STATE OF NEW MEXICO

NEW MEXICO PUBLIC EDUCATION DEPARTMENT SCHEDULE
OF FINDINGS AND QUESTIONED COSTS YEAR ENDED JUNE

THE GREAT ACADEMY

2023-001 (Previously 2022-001, 2021-001, 2019-003) Advance Payments of Lease Payments (Material Weakness and Material Noncompliance)

Condition/Context: We noted in FY19 that the School remitted $250,000 to the foundation characterized as "prepaid rent." These $250,000 "prepaid rents" amount is in addition to previous advance rent payments made prior to fiscal year 2018 of $450,000 and $300,000 by the school to the foundation. These payments amount to a total $1,000,000, including the $250,000 payment in 2019, of which $696,292 is reflected as prepaid rent as of June 30, 2023. This amount is expected to be amortized over a period of 20 years by the school. However, the foundation has $138,857 in cash as of June 30, 2023 and has expended the remaining prepayments advanced by the school. Therefore, the foundation lacks the ability to return the funds to the school, if required. Based upon the circumstances and substance of the transactions, there appears to be no financial benefit to the school related to the advanced prepaid rent payments made.

Criteria: As outlined in the manual of procedures PSAB Supplements 1 (Budgeting) and 13 (Purchasing), it would appear that the school should use the DFA paper for evaluating the public benefit and necessity of all expenditures per NMSA 1978 6-5-6. The DFA white paper outlines four criteria, each component of which should be achieved in making this determination regarding the public benefit and necessity. One of those four criteria is "Necessity."

Cause: Lack of documentation of the complete understanding of the nature, intent, benefit, and necessity of the transaction, as well as the compliance with applicable laws and regulations by all members of governance and management.

Effect: Possible noncompliance with regulations applicable to determining the necessity of an expenditure. In addition, the funds that have been advanced to the foundation have been fully expended and the school no longer has access to these assets if required, and the foundation appears to lack the resources to return the assets if required.

Auditor's Recommendation: We recommend the school and foundation continue to explore options with legal counsel to determine how to resolve this matter while adhering to federal, state, and local requirements.

Management's Response: In last few years, the school's budget has experienced 3 major events/legislation that negatively impacted the school's revenue.

1. Reduction in Lease Assistance
   The school has experienced a dramatic reduction in its lease assistance grant from PSFA. FY17 the school received - $158,767. The following year the amount was reduced to $120,377. And for FY19 the school received $97,947. Currently the school is only receiving $70,549. This constitutes a 56% decrease in lease assistance from FY 17. As a part of the school's long-term strategic budgetary planning, the school understands that Lease Assistance is a grant that is not guaranteed, and the school did and should make every effort to buydown its lease liabilities.

2. Age Cap Legislation
   In 2019, the state capped the school-age for students at 22. The school was forced to phase out its Adult Reengagement Program. As a result, the school saw a 30% reduction in membership and at least a $300,000 reduction in annual lost in revenue.

3. Small School Adjustment

In 2019, the state decided to phase out "Small School Adjustment". The phase out is over 5 years at 20% per year. The school has experienced a $159,000 reduction for the past 4 years and will end FY 23. The total budgetary reduction will total $795,000.

Currently, TGA only has 10% of ESSER funds remaining. The remaining funds will be exhausted by the end of this fiscal year. The $3,743 monthly rent savings is helping the school meet its budget obligations. As has been discussed and verified with the auditors, the total monthly amortized pre-paid rent is factored in, the school benefits in total annual saving of about $45,000 per year in annual reduced rent cost. For these reasons, the school viewed pre-paying its lease to reduce its annual lease liability as meeting the "necessity" requirement that the auditor referenced. These transactions were well documented and were approved by the school's Board of Directors, over 5 years of PED School Budget approved quarterly and end of year cash reports, and 6 PED Budget Office approved annual budgets.

With regard to School's necessity and benefit from the current lease arrangement, please see Lease paragraph 2 (declaring School's need for the Property and benefit to School for School use and occupancy); paragraph 11(d) (School's representation that the Lease is in best interest of School and serves public purpose), and 11(h)(School representation that Lease is necessary and essential to School's operations). This Lease and its terms were considered by the School's Governing Council at its October 30, 2018 meeting. To the extent, if at all, that the School and/or Foundation falls within the definition of a 'state agency' for purposes of NMSA 1978 Section 6-5-1 and 6-5-3, the Lease fulfills the "DFA White Paper" guidance criteria as follows:

1. Constitutional, Statutory and Contractual Mission. The expenditures for Lease rental payments, including any prepayments, for a School facility in which to house the School and its programs, is consistent with (and integral to) the School's mission of operating a charter school for grades 6-12. This is consistent with Section 22-8B-4(D) of the Charter Schools Act : "A charter school may contract with … any other third party for the use of a facility, its operation and maintenance and the provision of any service or activity that the charter school is required to perform in order to carry out the educational program described in its charter contract."

2. Public Benefit and Purpose. The White Paper indicates that expenditures can contribute to an agency achieving its constitutional, statutory, or contractual mission in two ways: (1) by serving a "public purpose", and (2) by providing a "public benefit". Rent payments for the leasing of a public school facility both serve both a public purpose and provide a public benefit (a facility in which to operate a public school for public school students). The Lease terms acknowledge both public purpose and public benefit. The rent prepayments to the Foundation served a public purpose and provided a public benefit by allowing the Foundation to continue to fulfill its role in supporting the School and its programs.

