

Hillsdale Preparatory School

Hillsdale, Michigan

Audited Financial Statements

June 30, 2007

CROSKEY, LANNI & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Hillsdale Preparatory School

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Hillsdale Preparatory School, as of and for the year ended June 30, 2007, which collectively comprise the Academy's basic financial statements listed in the table of contents. These financial statements are the responsibility of Hillsdale Preparatory School's management. Our responsibility is to express opinions 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of Hillsdale Preparatory School as of June 30, 2007, and the respective changes in financial position, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information on pages iii through viii and 16 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying financial statements have been prepared assuming that Hillsdale Preparatory School will continue as a going concern over the fiscal year ending June 30, 2008. The condition that leads to this going concern uncertainty includes declining enrollment directly affecting funding levels and as a result its ability to meet school building debt obligations. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters are described Note 11 to the financial statements. The financial statements do not include any adjustments that might result from this uncertainty.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Hillsdale Preparatory School's basic financial statements. The introductory section, combining and individual non major fund financial statements, and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual non major fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 27, 2007 on our consideration of Hillsdale Preparatory School's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.


Croskey, Lanni & Company, P.C.

July 27, 2007
Rochester, Michigan

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Hillsdale Preparatory School's, "HPS", annual financial report presents our discussion and analysis of the school's financial performance during the fiscal year that ended on June 30, 2007. Please read it in conjunction with the school's financial statements, which immediately follow this section.

FINANCIAL HIGHLIGHTS

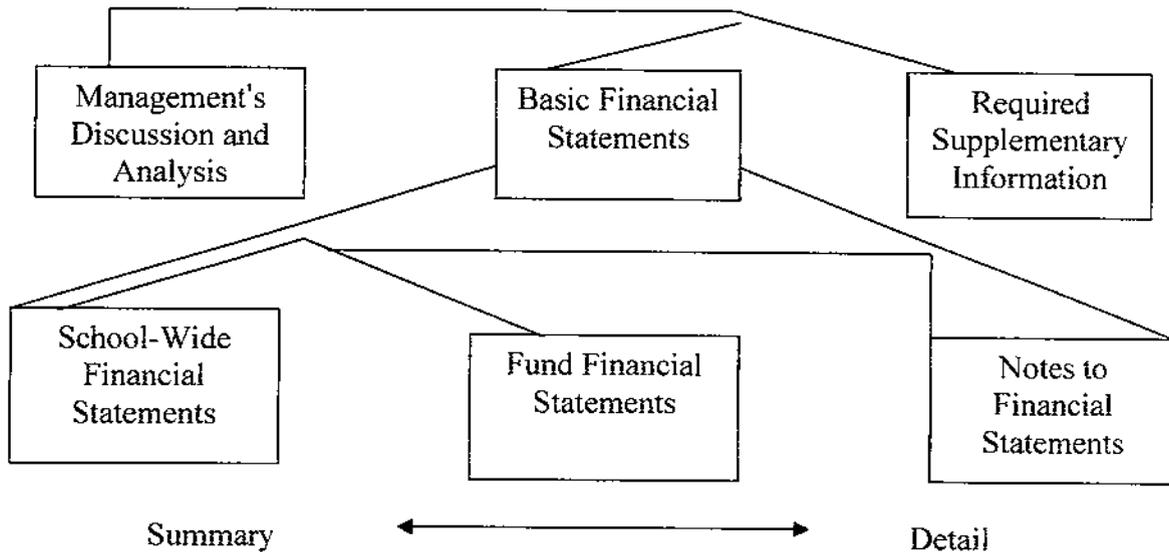
- ❖ Revenues were at \$357,874, while expenses were \$393,268 increasing the fund balance to \$232,107.
 - Instructional Expenditures were \$138,657.
- ❖ Enrollment was 43 students.
- ❖ The state aid increased by \$210 per student resulting in a per pupil allowance of \$7,085.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements which include two kinds of statements that present different views of the school:

- The first two statements are school wide financial statements that provide both short-term and long-term information about the school's overall financial status.
- The remaining statements are fund financial statements that focus on individual parts of the school, reporting the schools operations in more detail.
- The governmental fund statements tell how basic services like regular and special education were financed.
- Fiduciary funds statements provide information about the financial relationships in which the school acts solely as a trustee or agent for the benefit of others. These consist of student activity funds held by the school on behalf of the student group.

