled $1,779,890 and $528,988, respectively. There were no construction commitments or retainage payable at June 30, 2014.

11. Temporarily Restricted Net Assets

Temporarily restricted net assets consists of assets that are subject to grantor or donor-imposed stipulations that require the passage of time or the occurrence of a specified event.

	June 30,	
	2015	2014
Foundation School Program – State of Texas	**$ 357,509**	$ -
Donor restricted contributions	**500,000**	-
	$ 857,509	$ -

Net assets are released from donor restriction by incurring expenses satisfying the purpose or time restrictions specified by donors.

	June 30,	
	2015	2014
Foundation School Program – State of Texas	**$ 3,605,903**	$ -
Other state aid	**14**	-
Public Charter School ("PCS") start-up grant	**608,962**	-
IDEA B cluster	**53,125**	-
Child Nutrition cluster	**56,247**	-
Other grants	**-**	351,233
	$ 4,324,251	$ 351,233

12. Employee Benefit Plan

401(k) Plan – The Organization had a 401(k) employees' profit sharing plan for the benefit of substantially all employees. The Organization's contributions to the plan were at the discretion of the Board. The Organization's contributions for the years ended June 30, 2015 and 2014 totaled approximately $0 and $4,760, respectively. Effective July 1, 2014, the Organization no longer offered the 401(k) employees' profit sharing plan since it switched to the Teacher Retirement System of Texas ("TRS") as described below.

Pension Plan Obligations

Plan Description – On July 1, 2014, the Organization began contributing to the TRS, a public employee retirement system. TRS is a cost-sharing, multiple-employer defined benefit pension plan with one exception: all risks and costs are not shared by the Organization, but are the liability of the state of Texas. TRS provides service retirement, disability retirement, and death benefits to plan members and beneficiaries. TRS operates under the authority of provisions contained primarily in Texas Government Code, Title 8, *Public Retirement Systems,* Subtitle C, *Teacher Retirement System of Texas,* which is subject to amendment by the Texas legislature. TRS issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit plan. The report may be obtained by writing the Teacher Retirement System of Texas at 1000 Red River, Austin, Texas 78701-2698 or by calling (800) 877-0123 or by downloading the report from the TRS internet website, www.trs.state.tx.us, under TRS Publications.

Funding Policy – Under provisions in Texas state law, plan members are required to contribute 6.7% of their annual covered salary, and the state of Texas contributes an amount equal to 6.8% of the Organization's covered payroll. Contribution requirements are not actuarially determined, but are established and amended by the Texas state legislature. The state funding policy is as follows: (1) The state constitution requires the legislature to establish a member contribution rate of not less than 6.0% of the members' annual compensation and a state contribution rate of not less than 6.0% and not more than 10.0% of the aggregate annual compensation of all members of the system; (2) a state statute prohibits benefit improvements or contribution reductions if, as a result of a particular action, the time required to amortize TRS's unfunded actuarial liabilities would be increased to a period that exceeds 31 years, or if the amortization period already exceeds 31 years, the period would be increased by such action. The Organization's employees' contributions to TRS for the year ended June 30, 2015 totaled $266,760 equal to the required contributions for each year ($0 in 2014).

13. Health Insurance

During the year ended June 30, 2015, employees of the Organization were covered by a health insurance plan. The Organization contributes $283-$857 per month depending on the employees' health insurance plan rate. Employees, at their option, authorized payroll withholdings to pay contributions or premiums for dependents. All premiums were paid to licensed insurers.

14. Economic Dependency

During the year ended June 30, 2015, the Organization received approximately 87% of its contributions from three revenue sources (90% from two donors in 2014). With schools operational, the Organization earns the majority of its funding from various federal, state, and local entities. Changes in state funding levels for charter schools in Texas could have a significant impact on the Organization's future revenues.

15. State Compliance Matters

Budgetary Matters

In accordance with the TEA Special Supplement to the Financial Accountability System Resource Guide Charter Schools, if the original and final budgeted amounts vary by more than 10% of the original budgeted amounts, a written statement discussing the causes of the variances is required.

