

Financial Statements and Supplementary
Information Together with
Reports of Independent Certified Public Accountants

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

For the years ended June 30, 2013 and 2012

HARLEM CHILDREN'S ZONE PROMISE ACADEMY CHARTER SCHOOL

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

Report on the financial statements

We have audited the accompanying financial statements of Harlem Children's Zone Promise Academy Charter School (the "School"), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the School'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 School'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 Harlem Children's Zone Promise Academy Charter School as of June 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary information

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, 2013 and 2012 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 audits 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. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report, dated November 1, 2013, 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 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 School's internal control over financial reporting and compliance.

Grant Thornton LLP

New York, New York
November 1, 2013

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Statements of Financial Position
As of June 30, 2013 and 2012

ASSETS	<u>2013</u>	<u>2012</u>
Cash	\$ 3,874,979	\$ 1,834,185
Restricted cash	70,496	70,397
Government grants and contracts receivable	875,449	1,567,181
Due from Harlem Children's Zone - 457(f) plan	5,778,881	4,403,139
Other assets	45,784	222,513
Property and equipment, net	<u>349,017</u>	<u>267,665</u>
Total assets	<u><u>\$ 10,994,606</u></u>	<u><u>\$ 8,365,080</u></u>
 LIABILITIES AND NET ASSETS		
LIABILITIES		
Accounts payable and accrued expenses	\$ 1,637,241	\$ 1,678,493
Due to related parties	202,767	-
457(f) plan liability	<u>5,245,164</u>	<u>4,094,907</u>
Total liabilities	<u>7,085,172</u>	<u>5,773,400</u>
NET ASSETS - unrestricted	<u>3,909,434</u>	<u>2,591,680</u>
Total liabilities and net assets	<u><u>\$ 10,994,606</u></u>	<u><u>\$ 8,365,080</u></u>

The accompanying notes are an integral part of these statements.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Statements of Activities
For the years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
SUPPORT AND REVENUE		
Support:		
In-kind contributions	\$ 4,871,205	\$ 6,024,290
Subsidy from Harlem Children's Zone for 457(f) plan	<u>1,303,500</u>	<u>645,198</u>
Total support	<u>6,174,705</u>	<u>6,669,488</u>
Revenue:		
Government grants and contracts	14,117,810	14,409,003
Other income	<u>99</u>	<u>100</u>
Total revenue	<u>14,117,909</u>	<u>14,409,103</u>
Total support and revenue	<u>20,292,614</u>	<u>21,078,591</u>
EXPENSES		
Program services:		
Regular education	15,781,048	17,185,563
Special education	<u>2,304,382</u>	<u>2,536,784</u>
Total program services	18,085,430	19,722,347
Management and general	<u>889,430</u>	<u>945,574</u>
Total expenses	<u>18,974,860</u>	<u>20,667,921</u>
Change in net assets	1,317,754	410,670
Net assets, beginning of year	<u>2,591,680</u>	<u>2,181,010</u>
Net assets, end of year	<u>\$ 3,909,434</u>	<u>\$ 2,591,680</u>

The accompanying notes are an integral part of these statements.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Statements of Cash Flows
For the years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,317,754	\$ 410,670
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	116,642	167,475
Changes in assets and liabilities:		
Decrease (increase) in government grants and contracts receivable	691,732	(1,053,292)
(Increase) decrease in due from Harlem Children's Zone - 457(f) plan	(1,375,742)	167,387
Decrease (increase) in other assets	176,729	(149,476)
(Decrease) increase in accounts payable and accrued expenses	(42,652)	110,802
Increase in due to related parties	204,167	-
Increase in 457(f) plan liability	<u>1,150,257</u>	<u>485,559</u>
Net cash provided by operating activities	<u>2,238,887</u>	<u>139,125</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	<u>(197,994)</u>	<u>(91,535)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Change in restricted cash	<u>(99)</u>	<u>(100)</u>
Net increase in cash	2,040,794	47,490
Cash, beginning of year	<u>1,834,185</u>	<u>1,786,695</u>
Cash, end of year	<u>\$ 3,874,979</u>	<u>\$ 1,834,185</u>

The accompanying notes are an integral part of these statements.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

1. NATURE OF OPERATIONS

Harlem Children's Zone Promise Academy Charter School (the "School") is a public charter school that is open to all New York City public school children via a lottery. Opened in 2004, 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 ("US GAAP").

