

KIPP, Inc.

Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2012 and 2011

Independent Auditors' Report

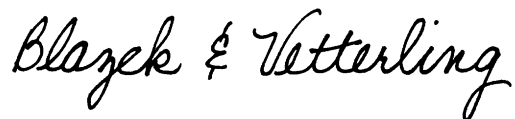
To the Board of Directors of
KIPP, Inc.:

We have audited the accompanying statements of financial position of KIPP, Inc. (KIPP) as of June 30, 2012 and 2011 and the related statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the management of KIPP. 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 our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 KIPP, Inc. 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 October 16, 2012, on our consideration of KIPP's internal control over financial reporting and 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 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.



October 16, 2012

KIPP, Inc.Statements of Financial Position as of June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and cash equivalents (<i>Note 2</i>)	\$ 7,690,223	\$ 12,655,763
Receivables:		
Government agencies	14,688,117	11,556,734
Pledges, net (<i>Note 3</i>)	1,504,302	1,692,472
Other	1,032,677	170,908
Prepaid expenses	497,794	551,320
Investments in certificates of deposit	300,000	300,000
Capitalized bond issuance costs	3,205,296	3,322,465
Bond proceeds held in trust (<i>Note 5</i>)	12,731,572	21,531,419
Property and equipment, net (<i>Note 4</i>)	<u>121,856,439</u>	<u>111,214,248</u>
TOTAL ASSETS	<u>\$ 163,506,420</u>	<u>\$ 162,995,329</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 4,426,361	\$ 2,665,970
Accrued payroll expenses	6,864,303	6,814,000
Due to PHILO Finance Corporation	170,310	2,664,143
Construction payable	1,514,245	4,026,309
Accrued interest	2,607,129	2,629,158
Refundable advances	101,656	75,185
Bonds and notes payable (<i>Notes 5 and 10</i>)	<u>125,787,976</u>	<u>125,697,730</u>
Total liabilities	<u>141,471,980</u>	<u>144,572,495</u>
Commitments (<i>Note 12</i>)		
Net assets (<i>Note 8</i>):		
Unrestricted	17,467,175	14,224,473
Temporarily restricted (<i>Note 7</i>)	4,377,265	4,008,361
Permanently restricted for scholarships	<u>190,000</u>	<u>190,000</u>
Total net assets	<u>22,034,440</u>	<u>18,422,834</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 163,506,420</u>	<u>\$ 162,995,329</u>

See accompanying notes to financial statements.

KIPP, Inc.**Statement of Activities for the year ended June 30, 2012**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Government grants <i>(Note 9)</i>	\$ 69,950,746			\$ 69,950,746
Contributions <i>(Note 10)</i>	4,114,338	\$ 2,393,684		6,508,022
Program service fees	6,873,113			6,873,113
Special events	1,175,944			1,175,944
Cost of direct donor benefits	(140,096)			(140,096)
Interest income	13,445	5,652		19,097
Other	<u>312,531</u>			<u>312,531</u>
Total revenue	82,300,021	2,399,336		84,699,357
Net assets released from restrictions:				
Program expenditures	1,832,703	(1,832,703)		
Capital expenditures	72,729	(72,729)		
Expiration of time restrictions	<u>125,000</u>	<u>(125,000)</u>		
Total	<u>84,330,453</u>	<u>368,904</u>		<u>84,699,357</u>
EXPENSES:				
Program expenses:				
Instructional program	56,792,828			56,792,828
Auxiliary services	<u>10,450,373</u>			<u>10,450,373</u>
Total program expenses	67,243,201			67,243,201
General and administrative	12,492,568			12,492,568
Fundraising	<u>1,328,582</u>			<u>1,328,582</u>
Total expenses	81,064,351			81,064,351
Transfer of funds to PHILO Finance Corporation <i>(Note 10)</i>	<u>23,400</u>			<u>23,400</u>
Total expenses and other reductions	<u>81,087,751</u>			<u>81,087,751</u>
CHANGES IN NET ASSETS	3,242,702	368,904		3,611,606
Net assets, beginning of year	<u>14,224,473</u>	<u>4,008,361</u>	<u>\$ 190,000</u>	<u>18,422,834</u>
Net assets, end of year	<u>\$ 17,467,175</u>	<u>\$ 4,377,265</u>	<u>\$ 190,000</u>	<u>\$ 22,034,440</u>

See accompanying notes to financial statements.

