Great Hearts America—Texas

Financial and Compliance Report
June 30, 2017

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Contents

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) ✓ approved ______ disapproved for the year ended June 30, 2017 at a meeting of the governing body of the charter holder on the 1 day of November, 2017.

Michael J. Burke
Board Secretary

James J. 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)

Independent Auditor's Report

To the Board of Directors
Great Hearts America—Texas

Report on the Financial Statements
We have audited the accompanying financial statements of Great Hearts America—Texas (the Organization), which comprise the statement of financial position as of June 30, 2017, the related statements of activities and changes in net assets and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*; issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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, 2017, and the changes in its net assets and cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter—2016 Financial Statements

The financial statements of Great Hearts America—Texas as of and for the year ended June 30, 2016, were audited by other auditors, whose report dated October 25, 2016, expressed an unmodified opinion on those statements.

Other Matter—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, is presented for purposes of additional analysis and is 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 is 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 November 10, 2017, 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.

RSM US LLP

San Antonio, Texas
November 10, 2017

Financial Statements

Great Hearts America—Texas

Exhibit A-1 Statements of Financial Position
June 30, 2017 and 2016

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	**$ 3,140,801**	$ 2,087,584
Due from government agencies	**3,234,470**	2,686,712
Unconditional promises to give—current portion	**1,378,975**	1,796,452
Prepaid expenses	**530,934**	319,264
Other current assets	**2,987**	5,894
Total current assets	**8,288,167**	6,895,906
Noncurrent assets:		
Property and equipment, net	**19,972,821**	11,459,808
Land held for sale	**-**	267,878
Lease deposits	**145,410**	140,640
Unconditional promises to give, net	**2,072,778**	844,927
Total noncurrent assets	**22,191,009**	12,713,253
Total assets	**$ 30,479,176**	$ 19,609,159
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	**$ 281,173**	$ 382,837
Retainage payable	**406,515**	7,710
Accrued expenses	**1,035,687**	560,616
Due to related party	**94,178**	180,055
Deferred revenue	**22,678**	104,612
Total current liabilities	**1,840,231**	1,235,830
Long-term liabilities—notes payable, net	**18,200,890**	12,039,424
Total liabilities	**20,041,121**	13,275,254
Net assets:		
Unrestricted	**235,289**	1,721,027
Temporarily restricted	**10,202,766**	4,612,878
Total net assets	**10,438,055**	6,333,905
Total liabilities and net assets	**$ 30,479,176**	$ 19,609,159

See notes to financial statements.

Great Hearts America—Texas

Exhibit A-2 Statements of Activities and Changes in Net Assets
Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Total
Revenues and other support:			
Local support:			
Contributions	$ 1,290,714	$ 3,512,600	$ 4,803,314
Food service	-	182,202	182,202
Other revenue	1,235,871	-	1,235,871
Total local support	2,526,585	3,694,802	6,221,387
State program revenues:			
Foundation School Program—State of Texas	-	16,273,129	16,273,129
Other state aid	-	755,555	755,555
Total state program revenues	-	17,028,684	17,028,684
Federal program revenues:			
Title I, Part A—Improving Basic Programs	-	48,001	48,001
IDEA B Formula	-	348,919	348,919
Title II, Part A—Teacher and Principal Training and Recruiting	-	35,230	35,230
Title III, Part A—English Language Acquisition and Language Enhancement	-	5,808	5,808
Child Nutrition cluster	-	87,933	87,933
Total federal program revenues	-	525,891	525,891
Net assets released from restrictions—satisfied by payments	15,659,489	(15,659,489)	-
Total revenues and other support	18,186,074	5,589,888	23,775,962
Expenses:			
Instructional	9,144,124	-	9,144,124
Curriculum development and instructional staff development	78,150	-	78,150
School leadership	1,492,119	-	1,492,119
Guidance, counseling and evaluation services	46,848	-	46,848
Health services	166,913	-	166,913
Food services	360,063	-	360,063
Extracurricular activities	315,185	-	315,185
General administration	2,582,498	-	2,582,498
Plant maintenance and operations	2,909,269	-	2,909,269
Security and monitoring services	32,734	-	32,734
Data processing services	354,329	-	354,329
Community services	291,991	-	291,991
Debt service	766,279	-	766,279
Fundraising	1,131,310	-	1,131,310
Total expenses	19,671,812	-	19,671,812
Change in net assets	(1,485,738)	5,589,888	4,104,150
Net assets at beginning of year	1,721,027	4,612,878	6,333,905
Net assets at end of year	$ 235,289	$ 10,202,766	$ 10,438,055

See notes to financial statements.