Fiscal year 2015 represents the first full instructional year for the Organization. The first campuses, Monte Vista North and South, opened in August 2014. The original budget presented to the Board was developed at the broadest level of expense categories. As the year progressed and the Organization began processing expenditures in accordance with the TEA guidelines, it became apparent that a budget amendment was necessary to shift budget amounts to the various categories. The Board approved one budget amendment in November 2014 and an additional amendment in June 2015. These amendments were necessary to more accurately reflect the budget and actual expense transactions in accordance with the Texas requirements.

The final budgeted amounts varied by more than 10% of the original budgeted amounts as follows:

- Federal program revenue decreased by $205,385 as a result of Public Charter School funds being made available earlier than anticipated with revenues being recognized in the previous year.

- Function 13 – decrease of $33,113 for personnel cost being classified incorrectly in the original budget.

- Function 21 – $29,249 for reclassification of personnel costs not originally classified as such in the original budget.

- Function 23 – $108,114 for personnel cost associated with the headmaster position originally included in Function 11, instructional budget.

- Function 31 – $7,800 for personnel cost associated with the counselor position originally included in Function 11, instructional budget.

- Function 33 – decrease of $28,000 due to position not being filled until later in the year and the incumbent in the position not participating in the school's benefit program.

- Function 35 – decrease of $51,759 due to less than predicted participation in the school lunch program throughout the second half of the school year.

- Function 36 – $35,000 for personnel cost associated with a portion of the athletic coach position originally included in Function 11, instructional budget.

- Function 41 – decrease of $339,499 due to personnel and operational costs, which should have been budgeted to functions 61, community service and 81, fund raising, originally budgeted to general administration.

- Function 53 – $110,562 of data processing costs originally included in Function 11, instructional budget.

- Function 61 – $50,000 of personnel and operating costs that were originally budgeted to Function 41, general administration.

- Function 71 – $119,297 for interest expense associated with building of new campus.

- Function 81 – $322,999 of personnel and operating costs which were originally budgeted to function 41 (general administration).

In accordance with the TEA Special Supplement to the Financial Accountability System Resource Guide Charter Schools, variances between the final budgeted amounts and the actual amounts that exceed 10% of the final budget amount also require a written statement discussing the cause of the variance.

The actual expenses varied by more than 10% from the final amended budget as follows:

- Local Revenue Sources – Actual revenue includes the recognition of previously deferred revenue tied to conditional pledges received. Conditions were satisfied with the opening of the Monte Vista campuses in August 2014 and previously deferred revenue was recognized in the current fiscal year.

- Function 13 – $6,116 less than budget due to training that was held in June 2014. The expense was budgeted for 2015, but actually occurred in 2014.

- Function 31 – $1,592 less than budget due to the personnel cost for the part-time position which was filled later than expected in the year.

- Function 53 – exceeded by $38,976 due to costs associated with the cabling of the Monte Vista campuses (North and South) to support the math curriculum. Amount was not included in the final budget amendment.

- Function 71 – exceeded by $207,388 due to interest costs associated with the building of the Northern Oaks campus.

Other Supplemental Information

Great Hearts America – Texas

Schedule of Expenses

Years Ended June 30, 2015 and 2014

		2015	2014
Expenses			
6100	Payroll costs	**$ 3,450,563**	$ *
6200	Professional and contracted services	**1,194,703**	*
6300	Supplies and materials	**1,063,376**	*
6400	Other operating costs	**575,229**	*
6500	Debt service costs	**326,684**	*
	Total expenses	**$ 6,610,555**	$ *

*The Organization did not have school operations in 2014.

Great Hearts America – Texas

Schedule of Capital Assets

Year Ended June 30, 2015

		Ownership Interest		
Asset Classification		Local	State	Federal
Property and Equipment				
1510	Land and improvements	**$ 2,404,878**	**$ -**	**$ -**
1520	Building and improvements	**3,300**	**-**	**-**
1539	Equipment	**112,071**	**-**	**12,256**
1580	Construction in progress	**6,511,480**	**-**	**-**
		$ 9,031,729	**$ -**	**$ 12,256**