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. At June 30, 2013 and 2012, 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, 2013 and 2012, the School did not possess any permanently restricted net assets.

Property and Equipment

Property and equipment purchased for a value greater than \$1,000 and with depreciable lives greater than one year are carried at cost, net of depreciation. Significant additions or improvements extending asset lives are capitalized; normal maintenance and repair costs are expensed as incurred. Leasehold improvements are amortized based on the lesser of the estimated useful life or remaining lease term.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

Property and equipment used in operations are depreciated over their estimated useful lives using the straight-line method, as follows:

	Useful Life (Years)
Furniture, fixtures, and equipment	5

Revenue

Revenue is recorded on the accrual basis of accounting. The School derives its revenue principally from the New York state and New York City governments, through the New York City Department of Education Office of Charter Schools, based on pupil enrollment for regular and special education, with the balance from contributions, subsidies and US Federal government grants.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by explicit donor-imposed restrictions. Revenues based on pupil enrollment are recognized over the period earned. Amounts received in advance are reported as deferred revenue.

Revenue from other grants and contracts is recognized as the related expenses are incurred in accordance with the terms of the respective grant or contract agreement. Amounts received in advance are reported as deferred revenues.

The School records contributions of cash and other assets when an unconditional promise to give such assets is received from a donor. Contributions are recorded at the fair market value of the assets received and are classified as either unrestricted, temporarily restricted or permanently restricted support, depending on whether the donor has imposed a restriction on the use of such assets. 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.

Receivables

Receivable contains some level of uncertainty surrounding timing and amount at collection. Therefore, 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 written-off receivables are recorded as income in the period received.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

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. This 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 organization described in Section 501(c)(3) of the Internal Revenue Code. Nevertheless, the School may be subject to tax on any income deemed 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 US GAAP 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 Depository 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, with the NYCDOE, the School is required 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 New York City 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, were to change, or other factors included in the calculations were to change, the level of funding that the School receives could vary significantly.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

The 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, 2013 and 2012:

	<u>Revenues</u>	<u>Receivable</u>	<u>Revenues</u>	<u>Receivable</u>
City of New York (Pupil enrollment)	\$ 12,847,982	\$ -	\$ 13,239,592	\$ 20,346
Outside the City of New York (Pupil enrollment)	131,725	82,204	-	-
Title I	370,296	153,867	595,244	862,729
Title II	34,440	369	11,990	13,642
E-rate	291,794	26,356	98,931	12,038
Food Service - State of New York	<u>441,573</u>	<u>612,653</u>	<u>463,246</u>	<u>658,426</u>
Total grants and contracts from government sources	<u>\$ 14,117,810</u>	<u>\$ 875,449</u>	<u>\$ 14,409,003</u>	<u>\$ 1,567,181</u>

6. PROPERTY AND EQUIPMENT, NET

At June 30, 2013 and 2012, property and equipment consisted of the following:

	<u>2013</u>	<u>2012</u>
Computer equipment	\$ 751,604	\$ 553,609
Furniture and fixtures	<u>620,632</u>	<u>620,633</u>
	1,372,236	1,174,242
Less: accumulated depreciation	<u>(1,023,219)</u>	<u>(906,577)</u>
Total	<u>\$ 349,017</u>	<u>\$ 267,665</u>

Depreciation expense for the years ended June 30, 2013 and 2012 amounted to \$116,642 and \$167,475, 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. Employer contributions made to the Plan are discretionary. For the years ended June 30, 2013 and 2012, contributions made to the Plan amounted to \$210,629 and \$225,000, respectively.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

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 2013 and 2012, HCZ provided a subsidy of \$1,303,500 and \$645,198 for contributions to the 457(f) plan. The cumulative amount due from HCZ relating to the 457(f) plan was \$5,778,881 and \$4,403,139 at June 30, 2013 and 2012, 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 \$5,245,164 and \$4,094,907 at June 30, 2013 and 2012, 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 certain services at no cost at least through August 10, 2014. These services include financial management, social, library, technology, fundraising, public relations, and teaching assistance services. In addition, HCZ committed to provide the School with the use of space in its premises located at 35 East 125th Street, New York, NY. 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, 2013 and 2012 amounted to \$4,871,205 and \$6,024,290, respectively. These amounts included personnel service costs for the years ended June 30, 2013 and 2012, of \$3,963,703 and \$4,976,480 and non-personnel service costs of \$907,502 and \$1,047,810, respectively.

