

**ACADEMY OF THE CITY
CHARTER SCHOOL**

**INDEPENDENT AUDITOR'S REPORTS
AND FINANCIAL STATEMENTS**

JUNE 30, 2018 AND 2017

ACADEMY OF THE CITY CHARTER SCHOOL

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Independent Auditor's Report

**Board of Trustees
Academy of the City Charter School
Woodside, New York**

We have audited the accompanying financial statements of Academy of the City Charter School, which comprise the balance sheet as of June 30, 2018, and the related statements of activities, 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 entity'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 entity'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 Academy of the City Charter School as of June 30, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Year Audited by Other Auditors

The 2017 financial statements were audited by other auditors, and their report thereon, dated October 17, 2017 expressed an unmodified opinion.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Functional Expenses 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 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 October 30, 2018 on our consideration of Academy of the City Charter School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Academy of the City Charter School's 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 Academy of the City Charter School's internal control over financial reporting and compliance.

BKD, LLP

New York, New York
October 30, 2018

ACADEMY OF THE CITY CHARTER SCHOOL

BALANCE SHEETS

JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current assets		
Cash	\$ 2,325,639	\$ 1,476,684
Grants and contracts receivable	164,040	227,135
Accounts receivable	-	1,517
Prepaid expenses	<u>147,656</u>	<u>112,014</u>
Total current assets	2,637,335	1,817,350
Security deposits	226,000	226,000
Cash - reserve	75,785	75,671
Fixed assets - net	<u>1,218,272</u>	<u>1,242,407</u>
Total assets	<u>\$ 4,157,392</u>	<u>\$ 3,361,428</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable and accrued expenses	\$ 175,196	\$ 197,232
Accrued salaries and related liabilities	<u>553,717</u>	<u>432,843</u>
Total current liabilities	728,913	630,075
Deferred rent	<u>979,174</u>	<u>852,697</u>
Total liabilities	1,708,087	1,482,772
Net assets		
Unrestricted	<u>2,449,305</u>	<u>1,878,656</u>
Total liabilities and net assets	<u>\$ 4,157,392</u>	<u>\$ 3,361,428</u>

The accompanying notes are an integral part of these statements.

ACADEMY OF THE CITY CHARTER SCHOOL

STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Operating revenues and other support		
Resident student enrollment	\$ 5,904,136	\$ 5,790,752
Students with disabilities	233,256	294,214
NYCDOE rental assistance revenue	<u>684,658</u>	<u>309,413</u>
Total state and local per-pupil operating revenues	6,822,050	6,394,379
Government grants and contracts	367,768	429,679
Contributions	71,294	91,522
Miscellaneous income	<u>7,525</u>	<u>5,559</u>
Total operating revenues and other support	<u>7,268,637</u>	<u>6,921,139</u>
Expenses		
Program services		
Education	4,831,141	4,536,390
Special education	<u>585,594</u>	<u>612,116</u>
Total program services	<u>5,416,735</u>	<u>5,148,506</u>
Supporting services		
Management and general	1,277,853	1,256,271
Fund raising	<u>3,400</u>	<u>9,639</u>
Total supporting services	<u>1,281,253</u>	<u>1,265,910</u>
Total expenses	<u>6,697,988</u>	<u>6,414,416</u>
Change in unrestricted net assets	570,649	506,723
Net assets, unrestricted - beginning of year	<u>1,878,656</u>	<u>1,371,933</u>
Net assets, unrestricted - end of year	<u><u>\$ 2,449,305</u></u>	<u><u>\$ 1,878,656</u></u>

The accompanying notes are an integral part of these statements.

ACADEMY OF THE CITY CHARTER SCHOOL

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
Operating activities		
Change in net assets	\$ 570,649	\$ 506,723
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	139,434	123,782
Decrease (increase) in assets		
Grants and contracts receivable	63,095	(218,409)
Accounts receivable	1,517	13,757
Security deposits	-	(70,000)
Prepaid expenses	(35,642)	(29,112)
Increase (decrease) in liabilities		
Accounts payable and accrued expenses	(22,036)	111,034
Accrued salaries and related liabilities	120,874	13,079
Refundable advances	-	(6,245)
Deferred rent	126,477	130,354
	<u>964,368</u>	<u>574,963</u>
Investing activities		
Fixed asset acquisitions	(115,299)	(235,312)
Cash - deposits in escrow	(114)	(118)
	<u>(115,413)</u>	<u>(235,430)</u>
Net change in cash	848,955	339,533
Cash - beginning of year	<u>1,476,684</u>	<u>1,137,151</u>
Cash - end of year	<u><u>\$ 2,325,639</u></u>	<u><u>\$ 1,476,684</u></u>

The accompanying notes are an integral part of these statements.

