

Financial Statements and Supplementary
Schedule Together with
Report of Independent Certified Public Accountants

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**

For the years ended June 30, 2012 and 2011

HARLEM CHILDREN'S ZONE PROMISE ACADEMY CHARTER SCHOOL II

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Trustees of
Harlem Children’s Zone Promise Academy Charter School II:

We have audited the accompanying statement of financial position of Harlem Children’s Zone Promise Academy Charter School II (the “School”) as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the School’s management. 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 established by the American Institute of Certified Public Accountants 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the School’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Harlem Children’s Zone Promise Academy Charter School II as of June 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2012, on our consideration of the School’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the School’s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Functional Expenses for the years ended June 30, 2012 and 2011 on pages 13 and 14 is presented for purposes of additional analysis and is not a required part of the financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Grant Thornton LLP

New York, New York
December 21, 2012

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Statements of Financial Position
As of June 30, 2012 and 2011

ASSETS	<u>2012</u>	<u>2011</u>
Cash	\$ 4,786,156	\$ 2,832,335
Restricted cash	70,399	70,293
Government grants receivable	357,837	301,958
Due from related party	1,401	222,141
Due from Harlem Children's Zone	2,344,105	1,593,526
Other assets	35,929	107,931
Property and equipment, net	<u>84,021</u>	<u>150,932</u>
Total assets	<u><u>\$ 7,679,848</u></u>	<u><u>\$ 5,279,116</u></u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable and accrued expenses	\$ 934,919	\$ 674,199
457(f) plan liability	<u>2,287,273</u>	<u>1,593,526</u>
Total liabilities	<u>3,222,192</u>	<u>2,267,725</u>
Commitments		
NET ASSETS - unrestricted	<u>4,457,656</u>	<u>3,011,391</u>
Total liabilities and net assets	<u><u>\$ 7,679,848</u></u>	<u><u>\$ 5,279,116</u></u>

The accompanying notes are an integral part of these statements.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Statements of Activities
For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
SUPPORT AND REVENUE		
Support:		
In-kind contributions	\$ 2,712,742	\$ 2,196,473
Subsidy from Harlem Children's Zone for 457(f) plan	<u>484,920</u>	<u>657,000</u>
Total support	<u>3,197,662</u>	<u>2,853,473</u>
Revenue:		
Regular education	7,399,268	6,748,571
Special education	96,980	100,438
Federal and state funding	201,621	211,280
Food service	243,453	208,334
Other income	<u>24,303</u>	<u>24,009</u>
Total revenue	<u>7,965,625</u>	<u>7,292,632</u>
 Total support and revenue	 <u>11,163,287</u>	 <u>10,146,105</u>
EXPENSES		
Program services:		
Regular education	7,965,406	6,752,190
Special education	<u>1,086,194</u>	<u>922,999</u>
Total program services	9,051,600	7,675,189
Supporting services:		
Management and general	<u>665,422</u>	<u>933,653</u>
Total expenses	<u>9,717,022</u>	<u>8,608,842</u>
 Change in net assets	 <u>1,446,265</u>	 <u>1,537,263</u>
Net assets, beginning of year	<u>3,011,391</u>	<u>1,474,128</u>
Net assets, end of year	<u>\$ 4,457,656</u>	<u>\$ 3,011,391</u>

The accompanying notes are an integral part of these statements.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Statements of Cash Flows
For the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,446,265	\$ 1,537,263
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	68,810	70,505
Changes in assets and liabilities:		
Increase in government grants receivables	(55,879)	(81,752)
Decrease (increase) in due from related party	220,740	(222,141)
Increase in due from Harlem Children's Zone	(750,579)	(595,148)
Decrease (increase) in other assets	72,002	(25,375)
Increase (decrease) in accounts payable and accrued expenses	260,720	(78,824)
Increase in 457(f) plan liability	<u>693,747</u>	<u>595,148</u>
Net cash provided by operating activities	<u>1,955,826</u>	<u>1,199,676</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	<u>(1,899)</u>	<u>(58,042)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Change in restricted cash	<u>(106)</u>	<u>(105)</u>
Net increase in cash	1,953,821	1,141,529
Cash, beginning of year	<u>2,832,335</u>	<u>1,690,806</u>
Cash, end of year	<u>\$ 4,786,156</u>	<u>\$ 2,832,335</u>

The accompanying notes are an integral part of these statements.