Figure A-1
Organization of HPS'S Annual Financial Report



The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the school's budget for the year. Figure A-1 shows how the various parts of this annual report are arranged and related to one another.

Figure A-2
Major Features of School-Wide and Fund Financial

	Fund Financial Statements		
	School-Wide Statements	Government Funds	Fiduciary Funds
Scope	Entire school (except fiduciary funds)	The activities of the school that are not proprietary or fiduciary, such as special education and building maintenance.	Instances in which the school administers resources on behalf of someone else, such as scholarship programs and student activities monies
Required Financial Statements	*Statement of net assets *Statement of activities	*Balance sheet *Statement of revenues, expenditures and changes in fund balances	*Statement of fiduciary net assets *Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter. no capital assets or long-term liabilities included	All assets and liabilities, both short-term and long-term
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and the related liability is due and payable	All additions and deductions during the year, regardless of when cash is received or paid

Figure A-2 summarizes the major features of the school's financial statements, including the portion of the schools activities they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis highlights the structure and contents of each of the statements.

SCHOOL-WIDE STATEMENTS

The school-wide statements report information about the school as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the school's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two school-wide statements report the school's net assets and how they have changed. Net assets – the difference between the school's assets and liabilities – are one way to measure the school's financial health or position.

- ❖ Over time, increases or decreases in the school's assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- ❖ To assess the overall health of the school, you need to consider additional non-financial factors such as changes in the school's enrollment and the condition of school buildings and other facilities.

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the school's funds, focusing on its most significant or "major" funds – not the school as a whole. Funds are accounting devices the school uses to keep track of specific sources of funding and spending on particular programs:

- ❖ *Governmental activities* – Most of the school's basic services are included in the general fund, such as regular and special education and administration. State foundation aid finances most of these activities.
- ❖ The school establishes other funds to control and manage money for particular purposes (like repaying its long-term debts) or to show that it is properly using certain revenues.

The school has two kinds of funds:

- ❖ *Governmental funds* – Most of the school's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the school's programs. Because this information does not encompass the additional long-term focus of the school-wide statements, we provide additional information with governmental funds statements that explain the relationship (or differences) between them.
- ❖ *Fiduciary funds* – The school is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the school-wide financial statements because the school cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE SCHOOL AS A WHOLE

The comparison of current year to prior year financial information is on the following pages. See tables A-3 and A-4.

The school's financial position is the product of many factors.

School Governmental

- ❖ A decline in enrollment over past year has resulted in the school unable to make its required debt payments on building. The school has entered into a forbearance agreement with US Bank and the bond holders in order to restructure the debt.
- ❖ HPS consistently curtails excessive spending.

General Fund Budgetary Analysis

Over the course of the year, the school reviewed the annual operating budget several times and amended the budget two times.

Financial Outlook

The following factors are contributing to Hillsdale Preparatory School's financial forecast for the 2007-2008 school year.

- ❖ The school has focused its efforts on student recruiting and anticipates an enrollment over 55 students for fall 07.
- ❖ Employing a new Management Company to further develop the school's mission, oversee classical instruction and recruit students.
- ❖ Continued efforts to curtail spending so that it aligns with revenue.

Appendix A

Table A-3
HPS's Net Assets

	<u>2006</u>	<u>2007</u>
Current and other assets	\$ 344,346	\$ 277,264
Capital assets	<u>1,918,873</u>	<u>1,871,175</u>
Total assets	<u>2,263,219</u>	<u>2,148,439</u>
Long-term debt outstanding	9,141	3,919
Other liabilities	<u>2,675,380</u>	<u>2,636,198</u>
Total liabilities	2,684,521	2,640,117
Net assets:		
Investment in capital asset, net of related debt	(582,986)	(617,970)
Restricted	253,690	214,071
Unrestricted	<u>(92,006)</u>	<u>(87,779)</u>
Total net assets	<u>\$ (421,302)</u>	<u>\$ (491,678)</u>

Table A-4
Changes in HPS's Net Assets

	<u>2006</u>	<u>2007</u>
Revenues:		
Program revenues:		
Charges for services	\$ 8,288	\$ 10,679
Federal and state operating grants	72,676	29,844
General revenues:		
State aid - unrestricted	370,081	299,341
Miscellaneous	<u>17,242</u>	<u>18,010</u>
Total revenues	<u>468,287</u>	<u>357,874</u>
Expenses:		
Instruction	156,849	138,657
Support services	223,108	142,001
Interest on long-term debt	28,012	99,893
Depreciation	<u>53,928</u>	<u>47,698</u>
Total expenses	<u>461,897</u>	<u>428,249</u>
Change in net assets	<u>\$ 6,390</u>	<u>\$ (70,375)</u>

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

By the end of 2007, the school had invested \$2,149,050 in capital assets, including facilities, computers and software. This amount represents no change from last year. (More detailed information about capital assets can be found in Note 5 to the financial statements.)