3. Necessity. Rental payments in general were necessary in order to meet the terms of the Lease and use the property for the School's programs. Rent prepayments were deemed necessary by the parties in order for the Foundation to make certain improvements to the facility's systems and structure in a timeframe that would allow for an enhanced environment for the School's students, employees, and programs. Additionally, the prepayments were necessary in order to reduce School's annual operating expenses due to budget reductions described above. The prepayments were amortized over the term of the Lease and resulted in about a $45,000 ($3,743 x 12 months) annual reduction in lease costs for the School. As initially planned between the parties and as later recommended by the auditor, the parties' expected eventual entry into an approved Lease Purchase

Arrangement (submitted for PED approval in 2018 and again in April 2020) was intended to immediately credit the total amount of the rent prepayment balance against the purchase price under the LPA, resulting in immediate School "equity" in the Property in at least the amount of the rent prepayments.

In addition, the School and the Foundation have ceased any further prepayments of rent as of October of 2018. The parties to the Lease further have amended the Lease to confirm that there is sufficient equity in the leased property, such that the Foundation upon which the Foundation could draw (via refinance, sale or other available mechanism) to return unamortized prepaid rental payments to the School or its successor, the State of New Mexico, pursuant to paragraph 6.c of the Lease, upon any early termination of the Lease. The Lease amendment also provides that in the event the Lease is terminated early because of a final, non-appealable decision upholding denial of the School's Charter by its authorizing agency, the Foundation shall promptly take all commercially reasonable actions to repay the unamortized prepaid rent, which the Foundation agrees include refinancing of the mortgage on the Property and, in the event other commercially reasonable actions are not feasible, sale of the Property.

Implementation: The school will submit another LPA (3rd) to PED for approval on or before June 30, 2024, pursuant to the requirements of the Public School Lease-Purchase Act.

Person Responsible: Board of Directors, Executive Director and Business Manager.

2023-002 Financial Close and Reporting (Other Noncompliance)

Condition/Context: During our audit, we noted the following issues related to financial close and reporting:

- There was one instance where a software subscription meeting the definition of a Subscription-Based Information Technology Arrangement (SBITA) was not identified by management.
- The School recorded the May 2023 property tax distribution incorrectly. The amount related to HB-33 funds was recorded to SB-9, and the amount related to SB-9 funds was recorded to HB-33.

Criteria: Per NMAC 6.20.2.11, every school district shall establish and maintain an internal control structure to provide management with reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with GAAP.

Cause: Management oversight.

Effect: Potential misstatement and inaccurate financial statements.

Auditor's Recommendation: We recommend that management review all contracts and agreements relating to software prior to the annual audit to determine applicability under GASB-96. We recommend management review account codes used for cash receipts to ensure accuracy.

Management's Response: The school will make every effort to ensure that all Subscription-Based Information Technology Arrangements (SBITA) related to GASB 96 are properly identified. Additionally, the school will take steps to verify that property tax revenues are recorded in the correct fund.

Implementation: After fiscal year end, the business manager will review all SBITAs that began over the prior fiscal year to determine whether they qualify for GASB 96 accounting treatment. Generally, SBTIAS greater than one year that are reasonably certain to continue will be included. For property tax receipts, the business manager will verify the correct fund classification by comparing the tax receipts remittance advice to the fund code in the accounting system.

Person Responsible: Business Manager

THE GREAT ACADEMY FOUNDATION

2023-001 (Previously 2022-001, 2021-001, 2020-001) Deficit Fund Balance (Significant Deficiency)

Condition/Context: The following conditions and observations were made during our audit that elevate the concerns of the overall financial condition of the Foundation and increase the risk of the Foundation's ability to remain a going concern:

- On a modified accrual basis of accounting, the Foundation reports a deficit fund balance of $553,742 as of June 30, 2023.
- As of June 30, 2023, the Foundation reports a cash balance of only $138,857 and reports a liability as of June 30, 2023 in the amount of $696,293 related to advance prepaid rent amounts from the school, which the Foundation lacks the ability to return the advance prepaid rent amounts to the School if necessary.

Criteria: The Foundation should have an established budgeting and monitoring process to ensure expenditures do not exceed available resources. Advancements of funds from the school characterized as “prepaid rent” should not be considered available resources to budget and/or expend. In addition, as per section 6 (c) of the lease agreement between the School and the Foundation, which reads “...if the lease is terminated early for any reason other than purchase of the property by lessee and the prepaid rent has not been fully amortized over the base rent payments made to the date of such termination, lessor shall repay to lessee any unamortized amounts of prepaid rent.”

Cause: The Foundation has previously lacked an adequate budgeting and monitoring process to ensure expenditures are not in excess of available resources, although during FY23 revenues were in excess of expenditures.

Effect: The Foundation reports a deficit fund balance of $553,742, as of June 30, 2023 and currently is unable to return the funds advanced by the school if required.

Auditor’s Recommendation: We recommend management continue to reduce expenditures, to include minimizing to just required debt service payments and any required capital activity to maintain state required standards so that the Foundation can begin to eliminate the deficit fund balance. The

Foundation should evaluate all expenditures incurred by the Foundation and determine if they are reasonable and necessary for the Foundation. In addition, we recommend management review the Foundation expenditures that are directly for the benefit of the school and consult with legal counsel as necessary to determine if these expenditures should be incurred by the school instead of the Foundation, including those professional contracts with individuals who are also employees of the school. We also recommend management evaluate and consult with legal counsel on the available refinance options to ensure the Foundation has adequate resources to fulfill its obligations.

Management's Response: The Foundation met its obligations throughout fiscal year 2023 and continues to fulfill its obligations in fiscal year 2024. We reduced our deficit in fiscal year 2023 and will continue to monitor our expenditures moving forward. In addition, we continue to make timely debt payments and reduce the outstanding principal balance.

Implementation: Ongoing as we continue to reduce the outstanding principal balance and monitor expenditures.

Person Responsible: Foundation Board of Directors