HARLEM CHILDREN'S ZONE PROMISE ACADEMY CHARTER SCHOOL II

Notes to Financial Statements

June 30, 2012 and 2011

1. NATURE OF OPERATIONS

Harlem Children's Zone Promise Academy Charter School II (the "School") is a public charter school that is open to all New York City public school children via a lottery. Opened in 2005, the School features small class sizes, an extended day and year, high expectations, and access to an extended support system through its Institutional Partner, Harlem Children's Zone, Inc. ("HCZ").

HCZ is a not-for-profit organization that offers a wide array of education and social programs to the children and families of Harlem. Created in 1970 as a truancy prevention agency (then called "Rheedlen"), HCZ has expanded its services to address the needs of children from birth through college, and as part of that mission, it also works to strengthen families and the surrounding community.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

The financial statement presentation conforms with accounting principles generally accepted in the United States of America for non-profit organizations, which require that the School report information regarding its financial position and changes in net assets according to three classes of net assets, as follows:

Unrestricted net assets

Net assets that are not subject to donor-imposed stipulations and are, therefore, available for the general operations of the School.

Temporarily restricted net assets

Net assets which include resources that have been limited by donor-imposed stipulations that either expire with the passage of time and/or can be fulfilled by the actions of the School pursuant to those stipulations are considered temporarily restricted. When a donor restriction expires, that is, when a stipulated time restriction ends and/or a 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. At June 30, 2012 and 2011, the School did not possess any temporarily restricted net assets.

Permanently restricted net assets

Net assets which include funds whereby the donors have stipulated that the principal contributed be invested and maintained in perpetuity. Income earned from these investments is available for expenditures according to restrictions, if any, imposed by donors. At June 30, 2012 and 2011, the School did not possess any permanently restricted net assets.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Notes to Financial Statements
June 30, 2012 and 2011

Property and Equipment

Property and equipment are valued at cost, less accumulated depreciation. Normal replacement and maintenance costs are charged to earnings as incurred, and major renewals and improvements are capitalized. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss for the period is recognized. The School capitalizes assets with costs of \$1,000 or more.

Depreciation is calculated on a straight-line basis and is based on the useful lives of the property and equipment as follows:

	<u>Useful Life(Years)</u>
Furniture, fixtures, and equipment	5

Pupil Enrollment – Regular and Special Education

The School records revenue from pupil enrollment as unrestricted revenue. Pupil enrollment revenue is based on the full-time equivalent number of students in attendance at the School at the New York State Department of Education authorized rate. Pupil enrollment revenue is recognized in the period earned.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a donor restriction expires (i.e., when a stipulated time restriction ends and/or a 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.

Government Contracts

Federal, state, and other grant awards received for specific purposes are recognized as support to the extent of the related expenses incurred. The unexpended funds are reported as contract advances.

Receivables

Due to the uncertainty surrounding collection, management provides an allowance for doubtful accounts based on the consideration of the type of receivable, responsible party, the known financial condition of the respective party, historical collection patterns and comparative aging. These allowances are maintained at a level management considers adequate to provide for subsequent adjustments and potential uncollectible accounts. These estimates are reviewed periodically and, if the financial condition of a party changes significantly, management will evaluate the recoverability of any receivables from that organization and write off any amounts that are no longer considered to be recoverable. Any payments subsequently collected on such receivables are recorded as income in the period received.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Notes to Financial Statements
June 30, 2012 and 2011

Accounting for Income Taxes

The School follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. The guidance provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if the position is “more-likely-than-not” to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged. Management determined that there are no uncertain tax positions within its financial statements.