ACADEMY OF THE CITY CHARTER SCHOOL

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

NOTE 1 - NATURE OF ORGANIZATION

Academy of the City Charter School (AoC) is an educational corporation that operates as a charter school in the borough of Queens, New York City. On December 14, 2010, the Board of Regents and the Board of Trustees of the University of the State of New York, for and on behalf of the State Education Department, granted AoC a charter valid for a term of 5 years and renewable upon expiration. The school was granted a charter from grades K-5. On July 26, 2016 the school's charter renewal was approved for an additional three years. AoC was organized to increase learning opportunities for students through innovative educational programs and to enable parents to be more involved in their children's education. During each of the fiscal years ended June 30, 2018 and 2017, AoC operated classes for approximately 410 students in grades K-5.

Academy of the City Charter School is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. However, AoC is subject to federal income tax on any unrelated business taxable income. AoC is supported primarily by state and local per-pupil operating revenues.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting - The financial statements are prepared on the accrual basis of accounting.

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash - reserve - As part of AoC's charter agreement, AoC agreed to establish a long-term reserve account to pay for legal and audit expenses that would be associated with a dissolution should it occur.

Accounts receivable - Accounts receivable consist of unpaid afterschool program balances and other charges earned but not yet received. Receivables are presented net of allowances for doubtful accounts. Interest is not accrued or recorded on outstanding receivables.

Allowance for doubtful accounts - Bad debt expense is charged if a receivable is determined to be uncollectible based on periodic review by management. Factors used to determine whether an allowance should be recorded include the age of the receivable and a review of payments subsequent to year end. Management deemed no allowance necessary for the years ended June 30, 2018 and 2017.

ACADEMY OF THE CITY CHARTER SCHOOL

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fixed assets - Fixed assets are recorded at cost less accumulated depreciation. Items with a cost of \$1,000 and an estimated useful life of more than one year are capitalized. Depreciation is provided on the straight-line basis over the estimated useful lives of assets. Leasehold improvements are amortized over the term of the lease or the life of the asset, whichever is shorter.

Long-lived asset impairment - AoC evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended June 30, 2018 and 2017.

Unrestricted net assets - Unrestricted net assets include funds having no restrictions as to use or purpose imposed by donors.

State and local per-pupil operating revenues - Revenues from the state and local governments resulting from AoC's charter status and based on the number of students enrolled are recorded when services are performed in accordance with the charter agreement. These grants are recorded as revenue by AoC when services are rendered.

Grants and contracts revenue and receivables - Revenues from government grants and contracts to which AoC is entitled are recognized mostly on student enrollment. Some grants are provided for specific educational endeavors which are not based on student enrollment and are recorded when related expenditures are incurred by AoC. Receivables are recorded when the revenue is earned.

Contributions - Unconditional contributions, including promises to give cash and other assets, are reported at fair value at the date the contribution is received. All contributions are considered to be available for unrestricted use unless specifically restricted by donors.

Deferred rent - Operating leases are straight-lined over the term of the lease. Deferred rent has been recorded for the difference between the fixed payment and the rent expense.

Functional allocation of expenses - The costs of providing AoC's programs and other activities have been summarized on a functional basis. Accordingly, certain costs have been allocated among the programs and supporting services benefited based on actual expenditures and cost allocations estimated by AoC's personnel.

Subsequent events - Subsequent events have been evaluated through October 30, 2018, which is the date the financial statements were available to be issued.

ACADEMY OF THE CITY CHARTER SCHOOL

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

NOTE 3 - FIXED ASSETS

	<u>2018</u>	<u>2017</u>	<u>Useful Lives</u>
Furniture and fixtures	\$ 238,291	\$ 217,647	3-5 years
Equipment	405,514	332,215	3-5 years
Leasehold improvements	1,142,820	1,100,498	22 years
Construction in progress	<u>-</u>	<u>20,966</u>	
	1,786,625	1,671,326	
Accumulated depreciation and amortization	<u>(568,353)</u>	<u>(428,919)</u>	
	<u>\$ 1,218,272</u>	<u>\$ 1,242,407</u>	

NOTE 4 - LEASE COMMITMENT

On May 20, 2013, AoC entered into a lease with the Roman Catholic Church of Corpus Christi for a location located in Woodside, NY. The lease commenced on July 1, 2013 and will expire on June 30, 2035. On August 1, 2015, AoC entered into an additional lease with the Roman Catholic Church of Corpus Christi for a location located at Woodside, NY which is the parking lot. The lease commenced on August 1, 2015 and will expire on July 31, 2020.

