Great Hearts America – Texas

Financial and Compliance Report

June 30, 2014 and 2013

Great Hearts America – Texas

Table of Contents

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Great Hearts America – Texas

Federal Employer Identification Number: 43-1973126

Certificate of Board

We, the undersigned, certify that the attached Financial and Compliance Report of Great Hearts America – Texas was reviewed and (check one) ✓ approved _______ disapproved for the year ended June 30, 2014 at a meeting of the governing body of the charter holder on the 12 day of November, 2014.

Signature of Board Secretary

Signature of Board President

If the governing body of the charter holder disapproved the independent auditor's report, the reason(s) for disapproving it is (are): (attach list as necessary)

PS&Co.

Padgett Stratemann

Independent Auditor's Report

To the Board of Directors
Great Hearts America – Texas
Phoenix, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of Great Hearts America – Texas (the "Organization"), which comprise the statements of financial position as of June 30, 2014 and 2013, and the related statements of activities and changes in net assets and cash flows for the years 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 audits. We conducted our audits 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of June 30, 2014 and 2013, and the changes in its net assets and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 12, 2014 on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.

Padgett, Stratemann & Co., L.L.P.

San Antonio, Texas
November 12, 2014

Financial Statements

Great Hearts America – Texas

Statements of Financial Position

Exhibit A-1

June 30, 2014 and 2013

	2014	2013
Current Assets		
Cash and cash equivalents	$ 411,883	$ 381,250
Due from government agencies	75,935	-
Due from related party	1,843	-
Prepaid expenses	282,172	1,088
Rental deposits	5,570	-
Unconditional promises to give – current portion	100,000	-
Total current assets	877,403	382,338
Property and Equipment		
Equipment	92,011	-
Construction in progress	98,020	-
Total property and equipment	190,031	-
Less accumulated depreciation	9,534	-
Net property and equipment	180,497	-
Other Assets		
Cash – noncurrent – restricted	1,780,000	-
Lease deposits	60,000	-
Unconditional promises to give – net	360,037	-
Total other assets	2,200,037	-
Total assets	$ 3,257,937	$ 382,338
Current Liabilities		
Due to related party	$ -	$ 99,726
Accounts payable	60,716	8,597
Deferred revenue	1,584,000	125,000
Total current liabilities	1,644,716	233,323
Long-Term Liabilities – notes payable	1,780,000	-
Total liabilities	3,424,716	233,323
Net Assets (Deficit)		
Temporarily restricted	-	149,015
Unrestricted deficit	(166,779)	-
Total net assets (deficit)	(166,779)	149,015
Total liabilities and net assets	$ 3,257,937	$ 382,338

Notes to the financial statements form an integral part of these statements.

Great Hearts America – Texas

Statement of Activities

Exhibit A-2

Year Ended June 30, 2014

	Unrestricted	Temporarily Restricted	Total
Revenues and Other Support			
Local support – contributions	$ 521,287	$ 11,180	$ 532,467
Federal program revenues – PCS start-up grant	-	191,038	191,038
Net assets released from restrictions – restrictions satisfied by payments	351,233	(351,233)	-
Total revenues	872,520	(149,015)	723,505
Expenses			
Support services – administrative support services	1,039,299	-	1,039,299
Total expenses	1,039,299	-	1,039,299
Change in net assets	(166,779)	(149,015)	(315,794)
Net assets at beginning of year	-	149,015	149,015
Net assets at end of year	$ (166,779)	$ -	$ (166,779)

Great Hearts America – Texas

Statement of Activities

Exhibit A-2

Year Ended June 30, 2013

	Unrestricted	Temporarily Restricted	Total
Revenues and Other Support			
Local support – contributions	$ 6,250	$ 250,000	$ 256,250
Net assets released from restrictions	100,985	(100,985)	-
Total revenues and other support	107,235	149,015	256,250
Expenses			
Support services – administrative support services	107,235	-	107,235
Total expenses	107,235	-	107,235
Change in net assets	-	149,015	149,015
Net assets at beginning of year	-	-	-
Net assets at end of year	$ -	$ 149,015	$ 149,015

Notes to the financial statements form an integral part of these statements.