Great Hearts America—Texas

Exhibit A-2 Statements of Activities and Changes in Net Assets
Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Total
Revenues and other support:			
Local support:			
Contributions	$ 2,812,576	$ 1,050,000	$ 3,862,576
Food service	-	208,056	208,056
Other revenue	926,781	-	926,781
Total local support	3,739,357	1,258,056	4,997,413
State program revenues:			
Foundation School Program—State of Texas	-	14,796,891	14,796,891
Other state aid	-	289,985	289,985
Total state program revenues	-	15,086,876	15,086,876
Federal program revenues:			
Title I, Part A—Improving Basic Programs	-	12,938	12,938
IDEA B Formula	-	107,418	107,418
Title II, Part A—Teacher and Principal Training and Recruiting	-	41,588	41,588
Child Nutrition cluster	-	123,267	123,267
Total federal program revenues	-	285,211	285,211
Net assets released from restrictions—satisfied by payments	12,874,774	(12,874,774)	-
Total revenues and other support	16,614,131	3,755,369	20,369,500
Expenses:			
Instructional	8,285,584	-	8,285,584
Curriculum development and instructional staff development	14,240	-	14,240
School leadership	1,146,428	-	1,146,428
Guidance, counseling and evaluation services	50,760	-	50,760
Health services	165,648	-	165,648
Food services	414,010	-	414,010
Extracurricular activities	280,646	-	280,646
General administration	1,979,141	-	1,979,141
Plant maintenance and operations	2,237,988	-	2,237,988
Data processing services	279,580	-	279,580
Community services	258,861	-	258,861
Debt service	826,975	-	826,975
Fundraising	634,032	-	634,032
Total expenses	16,573,893	-	16,573,893
Change in net assets	40,238	3,755,369	3,795,607
Net assets at beginning of year	1,680,789	857,509	2,538,298
Net assets at end of year	$ 1,721,027	$ 4,612,878	$ 6,333,905

See notes to financial statements.

Great Hearts America—Texas

Exhibit A-3 Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Change in net assets	**$ 4,104,150**	$ 3,795,607
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	**301,212**	270,907
Gain on sale of land	**(109,521)**	-
Amortization of loan issuance cost	**93,031**	284,854
Changes in:		
Due from governmental agencies	**(547,758)**	(2,056,835)
Prepaid expenses	**(211,670)**	(289,756)
Lease deposits	**(4,770)**	-
Unconditional promises to give	**(810,374)**	(178,084)
Other current assets	**2,907**	39,217
Accounts payable and retainage payable	**(109,374)**	(1,222,506)
Due to related party	**(85,877)**	77,313
Accrued expenses	**(467,742)**	516,086
Deferred revenue	**(81,934)**	(502,759)
Net cash provided by operating activities	**2,072,280**	734,044
Cash flows from investing activities:		
Purchase of property and equipment	**(7,464,897)**	(2,724,718)
Proceeds from sale of land	**377,399**	-
Net cash used in investing activities	**(7,087,498)**	(2,724,718)
Cash flows from financing activities:		
Proceeds from loans and notes payable	**6,068,435**	4,248,695
Loan issuance costs	**-**	(489,493)
Net cash provided by financing activities	**6,068,435**	3,759,202
Net increase in cash and cash equivalents	**1,053,217**	1,768,528
Cash and cash equivalents at beginning of year	**2,087,584**	319,056
Cash and cash equivalents at end of year	**$ 3,140,801**	$ 2,087,584
Supplemental disclosures of cash flow information:		
Cash paid for interest	**$ 752,147**	$ 617,748
Loans paid off through refinance	**$ -**	$ 11,944,930

See notes to financial statements.

Note 1. Organization and Significant Accounting Policies

Organization: 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 wholly-owned subsidiary of Great Hearts America, an Arizona not-for-profit 501(c)(3) corporation, as Great Hearts America is the sole corporate member of the Organization. This nonprofit corporate structure is intended to maintain the integrity of the national Great Hearts America academic and programmatic model, while also allowing for local input and control. The Organization is the charter holder for all campuses operated in Texas.

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, 2017 and 2016, there are six directors.

In November 2012, the Texas State Board of Education (State Board) 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 10 years, the renewal process will start during the 4th quarter of calendar year 2017. The Organization opened Great Hearts Academy—Monte Vista (North and South campuses) on August 18, 2014.