The School is exempt from federal income taxation by virtue of being an organizations described in section 501(c)(3) of the Internal Revenue Code. Nevertheless, the School may be subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the code. The tax years ending June 30, 2010, 2011, and 2012 are still open to audit for both federal and state purposes.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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.

3. CASH

The School maintains cash balances in financial institutions, which from time to time exceed the amount insured by the Federal Deposit Insurance Corporation (“FDIC”) and subject the School to credit risk. The School monitors this risk on a regular basis and has not experienced, nor does it anticipate, nonperformance by any of these financial institutions.

4. RESTRICTED CASH

Pursuant to an addendum to the Charter Agreement dated August 4, 2008, from the New York City Department of Education (“NYCDOE”), the NYCDOE required the School to set up an escrow of at least \$70,000. In the event of termination of the Charter, whether prematurely or otherwise, the School shall establish and follow procedures consistent with those required by Section 2851(2)(t) of the New York State Education Law in its use of the escrow.

5. PUPIL ENROLLMENT AND OTHER REVENUES FROM GOVERNMENT AGENCIES

Under the School’s Charter agreement and the Charter Schools Act, the School is entitled to receive funding from state and federal sources that are available to public schools. These funds include state pupil enrollment funds, federal food subsidies, and Title I and Title II funds. The calculation of the amounts to be paid to the School under these programs is determined by the State and is based on complex laws and regulations, enrollment levels, and economic information related to the home school districts of the children enrolled in the School. If these regulations, some of which are relatively new in the State of New York,

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Notes to Financial Statements
June 30, 2012 and 2011

were to change, or other factors included in the calculations were to change, the level of funding that the School receives could vary significantly.

The grant amounts received and receivable from government agencies and included as revenue in the financial statements consisted of the following as of and for the years ended June 30, 2012 and 2011:

	<u>2012</u>		<u>2011</u>	
	<u>Revenues</u>	<u>Receivable</u>	<u>Revenues</u>	<u>Receivable</u>
City of New York (Pupil enrollment)	\$ 7,496,248	\$ 5,483	\$ 6,849,009	\$ 57,077
Title I	196,978	32,354	196,802	145,255
Title II	2,550	-	14,478	23,079
Title IV	2,093	-	-	-
Food service - State of New York	<u>243,453</u>	<u>320,000</u>	<u>208,334</u>	<u>76,547</u>
Total grants from government sources	<u>\$ 7,941,322</u>	<u>\$ 357,837</u>	<u>\$ 7,268,623</u>	<u>\$ 301,958</u>

6. PROPERTY AND EQUIPMENT

At June 30, 2012 and 2011, property and equipment consisted of the following:

	<u>2012</u>	<u>2011</u>
Computer equipment	\$ 158,707	\$ 156,808
Leasehold improvements	34,634	34,634
Furniture and fixtures	<u>177,324</u>	<u>177,324</u>
	370,665	368,766
Less: accumulated depreciation	<u>(286,644)</u>	<u>(217,834)</u>
Total	<u>\$ 84,021</u>	<u>\$ 150,932</u>

Depreciation expense for the years ended June 30, 2012 and 2011 amounted to \$68,810 and \$70,505 respectively.

7. PROFIT-SHARING PLAN

The School maintains the Vanguard Profit Sharing Plan (the "Plan") with Vanguard Fiduciary Trust Company for all eligible employees. The Plan is non-contributory and employees become eligible once they have reached age 21 and have completed one year of service. Employees participating in the Plan will be fully vested after completing six years of service. Contributions made to the Plan are discretionary. For the years ended June 30, 2012 and 2011, contributions made to the Plan amounted to \$125,000 and \$131,268, respectively.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Notes to Financial Statements
June 30, 2012 and 2011