The future minimum lease payments as of June 30, 2018 are:

<u>Year Ending June 30</u>	
2019	\$ 967,556
2020	972,174
2021	828,117
2022	814,986
2023	814,986
Thereafter	<u>11,622,021</u>
	<u>\$ 16,019,840</u>

The leases for the building and parking lot are being straight-lined over the life of the lease. The deferred rent liability as of June 30, 2018 and 2017 was \$979,174 and \$852,697, respectively.

Rent expense for the years ended June 30, 2018 and 2017 was \$1,015,099 and \$1,019,689, respectively.

ACADEMY OF THE CITY CHARTER SCHOOL

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

NOTE 5 - CONTINGENCIES AND CONCENTRATIONS

Certain grants and contracts may be subject to audit by the funding sources. Such audits might result in disallowances of costs submitted for reimbursement. Management is of the opinion that such cost disallowances, if any, will not have a material effect on the accompanying financial statements. Accordingly, no amounts have been provided in the accompanying financial statements for such potential claims.

A significant portion of AoC's operating revenue is paid by New York State Department of Education.

In addition, all grants and contracts receivable due at year end were all due from the New York State Department of Education.

NOTE 6 - RELATED-PARTY TRANSACTION

AoC entered into an agreement with a not-for-profit organization named NYC Coalition of Community Charter Schools (DBA The Open School Project, Inc.) that employs two members of the board of AoC. The agreement is for supporting services including marketing, facility relocation search and advocacy. AoC paid NYC Coalition of Community Charter Schools \$34,000 in 2018 and \$96,390 in 2017. The agreement was terminated on June 30, 2018.

NOTE 7 - PENSIONS

AoC has a defined contribution retirement plan with Principal Financial which covers substantially all full-time employees. AoC contributes an amount equal to 4% in 2018 and 2017 of the employee's contribution to the plan up to the maximum amount allowed. Pension expense under this plan for the years ended June 30, 2018 and 2017 was \$93,223 and \$87,437, respectively.

Supplementary Information

ACADEMY OF THE CITY CHARTER SCHOOL

SCHEDULE OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2018

	<u>No. of Positions</u>	<u>Program Services</u>			<u>Supporting Services</u>			<u>Total</u>
		<u>Education</u>	<u>Special Education</u>	<u>Total</u>	<u>Management and General</u>	<u>Fund Raising</u>	<u>Total</u>	
Personnel service costs								
Administrative staff personnel	7	\$ 168,143	\$ 20,381	\$ 188,524	\$ 491,892		\$ 491,892	\$ 680,416
Instructional personnel	41	2,288,806	277,431	2,566,237	-		-	2,566,237
Noninstructional personnel	5	196,375	23,803	220,178	67,382		67,382	287,560
Salaries		2,653,324	321,615	2,974,939	559,274		559,274	3,534,213
Payroll taxes and employee benefits		687,411	83,323	770,734	156,694		156,694	927,428
Occupancy		768,054	93,098	861,152	241,563		241,563	1,102,715
Contracted services		126,014	15,274	141,288	64,108	\$ 3,400	67,508	208,796
Supplies and equipment		41,502	5,031	46,533	8,748		8,748	55,281
Repairs and maintenance		107,963	13,086	121,049	22,757		22,757	143,806
Professional fees				-	169,734		169,734	169,734
Classroom supplies and textbooks		61,443	7,448	68,891	-		-	68,891
Insurance		34,940	4,235	39,175	7,364		7,364	46,539
Student and staff recruitment		66,096	8,012	74,108	-		-	74,108
Telephone		34,483	4,180	38,663	7,268		7,268	45,931
Staff travel				-	2,102		2,102	2,102
Student field trips		11,325	1,373	12,698	-		-	12,698
Food services		27,240	3,302	30,542	5,742		5,742	36,284
Board and staff development		106,667	12,929	119,596	10,432		10,432	130,028
Depreciation		104,679	12,688	117,367	22,067		22,067	139,434
Total expenses		\$ 4,831,141	\$ 585,594	\$ 5,416,735	\$ 1,277,853	\$ 3,400	\$ 1,281,253	\$ 6,697,988