Building	\$ 2,050,503
Equipment	<u>98,547</u>
Subtotal	2,149,050
Accumulated depreciation	<u>(277,875)</u>
Net book value of assets	<u>\$ 1,871,175</u>

Long-Term Debt

At year end the school had debt of \$2,489,146 consisting of bond issuances and a capital lease.

- The school continued to pay down its debt, retiring \$12,716 of the amounts due on installment loan and capital lease.
- The balance on the certificates of participation remained at \$2,480,000.

FACTORS BEARING ON THE SCHOOL'S FUTURE

- Further development of the Classical Education Model.
- Increase and stabilization of student enrollment.
- New Management Company.

CONTACTING THE SCHOOL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our students, parents and creditors with a general overview of the school's finances and to demonstrate the school's accountability for the money it receives. If you have questions about this report or need additional information, contact the school's office at:

Hillsdale Preparatory School, 160 West Mechanic Hillsdale MI 49242

HILLSDALE PREPARATORY SCHOOL

STATEMENT OF NET ASSETS JUNE 30, 2007

ASSETS

Current Assets

Cash and cash equivalents	\$ 215,127
Due from other governmental units	<u>62,137</u>
Total current assets	277,264

Facilities, Furniture and Equipment

At cost less accumulated depreciation of \$277,875	<u>1,871,175</u>
Total assets	<u>\$ 2,148,439</u>

LIABILITIES AND NET ASSETS

Current Liabilities

Accounts payable	\$ 17,305
Notes payable	5,864
Other accrued expenses	127,802
Long-term debt - current portion	<u>2,485,227</u>
Total current liabilities	2,636,198

Long-Term Debt - Long-Term Portion 3,919

Net Assets

Invested in capital assets, net of related debt	(617,970)
Restricted for debt service	214,071
Unrestricted	<u>(87,779)</u>
Total net assets	<u>(491,678)</u>
Total liabilities and net assets	<u>\$ 2,148,439</u>

See accompanying notes to financial statements



HILLSDALE PREPARATORY SCHOOL

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2007

Functions	Expenses	Program Revenues		Net (Expense) Revenues and Changes in Net Assets
		Charges for Services	Operating Grants	Government Type Activities
Elementary school	\$ 138,657	\$ -	\$ 2,523	\$ (136,134)
Student support services	6,345	-	6,345	-
Improvement of instruction	20,976	-	20,976	-
General administration	10,648	-	-	(10,648)
Executive administration	14,800	-	-	(14,800)
Building administration	41,917	-	-	(41,917)
Operations and maintenance	47,316	-	-	(47,316)
Unallocated depreciation	47,698	-	-	(47,698)
Unallocated interest	99,893	10,679	-	(89,214)
Total primary government	<u>\$ 428,250</u>	<u>\$ 10,679</u>	<u>\$ 29,844</u>	<u>(387,728)</u>
 General Purpose Revenues:				
State school aid - unrestricted				299,341
Rental income				14,406
Miscellaneous				3,604
				<u>317,351</u>
Excess of expenses over revenues				(70,377)
Net assets - July 1, 2006				<u>(421,302)</u>
Net assets - June 30, 2007				<u>\$ (491,679)</u>

See accompanying notes to financial statements



HILLSDALE PREPARATORY SCHOOL

**BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2007**

ASSETS

	<u>General</u>	<u>Debt Service</u>
Cash and cash equivalents	\$ 1,056	\$ -
Investments	-	214,071
Due from other governmental units	<u>62,137</u>	<u>-</u>
Total assets	<u>\$ 63,193</u>	<u>\$ 214,071</u>

LIABILITIES AND FUND BALANCES

Liabilities

Accounts payable	\$ 17,305	\$ -
Notes payable	5,864	-
Other accrued expenses	<u>21,988</u>	<u>-</u>
Total liabilities	45,157	-