8. RELATED-PARTY TRANSACTIONS

457(f) Plan

HCZ maintains a 457(f) plan for certain eligible employees of the School. Employees become eligible to participate in this plan based solely at the discretion of the School's Board of Trustees. The amounts contributed vest five years after the date of the initial contribution and will then be paid to eligible employees when vested. Forfeitures of the plan are allocated to the remaining eligible employees at the discretion of management. Terminated employees become vested immediately at the date of their termination. HCZ provides the School with an annual subsidy to cover this cost by contributing to a HCZ investment account. During fiscal 2012 and 2011, HCZ provided a subsidy of \$484,920 and \$657,000 for the fiscal 2012 and 2011 contributions to the 457(f) plan. The cumulative amount due from HCZ relating to the 457(f) plan was \$2,344,105 and \$1,593,526 at June 30, 2012 and 2011, which will then be settled with the eligible employees when they become vested or represents reimbursements of amounts already paid by the School in advance of receiving the funds from HCZ. The cumulative amount due from the School to eligible employees was \$2,287,273 and \$1,593,526 at June 30, 2012 and 2011, respectively.

In-Kind Support

Pursuant to the terms of a commitment letter between HCZ and the School, HCZ, as the School's Institutional Partner, committed to provide the School, during the initial five-year term of its charter ending June 30, 2011, certain services at no cost. These services include financial management, social, library, technology, fundraising, public relations, and teaching assistance services. As of April 15, 2010, the School renewed its charter for an additional five year term and HCZ renewed its commitment to the school to provide the same level of services through April 15, 2015. The Commitment to the School can be cancelled by either party with one year's notice.

HCZ's in-kind services for the years ended June 30, 2012 and 2011 amounted to \$2,712,742 and \$2,196,473, respectively. These amounts included personnel service costs for the years ended June 30, 2012 and 2011, of \$2,212,098 and \$1,761,306 and non-personnel service costs of \$500,644 and \$435,167, respectively.

9. CONCENTRATION OF RISK

The School is dependent on various government agencies for funding and is responsible for meeting the requirements of such agencies. If the School were to lose students or the related government funding, it could have a substantial effect on the School's ability to continue operations.

As discussed in Note 8, HCZ is responsible for certain operations of the School and donates its services. If this relationship were to change or cease, such change could have a substantial effect on the School's ability to continue operations.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Notes to Financial Statements
June 30, 2012 and 2011

10. CONTINGENCY

Government Agency Audits

The School participates in a number of federal and state programs. These programs require that the School comply with certain requirements of laws, regulations, contracts, and agreements applicable to the programs in which it participates. All funds expended in connection with government grants and contracts are subject to audit by government agencies. While the ultimate liability, if any, from such audits of government contracts by government agencies is presently not determinable, it should not, in the opinion of management, have a material effect on the School's financial position or change in net assets. Accordingly, no provision for any such liability that may result has been made in the accompanying financial statements.

Litigation

The School may be involved in various legal actions from time to time arising in the normal course of business. In the opinion of management, there are no matters outstanding that would have a material adverse effect on the financial statements of the School.

11. SUBSEQUENT EVENTS

The School evaluated its June 30, 2012 financial statements for subsequent events through December 21, 2012, the date the financial statements were available to be issued. The School is not aware of any subsequent events which would require recognition or disclosure in the financial statements.

SUPPLEMENTARY INFORMATION

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Supplementary Schedule of Functional Expenses
For the year ended June 30, 2012**

