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STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum # 2019-10

To: Charter Schools and their Auditors

From: Sharon Edmundson, Director, Fiscal Management Section

Subject: Charter Schools – 2019 Audit Contracts and Financial Statements

Date: May 15, 2019

The audit contract and financial reporting for charter schools will change significantly for the fiscal year ending June 30, 2019.

Background

Charter schools are required by [G.S. 115C-218.30\(a\)](#) and State Board of Education Policy ([CHTR-006](#)) to timely submit audited financial statements to the Department of State Treasurer. [G.S. 115C-447](#) requires that these financial statements “be prepared in conformity with generally accepted accounting principles.” The applicable reporting standards for charter school financial statements were the subject of extensive discussions with representatives from GASB and it was determined that GASB standards are applicable to the reporting entity, not to a part of an organization. Therefore, to present financial statements that are compliant with generally accepted accounting principles, charter schools must present financial statements for the non-profit corporation as a whole (the reporting entity), not just a part thereof (the charter school).

Application: Non-Profit is Charter Holder for One School

Where the non-profit corporation is the holder of the charter for only one school, there will be very few but important differences in the audit contract and the financial reporting. The primary difference is that both the audit contract and the financial statements will be for the reporting entity, not *the school*. *In some cases, there may be activities undertaken by the reporting entity that are unrelated to the activities of the school and these will need to be identified and separately reported in the financial.* A sample financial report is provided in the financial statements for [Cardinal Charter, Inc.](#)

Application: Non-Profit is Charter Holder for More Than One School

The most significant audit contract and financial statement changes will occur where the non-profit is the holder of charters for multiple schools. In these cases, the audit contract will be with the non-profit corporation for its financial statements. The financial statements of the non-profit will include supplementary information for each of the separate charter schools. A sample financial report is provided in the financial statements for [Owl Charter, Inc.](#) So far, several non-profits have been identified that are the holder of charters for more than one school. In these circumstances, the audit contract will be with the non-profit for its financial statements, not with the individual charter schools, *i.e.* where there were two or three contracts, there will now be only one.

The Contract to Audit Accounts will be between the auditor and the non-profit corporation that is the holder of the charter for one or more charter schools. On the contract, the Governing Board will be the Board of

Directors and the Primary Government Unit will be the non-profit holder of the charter or charters. For a charter holder of only one charter, please include the name of the charter school in parentheses following the name of the non-profit. If space for the name of the charter school is inadequate or if the non-profit is the holder of multiple charters, please attach an addendum to the contract providing the names and addresses of all schools included in the financial statements. The exact corporate name of a non-profit and other information can be found [here](#), the business registration page on the website of the NC Secretary of State.

Foundations

A charter holder with a related non-profit corporation (often called a “foundation”) that finances and owns school buildings and leases them to a school must consider whether the foundation should be presented as a blended component unit. The guidance in paragraphs 1.01-1.02 and 3.16 of the AICPA’s Audit and Accounting Guide State and Local Governments (March 1, 2017) is pertinent to this decision. When a foundation is presented as a blended component unit, a disclosure similar to the one presented in the illustrative reporting entity note should be included.

Given the nature of the relationship between the non-profit sponsor of the charter school and the non-profit created to finance and own the school building, it seems that in almost all cases one or more of the tests described in GASB Statement 14, paragraph 53 (as amended by GASBS 61, ¶8 and GASBS 80, ¶5) would be met, although meeting only one of the four tests is sufficient to require blending. GASB, Codification of Governmental Accounting and Financial Reporting Standards, II. Financial Reporting, Section 2600, Sections 112-113 and a sample reporting entity note are attached.

When the foundation is not included as a blended component unit, please provide for our files a brief explanation of the factors supporting the decision so that we will not continue to question the presentation.

Summary

The reporting entity is the non-profit corporation that is the holder of the charter or charters. The Contract to Audit Accounts and the audited financial statements will be for the non-profit holder of the charter or charters, i.e., financial statements will be submitted for Cardinal Charter, Inc. which is the holder of the charter for the Cardinal Charter School. Where the non-profit is the holder of charters for multiple schools, supplementary information for each of the individual charter schools must be presented.

If you have questions, please contact Jones Norris at Jones.Norris@NCTreasurer.com or 919 814-4288.

