

**KIPP, Inc.**

Financial Statements  
and Independent Auditors' Report  
for the years ended June 30, 2016 and 2015

# **KIPP, Inc.**

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## Independent Auditors' Report

To the Board of Directors of  
KIPP, Inc.:

### Report on the Financial Statements

We have audited the accompanying financial statements of KIPP, Inc. (KIPP), which comprise the statements of financial position as of June 30, 2016 and 2015 and the related statements of activities and of 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.

### *Auditors' 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 our audits 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 auditors' 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 entity'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 entity'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 KIPP as of June 30, 2016 and 2015 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.

## Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2016 on our consideration of KIPP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KIPP's internal control over financial reporting and compliance.

*Blazek & Vetterling*

October 19, 2016

**KIPP, Inc.****Statements of Financial Position as of June 30, 2016 and 2015**

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	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents ( <i>Note 2</i> )	\$ 16,962,005	\$ 12,968,581
Certificate of deposit		300,000
Receivables:		
Government agencies	18,083,111	17,325,078
Pledges ( <i>Note 3</i> )	956,749	1,204,758
Other	1,056,640	1,579,475
Prepaid expenses and other assets	<u>511,494</u>	<u>659,066</u>
Total current assets	37,569,999	34,036,958
Pledges receivable, net ( <i>Note 3</i> )	336,521	438,739
Investments ( <i>Notes 4 and 5</i> )	866,001	797,035
Capitalized bond issuance costs	1,657,393	1,731,269
Bond proceeds held in trust ( <i>Notes 5 and 7</i> )	6,199,966	14,827,749
Property and equipment, net ( <i>Note 6</i> )	<u>172,822,748</u>	<u>165,013,096</u>
<b>TOTAL ASSETS</b>	<u><b>\$ 219,452,628</b></u>	<u><b>\$ 216,844,846</b></u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,927,398	\$ 4,765,249
Accrued payroll expenses	9,854,161	9,618,933
Construction payable	3,566,624	3,548,165
Accrued interest	2,818,911	2,036,353
Refundable advances	14,097	61,683
Current portion of bonds and notes payable ( <i>Note 7</i> )	<u>5,401,403</u>	<u>4,593,801</u>
Total current liabilities	26,582,594	24,624,184
Bonds and notes payable ( <i>Note 7</i> )	<u>173,008,149</u>	<u>178,676,605</u>
Total liabilities	<u>199,590,743</u>	<u>203,300,789</u>
Commitments ( <i>Note 13</i> )		
Net assets ( <i>Note 10</i> ):		
Unrestricted	16,894,894	11,049,540
Temporarily restricted ( <i>Note 9</i> )	2,776,991	2,304,517
Permanently restricted for scholarships	<u>190,000</u>	<u>190,000</u>
Total net assets	<u>19,861,885</u>	<u>13,544,057</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u><b>\$ 219,452,628</b></u>	<u><b>\$ 216,844,846</b></u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.**Statement of Activities for the year ended June 30, 2016

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	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
<b>OPERATING REVENUE:</b>				
Government grants <i>(Note 11)</i>	\$ 120,598,052			\$ 120,598,052
Contributions <i>(Note 12)</i>	1,657,606	\$ 6,335,292		7,992,898
Program service fees	9,400,481			9,400,481
Special events	1,381,579			1,381,579
Cost of direct donor benefits	(128,064)			(128,064)
Investment return, net <i>(Note 4)</i>	9,314	13,750		23,064
Other	<u>260,540</u>	<u>                    </u>		<u>260,540</u>
Total operating revenue	133,179,508	6,349,042		139,528,550
Net assets released from restrictions:				
Program expenditures	1,641,096	(1,641,096)		
Capital expenditures	4,108,254	(4,108,254)		
Expiration of time restrictions	<u>127,218</u>	<u>(127,218)</u>		<u>                    </u>
Total	<u>139,056,076</u>	<u>472,474</u>		<u>139,528,550</u>
<b>OPERATING EXPENSES:</b>				
Program expenses:				
Instructional program	99,757,387			99,757,387
Auxiliary services	<u>16,182,591</u>			<u>16,182,591</u>
Total program expenses	115,939,978			115,939,978
General and administrative	15,222,091			15,222,091
Fundraising	<u>2,048,653</u>			<u>2,048,653</u>
Total operating expenses	<u>133,210,722</u>			<u>133,210,722</u>
CHANGES IN NET ASSETS	5,845,354	472,474		6,317,828
Net assets, beginning of year	<u>11,049,540</u>	<u>2,304,517</u>	<u>\$ 190,000</u>	<u>13,544,057</u>
Net assets, end of year	<u>\$ 16,894,894</u>	<u>\$ 2,776,991</u>	<u>\$ 190,000</u>	<u>\$ 19,861,885</u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.****Statement of Activities for the year ended June 30, 2015**