	<u>Regular Education</u>	<u>Special Education</u>	<u>Management and General</u>	<u>Total</u>
EXPENSES				
Salaries	\$ 5,115,308	\$ 697,542	\$ 481,969	\$ 6,294,819
Payroll taxes	424,567	57,896	36,977	519,440
Employee benefits	914,615	124,720	54,701	1,094,036
Retirement plan contribution	<u>104,500</u>	<u>14,250</u>	<u>6,250</u>	<u>125,000</u>
 Total personnel services	 <u>6,558,990</u>	 <u>894,408</u>	 <u>579,897</u>	 <u>8,033,295</u>
 Admissions	 76,042	 10,369	 -	 86,411
Bank fees	1,253	171	75	1,499
Student travel	73,886	10,075	952	84,913
Consultants and professional fees	105,130	14,336	9,142	128,608
Depreciation	57,524	7,844	3,442	68,810
Classroom supplies	212,250	28,943	1,037	242,230
Equipment rental and maintenance	28,694	3,913	4,288	36,895
Food	435,622	59,403	658	495,683
Insurance	12,038	1,642	720	14,400
Occupancy	33,259	4,535	1,875	39,669
Office supplies and furniture	105,131	14,336	10,094	129,561
Payroll processing	6,422	876	384	7,682
Printing, publications, and memberships	2,660	363	18,081	21,104
Software/software maintenance	108,649	14,816	11,454	134,919
Special services/incentives	10,622	1,448	2,489	14,559
Staff travel	3,792	517	419	4,728
Telephone and internet	26,828	3,658	11,085	41,571
Training	63,943	8,719	6,027	78,689
Uniforms	42,151	5,748	3,303	51,202
Miscellaneous	<u>520</u>	<u>74</u>	<u>-</u>	<u>594</u>
 Total other than personnel services	 <u>1,406,416</u>	 <u>191,786</u>	 <u>85,525</u>	 <u>1,683,727</u>
 Total expenses	 <u>\$ 7,965,406</u>	 <u>\$ 1,086,194</u>	 <u>\$ 665,422</u>	 <u>\$ 9,717,022</u>

This schedule should be read in conjunction with the accompanying financial statements and notes thereto.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
Supplementary Schedule of Functional Expenses
For the year ended June 30, 2011

	Regular Education	Special Education	Management and General	Total
EXPENSES				
Salaries	\$ 4,564,909	\$ 622,488	\$ 427,681	\$ 5,615,078
Payroll taxes	394,701	53,823	31,546	480,070
Employee benefits	718,648	97,997	172,381	989,026
Retirement plan contribution	99,047	15,752	16,469	131,268
Total personnel services	<u>5,777,305</u>	<u>790,060</u>	<u>648,077</u>	<u>7,215,442</u>
Admissions	36,570	4,987	-	41,557
Bank fees	-	-	1,067	1,067
Student travel	51,392	7,008	-	58,400
Consultants and professional fees	3,649	498	71,447	75,594
Depreciation	-	-	70,505	70,505
Classroom supplies	239,934	32,718	10,147	282,799
Equipment rental and maintenance	16,888	2,303	26,199	45,390
Food	376,054	51,280	1,458	428,792
Insurance	-	-	20,000	20,000
Occupancy	39,355	5,367	-	44,722
Office supplies	90,476	12,338	1,914	104,728
Payroll processing	-	-	6,408	6,408
Printing, publications, and memberships	7,462	1,017	12,896	21,375
Software/software maintenance	12,116	1,652	38,907	52,675
Special services/incentives	12,865	1,754	871	15,490
Staff travel	4,900	668	641	6,209
Telephone	638	87	5,060	5,785
Training	39,754	5,421	16,414	61,589
Uniforms	22,379	3,052	-	25,431
Miscellaneous	20,453	2,789	1,642	24,884
Total other than personnel services	<u>974,885</u>	<u>132,939</u>	<u>285,576</u>	<u>1,393,400</u>
Total expenses	<u>\$ 6,752,190</u>	<u>\$ 922,999</u>	<u>\$ 933,653</u>	<u>\$ 8,608,842</u>

This schedule should be read in conjunction with the accompanying financial statements and notes thereto.

**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS**

To the Board of Trustees of
Harlem Children’s Zone Promise Academy Charter School II:

We have audited the financial statements of Harlem Children’s Zone Promise Academy Charter School II (the “School”) as of and for the year ended June 30, 2012, and have issued our report thereon dated December 21, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants 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 the School’s internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School’s internal control over financial reporting. Accordingly, we express no such opinion.