In June 2014, the State Board 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 State Board 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, the State Board approved a nonexpansion amendment for the Organization 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, 2016: Great Hearts Academy—Monte Vista North, Great Hearts Academy—Monte Vista South, Great Hearts Academy—Northern Oaks and Great Hearts Academy—Irving. During the 2016-2017 fiscal year, the Organization requested three expansion amendments to increase enrollment from 3,930 to 5,600 students, add a Great Hearts San Antonio campus and add a Great Hearts Irving campus. The Texas Education Agency (TEA) granted approval of the requests with an effective date of July 1, 2018. The Organization does not conduct any other charter or noncharter activities.

Note 1. Organization and Significant Accounting Policies (Continued)

Basis of presentation: The financial statements of the Organization have been prepared on the accrual basis of accounting applicable to nonprofit organizations in accordance with the accounting principles generally accepted in the United States of America (U.S. GAAP).

The Financial Accounting Standards Board (FASB) is the accepted standard setting body for establishing nonprofit accounting and financial reporting principles.

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

Revenues and other support 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, as applicable, 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 (i.e., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reclassified to unrestricted net assets and reported as net assets released from restrictions.

Unrestricted: 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.

Temporarily restricted: 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 statements of activities and changes in net assets 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.

Permanently restricted: 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, 2017 and 2016.

Cash and cash equivalents: For financial statement purposes, the Organization considers all highly liquid investment with an original maturity of three months or less to be cash and cash equivalents.

Due from government agencies: Due from government agencies is comprised of amounts due from state and pass-through grants from the TEA. Due from state consists of underpayments for the foundation school program made to the Organization from TEA. Eligible expenditures incurred in excess of grant fund reimbursements are recorded as due from pass-through grants 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. The Organization has never experienced any losses due to nonpayment, none are expected and, therefore, an allowance for doubtful accounts has not been established.

Allowance for doubtful accounts: Management reviews accounts receivable (i.e., due from) and promises to give on a regular basis to determine if any receivable will potentially be uncollectible.

Note 1. Organization and Significant Accounting Policies (Continued)

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 that is likely to be collected. Management includes receivable balances that are determined to be uncollectible in the 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, 2017 and 2016.

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.

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 based on the following estimated useful lives of the respective assets. Construction in progress will be depreciated when placed into service.

Asset Classification	Estimated Useful Lives
Building and improvements	40 years
Furniture and equipment	3-10 years
Computers and software	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, 2017 and 2016.

Land held for sale: Land held for sale represents land purchased by the Organization; the land was sold in July 2016.

Capitalized interest: Interest expense during the construction period is capitalized as part of the cost of property and equipment. Capitalized interest for the years ended June 30, 2017 and 2016, totaled $81,398 and $-0-, respectively.

Lease deposits: The Organization paid deposits upon execution of several lease agreements for building space. The amounts will be refunded or expensed at the end of the lease term.

Loan issuance costs: Loan issuance costs are amortized over the term of the respective financing agreements and the unamortized balance is presented as a direct deduction of the debt liability.

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 will be recognized.

Note 1. Organization and Significant Accounting Policies (Continued)

Revenue recognition: Capitation received, including base capitation, entitlements and special services, is recognized in the period services are provided and eligibility requirements are met. 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.

The Organization reports all its state funding and federal awards as restricted support. When these restrictions are fulfilled, that is, when the stipulated time restriction ends or purpose restriction (i.e., eligible expenditures are incurred) is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions.

Local 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 statements of activities and changes in net assets 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 statements 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, 2017 and 2016.

In-kind contributions of goods and services are recorded at fair 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, 2017 and 2016.

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.

Regulated industry: The majority of the Organization's activities and revenues are a result of contracts with TEA. The Organization operations are concentrated in the education field. As such, the Organization is subject to administrative directives, rules and regulations of federal, state and local regulatory agencies, including, but not limited to, TEA. Such administrative directives, rules and regulations are subject to change by an act of Congress or act of the state legislature, or an administrative change mandated by TEA. Funding may be changed or decreased as a result of the above legislative or administrative changes.

Note 1. Organization and Significant Accounting Policies (Continued)

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. Uncertain tax provisions, if any, are recorded in accordance with accounting guidance for income taxes, which requires the recognition of a liability for tax provisions taken that do not meet the more-likely-than-not standard that the position will be sustained upon examination by the taxing authorities. There is no liability for uncertain tax positions recorded at June 30, 2017 and 2016.

The Organization's policy is to record interest and penalty expense related to income taxes as interest and other expense, respectively. At June 30, 2017 and 2016, no interest or penalties have been or are required to be accrued.