New Building Construction

During the fiscal year ended June 30, 2011, HCZ entered into agreements for the construction of a new charter school (the "School Project"). The agreements provided that the New York School Construction Authority (the "SCA") contribute up to \$60,000,000 towards the School Project, with the estimated balance of approximately \$40,000,000, to be contributed by HCZ or other donors. Upon completion of construction and issuance of the certificate of occupancy, title to the School Project will be transferred to the New York City Department of Education (the "DOE") and leased back to HCZ. Although the lease will be between HCZ and the DOE, the lease agreement will designate the School as an initial user of the premises.

Upon transfer and execution of the leases, the School will record a right of use asset and contribution revenue for the fair value of the lease from HCZ.

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
Notes to Financial Statements
June 30, 2013 and 2012

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 and space. If this relationship were to change or cease, such change could have a substantial effect on the School's ability to continue operations.

10. CONTINGENCIES

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 any 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, 2013 financial statements for subsequent events through November 1, 2013, 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**
Schedule of Functional Expenses
For the year ended June 30, 2013

	<u>Regular Education</u>	<u>Special Education</u>	<u>Management and General</u>	<u>Total</u>
Salaries	\$ 10,162,327	\$ 1,483,924	\$ 612,961	\$ 12,259,212
Payroll taxes	821,233	119,918	49,534	990,685
Employee benefits	1,834,038	267,810	110,624	2,212,472
Retirement plan contribution	<u>174,602</u>	<u>25,496</u>	<u>10,531</u>	<u>210,629</u>
Total personnel services	<u>12,992,200</u>	<u>1,897,148</u>	<u>783,650</u>	<u>15,672,998</u>
Admissions	28,872	4,216	1,741	34,829
Student travel	147,512	21,540	-	169,052
Consultants and professional fees	343,063	50,095	20,693	413,851
Depreciation	96,691	14,119	5,832	116,642
Classroom supplies	282,762	41,290	17,055	341,107
Equipment rental and maintenance	131,580	19,214	7,937	158,731
Food	658,462	96,150	-	754,612
Insurance	54,276	7,926	3,274	65,476
Occupancy	140,539	20,522	8,477	169,538
Office supplies	64,981	9,489	3,919	78,389
Payroll processing	9,558	1,396	577	11,531
Printing, publications, and memberships	87,127	12,722	5,255	105,104
Software/software maintenance	94,159	13,749	5,679	113,587
Special services/incentives	176,887	25,829	-	202,716
Staff travel	21,891	3,197	1,320	26,408
Telephone	159,814	23,336	9,639	192,789
Training	208,107	30,388	12,552	251,047
Uniforms	52,286	7,635	2	59,923
Miscellaneous	<u>30,281</u>	<u>4,421</u>	<u>1,828</u>	<u>36,530</u>
Total other than personnel services	<u>2,788,848</u>	<u>407,234</u>	<u>105,780</u>	<u>3,301,862</u>
Total expenses	<u>\$ 15,781,048</u>	<u>\$ 2,304,382</u>	<u>\$ 889,430</u>	<u>\$ 18,974,860</u>