Fund Balances

Restricted for debt service	-	214,071
Unreserved:		
Undesignated	<u>18,036</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 63,193</u>	<u>\$ 214,071</u>

See accompanying notes to financial statements



HILLSDALE PREPARATORY SCHOOL

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE TO NET ASSETS
OF GOVERNMENTAL ACTIVITIES**

JUNE 30, 2007

Amounts reported for governmental activities in the statement of net assets are different because:

Total Governmental Fund Balance	\$ 232,107
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The cost of the assets is \$2,149,050 and the accumulated depreciation is \$277,875.	1,871,175
Interest is not payable until due in governmental activities and, therefore, is not recorded in the funds.	(105,814)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.	<u>(2,489,146)</u>
Net Assets of Governmental Activities	<u><u>\$ (491,678)</u></u>

See accompanying notes to financial statements



HILLSDALE PREPARATORY SCHOOL

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS FOR THE YEAR ENDED JUNE 30, 2007

	General	Debt Service
Revenues		
Local sources	\$ 18,010	\$ 10,679
State sources	304,381	-
Federal sources	24,804	-
	347,195	10,679
Expenditures		
Elementary school	138,657	-
Student support services	6,345	-
Improvement of instruction	20,976	-
General administration	7,649	2,999
Executive administration	14,800	-
Building administration	41,917	-
Operations and maintenance	47,316	-
Debt principle and interest	14,530	98,079
	292,190	101,078
Excess (deficiency) of revenues over expenditures	55,005	(90,399)
Other Financing Sources (Uses)		
Operating transfers in	-	50,780
Operating transfers out	(50,780)	-
	(50,780)	50,780
Excess (deficiency) of revenues and other financing sources over expenditures and other (uses)	4,225	(39,619)
Fund balance - July 1, 2006	13,811	253,690
Fund balance - June 30, 2007	\$ 18,036	\$ 214,071

See accompanying notes to financial statements

HILLSDALE PREPARATORY SCHOOL

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2007

Amounts reported for governmental activities in the statement of activities are different because:

Net Change in Fund Balances - Total Governmental Funds	\$ (35,394)
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Governmental funds report capital outlays as expenditures. However, in the statement of activities, assets are capitalized and the cost is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.

Depreciation expense	(47,698)
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The governmental funds report loan proceeds as an other financing source, while repayment of loan principal is reported as an expenditure. Interest is recognized as an expenditure in the governmental funds when it is due. The net effect of these differences in the treatment of general loan obligations is as follows:

Payments on long-term debt	<u>12,716</u>
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Change in Net Assets of Governmental Activities	<u><u>\$ (70,376)</u></u>
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See accompanying notes to financial statements

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 1 - Summary of Significant Accounting Policies

The accounting policies of Hillsdale Preparatory School (the "Academy") conform to generally accepted accounting principles applicable to public school academies. The following is a summary of the significant accounting policies:

Reporting Entity

Hillsdale Preparatory School, formerly Sauk Trail Academy, was formed as a public school academy pursuant to the Michigan School Code of 1976, as amended by Act No. 362 of the Public Acts of 1993 and Act No. 416 of the Public Acts of 1994. The Academy filed articles of incorporation as a nonprofit corporation pursuant to the provisions of the Michigan Nonprofit Corporation Act of 1982, as amended, on June 5, 1996, and began operation in June 2001.

The Academy entered into a contract with the Hillsdale Intermediate School District to charter a public school academy. The contract requires the Academy to act exclusively as a governmental agency and not undertake any action inconsistent with its status as an entity authorized to receive state school aid funds pursuant to the State constitution. The Hillsdale Intermediate School District is the fiscal agent for the Academy and is responsible for overseeing the Academy's compliance with the contract and all applicable laws. The Academy pays the Hillsdale Intermediate School District three percent of state aid as administrative fees. Total administrative fees paid for the year ended June 30, 2007 was \$9,010.

In August 2005, the Academy entered into a three year agreement with CS Partners, LLC (CSP) under the terms of this agreement. CSP will provide a variety of services including oversight of administration and staff and coordinate the development of budgets and financial reports. The Academy is obligated to pay CSP two percent of state aid funds for the year ended June 30, 2007. Total paid for these services amounted to \$5,790.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operation of financial relationships with the public school academy. Based on application of criteria, the entity does not contain component units.