A deficiency in internal control over financial reporting 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 over financial reporting, such that there is a reasonable possibility that a material misstatement of the School’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs as item 2012-01, that we consider to be a material weakness in the School’s internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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*.

We did not audit the School's written response to the matters described in the accompanying Schedule of Findings and Questioned Costs and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the School's Board of Trustees, management, federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton LLP

New York, New York
December 21, 2012

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Schedule of Prior Year (Fiscal 2011) Findings and Corrective Action Plan
For the year ended June 30, 2012**

FINDING NO. 2012-01 – INTERNAL CONTROLS OVER FINANCIAL REPORTING (MATERIAL WEAKNESS)

Criteria:

Government Auditing Standards require an auditee to design and implement an internal control environment to achieve effective and efficient operations; reliability of financial reporting; and compliance with applicable laws and regulations. The control environment sets the tone of an organization, which influences the control consciousness of its people. The key factors impacting the control environment include, among other things, management's philosophy and operating style, organizational structure, assignment of authority and responsibility and policies and practices with respect to human resources.

Condition, Context, Effect and Recommendation:

During our audit, we noted a material weakness in the internal control over financial reporting with regard to the following:

Accounting for 457(f) Plan

During our fiscal 2012 audit, we noted that the deferred compensation balance related to the School's 457(f) Plan was overstated at June 30, 2012. The School does not maintain and/or reconcile a schedule by participant, which was why the overstatement was not detected. As such, an audit adjustment was recorded to reduce the deferred compensation balance by approximately \$66,000. We recommend that the School maintain a detailed schedule by participant and reconcile the balance to the general ledger periodically throughout the year to ensure that the deferred compensation balance is properly stated.

Grant Revenue

During our fiscal 2012 audit, we noted that the School incorrectly calculated grant revenue earned during the year, which resulted in both the revenue and receivable to be overstated. As such, an audit adjustment was recorded for approximately \$147,000 to reduce both the revenue and the receivable recorded during fiscal 2012.

Year-end Accruals

During our fiscal 2012 audit, we noted that the School did not accrue for severance package agreements that were in effect at the end of fiscal 2012. As such, an audit adjustment was recorded for approximately \$15,000 to record the severance accrual at June 30, 2012.

Backdating Checks

During our fiscal 2012 audit, we noted that checks written in July 2012 for expenses incurred during fiscal 2012 were backdated using a June 30, 2012 date. These checks were then included in the list of June 30, 2012 outstanding checks as if they were issued in June. As such, an audit adjustment was recorded for approximately \$38,000 to reclassify the amount of these checks to accounts payable.

Journal Entries

During our fiscal 2012 audit, we noted that the CFO, Assistant CFO, and Senior Accountants all had the ability to prepare and post journal entries. Also, while the School's policies and procedures call for the CFO to review journal entries, our review of the journal entry documentation did not indicate that an approval process was performed. We also noted that many reversing journal entries were made to correct prior entries made during the

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year. The above findings indicate that there is both a lack of segregation of duties, as well as a lack of internal controls over the journal entry process. We recommend that a formal journal entry process be followed that will address the segregation of duties as well as review process.

Accounting Staff

During our fiscal 2012 audit, we noted that the School lacks an adequate number of experienced accounting/finance personnel to properly manage the accounting/ finance function and prepare financial statements in a timely and accurate manner. The School has not implemented adequate monitoring controls and there are significant processes that are not supported by up-to-date written policies and procedures. We recommend that the School hire additional competent personnel to strengthen its accounting/finance function. We also recommend that additional written policies, procedures and controls be implemented to ensure that accounts are analyzed and reconciled in a timely manner, that the general ledger is closed timely and that financial statements are accurately prepared.

Questioned Costs:

None noted.

Views of Responsible Officials and Planned Corrective Action:

Accounting for 457(f) Plan

During the Fiscal 2012 audit, a detailed schedule by participant was created which resulted in the overstatement being detected. The School will maintain the schedule going forward and reconcile the balance to the general ledger periodically through the year to ensure that the deferred compensation balance is properly stated.