Attachments:

Excerpt from GASB Codification, Section 2600, Blending Component Units
Sample Reporting Entity Note

Governmental Accounting Standards Board (GASB)

Codification of Governmental Accounting and Financial Reporting Standards

II. Financial Reporting

Section 2600

Blending Component Units (footnotes omitted)

.112 Even though it is desirable for users to be able to distinguish between the primary government and its component units, there are nevertheless some component units that, despite being legally separate from the primary government, are so intertwined with the primary government that they are, in substance, the same as the primary government. These component units should be reported as part of the primary government in both the fund financial statements and the government-wide financial statements. That is, the component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself. This method of inclusion is known as blending. [GASBS 14, ¶52; GASBS 34, ¶6 and ¶125]

.113 A component unit should be included in the reporting entity financial statements using the blending method in any of these circumstances:

- a. The component unit's governing body is substantively the same as the governing body of the primary government *and* (1) there is a financial benefit or burden relationship between the primary government and the component unit, as described in paragraphs .126–.132 of Section 2100, or (2) management of the primary government has operational responsibility for the component unit. Management of a primary government has operational responsibility for a component unit if it manages the activities of the component unit in essentially the same manner in which it manages its own programs, departments, or agencies. Management, for purposes of this determination, consists of the person(s), below the level of the governing board, responsible for the day-to-day operations of the primary government (for example, a county executive or city manager).
- b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it. The essence of this type of arrangement is much the same as an internal service fund—the goods or services are provided to the government itself rather than to the citizenry. Usually the services provided by a blended component unit are financing services provided solely to the primary government. For example, a building authority may be created to finance the construction of office buildings for the primary government. However, a component unit that provides services to more than just the primary government should also be blended if the services provided to others are insignificant to the overall activities of the component unit. Other component units that should be blended are those that exclusively, or almost exclusively, benefit the primary government by providing services indirectly; for example, a component unit that provides services on behalf of the primary government to its employees rather than directly to the primary government itself.
- c. The component unit's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government. Repayment generally occurs through a continuing

pledge and appropriation by the primary government to the component unit that, in turn, pledges those appropriation payments as the primary source of repayment for its debt.

- d. The component unit is organized as a not-for-profit corporation in which the primary government is the sole corporate member, as identified in the component unit's articles of incorporation or bylaws, and the component unit is included in the financial reporting entity pursuant to the provisions in paragraphs .120–.136 of Section 2100.

[GASBS 14, ¶53, as amended by GASBS 61, ¶8 and GASBS 80, ¶5]

Sample Reporting Entity Note:

The accounting policies of Eagle Charter, Inc. (“Eagle”) conform to generally accepted accounting principles (“GAAP”) as applicable to governments. Charter schools in North Carolina such as Eagle are established by non-profit entities. Eagle is considered a governmental organization because of the potential for its unilateral dissolution by the State with its net assets returning to a local education agency and therefore follows the governmental reporting model as used by local education agencies.

The following is a summary of the more significant accounting policies.

A. The Reporting Entity

Eagle is a North Carolina non-profit corporation incorporated in October 2013. Pursuant to the provisions of the Charter School Act of 1996 as amended (the “Act”), Eagle has been approved to operate The Eagle Charter School (the “School”), a public school serving approximately 350 students. The School operates under a charter agreement applied for under the provisions of North Carolina General Statute (hereafter “G.S.”) 115C-218.1 and entered into with the State Board of Education (“SBE”). The SBE has the authority to terminate, not renew or seek applicants to assume a charter on grounds sent out at G.S. 115C-218.95 with all net assets purchased with public funds reverting to a local education agency (G.S. 115C-218.100). The current charter is effective until June 30, 2022 and may be renewed for subsequent periods of ten (10) years unless one of the conditions in G.S. 115C-218.6(b) applies in which case the SBE may renew the charter for a shorter period or not renew the charter.

The Eagle Foundation, Inc. (the “Foundation”) was formed in December 2015 as a North Carolina non-profit corporation. The Foundation was created primarily as a vehicle to finance and own real estate and school facilities utilized by the School. GASB Statement No. 14 as amended, The Financial Reporting Entity, requires blending when 1) a component unit’s governing body is substantively the same as the governing body of the primary government, 2) a component unit provides services entirely, or almost entirely, to the primary government, 3) a component unit’s total debt outstanding, including leases, is expected to be repaid entirely, or almost entirely, with resources of the primary government, or 4) the primary government is the sole corporate member of the component unit. The Foundation provides services almost entirely to Eagle and the outstanding debt of the Foundation is expected to be repaid from the lease payments received from Eagle. Therefore, the Foundation is reported as blended component unit in a special revenue fund in Eagle’s financial statements. The Foundation did not issue separate financial statements.