Great Hearts America – Texas

Budgetary Comparison Schedule

Year Ended June 30, 2015

		Original	Final	Actual	Positive (Negative)
	Revenues and Other Support				
5700	Local support	$ 3,589,939	$ 3,290,000	$ 4,661,880	$ 1,371,880
5800	State program revenues	3,814,294	3,998,344	3,963,426	(34,918)
5900	Federal program revenues	889,697	684,312	690,326	6,014
	Total revenues and other support	8,293,930	7,972,656	9,315,632	1,342,976
	Expenses				
11	Instructional	3,095,332	2,848,524	2,762,791	85,733
13	Curriculum development and instructional staff development	88,224	55,111	48,995	6,116
21	Instructional leadership	-	29,249	29,352	(103)
23	School Leadership	447,854	555,968	584,535	(28,567)
31	Guidance, counseling, and evaluation services	-	7,800	6,208	1,592
33	Health services	70,407	42,407	43,739	(1,332)
35	Food services	196,759	145,000	148,594	(3,594)
36	Extracurricular activities	71,700	106,700	99,482	7,218
41	General administration	1,585,210	1,245,711	1,291,911	(46,200)
51	Plant maintenance and operations	730,106	677,543	663,448	14,095
53	Data processing services	-	110,562	149,538	(38,976)
61	Community services	-	50,000	54,955	(4,955)
71	Debt service	-	119,297	326,685	(207,388)
81	Fund Raising	54,192	377,191	400,322	(23,131)
	Total expenses	6,339,784	6,371,063	6,610,555	(239,492)
	Change in net assets	1,954,146	1,601,593	2,705,077	1,103,484
	Net deficit at beginning of year	(166,779)	(166,779)	(166,779)	-
	Net assets at end of year	$ 1,787,367	$ 1,434,814	$ 2,538,298	$ 1,103,484

Compliance Section

PS&Co.

Padgett Stratemann

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

To the Board of Directors
Great Hearts America – Texas
San Antonio, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Great Hearts America – Texas (the "Organization") which comprise the statement of financial position as of June 30, 2015, the related statements of activities and cash flows for the year then ended, and the related notes to financial statements, and have issued our report thereon dated September 30, 2015.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control described in the accompanying Schedule of Findings and Questioned Costs as item 2015-001 that we consider to be a significant deficiency.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and described in the accompanying Schedule of Findings and Questioned Costs as item 2015-002.

The Organization's Response to Findings

The Organization's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs and Corrective Action Plan. The Organization's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

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

Padgett, Stratemann + Co., L.L.P.

San Antonio, Texas
September 30, 2015

PS&Co.

Padgett Stratemann

Independent Auditor's Report on Compliance for its Major Federal Program and Report on Internal Control Over Compliance as Required by OMB Circular A-133

To the Board of Directors
Great Hearts America – Texas
San Antonio, Texas

Report on Compliance for its Major Federal Program

We have audited Great Hearts America – Texas (the "Organization") compliance with the types of compliance requirements described in *OMB Compliance Supplement* that could have a direct and material effect on the Organization's major federal program for the year ended June 30, 2015. The Organization's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to its federal program.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Organization's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Organization's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for its major federal program. However, our audit does not provide a legal determination of the Organization's compliance.

Opinion on its Major Federal Program

In our opinion, the Organization complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2015.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2015-003 and 2015-004. Our opinion on its major federal program is not modified with respect to these matters.

The Organization's responses to the noncompliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs and Corrective Action Plan. The Organization's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the Organization is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Organization's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for its major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected and corrected on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. We identified deficiencies in internal control over compliance, which are described in the accompanying Schedule of Findings and Questioned Costs as item 2015-003 and 2015-004, that we consider to be significant deficiencies.

The Organization's responses to the internal control over compliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs and Corrective Action plan. The Organization's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Padgett, Stratemann & Co., L.L.P.

San Antonio, Texas
September 30, 2015

Great Hearts America – Texas

Schedule of Findings and Questioned Costs

Year Ended June 30, 2015

I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unmodified	
Internal control over financial reporting:		
Material weakness(es) identified?	____ Yes	X No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	X Yes	____ None Reported
Noncompliance material to financial statements noted?	____ Yes	X No

Federal Awards

Internal control over major programs:		
Type of auditor's report issued on compliance for major programs:	Unmodified	
Material weakness(es) identified?	____ Yes	X No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	X Yes	____ None Reported
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133	X Yes	____ No

Identification of major programs:

CFDA Number	Name of Federal Program
84.282A	Public Charter Schools Program

Dollar threshold used to distinguish between type A and type B programs:	$300,000	
Auditee qualified as low-risk auditee?	____ Yes	X No

II – Financial Statement Findings
Finding 2015-001 – Construction Payables
Type of Finding: Significant Deficiency

Criteria: During the year, the Organization entered into construction contracts for the construction of the Northern Oaks campus. In accordance with the construction contract, the Organization is required to withhold 10% of each invoice as retainage until the project is completed.