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

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL**
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>
Salaries	\$ 11,033,164	\$ 1,628,620	\$ 666,410	\$ 13,328,194
Payroll taxes	1,013,119	149,548	61,193	1,223,860
Employee benefits	2,060,680	304,180	124,465	2,489,325
Retirement plan contribution	<u>186,256</u>	<u>27,493</u>	<u>11,251</u>	<u>225,000</u>
Total personnel services	<u>14,293,219</u>	<u>2,109,841</u>	<u>863,319</u>	<u>17,266,379</u>
Admissions	49,170	7,258	-	56,428
Student travel	157,605	23,264	-	180,869
Consultants and professional fees	377,228	55,683	22,714	455,625
Depreciation	138,637	20,464	8,374	167,475
Classroom supplies	320,862	47,363	-	368,225
Equipment rental and maintenance	125,435	18,516	7,576	151,526
Food	784,512	115,803	-	900,315
Insurance	21,192	3,128	1,280	25,600
Occupancy	89,580	13,223	5,336	108,139
Office supplies	198,416	29,289	11,984	239,689
Payroll processing	10,099	1,491	610	12,200
Printing, publications, and memberships	43,779	6,462	2,644	52,885
Software/software maintenance	196,893	29,064	11,892	237,849
Special services/incentives	114,800	16,946	-	131,746
Staff travel	23,253	3,432	1,404	28,089
Telephone	83,862	12,379	5,065	101,306
Training	93,992	13,874	2,694	110,560
Uniforms	51,758	7,640	-	59,398
Miscellaneous	<u>11,271</u>	<u>1,664</u>	<u>682</u>	<u>13,617</u>
Total other than personnel services	<u>2,892,344</u>	<u>426,943</u>	<u>82,255</u>	<u>3,401,542</u>
Total expenses	<u>\$ 17,185,563</u>	<u>\$ 2,536,784</u>	<u>\$ 945,574</u>	<u>\$ 20,667,921</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 REQUIRED BY
GOVERNMENT AUDITING STANDARDS**

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

We have audited, 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, the financial statements of Harlem Children’s Zone Promise Academy Charter School (the “School”), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 1, 2013.

Internal control over financial reporting

In planning and performing our audit of the financial statements, we considered the School’s internal control over financial reporting (“internal control”) to design 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 internal control. Accordingly, we do not express an opinion on the effectiveness of the School’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the School’s financial statements will not be prevented, or detected and corrected, on a timely basis.

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. However, we identified certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as finding 2013-01, that we consider to be a material weakness in the School’s internal control.

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Our consideration of internal control was also not designed to identify all deficiencies in internal control that might be significant deficiencies. 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. We identified certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as item 2013-02, that we consider to be significant deficiencies in the School's internal control.

Compliance and other matters

As part of obtaining reasonable assurance about whether the School's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

School's response to findings

The School's response to our findings, which is described in the accompanying schedule of findings and questioned costs, was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on the School's response.

Intended purpose

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

Grant Thornton LLP

New York, New York
November 1, 2013

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

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Schedule of Findings and Questioned Costs
For the year ended June 30, 2013**

FINDING NO. 2013-01 – 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 fiscal 2013 audit, we noted a material weakness in the internal control over financial reporting with regard to the School's journal entry process. We noted that the CFO, Assistant CFO, Controller and Senior Accountants all had the ability to prepare and post journal entries. Additionally, 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 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 implemented that will address the segregation of duties as well as the review process.

FINDING NO. 2013-02 – INTERNAL CONTROLS OVER FINANCIAL REPORTING (SIGNIFICANT DEFICIENCY)

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 457(f) Plan

During our fiscal 2013 audit, we noted that the School does not retain adequate documentation or approval of the calculations performed for payments made to terminated employees and that the School does not have formal policies or procedures in place for the payments to terminated employees. We recommend that the school establish formal policies and procedures for deferred compensation payments made to employees, including formal documentation and approval for all payments.

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Schedule of Findings and Questioned Costs
For the year ended June 30, 2013**

Accounting for In-kind Contributions

During our fiscal 2013 audit, we noted that the School recorded an expense and payable for bonuses pertaining to fiscal 2013, however these bonuses were paid by HCZ on behalf of the School. As such, the School overstated its payables and understated its in-kind contribution for the bonuses paid by HCZ for the School's employees. As a result, an audit adjustment of approximately \$55,000 was recorded to reduce the payable and record the in-kind contribution.

During our fiscal 2013 audit, we also noted that the School recorded an incorrect amount of in-kind revenue and expense for employer payroll taxes that were paid by HCZ for the School's employees. As a result, an audit adjustment was recorded for approximately \$26,000 to decrease in-kind contribution revenue and in-kind payroll tax expenses. We also noted that the School did not record in-kind revenue and expense for the free space provided by HCZ, resulting in an adjustment of \$100,000 to increase both in-kind revenue and in-kind rent expense.

We recommend that the School meet with personnel from HCZ on a monthly basis to capture, reconcile and record all of the in-kind contributions made by HCZ.