Great Hearts America – Texas

Statements of Cash Flows

Exhibit A-3

Years Ended June 30, 2014 and 2013

	2014	2013
Cash Flows From Operating Activities		
Change in net assets	$ (315,794)	$ 149,015
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	9,534	-
Changes in:		
Due from governmental agencies	(75,935)	-
Due from related party	(1,843)	99,726
Prepaid expenses	(281,084)	(1,088)
Rental and lease deposits	(65,570)	-
Unconditional promises to give	(460,037)	-
Due to related party	(99,726)	-
Accounts payable	52,119	8,597
Deferred revenue	1,459,000	125,000
Net cash provided by operating activities	220,664	381,250
Cash Flows From Investing Activities – purchase of property and equipment	(190,031)	-
Net cash used in investing activities	(190,031)	-
Cash Flows From Financing Activities – proceeds from loans	1,780,000	-
Net cash provided by financing activities	1,780,000	-
Net increase in cash and cash equivalents	1,810,633	381,250
Cash and cash equivalents at beginning of year	381,250	-
Cash and cash equivalents at end of year	$ 2,191,883	$ 381,250

Notes to the financial statements form an integral part of these statements.

1. Organization and Significant Accounting Policies

Reporting Entity, Operations, and Nature of Activities

Great Hearts America – Texas (the "Organization") is a not-for-profit 501(c)(3) corporation established in the state of Texas to operate public charter schools with open admissions policies in Texas. The Organization was originally established in 2002 for the purpose of providing education under the name of Sister Creek Center for Liberal Arts. A Restated Certificate of Formation with New Amendments was filed on February 17, 2012 to change the Organization's name to Great Hearts America – Texas and amend its purpose to develop each student's academic potential, personal character, and leadership qualities through an academically rigorous and content-rich educational program grounded in the classical liberal arts tradition and to strive to give every student the education he or she deserves and needs. The primary goal of the Organization is to graduate thoughtful leaders of character who will contribute to a more philosophical, humane, and just society. No assets were transferred in the reformation process.

The Organization is the charter holder for all Great Hearts academies operated in Texas. The Organization has a sole corporate member, Great Hearts America, an Arizona nonprofit corporation, as permitted by the Texas Business Organizations Code. This nonprofit corporate structure is intended to maintain the integrity of the national Great Hearts academic and programmatic model, while also allowing for local input and control.

Pursuant to the bylaws of the Organization, the Board of Directors (the "Board") will be comprised of not less than three and not more than seven members. Each director will serve a one-year term or until his or her successor is appointed, and a director whose term has expired may be appointed to succeed him or herself. The Board is responsible for the adoption and implementation of policy for the Organization and for the management, operation, and accountability of the charter school in all locations. At June 30, 2014, there are six directors.

In November 2012, the Texas State Board of Education approved the Organization's first charter authorizing the opening of at least two K-12 campuses in and around San Antonio, Texas. According to the terms of the charter, the charter shall be in effect from the date of execution through July 31, 2018, unless renewed or terminated. The charter may be renewed for an additional period of ten years. Under the terms of the charter, the Organization was authorized to open and hold classes beginning with the 2013-2014 school year; however, the Organization submitted for review and approval an amendment to the charter to delay opening its first schools, Great Hearts Academy – Monte Vista (North and South campuses), by one year (i.e., to August 2014 for the 2014-2015 school year), which was granted by the Texas Education Agency ("TEA"). Therefore, as of June 30, 2014, the Organization has not opened any schools. However, the Organization opened Great Hearts Academy – Monte Vista (North and South campuses) on August 18, 2014.

In June 2014, the TEA also approved an expansion amendment to the charter, allowing the Organization to open up to two additional campuses (Great Hearts Academy – Dallas and Great Hearts Academy – Irving) to serve families in those additional geographic territories effective July 1, 2015. The TEA also approved an amendment in June to increase the charter's maximum enrollment of the Organization from 1,965 to 3,930 effective July 1, 2015.

Basis of Accounting
The accompanying financial statements were prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Financial Accounting Standards Board is the accepted standard setting body for establishing not-for-profit accounting and financial reporting principles. Accordingly, revenues are recognized when earned and expenses are recognized when they are incurred.