Fund Financial Statements

Fund financial statements report detailed information about the Academy. The focus of governmental fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. The Academy has elected to specify all of its funds as major.

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 1 - Summary of Significant Accounting Policies - Continued

Basis of Presentation - Fund Accounting

The accounts of the Academy are organized on the basis of funds. The operations of a fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenue and expenditures. Government resources are allocated to and accounted for in individual funds based on the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped, in the combined financial statements in this report, into generic fund types in two broad fund categories.

Governmental Funds

A governmental fund is a fund through which most academy functions typically are financed. The acquisition, use and balances of the Academy's expendable financial resources and the related current liabilities are accounted for through a governmental fund.

General Fund - The general fund is used to record the general operations of the Academy pertaining to education and those operations not provided for in other funds. Included are all transactions related to the approved current operating budget.

Debt Service Fund - The debt service fund is used to record certain revenue and the payment of interest, principal and other expenditures on long-term debt.

Governmental funds utilize the modified accrual basis of accounting. Modifications in such method from the accrual basis are as follows:

- a. Revenue that is both measurable and available for use to finance operations is recorded as revenue when earned. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Academy considers revenues to be available if they are collected within sixty days of the end of the current fiscal period.
- b. Payments for inventorable types of supplies, which are not significant at year end, are recorded as expenditures at the time of purchase.
- c. Principal and interest of general long-term debt are not recorded as expenditures until their due dates.
- d. The State of Michigan utilizes a foundation allowance funding approach, which provides for a specific annual amount of revenue per student based on a state-wide formula. The foundation allowance is funded from a combination of state and local sources. Revenue from state sources is primarily governed by the School Aid Act and the School Code of Michigan. The State portion of the foundation is provided from the State's School Aid Fund and so recognized as revenue in accordance with state law. A major portion of the Academy is considered to be economically dependent on this aid. The Academy's existence is dependent upon continued qualification for such aid.

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

Government Wide Financial Statements

The government-wide financial statements (i.e. the statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This approach differs from the manner in which governmental fund financial statements are prepared. Therefore, governmental fund financial statements include reconciliations with brief explanations to better identify the relationships between the government-wide statements and the statements for governmental funds.

The government-wide Statement of Activities presents a comparison between expenses, and program revenues for each segment of the business-type activities of the Academy and for each governmental program. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular function. The Academy does not allocate indirect expenses to programs. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues not classified as program revenues are presented as general purpose revenues. The comparison of program revenues and expenses identifies the extent to which each program or function is self financing or draws from the general purpose revenues of the Academy.

Net assets should be reported as restricted when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The Academy first utilizes restricted resources to finance qualifying activities.

Cash and Cash Equivalents

The Academy's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with maturities of three months or less from the date of acquisition. The Academy reports its investments in accordance with GASB Statement No. 31, accounting and financial reporting for certain investments and for external investment pools and GASB No. 40, Deposit and Investment Risk Disclosures. Under these standards, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standards also provide that certain investments are valued at cost (or amortized cost) when they are at a short-term duration the rate of return is fixed and the academy intends to hold the investment until maturity. The Academy held no investments as of June 30, 2007. State statutes authorize the Academy to invest in bonds and other direct and certain in-direct obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal deposit Insurance Corporation, Federal Savings and Loan Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The Academy also authorized to invest in U.S. Government or Federal agency obligation re-purchase agreements, bankers' acceptances of U.S. Banks, and mutual funds composed of investments as outlined above.

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 1 - Summary of Significant Accounting Policies - Continued

Receivables

Receivables at the balance sheet dates consist primarily of state school aid due from the State of Michigan. All receivables are expected to be fully collected and are considered current for the purposes of these basic financial statements.

Capital Assets and Depreciation

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. The Academy follows the policy of not capitalizing assets with a cost of less than \$1,000, and a useful life of less than one year. The Academy does not possess any infrastructure assets.

All reported capital assets, with the exception of land, are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives:

Building and improvements	50 years
Furniture and equipment	5 - 20 years
Computers and software	5 years

Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements. In general, payables and accrued liabilities that will be paid from governmental funds are reported on the governmental fund financial statements regardless of whether they will be liquidated with current resources. However, the non-current portion of capital leases that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they will be paid with current, expendable, available financial resources. In general, payments made within sixty days after year-end are considered to have been made with current available financial resources. Other long-term obligations that will be paid from governmental funds are not recognized as a liability in the fund financial statements until due.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the Academy or through external restrictions imposed by creditors, grantors or laws of regulations of other governments.