**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***

Independent Auditor's Report

**Board of Trustees
Academy of the City Charter School
Woodside, New York**

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 Academy of the City Charter School, which comprise the balance sheet as of June 30, 2018, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 30, 2018, which included a reference to prior year auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Academy of the City Charter School'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 Academy of the City Charter School's internal control. Accordingly, we do not express an opinion on the effectiveness of Academy of the City Charter School'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 entity'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. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Academy of the City Charter School'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*.

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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

New York, New York
October 30, 2018

Board of Trustees and Management
Academy of the City Charter School
Woodside, New York

As part of our audit of the financial statements of Academy of the City Charter School (the School) as of and for the year ended June 30, 2018, we wish to communicate the following to you.

AUDIT SCOPE AND RESULTS

Auditor's Responsibility Under 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

An audit performed 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 is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

Qualitative Aspects of Significant Accounting Policies and Practices

Significant Accounting Policies

The School's significant accounting policies are described in Note 2 of the audited financial statements.

Alternative Accounting Treatments

No matters are reportable.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant areas of such estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Receivables and allowance for doubtful accounts

Financial Statement Disclosures

The following areas involve particularly sensitive financial statement disclosures for which we are prepared to discuss the issues involved and related judgments made in formulating those disclosures:

- Significant estimates and concentrations
- Related parties

Audit Adjustments

No matters are reportable.

Auditor's Judgments About the Quality of the School's Accounting Principles

No matters are reportable.

Other Material Communications

Listed below are other material communications between management and us related to the audit:

- Management representation letter (attached)

OTHER MATTERS

We observed the following matters and offer these comments and suggestions with respect to matters which came to our attention during the course of the audit of the financial statements. Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies and procedures that may exist. However, these matters are offered as constructive suggestions for the consideration of management as part of the ongoing process of modifying and improving financial and administrative practices and procedures. We can discuss these matters further at your convenience and may provide implementation assistance for changes or improvements.

Significant New FASB Accounting Standards

FASB Releases NFP Accounting Standard for Financial Reporting

Accounting Standards Update (ASU) 2016-14 changes requirements for financial statements and notes of all not-for-profit (NFP) entities and is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted and should be applied on a retrospective basis; however, NFPs have the option in the year adopted to omit certain disclosures shown in comparative financials.

A summary of the changes by financial statement area is as follows:

Statement of financial position:

- The NFP statement of financial position will distinguish between two new classes of net assets – those with donor-imposed restrictions and those without. The ASU retains the current requirements to provide information on the nature and amount of different types of donor restrictions in the notes to the financial statements.
- Underwater donor-restricted endowment funds are to be shown within the donor-restricted fund class. This is a change from the previously required classification as unrestricted.

Statement of activities:

- The standard requires NFPs to report expenses by both nature and function, either on the face of the statement of activities, as a separate statement or within the notes.
- NFPs are required to use 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, in the absence of explicit donor stipulations. This eliminates the option to release the donor-imposed restriction over the estimated useful life of the acquired asset.
- Investment income will be shown net of external and direct internal investment expenses. There is no longer a requirement to include a disclosure of those netted expenses.

Statement of cash flows:

- A NFP can continue to choose to either use the indirect or direct method of reporting to present operating cash flows. If the direct method is used, there is no longer a requirement to present or disclose cash flows using the indirect (reconciliation) method.

Notes to the financial statements:

- FASB requires enhanced quantitative and qualitative disclosures to provide additional information useful in assessing liquidity and cash flows.
- Provide disclosures on amounts and purposes of governing board or self-imposed designations and appropriations as of the end of the period.

For many NFPs, adoption of the ASU will result in significant changes to financial reporting and disclosures which likely will require significant hours to implement correctly. Management should examine its current reporting system to identify what changes are necessary to comply with the new standard for both its internal and external reporting requirements. Based on your financial statement reporting changes, BKD will need to spend additional time in formatting these changes within our audit reporting system if you outsource your annual report and disclosure preparation to BKD. Please contact your BKD Advisor if you would like assistance converting the School's financial statements to the new model and preparing the new disclosures.