Support and revenue are reported as an increase in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (e.g., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Use of Estimates
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

Unrestricted Net Assets – Unrestricted net assets consist of net assets that are not subject to donor-imposed stipulations. Unrestricted net assets result from operating revenues, unrestricted contributions, and unrestricted dividend and interest income. Unrestricted net assets may be designated for specific purposes by action of the Board. The Organization had deficit unrestricted net assets of $166,779 and $0 at June 30, 2014 and 2013, respectively.

Temporarily Restricted Net Assets – Temporarily restricted net assets consist of assets that are subject to grantor or donor-imposed stipulations that require the passage of time or the occurrence of a specified event (actions by the Organization). When the donor restriction expires, the temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. The Organization had $0 and $149,105 of temporarily restricted net asset at June 30, 2014 and 2013, respectively.

Permanently Restricted Net Assets – Permanently restricted net assets consist of net assets required to be maintained in perpetuity with only the income to be used for the Organization's charter school activities due to grantor donor-imposed restrictions. The Organization had no permanently restricted net assets at June 30, 2014 and 2013.

Cash and Cash Equivalents
For financial statement purposes, the Organization considers all highly liquid investment instruments with an original maturity of three months or less to be cash and cash equivalents. The Organization maintains a balance at a bank in excess of the federally insured limits. The Organization has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on cash deposits and investment holdings. At June 2014 and 2013, cash and cash equivalents are comprised of bank accounts with a balance of $2,191,883 and $381,250; respectively. Restricted cash represents note payable proceeds restricted for the purchase of land.

Capital Assets
Capital assets, as defined by the Organization, are assets with individual cost of more than $5,000. Such assets are recorded at cost if purchased or fair value if donated. Depreciation is calculated on the straight-line method. The useful life for equipment is 3 to 3.5 years.

Impairment of Long-Lived Assets
The Organization reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, and the effects of obsolescence, demand, competition, and other economic factors. The Organization did not recognize an impairment loss during the years ended June 30, 2014 and 2013.

Federal Income Tax
The Organization is a not-for-profit organization and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, except to the extent it has unrelated business activities. As such, no provision for federal income taxes has been made in the accompanying financial statements. At June 30, 2014 and 2013, the Organization has no material unrelated business taxable income.

The Organization's policy is to record interest and penalty expense related to income taxes as interest and other expense, respectively. At June 30, 2014 and 2013, no interest or penalties have been or are required to be accrued. The Organization, generally, is no longer subject to income tax examinations by federal authorities for the years prior to June 30, 2009.

Public Support and Revenue
Contributions are recorded at fair value when the Organization is in possession of or receives an unconditional promise to give. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted support based on the existence and/or nature of any donor restrictions. Support that is restricted by the donor is reported as an increase in temporarily restricted net assets in the reporting period in which the support is recognized. When a donor restriction expires, that is, when a stipulated time restriction passes or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Unconditional promises to give, including contributions and pledges that are expected to be collected within one year, are recorded at their net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows based on the fair value option.

Conditional promises to give are not included as revenues in the financial statement until such time as the conditions are met.

Donated services are recognized only if the services received either create or enhance assets or require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. No material amount of donated services were received during the year ended June 30, 2014 and 2013.

In-kind contributions of goods and services are recorded at fair market value and recognized as revenue in the accounting period in which they are received. No in-kind contributions were received during the year ended June 30, 2014 and 2013.

Federal Program Revenues and Due from Government Agencies

The Organization considers all government grants and contracts as exchange transactions rather than contributions. The Organization recognizes revenue from fee-for-service transactions as services are rendered and, for grants, as eligible expenditures are incurred. Advances from government agencies are recorded as refundable advances. Eligible expenditures incurred in excess of grant fund reimbursements are recorded as receivables. At June 30, 2014, $75,935 is due from the Texas Department of Education, Texas Education Agency ($0 in 2013).

Any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds, or both, as a result of any noncompliance with the terms of the grant or contract.

Allowance for Bad Debts

Management reviews accounts receivable (e.g., due from) and promises to give on a regular basis to determine if any receivable will potentially be uncollectible. Management uses its judgment, based on the best available facts and circumstances, and records a specific reserve for each receivable to reduce the receivable to the amount that is expected to be collected. Factors such as the third-party organization's ability to meet its financial obligations and historical experience are used to determine the amount which is likely to be collected. Management includes receivable balances that are determined to be uncollectible in its overall allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. The allowance for doubtful accounts totaled $0 as of June 30, 2014 and 2013.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. The cost of prepaid items is recorded as an expense when consumed rather than when purchased.