Use of estimates: The preparation of financial statements in conformity with U.S. 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.

Functional allocation of expenses: The costs of providing various programs and activities have been summarized on a functional basis in the statements of activities and changes in net assets. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

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.

Adopted accounting pronouncement:

Debt issuance costs: In April, 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-02, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The Organization has adopted this accounting pronouncement effective July 1, 2016. Debt issuance cost were reclassified from other assets to long-term liabilities on the statement of financial position.

Note 1. Organization and Significant Accounting Policies (Continued)

Recent accounting pronouncements:

Presentation of financial statements: In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance amends the requirements for financial statements and notes presented by a not-for-profit entity to: (a) present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes; (b) present on the face of the statement of activities and changes in net assets the amount of the change in either of the two classes of net assets rather than that of the currently required three classes; (c) provide enhanced disclosures in the notes to the financial statements; (d) report investment return net of external and direct internal investment expenses and (e) utilize, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset. The ASU will be effective for the Organization for the year ending June 30, 2019. Early application is permitted. Retrospective application is required for many provisions of this guidance.

Leases: In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months, regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases.

Revenue: In May 2014, the FASB issued ASU No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2018.

The Organization has not yet selected a transition method for the recent accounting pronouncements above and is currently evaluating the effect these standards will have on its financial statements.

Subsequent events: The Organization has evaluated subsequent events through November 10, 2017, the date the financial statements were available to be issued. See Note 17 for significant events requiring disclosure.

Reclassification: Certain reclassifications have been made in the prior-year financial statements to conform to the current-year presentation.

Note 2. Functional Expenses

Functional expenses consists of the following:

	June 30	
	2017	2016
Program services:		
Instruction and instructional related services	$ 9,222,274	$ 8,299,824
Instructional and school leadership	1,492,119	1,146,428
Support services:		
Administrative support services	2,582,498	1,979,141
Ancillary services	291,991	258,861
Support services—nonstudent based	3,296,332	2,517,568
Support services—student (pupil)	889,009	911,064
Debt service	766,279	826,975
Fundraising	1,131,310	634,032
Total expenses	$ 19,671,812	$ 16,573,893

Note 3. Fair Value Measurements and Disclosures

The requirements of Fair Value Measurements and Disclosures of the *FASB 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 are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are observable, 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 are unobservable, are supported by little or no market activity and 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.

The Organization did not have any investments that are required to be measured at fair value.

Financial instruments: 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.

Note 4. Due From Government Agencies

Due from government agencies consists of the following:

	June 30 2017	June 30 2016
Due from state—settlement of underpayment	$ 2,803,091	$ 2,524,768
Due from pass-through grants from TEA:		
Title I, Part A—Improving Basic Programs	48,001	12,938
IDEA B Formula	341,710	107,418
Title II, Part A—Teacher and Principal Training and Recruiting	35,230	41,588
Title III, Part A—English Language Acquisition and Language Enhancement	5,808	-
Due from pass-through grants from Region XX:		
State Supplemental Visually Impaired	630	-
Total due from government agencies	$ 3,234,470	$ 2,686,712

Note 5. Promises to Give

Unconditional promises to give consists of the following:

	June 30 2017	June 30 2016
Gross amounts due in:		
One year or less	$ 1,378,975	$ 1,796,452
One to five years	2,185,447	967,300
Total unconditional promises to give	3,564,422	2,763,752
Less discounts to net present value	(112,669)	(122,373)
Less allowance for doubtful accounts	-	-
Net unconditional promises to give	$ 3,451,753	$ 2,641,379

Discount rates used on long-term promises to give ranged from 0.48 percent to 2.07 percent (0.92 percent to 2.07 percent in 2016).

Note 6. Property and Equipment

Property and equipment consist of the following:

	June 30	
	2017	2016
Land and improvements	$ 2,404,878	$ 2,404,878
Building and improvements	8,329,104	8,329,104
Furniture and equipment	521,663	416,354
Computers and software	68,334	68,334
Construction in progress	9,258,949	550,033
	20,582,928	11,768,703
Less accumulated depreciation	610,107	308,895
Net property and equipment	$ 19,972,821	$ 11,459,808

Depreciation expense totaled $301,212 and $270,907, respectively, for the years ended June 30, 2017 and 2016.