KIPP, Inc.**Statement of Activities for the year ended June 30, 2011**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Government grants <i>(Note 9)</i>	\$ 61,467,351			\$ 61,467,351
Contributions <i>(Note 10)</i>	5,988,404	\$ 3,245,336		9,233,740
Program service fees	6,578,186			6,578,186
Special events	1,033,108			1,033,108
Cost of direct donor benefits	(111,023)			(111,023)
Interest income	31,528	5,637		37,165
Other	<u>452,629</u>			<u>452,629</u>
Total revenue	75,440,183	3,250,973		78,691,156
Net assets released from restrictions:				
Program expenditures	1,169,410	(1,169,410)		
Capital expenditures	838,774	(838,774)		
Expiration of time restrictions	<u>187,850</u>	<u>(187,850)</u>		
Total	<u>77,636,217</u>	<u>1,054,939</u>		<u>78,691,156</u>
EXPENSES:				
Program expenses:				
Instructional program	50,606,084			50,606,084
Auxiliary services	<u>12,499,770</u>			<u>12,499,770</u>
Total program expenses	63,105,854			63,105,854
General and administrative	11,512,582			11,512,582
Fundraising	<u>876,483</u>			<u>876,483</u>
Total expenses	75,494,919			75,494,919
Transfer of funds to PHILO Finance Corporation <i>(Note 10)</i>	<u>548,250</u>			<u>548,250</u>
Total expenses and other reductions	<u>76,043,169</u>			<u>76,043,169</u>
CHANGES IN NET ASSETS	1,593,048	1,054,939		2,647,987
Net assets, beginning of year	<u>12,631,425</u>	<u>2,953,422</u>	<u>\$ 190,000</u>	<u>15,774,847</u>
Net assets, end of year	<u>\$ 14,224,473</u>	<u>\$ 4,008,361</u>	<u>\$ 190,000</u>	<u>\$ 18,422,834</u>

See accompanying notes to financial statements.

KIPP, Inc.**Statements of Cash Flows for the years ended June 30, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 3,611,606	\$ 2,647,987
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities		(2,234,806)
Donated land	(1,100,000)	
Depreciation	3,866,422	2,683,426
Amortization of bond issuance costs	117,169	122,525
Amortization of bond issuance discounts	36,271	36,271
Changes in operating assets and liabilities:		
Receivables	(3,814,982)	(2,186,964)
Prepaid expenses	53,526	261,099
Accounts payable and accrued expenses	1,810,694	3,300,417
Due to PHILO Finance Corporation	(2,493,833)	(2,394,585)
Accrued interest	(22,029)	206,274
Refundable advances	<u>26,471</u>	<u>(7,160)</u>
Net cash provided by operating activities	<u>2,091,315</u>	<u>2,434,484</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	<u>(11,126,850)</u>	<u>(18,065,853)</u>
Net cash used by investing activities	<u>(11,126,850)</u>	<u>(18,065,853)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in bond proceeds held in trust	8,799,847	(3,430,712)
Proceeds from bonds and notes payable		23,436,000
Principal repayments of bonds and notes payable	(4,739,852)	(1,481,173)
Capitalized bond issuance costs		(276,501)
Proceeds from contributions restricted for expansion of facilities	<u>10,000</u>	<u>2,774,806</u>
Net cash provided by financing activities	<u>4,069,995</u>	<u>21,022,420</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(4,965,540)	5,391,051
Cash and cash equivalents, beginning of year	<u>12,655,763</u>	<u>7,264,712</u>
Cash and cash equivalents, end of year	<u>\$ 7,690,223</u>	<u>\$ 12,655,763</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$6,916,062	\$6,243,099
Property and equipment purchased with debt to PHILO Finance Corporation	\$4,793,827	\$6,499,889

See accompanying notes to financial statements.

KIPP, Inc.

Notes to Financial Statements for the years ended June 30, 2012 and 2011

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – KIPP, Inc. (KIPP) operates eighteen Texas Open-Enrollment Charter Schools under two state charters. The schools are located in Houston, Texas and serve students from pre-kindergarten through 12th grades. Additionally, KIPP operates an elementary school and middle school within Galveston Independent School District on a contract basis.

Federal income tax status – KIPP is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(1) and §170(b)(1)(A)(ii). KIPP files annual federal information returns and is subject to routine examinations of its returns; however, there are no examinations for any tax periods currently in progress. KIPP believes it is no longer subject to examinations of returns for tax years ending before 2009.

Cash equivalents include highly liquid investments with original maturities of three months or less.

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Amounts that are expected to be collected in future years are discounted to estimate the present value of future cash flows.

Capitalized bond issuance costs represent costs incurred related to the issuance of bonds and notes payable and are amortized over the term of the bonds or notes.