Rental and Lease Deposits
The Organization paid deposits for the rental or lease of building space. The amounts will be refunded or expensed at the end of the lease term.

Deferred Revenue
Amounts received for conditional promises to give for which the condition has not been met are recorded as deferred revenue. When the condition is met, the revenue will be recognized.

Functional Allocation of Expenses
The costs of providing various programs and activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Contingencies
Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Organization, but which will only be resolved when one or more future events occur or fail to occur. The Organization's management assesses such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Organization or unasserted claims that may result in such proceedings, the Organization's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Organization's financial statements. If the assessment indicates a potentially material loss contingency is not probable, but is reasonably possible, or is probable, but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, would be disclosed in the notes to the financial statements. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed in the notes to financial statements.

Subsequent Events
The Organization has evaluated subsequent events through November 12, 2014, the date the financial statements were available to be issued. See Note 14.

2. Fair Value Measurements and Disclosures

The requirements of *Fair Value Measurements and Disclosures* of the Accounting Standards Codification ("ASC") apply to all financial instruments and all nonfinancial assets and nonfinancial liabilities that are being measured and reported on a fair value basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Fair Value Measurements and Disclosures* also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Inputs – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

At June 30, 2014 and 2013, the Organization had no investments.

The fair value of the Organization's cash and cash equivalents, due from government agencies, prepaid expenses, and deposits approximates the carrying amounts of such instruments due to their short maturity. The fair value of the debt approximates the carrying amount because the rate and terms currently available to the Organization approximate the rate and terms on the existing debt.

3. Promise to Give

On June 25, 2014, the Organization received an unconditional promise to give of $500,000 payable in five $100,000 annual installments starting on December 31, 2014 through December 31, 2018. The discount rate used to calculate the fair value of long-term promises to give at June 30, 2014 is 1.68%.

Unconditional promise to give consists of the following:

	June 30,	
	2014	2013
Gross amounts due in:		
One year or less	**$ 100,000**	$ -
One to five years	**400,000**	-
Total unconditional promises to give	**500,000**	-
Less discounts to net present value	**39,963**	-
Net unconditional promises to give	**$ 460,037**	$ -

4. Related Party Transactions

During the audit period, the Organization received donated accounting and administrative services from Great Hearts Academies ("GHA-AZ"), a fiscal sponsor of Great Hearts America. The amount of services received is minimal and, therefore, is not reflected in the financial statements. GHA-AZ is an Arizona not-for-profit 501(c)(3) corporation that manages a network of 19 academically rigorous classical liberal arts academies (serving grades K-12) in the Phoenix, Arizona metropolitan area. The Organization and GHA-AZ are considered affiliates as of June 30, 2014 and 2013, since the Board of the Organization is comprised of key management personnel of GHA-AZ and Great Hearts America. As of June 30, 2014, the Organization owed GHA-AZ $99,726 for reimbursement of expenses paid by GHA-AZ on behalf of the Organization. During the year ended June 30, 2014, the Organization settled up the amounts owed to GHA-AZ.

5. Deferred Revenues

Deferred revenues consisted of a $1,584,000 and $125,000 of donations received related to conditional promises to give as of June 30, 2014 and 2013, respectively. Such conditions were satisfied in August 2014.

6. Conditional Contributions

The Organization has a conditional promise to give. Payment is contingent upon the Organization meeting certain criteria specified by the donor. As the condition for payment from the donor has not been met as of June 30, 2014, the amount has not been included in these financial statements. Such conditions were satisfied in August 2014.

The future payments under the conditional contributions at June 30, 2014 are as follows:

Year ending June 30:	
2015	$ 433,000
2016	433,000
2017	100,000
2018	100,000
2019	100,000
Thereafter	250,000
	$ 1,416,000

7. Property and Equipment

Property and equipment consist of the following:

	June 30, 2014	June 30, 2013
Equipment	$ 92,011	$ -
Construction in progress	98,020	-
	190,031	-
Less accumulated depreciation	9,534	-
Net property and equipment	$ 180,497	$ -

Depreciation expense for the year ended June 30, 2014 and 2013 totaled $9,534 and $0, respectively.