Note 7. Deferred Revenues

Deferred revenues consist of the following:

	June 30	
	2017	2016
Deferred grant revenue	$ -	$ 70,000
After school program deposits	22,678	34,612
Total deferred revenues	$ 22,678	$ 104,612

Note 8. Notes Payable

On June 30, 2016, the Organization entered into a long-term debt instrument of up to $16,768,800 in principal (Mutual of Omaha loan). The loan bears an interest rate of 3.98 percent and is scheduled to mature on June 29, 2021.

On June 30, 2016, the Organization also entered into a subordinated note of $4,192,200. The subordinate loan bears an interest rate of 8 percent and is scheduled to mature on November 30, 2021.

Note 8. Notes Payable (Continued)

Notes payable consist of the following:

	June 30	
	2017	2016
Debt instrument payable to Mutual of Omaha in the maximum amount of $16,768,800, including interest at 3.98%; due June 2021; collateralized by property	$ 14,405,152	$ 8,336,717
Subordinate note payable in the original amount of $4,192,200, including interest at 8.00%; due November 2021; collateralized by property	4,192,200	4,192,200
Total notes payable	18,597,352	12,528,917
Less loan issuance cost	396,462	489,493
Notes payable, net	$ 18,200,890	$ 12,039,424

Aggregate maturities required at June 30, 2017, were as follows:

Years ending June 30:	
2018	$ -
2019	-
2020	-
2021	50,138
2022	14,464,194
Thereafter	4,083,020
	$ 18,597,352

Interest expense totaled $670,749 and $542,120, respectively, for the years ended June 30, 2017 and 2016.

Covenants: In accordance with the long-term debt instrument, the Organization is required to maintain a debt service coverage ratio of not less than 1.20. In addition, there are negative covenants that preclude the Organization from selling, leasing or transferring its assets or collateral; making material alternations, modifications or substitutions to the collateral without prior consent; or changing the use for which the property was intended.

Note 9. Operating Leases

The Organization leases building space pursuant to noncancelable operating lease agreements expiring through 2025.

One of the lease agreements requires the Organization to obtain a letter of credit that can be used in the event the Organization cannot pay the required lease payments. On March 2, 2015, a third-party nonprofit corporation entered into a letter of credit reimbursement agreement for the Organization to meet this requirement. The outstanding amount on the letter of credit as of June 30, 2017 and 2016 is $-0-.

Note 9. Operating Leases (Continued)

Future minimum lease payments under noncancelable operating leases as of June 30, 2017, were as follows:

Years ending June 30:		
2018	$	999,752
2019		1,073,899
2020		712,385
2021		738,974
2022		721,813
Thereafter		2,399,336
Future minimum lease payments	$	6,646,159

Rent expense totaled $1,130,418 and $1,134,444 for the years ended June 30, 2017 and 2016, respectively.

Note 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 years ended June 30, 2017 and 2016, the Organization entered into contracts to perform construction on new schools. The construction commitment balance and retainage payable totaled $857,217 and $406,515, respectively, at June 30, 2017, and $1,153,504 and $7,710, respectively, at June 30, 2016.

Note 11. 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.

	June 30	
	2017	2016
Foundation School Program—State of Texas	$ 6,372,179	$ 3,125,813
Donor restricted contributions	3,830,587	1,487,065
	$ 10,202,766	$ 4,612,878

Note 11. Temporarily Restricted Net Assets (Continued)

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

	June 30	
	2017	2016
Foundation School Program—State of Texas	$ 13,781,087	$ 12,127,987
Other state aid	-	190,585
Child Nutrition cluster	270,135	331,324
Title I, Part A—Improving Basic Programs	48,001	12,938
IDEA B formula	348,919	107,418
Title II, Part A—Teacher and Principal Training and Recruiting	35,230	41,588
Other grants	1,176,117	62,934
	$ 15,659,489	$ 12,874,774

Note 12. Related Party Transactions

During the audit period, the Organization received donated administrative services from Great Hearts—Arizona (GHA—AZ). 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 22 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, 2017 and 2016, since the Board of the Organization is comprised of key management personnel of GHA—AZ and Great Hearts America. The amount due to related parties at June 30, 2017, totaled $94,178 ($180,055 in 2016). These transactions represent expenses incurred by GHA—AZ and Great Hearts America on behalf of Great Hearts America—Texas.

Note 13. Cash Balance and Credit Risk

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.