Property and equipment are reported at cost if purchased or at fair value at the date of gift if donated. KIPP recognizes depreciation using the straight-line method over the estimated useful lives of the assets, which range from 12 to 39 years for buildings and improvements and 3 to 12 years for vehicles and equipment. KIPP capitalizes additions and improvements that have a cost of more than \$5,000.

Net asset classification – Contributions, investment return and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations even though their use may be limited in other respects such as by contract or board designation.
- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity. Investment return may be used to support general operations.

Government grants are recognized as revenue in the period in which the services are provided. Amounts collected in advance are recorded as refundable advances.

Contributions are recognized at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are recorded as restricted support.

Conditional contributions are included in contribution revenue when the conditions are substantially met. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted revenue. Absent explicit donor stipulations about how long those long-lived assets must be maintained, KIPP reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Program service fees are recognized in the period in which services are provided.

Contributed services and facilities are recognized at fair value when an unconditional commitment is received from the donor. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2012</u>	<u>2011</u>
Demand deposits	\$ 5,733,961	\$ 11,189,414
Money market mutual funds	<u>1,956,262</u>	<u>1,466,349</u>
Total cash and cash equivalents	<u>\$ 7,690,223</u>	<u>\$ 12,655,763</u>

Bank deposits exceed the federally insured limit per depositor per institution. Accounts with state and federal funds are non-interest bearing accounts and have unlimited protection per the Transaction Account Guarantee program of the FDIC.

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are comprised of the following:

	<u>2012</u>	<u>2011</u>
Pledges receivable	\$ 1,569,791	\$ 1,794,594
Discount to net present value at 1% to 5%	<u>(65,489)</u>	<u>(102,122)</u>
Pledges receivable, net	<u>\$ 1,504,302</u>	<u>\$ 1,692,472</u>

At June 30, 2012, amounts due from two contributors represent 54% of total pledges receivable.

Pledges receivable at June 30, 2012 are expected to be collected as follows:

Due within one year	\$ 839,791
Due in one to five years	<u>730,000</u>
Total pledges receivable	<u>\$ 1,569,791</u>

KIPP received a conditional pledge for approximately \$1.9 million from a foundation with payments contingent upon meeting certain milestones and conditions. At June 30, 2012, conditional pledges outstanding related to these grants totaled approximately \$1.2 million.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment are comprised of the following:

	<u>2012</u>	<u>2011</u>
Land	\$ 29,549,775	\$ 28,354,855
Buildings and improvements	88,993,287	72,498,071
Vehicles and equipment	5,449,550	4,813,826
Construction in process	<u>15,392,150</u>	<u>19,204,365</u>
Total property and equipment, at cost	139,384,762	124,871,117
Accumulated depreciation	<u>(17,528,323)</u>	<u>(13,656,869)</u>
Property and equipment, net	<u>\$ 121,856,439</u>	<u>\$ 111,214,248</u>

NOTE 5 – BONDS AND NOTES PAYABLE

Bonds and notes payable consist of the following:

	<u>2012</u>	<u>2011</u>
Series 2009A bonds payable issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of \$960,404 at June 30, 2012 and \$990,108 at June 30, 2011. The bonds bear interest at rates from 4% to 6.4% and are due in installments through August 15, 2044. The proceeds were used to refinance certain existing obligations and to fund construction, debt service, and debt service reserve. The bonds are secured by real property and are guaranteed by PHILO Finance Corporation.	\$ 64,214,596	\$ 64,184,892
Series 2006A bonds payable issued by Texas Public Finance Authority Charter School Finance Corporation, interest at rates ranging from 4% to 5% and are due in installments through February 15, 2036. The proceeds were used to refinance certain existing obligations and to fund construction, debt service, and debt service reserve. The bonds are secured by real property.	32,865,000	33,570,000
Qualified Zone Academy Bond, Taxable Series 2010, issued by the City of Houston Higher Education Finance Corporation. PHILO Finance Corporation is the third party in the bond agreement having loaned the funds to the City of Houston Higher Education Finance Corporation. Interest on the bond of 5.42% is paid every six months to the bond-holder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2029. The proceeds were used to rehabilitate or repair specified campus facilities, provide school program course materials, and training and are secured by pledged revenue.	12,345,000	12,345,000

Qualified School Construction Bond, Taxable Series 2010, issued by the City of Houston Higher Education Finance Corporation. PHILO Finance Corporation is the third party in the bond agreement, having loaned the funds to the City of Houston Higher Education Finance Corporation. Interest on the bond of 5.42% is paid every six months to the bond-holder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2029. The proceeds were used for building construction on specified campuses and are secured by pledged revenue.