Context: During testing of construction in progress pay applications and review of the general ledger, it was noted that retainage withheld was not recorded during the year. In addition, the year-end pay application was not accrued.

Condition: At June 30, 2015, the Organization did not record the retainage payable of approximately $529,000 and did not record the June construction invoices of approximately $818,000.

Cause and Effect: Lack of year-end accrual of construction pay applications and retainage leads to material understatement of liabilities.

Recommendation: We recommend the Organization develop a process to record the retainage payable for each invoice received and perform a thorough review of the construction invoices at fiscal year-end to ensure the construction liability is properly recorded.

Views of Responsible Officials: See Corrective Action Plan.

Finding 2015-002 – Local Procurement Policies and Procedures
Type of Finding: Compliance

Criteria: The TEA Special Supplement to the Financial Accountability System Resource Guide Charter School Update 5.0 requires charter schools to adopt local policies addressing competitive procurement and that purchases are made using a process that provides the best value for the charter school in accordance with the Texas Education Code ("TEC") 44.031-44.901.

Condition: The Organization's current policies do not address competitive procurement in accordance with the criteria described above.

Context: The condition noted is based on inquiry of management and review of the Organization's policies.

Cause and Effect: Fiscal year 2015 is the Organization's first year of Texas charter school operations, and as a result, the Organization did not comply with the criteria described above.

Recommendation: We recommend the Organization revise the financial policies and procedures to ensure compliance with the criteria described above.

Views of Responsible Officials: See Corrective Action Plan.

III – Federal Awards Findings and Questioned Costs

Finding 2015-003 – Procurement and Suspension and Debarment
Federal Program: 2013-2014 PCS Start-Up Grants
CFDA Number: 84.292A
Pass-Through Entity Identification Number: 590013
Passed Through the State Department of Education
Type of Finding: Noncompliance/Significant Deficiency

Criteria:
Procurement – 2 CFR Section 215.46 requires procurement records and files for purchases in excess of the small purchase threshold ($25,000) to include the following at a minimum: (a) basis for contractor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price.

Suspension and Debarment – When a non-federal entity enters into a covered transaction with an entity at a lower tier, the non-federal entity must verify that the lower tier entity is not suspended or debarred or otherwise excluded from federal contracts.

Condition: The Organization did not fully follow the procurement guidelines and also did not check for suspension and debarment for three vendors paid $522,674 with the PCS start-up grant funds. However, the vendors used were not suspended or debarred.

Questioned Costs: None.

Context: There were three vendors that required procurement and suspension and debarment.

Cause and Effect: The Organization started its first year of Texas charter school operations in 2015 and the purchasing policies and procedures are still being finalized to ensure compliance with federal guidelines.

Recommendation: We recommend the Organization amend its current policies and procedures to include controls and procedures over federally purchased items to ensure such expenditures are adequately documented and in compliance with the criteria described above.

Views of Responsible Officials: See Corrective Action Plan.

Finding 2015-004 – Cash Management and Financial Reporting

Federal Program: 2013-2014 PCS Start-Up Grants
CFDA Number: 84.292A
Pass-Through Entity Identification Number: 590013
Passed Through the State Department of Education
Type of Finding: Noncompliance/Significant Deficiency

Criteria: When awards provide for advance payments, recipients must follow procedures to minimize the time elapsing between the transfer of funds from grantor and disbursement. The TEA General and Fiscal Guidelines, revised December 2014, includes the cash management requirements for grants passed through the state department of education. In accordance with these guidelines, grantees should not have more cash on hand than is necessary to meet three days' cash needs. Therefore, grantees should request only that amount that will be paid out within three business days once the payment is received from TEA. Any funds that are not paid out within three business days of receipt of funds are considered an advance of funds and must be returned to TEA immediately as a refund. If a grantee draws excess cash and keeps cash on hand for more than three days, the grantee may be required to return the federal government any interest earned on payments drawn down. In accordance with the requirements of 34 CFR 80.21(i), for each grant award, the grantee may retain up to $100 annually in interest earned to pay the cost of maintaining the interest-bearing account.