Note 14. Pension Plan Obligations

Plan description: The Organization participates in a cost-sharing multiple employer defined benefit pension plan that has a special funding situation. The plan is administered by the Teacher Retirement System of Texas (TRS). TRS' defined benefit pension plan is established and administered in accordance with the Texas Constitution, Article XVI, Section 67 and Texas Government Code, Title 8, Subtitle C. The pension trust fund is a qualified pension trust under Section 401(a) of the Internal Revenue Code. The Texas Legislature establishes benefits and contribution rates within the guidelines of the Texas Constitution. The pension's Board of Trustees does not have the authority to establish or amend benefit terms. The TRS plan does not include a collective-bargaining agreement.

All employees of public, state-supported educational institutions in Texas who are employed for one-half or more of the standard work load and who are not exempted from membership under Texas Government Code, Title 8, Section 822.002 are covered by TRS.

Note 14. Pension Plan Obligations (Continued)

The TRS plan differs from single employer plans in the following ways:

1. Charters are legally separate entities from the state and each other.

2. Assets contributed by one charter or independent school district (ISD) may be used for the benefit of an employee of another charter or ISD.

3. The unfunded obligations get passed along to other charters or ISDs.

4. There is not a withdrawal penalty for leaving the TRS system.

Pension plan fiduciary net position: At August 31, 2016, TRS total plan assets were $152,925,647,396; the accumulated benefit obligation was $171,797,150,487; and the plan was 78 percent funded.

Detailed information about TRS' fiduciary net position is available in a separately issued Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information. That report may be obtained on the Internet at http://www.trs.state.tx.us/about/documents/cafr.pdf#CAFR; by writing to TRS at 1000 Red River Street, Austin, Texas, 78701-2698; or by calling (512) 542-6592.

Contributions: Contribution requirements are established or amended pursuant to Article 16, Section 67 of the Texas Constitution, which requires the Texas legislature to establish a member contribution rate of not less than 6 percent of the member's annual compensation and a state contribution rate of not less than 6 percent and not more than 10 percent of the aggregate annual compensation paid to members of TRS during the fiscal year. Texas Government Code, Section 821.006 prohibits benefit improvements, if as a result of the particular action, the time required to amortize TRS' 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.

Employee contribution rates are set in state statute, Texas Government Code, Section 825.402. Senate Bill 1458 of the 83rd Texas Legislature amended Texas Government Code, Section 825.402 for member contributions and established employee contribution rates for fiscal years 2014 through 2017. The 84th Texas Legislature, General Appropriations Act (GAA) established the employer contribution rates for fiscal years 2016 and 2017.

Contributors to the plan include members, the Organization and the state of Texas as the only nonemployer contributing entity (NECE). The state is the employer for senior colleges, medical schools and state agencies, including TRS. In each respective role, the state contributes to the plan in accordance with state statutes and the GAA.

As the NECE for public education and junior colleges, the state of Texas contributes to TRS an amount equal to the current employer contribution rate times the aggregate annual compensation of all participating members of the pension trust fund during that fiscal year reduced by the amounts described below which are paid by the Organization. The Organization is required to pay the employer contribution rate in the following instances:

- On the portion of the member's salary that exceeds the statutory minimum for members entitled to the statutory minimum under Section 21.402 of the Texas Education Code.

- During a new member's first 90 days of employment.

Note 14. Pension Plan Obligations (Continued)

- When any part or all of an employee's salary is paid by federal funding sources, a privately sponsored source or from noneducational and general or local funds.

- When the employing district is a public junior college or junior college district, the district shall contribute to TRS an amount equal to 50 percent of the state contribution rate for certain instructional or administrative employees and 100 percent of the state contribution rate for all other employees.

In addition to the Organization employer contributions listed below, when employing a retiree of TRS, the Organization shall pay both the member contribution and the state contribution as an employment after retirement surcharge. The Organization's contribution to TRS does not represent more than 5 percent of the total contributions to the TRS plan. There have been no changes that would affect the comparison of employer contributions from year to year.

	2017	2016
Member (employees)	7.2%	7.2%
NECE	6.8%	6.8%
Employers	6.8%	6.8%
Employer contributions	$ 78,960	$ 112,590
Member contributions	769,524	568,394
Non-OASDI contributions	151,243	119,618

Note 15. Health Insurance

During the years ended June 30, 217 and 2016, employees of the Organization were covered by a health insurance plan. The Organization contributed $325-$920 per employee, per month ($316-$893 per employee, per month for 2016) 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.

Note 16. 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 percent of the original budgeted amounts, a written statement discussing the causes of the variances is required.