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 amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 2 - Stewardship, Compliance and Accountability

Annual budgets are adopted on a consistent basis with accounting principles generally accepted in the United States of America and state law for the general fund. All annual appropriations lapse at fiscal year end and encumbrances are not formally recorded.

The budget document presents information by fund and function. The legal level of budgetary control adopted by the governing body is the function level. State law requires the Academy to have its budget in place by July 1. Expenditures in excess of amounts budgeted is a violation of Michigan law.

Annual budgets are adopted on the consistent basis with accounting principles generally accepted in the United States of America and state law for the general fund. All annual appropriations lapse at fiscal year end and encumbrances are not formally recorded.

The budget document presents information by fund and function. The legal level of budgetary control adopted by the governing body is the function level. State law requires the Academy to have its budget in place by July 1. Expenditures in excess of amounts budgeted is a violation of Michigan law. The Academy is required by law to adopt a general fund budget. The Academy originally adopted a general fund budget, which includes traditional debt service fund revenues and expenditures. For the financial statement presentation these amounts are shown as a separate debt service fund. During the year ended June 30, 2007 the budget was amended in a legally permissible manner.

The budget statement (budgetary comparison schedule - all governmental funds) is presented on the combined statement of revenue, expenditures, and fund balances. Budget overruns are as follows:

General Fund	<u>Budget</u>	<u>Actual</u>
Executive administration	\$ 14,799	\$ 14,800
Debt principal and interest	2,642	14,531

NOTE 3 - Deposits and Investments

The Academy maintains cash balances at various financial institutions. The balances are insured by the Federal Deposit Insurance Corporation up to \$100,000 per account. The Academy's cash was fully insured as of June 30, 2007. The Academy's investments were comprised of fund shares that had a carrying amount and market value of \$214,071 for the year ended June 30, 2007. These investments are held by a trustee for debt service on the Certificates of Participation as described in Note 8. The investments are in mutual funds that invest solely in US Treasury obligations.

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 4 - Due From Other Governmental Units

Amounts owed from governmental units and other consist of the following:

State sources	\$ 55,374
Federal sources	<u>6,763</u>
Total	<u>\$ 62,137</u>

NOTE 5 - Capital Assets and Depreciation

Capital asset activity of the Academy's governmental activities was as follows:

	<u>Balance July 1, 2006</u>	<u>Additions</u>	<u>Balance June 30, 2007</u>
Land (non-depreciable)	\$ 100,000	\$ -	\$ 100,000
Building	1,950,503	-	1,950,503
Computers	42,243	-	42,243
Equipment and furniture	<u>56,304</u>	<u>-</u>	<u>56,304</u>
Subtotal	2,149,050	-	2,149,050
Accumulated depreciation	<u>230,177</u>	<u>47,698</u>	<u>277,875</u>
Net book value of assets	<u>\$ 1,918,873</u>	<u>\$ (47,698)</u>	<u>\$ 1,871,175</u>

Depreciation expense was not charged to activities as the Academy considers its assets to impact multiple activities and allocation is not practical.

NOTE 6 - Notes Payable

The Academy has obtained a business loan through the Michigan Public Educational Facilities Authority amounting to \$50,150 for the year ended June 30, 2007. The loan was issued to provide the Academy with funds to finance school operations at the beginning of the fiscal year. The loan bears interest at 8.75% and security is provided through future state school aid payments. The amount outstanding on the loan at June 30, 2007 was \$5,864.

NOTE 7 - Accrued Expenses

Amounts accrued at year end consist of the following:

	<u>Net Assets</u>	<u>Funds</u>
Interest	\$ 105,814	\$ -
Purchased services	20,351	20,351
University oversight fee	<u>1,637</u>	<u>1,637</u>
Total accrued expenses	<u>\$ 127,802</u>	<u>\$ 21,988</u>

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 8 - Long-Term Obligations Payable

The following is a summary of long-term obligations for the Academy for the year ended June 30, 2007.