Grant Revenue

The School will ensure that grant revenue is recorded properly and in the correct fiscal year.

Year-end Accruals

The School will ensure that year-end accruals are properly reconciled to ensure expenses are accurately reported.

Backdating Checks

The School only backdated checks related to invoices which they received during the first ten days of the following fiscal year. In the future, the School will ensure that all checks are dated the day they are written.

Journal Entries

The CFO and the Assistant CFO do not post journal entries for the School. In the future, the School will ensure that the proper approval is in place to ensure the accuracy of the entry and to avoid multiple reversing journal entries.

Accounting Staff

A new Controller has been hired and the School, in partnership with HCZ, is still in the process of finalizing an internal review of accounting policies and personnel. Based on the results of the internal review, the School and HCZ will develop policies and procedures to ensure that all accounting related activities are accounted for consistently and in accordance with US GAAP.

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FINDING NO. 2011-01 – INTERNAL CONTROLS OVER FINANCIAL REPORTING (MATERIAL WEAKNESS)

Criteria:

Government Auditing Standards require an auditee to design and implement an internal control environment to achieve effective and efficient operations; reliability of financial reporting; and compliance with applicable laws and regulations. The control environment sets the tone of an organization, which influences the control consciousness of its people. The key factors impacting the control environment include, among other things, management's philosophy and operating style, organizational structure, assignment of authority and responsibility and policies and practices with respect to human resources.

Condition, Context, Effect and Recommendation:

During our audit, we noted a significant deficiency in the internal control over financial reporting with regard to the following:

Accounting for In-kind Contributions

During our fiscal 2011 audit, we noted that the School did not record donated food provided by Harlem Children's Zone for administering school lunches during the year. As such, management recorded an audit adjustment for \$423,087 to record both the in-kind contribution and expense.

Grant Revenue

During our fiscal 2011 audit, we noted that the School did not accrue for grant revenue earned in the months of April through June of fiscal 2011. As such, management recorded an audit adjustment for \$209,778 to record both the revenue and receivable earned during fiscal 2011.

In addition, during our fiscal 2011 audit, we noted that the HCZ Promise Academy Charter School I recorded grant revenue that was related to the School. As such, management recorded an audit adjustment for \$195,203 to increase the School's grant revenue and to record an asset due from the HCZ Promise Academy Charter School I.

Reconciliation of the 457(f) Plan

During our fiscal 2011 audit, we noted that the School had not properly reconciled the activity relating to its 457(f) plan. As such, management recorded an audit adjustment for \$113,011 to reduce both the expense and the liability associated with this plan.

Year-end Accruals

During our fiscal 2011 audit, we noted that the School did not accrue for bonuses in fiscal 2011. As such, management recorded an audit adjustment for \$395,076 to record bonuses earned during fiscal 2011.

Accounting Staff

In 2012, HCZ, who performs the accounting function for the School, has hired a new Executive Vice President for Strategy, Finance and Planning. However, we noted that the School still lacks an adequate number of experienced accounting/finance personnel to properly manage the accounting/finance function and prepare financial statements in a timely and accurate manner. The School has not implemented adequate monitoring controls and there are significant processes that are not supported by up-to-date written policies and procedures.

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We recommend that the School hire additional competent personnel to strengthen its accounting/finance function. We also recommend that additional written policies, procedures and controls be implemented to ensure that accounts are analyzed and reconciled in a timely manner, that the general ledger is closed timely and that financial statements are accurately prepared.

Questioned Costs:

None noted.

Views of Responsible Officials and Planned Corrective Action:

HCZ and the School are currently conducting an internal review of accounting policies and personnel. Based on the results of the internal review, HCZ and the school are developing policies and procedures to ensure that all accounting related activities are accounted for consistently and in accordance with U.S. GAAP.

Fiscal 2012 Status:

Please refer to Finding 2012-01.