Condition: During the year, the Organization requested advance funds from TEA and did not make the disbursement of funds within three days.

Questioned Costs: None reportable. The projected questioned cost using the federal funds rate was under $10,000.

Context: The time between receipt of funds and disbursement ranged from 5 to 20 days. The Organization did not deposit the advanced funds in an interest bearing account, therefore, no interest was earned.

Cause and Effect: Due to lack of procedures and controls over cash management, including supervisory review of the request for funds, advance funds were requested from TEA and not disbursed within three business days.

Recommendation: We recommend the Organization implement control procedures segregating the duties of preparing, submitting, and certifying the request for funds from TEA. In addition, the Organization should implement procedures that monitor the receipts of funds and subsequent disbursement in accordance with the criteria described above.

Views of Responsible Officials: See Corrective Action Plan.

Finding 2015-001 – Construction Payables

Views of Responsible Officials and Planned Corrective Action: Management agrees with the finding. The Organization has begun formalized month-end closing procedures which include month-end closing entries such as retainage payable. In addition, the Organization is in the process of developing a year-end checklist including a review/reconciliation of all statement of financial position accounts to ensure that no over/under statement of assets or liabilities occurs.

Responsible Person: Deborah Zimmerman

Implementation Date: Immediately

Finding 2015-002 – Local Procurement Policies and Procedures

Views of Responsible Officials and Planned Corrective Action: The Organization will review all financial policies and procedures to ensure compliance with the Texas Education Code as outlined in the TEA Special Supplement to the Financial Accountability System Resource Guide. The review and implementation of revised financial policies and procedures will be completed by November 15, 2015.

Responsible Person: Deborah Zimmerman

Implementation Date: November 15, 2015

Finding 2015-003 – Procurement and Suspension and Debarment

Views of Responsible Officials and Planned Corrective Action: The Organization is currently reviewing all purchasing and procurement policies and procedures to ensure compliance with federal and state guidelines. The review and implementation of revised financial policies and procedures will be completed by November 15, 2015.

Responsible Person: Deborah Zimmerman

Implementation Date: November 15, 2015

Finding 2015-004 – Cash Management and Financial Reporting

Views of Responsible Officials and Planned Corrective Action: At the time of the payments cited in this finding, the Organization had contracted with a third party for processing of payments to vendors, regardless of the source of funding. The Organization drew down funds for those expenditures which had been submitted for payment to the third party for processing; however, the processing by the third party was not completed in a timely manner. Since April 2015, the Organization has taken over processing of all expenditure payments. For all future grant funding, additional processes have been put into place whereby drawdowns of the funds will only occur on a monthly basis and at no time until the final submission will the entire amount available for disbursement be drawn. Only amounts which have been expensed by the Organization will be requested for reimbursement.

Responsible Person: Deborah Zimmerman

Implementation Date: Immediately

Great Hearts America – Texas

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2015

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number		Federal Expenditures
United States Department of Agriculture:				
Passed Through the State Department of Education:				
National School Breakfast Program	10.553	71401501	$	7,559
National School Lunch Program	10.555	71301501		20,680
Total Passed Through the State Department of Education				28,239
Total United States Department of Agriculture				28,239
United States Department of Education:				
Passed Through the State Department of Education:				
Public Charter Schools Program	84.282A	135900017110003		608,962
IDEA B-Formula	84.027A	156600010158356000		50,895
IDEA B-Preschool	84.173A	156610010158356000		2,230
Total Passed Through the State Department of Education				662,087
Total United States Department of Education				662,087
Total Expenditures of Federal Awards			**$**	**690,326**

1. The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal grant activity of Great Hearts of America – Texas (the "Organization") under programs of the federal government for the year ended June 30, 2015. The information in this Schedule is presented in accordance with the requirements of the Office of Management and Budget ("OMB") Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the Organization, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Organization.

2. Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the costs principles contained in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

3. For all federal programs, the Organization used the net asset classes and codes specified by TEA in the Special Supplement to Financial Accounting and Reporting, Non-Profit Charter School Chart of Accounts. Temporarily restricted net asset codes are used to account for resources restricted to or designated for specific purposes by the grantor. Federal and state financial assistance is generally accounted for in temporarily restricted net asset codes.