	<u>Balance</u> <u>July 1, 2006</u>	<u>Additions</u>	<u>Retirements</u> <u>and Payments</u>	<u>Balance</u> <u>June 30, 2007</u>	<u>Due Within</u> <u>One Year</u>
Installment loan	\$ 7,977	\$ -	\$ 7,977	\$ -	\$ -
Capital lease	13,885	-	4,739	9,146	5,227
Certificates of participation	2,480,000	-	-	2,480,000	2,480,000
Total	<u>\$ 2,501,862</u>	<u>\$ -</u>	<u>\$ 12,716</u>	<u>\$ 2,489,146</u>	<u>\$ 2,485,227</u>

The Academy has issued Certificates of Participation bearing interest at an average rate of 6% through the year ended June 30, 2031. The obligations require semi-annual interest payments due on December 1st and June 1st and an annual payment of principal due on June 1st beginning in 2005. The certificates are collateralized by a mortgage on the Academy's facility as well as a pledge for 20% of State School Aid payments and investments held in trust for debt service. Currently the above mentioned certificates are in default and therefore are classified as current.

Following are maturities of long-term obligations principal and interest for the next two years:

	<u>Principal</u>	<u>Interest</u>
2008	\$ 2,485,227	\$ 665
2009	3,919	150

The Academy is the lessee of equipment held under a capital lease. The lease bears interest at 9.8% and expires in the year ending June 30, 2009. The lease is secured by equipment.

Minimum annual payments under capital leases coming due during the two years ending June 30, 2009 are as follows:

2008	\$ 5,892
2009	4,069
Total minimum lease payment	<u>9,961</u>
Less amount representing interest	<u>815</u>
Present value of minimum lease payments	<u>\$ 9,146</u>

HILLSDALE PREPARATORY SCHOOL
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2007

NOTE 9 - Interfund Transfers

During the normal course of the school year the Academy transferred amounts between its two major funds as follows:

	<u>General</u>	<u>Debt Service</u>
Transfers In	\$ -	\$ 50,780
Transfers Out	50,780	-

As stipulated by the Academy's Certificates of Participation as described in Note 8, the Academy must transfer 20% of its state aid to a trustee. The trustee retains the required portion needed for debt service and returns the remainder to the Academy. This accounts for the major activity in the Academy's interfund transfer account.

NOTE 10 - Risk Management

The Academy is exposed to various risks of loss related to property loss, torts, errors and omissions and employee injuries (worker's compensation), as well as medical benefits provided to employees. The Academy has purchased commercial insurance for all claims. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

NOTE 11 - Going Concern

The Academy's financial statements have been presented on the basis that it is a going concern for the fiscal year ending June 30, 2008.

A forbearance agreement has been approved as of August 24, 2006 between the school and its bondholders regarding the indebtedness of the school building.

The Academy's student count has declined, which in turn, has lowered the amount of state aid funding. A new board of directors has been appointed and with the name change, the Academy hopes to increase its student body.

David M. Croskey, CPA
Thomas B. Lanni, CPA
Carolyn A. Jones, CPA
Clifton F. Powell Jr., CPA

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTAL INFORMATION

**To the Board of Directors
of Hillsdale Preparatory School**

We have audited the accompanying basic financial statements of Hillsdale Preparatory School for the year ended June 30, 2007. Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The additional information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of Hillsdale Preparatory School. This information has been subjected to the procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.


Croskey, Lanni & Company, P.C.

July 27, 2007
Rochester, Michigan

HILLSDALE PREPARATORY SCHOOL

REQUIRED SUPPLEMENTAL INFORMATION BUDGETARY COMPARISON SCHEDULE - ALL GOVERNMENTAL FUNDS FOR THE YEAR ENDED JUNE 30, 2007

	General Fund		
	Original Budget	Final Budget	Actual
Revenues			
Local sources	\$ 14,400	\$ 17,400	\$ 18,010
State sources	367,849	305,353	304,381
Federal sources	-	32,807	24,804
Total governmental fund revenues	382,249	355,560	347,195
Expenditures			
Elementary school	142,001	148,615	138,657
Student support services	-	6,400	6,345
Improvement of instruction	-	22,128	20,976
General administration	9,650	8,080	7,649
Executive administration	31,997	14,799	14,800
Building administration	51,788	42,712	41,917
Operations and maintenance	53,116	47,801	47,316
Debt principle and interest	7,750	2,642	14,530
Total governmental fund expenditures	296,302	293,177	292,190
Excess (deficiency) of revenues over expenditures	85,947	62,383	55,005
Other Financing Sources (Uses)			
Operating transfers in	-	-	-
Operating transfers out	(76,996)	(69,705)	(50,780)
Total other financing sources (uses)	(76,996)	(69,705)	(50,780)
Excess (deficiency) of revenues and other financing sources over expenditures and other uses	8,951	(7,322)	4,225
Fund balance - July 1, 2006	13,811	13,811	13,811
Fund balance - June 30, 2007	\$ 22,762	\$ 6,489	\$ 18,036