8. Notes Payable

On June 30, 2014, the Organization entered in a note agreement in the amount of $1,780,000. The note bears an interest rate of 3.75% and matures on October 31, 2014. However, the note was refinanced subsequent to year-end into long-term and, thus, has been presented as a long-term liability in the statement of financial position as of June 30, 2014. See Note 14 for further subsequent events.

9. Leases

The Organization leases building space pursuant to noncancellable operating lease agreement expiring through 2019. Future minimum lease payments under noncancellable operating leases as of June 30, 2014 were as follows:

Year ending June 30,	
2015	$ 421,511
2016	340,956
2017	325,000
2018	325,000
2019	325,000
Future minimum lease payments	$ 1,737,467

Rent expense totaled $21,430 for the year ended June 30, 2014 ($0 in 2013).

10. Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2013 consisted of $149,015 for start-up costs. No amounts are temporarily restricted at June 30, 2014.

As of June 30, 2014, net assets in the amount of $351,233 were released from donor restrictions by incurring start-up costs ($100,985 in 2013).

11. Employee Benefit Plan

The Organization has a 401(k) employees' profit sharing plan for the benefit of substantially all employees. The Organization's contributions to the plan are at the discretion of the Board. The Organization's contributions for the years ended June 30, 2014 and 2013 totaled approximately $4,760 and $0, respectively.

12. Economic Dependency

During the year ended June 30, 2014, the Organization received approximately 90% of its contributions from two revenue sources (97% from one donor in 2013). Once schools are operational, the Organization will earn the majority of its funding from various federal, state, and local entities. Changes in funding levels for charter schools in Texas could have a significant impact on the Organization's future revenues.

13. Financial Condition

At June 30, 2014, the Organization had a deficit in unrestricted net asset totaling $166,779 and a deficit in working capital totaling $767,313. Unrestricted cash available for operations totaled $411,883 and net assets decreased by $315,794. The deficit in working capital is largely due to deferred revenue totaling $1,584,000 as of June 30, 2014 (see Note 5), which has been earned and recognized in its entirety in August, 2014 upon the opening of the Organizations' first schools. Furthermore, the Organization has begun earning and receiving funding from various federal, state, and local entities as a result of its schools now being operational in the year ended June 30, 2015 and has reversed its deficit in unrestricted net assets and working capital as of date the financial statements were available to be issued.

14. Subsequent Events

On June 30, 2014, the Organization entered into a loan commitment agreement to borrow $1,800,000. The loan bears an interest rate of 6.5% and matures on October 31, 2014. On July 1, 2014, the lender funded the loan and deposited the loan proceeds into an escrow account for the Organization to purchase land.

On July 1, 2014, the Organization purchased land for $2,678,418 using the proceeds from the $1,800,000 loan and $914,372 from the proceeds of the $1,780,000 note payable described in Note 8, the difference of $35,954 is comprised of various fees associated with the closing of the purchase.

The $1,800,000 loan and $1,780,000 note payable, described in Note 8, were to mature on October 31, 2014, but management refinanced these through the issuance of a long-term debt instrument dated October 28, 2014. The long-term financing is structured as private issued tax-exempt notes through a bank draw-down facility, of up to $10,000,000 in principal with an annual interest rate of 4.80%. The final stated maturity of the notes is October 27, 2017. The Organization also entered into two subordinated notes, each with principal immediately outstanding of $1,000,000 and annual interest of 3.75%. The entire unpaid principal amount of the subordinated notes, together with all accrued unpaid interest, shall be due and payable on October 27, 2017.

Land purchased on July 1, 2014 and long-term financing, referenced above, is for the purpose of constructing a new K-8 campus in San Antonio, Texas.

On July 1, 2014, the Organization started participating in the Teacher Retirement System of Texas, a public employee retirement system.

Government Auditing Standards Report

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Padgett Stratemann

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

To the Board of Directors
Great Hearts America – Texas
Phoenix, Arizona

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Great Hearts America – Texas (the "Organization") which comprise the statement of financial position as of June 30, 2014, the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to financial statements, and have issued our report thereon dated November 12, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. 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 the Organization's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Padgett, Stratemann + Co., L.L.P.

San Antonio, Texas
November 12, 2014