The Tax Cuts and Jobs Act of 2017

In late December, President Donald J. Trump signed into law tax legislation, informally known as the *Tax Cuts and Jobs Act* (TCJA), representing one of the largest overhauls of the Internal Revenue Code (IRC) in more than 30 years. Many TCJA provisions took effect January 1, 2018, and affect virtually all U.S. taxpayers, including tax-exempt organizations. Some of the important provisions that may affect the School are as follows:

- **Excise tax on executive compensation:** For tax years beginning after December 31, 2017, the TCJA imposes an excise tax on excess tax-exempt organization executive compensation. This excise tax will be 21 percent of the remuneration paid by a tax-exempt organization – and related organizations – to any covered employee in excess of \$1,000,000 plus any excess parachute payment paid by the organization to any covered employee. Covered employees include the five highest compensated employees of the organization for the taxable year and any employee that was a covered employee of the organization for any preceding taxable year beginning after December 31, 2016. The term remuneration does not include any compensation paid to a licensed medical professional (including a veterinarian) for the performance of medical or veterinary services by the professional.
- **Computation of unrelated business taxable income (UBTI):** Under the TCJA, for tax years beginning after December 31, 2017, UBTI will be computed separately with respect to each trade or business for organizations with more than one unrelated trade or business activity. Therefore, net operating losses (NOLs) from one unrelated trade or business activity will not be allowed to offset profits from another. Please note that corporate law changes will affect controlled corporations of tax-exempt organizations and the computation of unrelated business income. For more information on the corporate law changes, please view the appropriate charts on the following website: <http://www.bkd.com/services/tax/tax-reform-resource-center>.
- **Excise tax on private colleges and universities:** The TCJA enacted a 1.4 percent excise tax on the net investment income of private colleges and universities that is an “applicable educational institution.” An applicable educational institution is a school that has 500 or more tuition-paying students, more than 50 percent of the tuition-paying students are located within the United States and has assets with a value of at least \$500,000 per full-time student, not including those used directly in carrying out the institution’s educational purpose. Assets and related net investment income of related organizations would be treated as part of the private college or university. The excise tax is effective for tax years beginning after December 31, 2017.
- **Tax-exempt bond financing:** The TCJA repealed the exclusion from gross income for interest on advance refunding bonds for such bonds issued after December 31, 2017.

Also important to consider is the elimination of the deduction for qualified transportation fringe benefits, as this affects tax-exempt employers in a unique way. Instead of losing a deduction, IRC §512(a)(7) provides that any disallowed benefit provided to an employee after December 31, 2017, and not associated with any unrelated business that is regularly carried on by the organization must be included as additional UBTI. The UBTI increase also may apply to expenditures for any parking facility used in connection with qualified parking and any on-premises athletic facility (as defined under IRC §132(j)(4)(B)). Tax-exempt employers face the same issues as taxable employers in regard to the actual calculation of these benefits. Nevertheless, the amount of any disallowed fringe benefits must either be included as UBTI and reported on Form 990-T, *Exempt Organization Business Income Tax Return*, or included as taxable wages to employees on Form W-2.

FASB Releases Not-for-Profit Accounting Standard for Grants and Contributions

On June 21, 2018, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2018-08. This standard clarifies existing guidance on determining whether a transaction with a resource provider, *e.g.*, the receipt of funds under a government grant or contract, is a contribution or an exchange transaction. The guidance requires all organizations to evaluate whether the resource provider is receiving commensurate value in a transfer of assets transaction, and whether contributions are conditional or unconditional.

If commensurate value is received by the resource provider, the transaction would be accounted for as an exchange transaction by applying Topic 606, *Revenue from Contracts with Customers*, or other topics. The standard clarifies that a resource provider is not synonymous with the general public. Indirect benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider. If commensurate value is not received by the resource provider, *i.e.*, the transaction is nonexchange, the recipient organization would record the transaction as a contribution under Topic 958 and determine whether the contribution is conditional or unconditional.

FASB expects that the new standard could result in more grants and contracts being accounted for as contributions (often conditional contributions) than under current generally accepted accounting principles. Because of this, it believes the clarifying guidance about whether a contribution is conditional or unconditional, which affects the timing of revenue recognition, is important. Both the recipient and resource provider would equally apply the guidance.

For public entities, the standard will be effective for annual reporting periods beginning on or after June 15, 2018. For all other entities, the standard will be effective for reporting periods beginning on or after December 15, 2018.

This communication is intended solely for the information and use of management, the board of trustees and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

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