The Board approved one budget amendment in April 2017. This amendment was 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 percent of the original budgeted amounts as follows:

- Local revenue sources decreased $1,995,806—represented in this category are fundraising amounts at both the campus and lead office levels. Fundraising at the campus level or community investment was on target and within budget; however, at the network level, fundraising fell short. The Vice President (VP) of Development position was vacant from October 2016 to late April 2017. During this time, the Regional Director of Development took on many duties associated with the VP of Development role, but focus was placed on the capital campaign at the Northern Oaks campus and not on overall network-wide fundraising.

Note 16. State Compliance Matters (Continued)

- Function 13—decreased $312,487 due to not hiring a position originally budgeted for and limiting outside professional development in favor of bringing in trainers to provide services to larger groups.

- Function 31—decreased $13,450 due to hiring of the position at a lower cost and related benefit savings.

- Function 41—increased $910,355 due to salary and benefits of fully staffing the lead office during the year, with some positions being filled earlier than budgeted and three positions which were unbudgeted being hired in the second half of the year. Additionally, increased costs of travel were incurred and consulting fees related to expansion were not originally budgeted. Finally, there were additional costs due to increased enrollment, which were not originally included.

- Function 52—increased $33,000 due to expenses related to this function, which were originally budgeted as part of plant maintenance and operations.

- Function 53—decreased $219,919 due to less than anticipated purchasing of computer hardware and software and better negotiated pricing on third-party IT services.

- Function 61—decreased $115,539 due to personnel costs and related benefits in having one of the Athenaeum coordinator positions being vacant for six months and a decrease in programming costs at Northern Oaks site due to fewer participants.

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 percent of the final budget amount also require a written statement discussing the cause of the variance.

- Function 51—varies from actual by ($268,966) or (10 percent) due to the expensing of the costs associated with a cancelled project at a campus, which had previously been recorded as construction in progress.

- Function 71—varies from actual by $173,827 or 18 percent due to a decrease in interest expense related to Phase II of Northern Oaks. Interest expense for the year was less than budgeted due to the fact that draw requests on a loan started later than anticipated, while the amount of equity in the project was being increased and amounts capitalized during the year.

Note 17. Subsequent Event

On August 14, 2017, the Organization completed the financing arrangement for the third San Antonio campus location known as Western Hills. The school is scheduled to open in the fall of 2018 with 560 students in grades K-4. This financing includes the purchase of the land and the construction of the lower school which, at capacity, will serve grades K-6. To complete this transaction, the following instruments were issued:

- Long-term debt instrument of up to $9.2 million in principal (senior debt—Mutual of Omaha loan)—the loan bears an interest rate of 4.5 percent and is scheduled to mature on August 14, 2022.

- Subordinate note of $3.275 million—the subordinate note bears an interest rate of 8.0 percent and is scheduled to mature on January 14, 2023.

Note 17. Subsequent Event (Continued)

On October 9, 2017, the Organization entered into a letter of intent to purchase 7.2 acres of land for $2.4 million located at Carbon Road and Beltline in Irving, Texas. The land purchase is for the building of the permanent location of Great Hearts Academy—Irving. The investigation period is currently underway and scheduled to be completed in the first quarter of 2018, with closing scheduled within 30 days of the expiration of the investigation period.

Other Supplemental Information

Great Hearts America—Texas

Schedules of Expenses
Years Ended June 30, 2017 and 2016

		2017	2016
	Expenses:		
6100	Payroll costs	**$ 12,337,111**	$ 9,689,520
6200	Professional and contracted services	**4,168,855**	3,132,525
6300	Supplies and materials	**1,410,842**	2,187,683
6400	Other operating costs	**988,724**	737,191
6500	Debt service costs	**766,280**	826,974
	Total expenses	**$ 19,671,812**	$ 16,573,893

Great Hearts America—Texas

Schedule of Capital Assets
June 30, 2017

	Asset Classification	Ownership Interest Local	State	Federal
	Property and equipment:			
1510	Land and improvements	$ -	$ 2,404,878	$ -
1520	Building and improvements	-	8,329,104	-
1530	Furniture and equipment	-	521,663	-
1532	Computers and software	-	56,078	12,256
1580	Construction in progress	-	9,258,949	-
	Total property and equipment	$ -	$ 20,570,672	$ 12,256