Bank Reconciliations

During our fiscal 2013 audit, we noted that the School did not complete bank reconciliations on a monthly basis for its payroll account. As such, upon reconciling the account at year-end, an audit adjustment was recorded for approximately \$7,000 to increase the payroll cash account balance and decrease payroll tax expense. We recommend the School complete bank reconciliations on a monthly basis going forward, in order to properly manage cash balances throughout the year.

Accounting Staff

Although HCZ hired a new controller during fiscal 2013, the position was not filled until the latter part of the year. As a result, as of year-end, the School had not implemented adequate monitoring controls and there were significant processes that were not supported by up-to-date written policies and procedures. We recommend that HCZ and the School ensure the personnel in the accounting/finance function are sufficiently qualified to meet the financial reporting needs of the organization. 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:

Journal Entries

We agree that the ability to both prepare and post journals is not a proper segregation of duties; however, we note that there were no improper journal entries posted as a result. The staff size and skill sets that existed throughout most of the fiscal year were not conducive to establishing the requisite segregation of duties with regard to journal entries. During the second half of the year, a new CFO and Controller were added to the financial management team and, effective beginning fiscal 2014, we have implemented a procedure whereby each journal entry contains a

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cover sheet, requiring signoff by a preparer and a separate approver, generally the Controller – the CFO signs off of any journal entries prepared by the controller.

Accounting for 457(f) Plan

Though the payments made to terminated employees were based on account balances at the time of termination, we agree that not retaining a copy of such account balances was an inadequate control. Effective late in fiscal 2013, accounting for the 457(f) plan was transferred to the new Controller and, effective for fiscal 2014, we will retain a copy each month's file of employee account balances. We will also ensure each payment to employees is properly authorized and documented.

Accounting for In-kind Contributions

Beginning effective with fiscal 2014, we implemented weekly staff meetings of the financial and business office personnel for HCZ and the School to better ensure proper coordination of accounting and payment activities between HCZ and the School.

Bank Reconciliations

We note that all reconciliations of the payroll bank accounts were completed prior to finalizing the audit, but that such reconciliations were not performed timely during fiscal 2013. We are in the process of adding accounting resources, with roles specifically assigned to prepare such reconciliations on a monthly basis.

Accounting Staff

As noted in prior comments, we added a new CFO and Controller in the second half of fiscal 2013. We have recently concluded a review of our staffing and are implementing a new staffing plan that will better define the roles and add resources to improve the internal control environment as well as the quality and timeliness of financial reporting, both internally and externally.

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Schedule of Prior Year (Fiscal 2012) Audit Findings and Corrective Action Plan
For the year ended June 30, 2013**

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 \$352,000. 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.

Accounting for In-kind Contributions

During our fiscal 2012 audit, we noted that the School did not properly record an in-kind contribution for bonuses that were paid by Harlem Children's Zone for the School's employees. As such, an audit adjustment was recorded for approximately \$89,000 to record the in-kind contribution.

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 \$44,000 to reduce both the revenue and the receivable recorded during fiscal 2012.

In addition, during our fiscal 2012 audit, we noted that the School did not recognize deferred revenue from the prior year that was earned during fiscal 2012, which resulted in the School's deferred revenue to be overstated and the revenue to be understated. As such, an audit adjustment was recorded for approximately \$62,000 to reduce the School's deferred revenue and to record the additional revenue earned.

Year-end Accruals

During our fiscal 2012 audit, we noted that the School did not properly reconcile and adjust their bonus and vacation accruals, which resulted in both accounts payable and expenses to be overstated. As such, an audit adjustment was recorded for approximately \$142,000 to reduce the bonus and vacation expenses and the related payable balances.

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For the year ended June 30, 2013**

In addition, 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 \$112,000 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 \$44,000 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 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.

Accounting for In-kind Contributions

The in-kind contribution was included with the total bonus expense for the School. In the future, the School will ensure that bonuses are presented in a matter that separates school expenses and in-kind contribution.

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Schedule of Prior Year (Fiscal 2012) Audit Findings and Corrective Action Plan
For the year ended June 30, 2013**

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.

Fiscal 2013 Status:

Please refer to Findings 2013-01 and 2013-02.