See independent auditors report on supplemental information

Debt Service Fund

Original Budget	Final Budget	Actual
\$ 1,000	\$ -	\$ 10,679
-	-	-
-	-	-
1,000	-	10,679
-	-	-
-	-	-
-	-	-
-	-	2,999
-	-	-
-	-	-
-	-	-
76,996	69,705	98,079
76,996	69,705	101,078
(75,996)	(69,705)	(90,399)
76,996	69,705	50,780
-	-	-
76,996	69,705	50,780
1,000	-	(39,619)
253,690	253,690	253,690
<u>\$ 254,690</u>	<u>\$ 253,690</u>	<u>\$ 214,071</u>

HILLSDALE PREPARATORY SCHOOL

SCHEDULE OF REVENUES - ALL GOVERNMENTAL FUNDS FOR THE YEAR ENDED JUNE 30, 2007

	General	Debt Service
Local Sources		
Interest	\$ -	\$ 10,679
Rental income	14,406	-
Miscellaneous	3,604	-
	18,010	10,679
State Sources		
At risk	3,651	-
Middle school math	417	-
State aid	300,313	-
	304,381	-
Federal Sources		
REAP grant	15,324	-
Title I	2,815	-
Title IIA	6,665	-
	24,804	-
Total governmental fund revenues	\$ 347,195	\$ 10,679

See independent auditor's report on supplemental information



HILLSDALE PREPARATORY SCHOOL

SCHEDULE OF EXPENDITURES - ALL GOVERNMENTAL FUNDS FOR THE YEAR ENDED JUNE 30, 2007

	General	Debt Service
Elementary School		
Purchased services - salaries	\$ 118,289	\$ -
Purchased services - payroll taxes	10,730	-
Teaching supplies and materials	9,338	-
Miscellaneous	300	-
	138,657	-
Student Support Services		
Guidance services	6,102	-
Materials and supplies	243	-
	6,345	-
Improvement of Instruction		
Purchased services	16,317	-
Teaching supplies and materials	1,844	-
Workshops and conferences	2,815	-
	20,976	-
General Administration		
Advertising	689	-
Dues and fees	120	-
Professional services	6,840	2,999
	7,649	2,999
Executive Administration		
Management fees	5,790	-
Oversight fees	9,010	-
	14,800	-

See independent auditor's report on supplemental information



HILLSDALE PREPARATORY SCHOOL

SCHEDULE OF EXPENDITURES - ALL GOVERNMENTAL FUNDS - Continued FOR THE YEAR ENDED JUNE 30, 2007

	General	Debt Service
Building Administration		
Purchased services - salaries	33,003	-
Purchased services - payroll taxes	3,271	-
Equipment lease	1,863	-
Postage	548	-
Supplies and other	3,232	-
	41,917	-
Operations and Maintenance		
Liability insurance	4,831	-
Outside services	5,755	-
Repair and maintenance	7,905	-
Supplies and materials	2,126	-
Utilities	26,699	-
	47,316	-
	14,530	98,079
	Debt Principle and Interest	98,079
	Total governmental fund expenditures	Total governmental fund expenditures
	\$ 292,190	\$ 101,078

See independent auditor's report on supplemental information

David M. Croskey, CPA
Thomas B. Lanni, CPA
Carolyn A. Jones, CPA
Clifton F. Powell Jr., CPA

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance with
with *Government Auditing Standards*

**To the Board of Directors
of Hillsdale Preparatory School**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Hillsdale Preparatory School as of and for the year ended June 30, 2007, which collectively comprise the Academy's basic financial statements and have issued our report thereon dated July 27, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Hillsdale Preparatory School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Hillsdale Preparatory School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Hillsdale Preparatory School's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance

As part of obtaining reasonable assurance about whether Hillsdale Preparatory School's financial statements are free of 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*.

This report is intended solely for the information and use of management, the board of directors, the Michigan Department of Education, and others within the entity and is not intended to be and should not be used by anyone other than those specified parties.


Croskey Lanni & Company, P.C.

July 27, 2007
Rochester, Michigan