10,681,000 10,681,000

Uncollateralized, non-interest bearing note payable to PHILO Finance Corporation due December 31, 2012.

5,004,721 3,835,746

Series 2009B bonds payable issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of \$212,341 at June 30, 2012 and \$218,908 at June 30, 2011. The bonds bear interest at rates from 4.9% to 6.4% and are due in installments through August 15, 2013. The proceeds were used to refinance certain existing obligations and to fund construction, debt service, and debt service reserve. The bonds are secured by real property and are guaranteed by PHILO Finance Corporation.

677,659 1,081,092

Total bonds and notes payable

\$ 125,787,976 \$ 125,697,730

KIPP capitalized interest of approximately \$320,000 in 2012 and \$470,000 in 2011. Interest expense totaled approximately \$6,883,000 and \$5,943,000 in 2012 and 2011, respectively. The discount on the bonds is being amortized over the lives of the bonds. Imputed interest expense of approximately \$56,000 and \$36,000 was reported in the accompanying statement of activities for the year ended June 30, 2012 and 2011, respectively.

The Texas Public Finance Authority (TPFA) under the Texas Credit Enhancement Program for Charter Schools provided a \$2 million guarantee for the Series 2009A and Series 2006A bonds issued in 2010 and 2007, respectively.

Maturities of bonds and notes payable at June 30, 2012 are as follows:

2013	\$ 6,138,452
2014	1,203,730
2015	1,283,730
2016	1,328,730
2017	1,403,730
Thereafter	<u>114,429,604</u>
Total	<u>\$ 125,787,976</u>

KIPP has a \$3,000,000 line of credit with a financial institution that expires in August 2013. No draws were outstanding at June 30, 2012.

NOTE 6 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of significant financial instruments including cash and cash equivalents, pledges receivable, bond proceeds held in trust and other short-term assets and liabilities approximates fair value as of June 30, 2012 and 2011. The fair value of bonds and notes payable at June 30, 2012 carried at \$125,787,976 was \$137,388,863. The fair value of bonds and notes payable at June 30, 2011 carried at \$125,697,730 was \$128,562,918.

NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2012</u>	<u>2011</u>
KIPP Turbo expansion	\$ 1,362,016	\$ 1,434,745
KIPP future operations	719,511	697,877
KIPP scholarships	634,284	563,109
Teacher recruitment	357,140	355,115
STEM lab and teacher development	348,024	
Teacher excellence awards	180,000	280,000
Courage future operations	154,000	
Peace & Generation future operations	147,197	
Administrative costs – Government Affairs Grant	125,000	
Sunnyside future operations	119,761	250,000
KIPP through college	98,459	192,500
College Readiness Model	38,762	
Legacy future operations		166,681
Other	<u>93,111</u>	<u>68,334</u>
Total temporarily restricted net assets	<u>\$ 4,377,265</u>	<u>\$ 4,008,361</u>

NOTE 8 – ENDOWMENT FUNDS

KIPP is subject to the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA). The Board of Directors of KIPP has interpreted TUPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, KIPP classifies the original value of gifts donated to the permanent endowment as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by KIPP in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, KIPP considers the following factors in making a determination to appropriate accumulated donor-restricted endowment funds:

- The duration and preservation of the endowment fund
- The purposes of KIPP and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of KIPP
- The investment policies of KIPP

Changes in endowment net assets are as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, July 1, 2010	\$ 0	\$ 210,000	\$ 190,000	\$ 400,000
Contributions		500		500
Interest		5,637		5,637
Appropriation for distribution		(6,137)		(6,137)
Endowment net assets, June 30, 2011	<u>0</u>	<u>210,000</u>	<u>190,000</u>	<u>400,000</u>
Interest		5,652		5,652
Appropriation for distribution		(5,652)		(5,652)
Endowment net assets, June 30, 2012	<u>\$ 0</u>	<u>\$ 210,000</u>	<u>\$ 190,000</u>	<u>\$ 400,000</u>

Spending Policies and Return Objectives

KIPP has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by the endowment in such a manner as to preserve and enhance the net asset value. The endowment funds consist of contributions that are permanently restricted by the donor as well as temporarily restricted by the donor. KIPP expects its endowment funds, over time, to provide an average annual rate-of-return of 5%. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, KIPP relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Distributions are determined annually by the Superintendent.