Great Hearts America—Texas

Budgetary Comparison Schedule
Year Ended June 30, 2017

		Budgeted Amounts Original	Budgeted Amounts Final	Actual	Variance With Final Budget Positive (Negative)
	Revenues and other support:				
5700	Local support	$ 8,499,174	$ 6,503,368	$ 6,221,387	$ (281,981)
5800	State program revenues	15,765,474	16,101,921	17,028,684	926,763
5900	Federal program revenues	471,925	499,165	525,891	26,726
	Total revenues and other support	24,736,573	23,104,454	23,775,962	671,508
	Expenses:				
11	Instructional	9,744,250	9,744,250	9,144,124	600,126
13	Curriculum development and instructional staff development	392,988	80,501	78,150	2,351
23	School leadership	1,548,471	1,548,471	1,492,119	56,352
31	Guidance, counseling and evaluation services	57,956	44,506	46,848	(2,342)
33	Health services	179,027	179,027	166,913	12,114
35	Food services	388,450	388,450	360,063	28,387
36	Extracurricular activities	322,623	322,623	315,185	7,438
41	General administration	1,811,700	2,722,055	2,582,498	139,557
51	Plant maintenance and operations	2,603,664	2,640,303	2,909,269	(268,966)
52	Security and monitoring services	-	33,000	32,734	266
53	Data processing services	593,207	373,288	354,329	18,959
61	Community services	435,598	320,059	291,991	28,068
71	Debt service	940,106	940,106	766,279	173,827
81	Fundraising	1,061,416	1,061,416	1,131,310	(69,894)
	Total expenses	20,079,456	20,398,055	19,671,812	726,243
	Change in net assets	4,657,117	2,706,399	4,104,150	1,397,751
	Net assets at beginning of year	6,333,905	6,333,905	6,333,905	-
	Net assets at end of year	$ 10,991,022	$ 9,040,304	$ 10,438,055	$ 1,397,751

Compliance Section

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

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, 2017, the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to financial statements, and have issued our report thereon dated November 10, 2017.

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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. 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 2017-001 that we consider to be significant deficiency.

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Organization's Response to the Finding
The Organization's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. 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.

RSM US LLP

San Antonio, Texas
November 10, 2017

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

II—Financial Statement Finding

Finding 2017-001: Financial Reporting
Type of Finding: Significant Deficiency

Criteria: Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. This includes the design, implementation and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements.

Condition: As a result of the audit procedures performed, we noted various accounts in the financial statements that required adjustments to properly reflect the year-end balance. Although adjustments were needed in various accounts, the deficiency appears to exist in the area of cut-off related to accounts payable and revenue recognition.

Context: Adjustments were required for the accounts payable, unconditional promises to give, contribution revenue and payroll liability accounts.

Cause and effect: The financial statements required adjustments to properly reflect the year-end balances.

Recommendation: We recommend management develop a control procedure whereby accounts payable cut-off and revenue recognition at year-end is reconciled to supporting documentation and thoroughly reviewed by supervisory personnel.

Views of responsible officials: Management agrees with this finding, see also Corrective Action Plan.

Summary Schedule of Prior Audit Findings
Year Ended June 30, 2017

Finding 2016-001: Procurement

Prior-year finding: The Organization currently is utilizing a vendor to purchase textbooks that was not properly procured in the prior year, yet the Organization continued to use the vendor in the current year.

Status: The Organization has taken the recommended corrective action.

Finding 2016-002: Temporarily Restricted Net Assets

Prior-year finding: In fiscal year 2016, the Organization did not have a formal process in place to accurately track the expenses of the restricted contributions being released from restriction.

Status: The Organization has taken the recommended corrective action.

Finding 2016-003: Segregation of Duties

Prior-year finding: A small number of people have the primary responsibility for performing most of the accounting and financial reporting duties. As a result, some aspects of internal controls that rely upon adequate segregation of duties are missing.

Status: The Organization has taken the recommended corrective action.

Great Hearts America—Texas

Corrective Action Plan
Year Ended June 30, 2017

Finding 2017-001: Financial Reporting
Type of Finding: Significant Deficiency

Views of responsible officials and planned corrective action: Management agrees with the finding. At this time, the Organization is in the process of recruiting and hiring an Accounting Manager who will be responsible for the day-to-day operations of the Finance area, allowing the VP of Finance to perform thorough reviews of transactions processed throughout the year and at year-end. The Organization is placing into effect immediately a cut-off review process beginning two months prior and two months subsequent to year-end of all expenditures in excess of $5,000 to ensure that the expenses are being accounted for in the proper period. For revenue recognition, the Finance team will work with all areas within the Organization to ensure that proper documentation exists for all items of revenue (e.g., properly signed pledge forms, properly executed grant/pledge agreements).

Responsible person: Deborah Zimmerman

Implementation date: Hiring of additional personnel will be completed by December 31, 2017. Processes discussed above will be developed and put into place immediately.

RSM