NOTE 9 – GOVERNMENT GRANTS

KIPP is the recipient of government grants from various federal, state and local agencies. Government grants include the following:

	<u>2012</u>	<u>2011</u>
<i>State grants:</i>		
Texas Education Agency Foundation School Program Act	\$ 55,194,018	\$ 47,561,540
Texas Science, Technology, Engineering, and Math Initiative	308,741	160,734
Textbook and Kindergarten Materials	93,424	
SSI Intensive Math Initiative	76,177	47,042
Pre-K Expansion Grant	53,817	674,260
Teacher Excellence Awards	49,883	117,891
School Lunch Matching	24,436	19,469
Texas Fitness Now	12,080	10,297
Technology Allotment		162,459
Intensive Summer Programs		144,770
Above and Beyond Grant		51,001
FSP Investment Capital Fund		23,475
APIB Technical Training		<u>3,600</u>
Total state grants	<u>55,812,576</u>	<u>48,976,538</u>
<i>Federal grants:</i>		
U. S. Department of Education	9,938,799	8,267,172
U. S. Department of Agriculture	<u>4,199,371</u>	<u>4,223,641</u>
Total federal grants	<u>14,138,170</u>	<u>12,490,813</u>
Total government grants	<u>\$ 69,950,746</u>	<u>\$ 61,467,351</u>

The grants from government funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by KIPP with the terms of the contracts. Management believes such disallowances, if any, would not be material to KIPP's financial position or changes in net assets.

NOTE 10 – PHILO FINANCE CORPORATION

PHILO Finance Corporation (PHILO) is a separate, independent §501(c)(3) nonprofit organization organized to assist public charter schools with obtaining financing, including providing below-market loans. KIPP's superintendent is on the Board of Directors of PHILO. KIPP participated in several transactions with PHILO related to the financing of KIPP's capital expansion program, *KIPP Turbo*.

KIPP's Board of Directors authorized a transfer to PHILO of up to \$55,000,000 raised in connection with *KIPP Turbo*. As of June 30, 2012, KIPP has transferred a cumulative amount of \$29,573,000 to PHILO. KIPP transferred approximately \$23,000 and \$550,000 of *KIPP Turbo* funds raised in 2012 and 2011, respectively. These transactions are reported in the statements of activities as transfers to PHILO.

During 2012 and 2011, PHILO made land and building purchases and building construction expenditures on behalf of KIPP totaling approximately \$4,800,000 and \$10,300,000, respectively. Approximately \$3,625,000 in 2012 and \$6,404,000 in 2011 were repaid to PHILO. The net amounts owed to PHILO by KIPP are reported as bonds and notes payable at June 30, 2012 and 2011 in the accompanying statements of financial position.

KIPP received a grant of \$4,165,000 from PHILO for operating purposes during 2011. KIPP also received a \$1,235,000 grant from PHILO during 2011 as part of a match requirement under the Qualified Zone Academy Bonds.

NOTE 11 – LEASE COMMITMENTS

KIPP leases office space and certain equipment under noncancellable operating leases. Future minimum lease payments are due as follows:

2013	\$ 258,014
2014	219,878
2015	174,896
2016	69,402
2017	<u>14,529</u>
Total	<u>\$ 736,719</u>

Rental expense was approximately \$773,000 and \$952,000 in 2012 and 2011, respectively.

NOTE 12 – CONSTRUCTION COMMITMENTS

In 2011, KIPP had entered into several contracts totaling approximately \$6.3 million for construction projects at certain schools. As of June 30, 2012, outstanding commitments totaled approximately \$1.3 million.

NOTE 13 – EMPLOYEE BENEFIT PLANS

KIPP offers a §403(b) retirement plan and a §457 deferred compensation plan to all employees in their third school year of employment. KIPP matches 100% of employee contributions up to a maximum of \$1,200 per employee per year. KIPP contributed approximately \$164,000 to these plans in 2011. No contribution was made in 2012.

KIPP's full-time employees participate in the Teacher Retirement System of Texas, a public employee retirement system. It is a cost-sharing, multi-employer defined benefit pension plan. All risks and costs are the responsibility of the State of Texas. Plan members contribute 6.5% of their annual covered salary. KIPP contributed \$798,571 and \$1,269,509 to the plan during 2012 and 2011, respectively.

Health benefits – Beginning in December 2010, KIPP became self-insured for health benefits. Under this plan, health benefit claims are the responsibility of KIPP subject to a maximum on a per employee and aggregate basis based on the number of employees currently covered. KIPP maintains a stop-loss policy (up to \$1 million) that becomes effective when claims aggregate to a predetermined amount based on 125% of expected claims. KIPP has recorded an accrued liability of approximately \$458,000 in the accompanying statements of financial position for its share of claims arising from incidents occurring on or before June 30, 2012.

NOTE 14 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 16, 2012, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.