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	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
<b>OPERATING REVENUE:</b>				
Government grants <i>(Note 11)</i>	\$ 105,796,192			\$ 105,796,192
Contributions <i>(Note 12)</i>	3,866,342	\$ 6,569,549		10,435,891
Program service fees	8,031,447			8,031,447
Special events	1,624,161			1,624,161
Cost of direct donor benefits	(147,019)			(147,019)
Investment return, net <i>(Note 4)</i>	(4,817)	5,637		820
Other	<u>346,450</u>	<u>                    </u>		<u>346,450</u>
Total operating revenue	119,512,756	6,575,186		126,087,942
Net assets released from restrictions:				
Program expenditures	2,040,693	(2,040,693)		
Capital expenditures	4,808,932	(4,808,932)		
Expiration of time restrictions	<u>122,513</u>	<u>(122,513)</u>		<u>                    </u>
Total	<u>126,484,894</u>	<u>(396,952)</u>		<u>126,087,942</u>
<b>OPERATING EXPENSES:</b>				
Program expenses:				
Instructional program	90,765,383			90,765,383
Auxiliary services	<u>14,669,848</u>			<u>14,669,848</u>
Total program expenses	105,435,231			105,435,231
General and administrative	16,195,636			16,195,636
Fundraising	<u>2,138,823</u>			<u>2,138,823</u>
Total operating expenses	<u>123,769,690</u>			<u>123,769,690</u>
Changes in net assets from operating activities	2,715,204	(396,952)		2,318,252
<b>NON-OPERATING:</b>				
Loss on extinguishment of debt	<u>(16,819,644)</u>	<u>                    </u>		<u>(16,819,644)</u>
<b>CHANGES IN NET ASSETS</b>	(14,104,440)	(396,952)		(14,501,392)
Net assets, beginning of year	<u>25,153,980</u>	<u>2,701,469</u>	<u>\$ 190,000</u>	<u>28,045,449</u>
Net assets, end of year	<u>\$ 11,049,540</u>	<u>\$ 2,304,517</u>	<u>\$ 190,000</u>	<u>\$ 13,544,057</u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.**Statements of Cash Flows for the years ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Changes in net assets	\$ 6,317,828	\$(14,501,392)
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(4,000,000)	(4,500,000)
Net realized and unrealized (gain) loss on investments	(10,762)	15,769
Depreciation	9,420,334	8,333,250
Amortization of bond issuance costs	73,876	156,928
Loss on extinguishment of debt		16,819,644
Amortization of bond issuance premiums	(156,200)	(33,295)
Changes in operating assets and liabilities:		
Certificate of deposit	300,000	(300,000)
Receivables	(634,971)	(2,233,734)
Prepaid expenses and other assets	147,572	(123,123)
Accounts payable and accrued expenses	397,377	(803,492)
Accrued interest	782,558	(980,314)
Refundable advances	(47,586)	24,800
Net cash provided by operating activities	<u>12,590,026</u>	<u>1,875,041</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of investments	270,602	89,476
Purchases of investments	(293,274)	(761,485)
Net change in cash held as investments	(35,532)	159,205
Purchases of property and equipment	(8,583,744)	(10,545,519)
Net cash used by investing activities	<u>(8,641,948)</u>	<u>(11,058,323)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from bonds payable		8,812,517
Principal repayments of bonds and notes payable	(4,704,654)	(40,000)
Proceeds from contributions restricted for expansion of facilities	4,750,000	4,250,000
Net cash provided by financing activities	<u>45,346</u>	<u>13,022,517</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>3,993,424</b>	<b>3,839,235</b>
Cash and cash equivalents, beginning of year	<u>12,968,581</u>	<u>9,129,346</u>
Cash and cash equivalents, end of year	<u>\$ 16,962,005</u>	<u>\$ 12,968,581</u>
<i>Supplemental disclosure of cash flow information:</i>		
Bonds defeased with bond proceeds		\$110,812,335
Interest payments	\$6,818,989	\$8,326,295
Property and equipment acquired with bond proceeds	\$8,627,783	\$2,137,870

*See accompanying notes to financial statements.*

## KIPP, Inc.

Notes to Financial Statements for the years ended June 30, 2016 and 2015

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### NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – KIPP, Inc. (KIPP) operates twenty-three Texas Open-Enrollment Charter Schools under one state charter. The schools are located in Houston, Texas and serve approximately 12,500 students from pre-kindergarten through 12<sup>th</sup> grade. Additionally, KIPP operates a middle school within Spring Branch 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).

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.

Investments in marketable securities are reported at fair value. Investment return is reported in the statement of activities as an increase in unrestricted net assets unless the use of income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported as an increase in temporarily restricted net assets.

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 is 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 furniture, equipment and vehicles. KIPP capitalizes additions and improvements that have a cost of more than \$5,000.

Net asset classification – Contributions, interest income 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 and interest income 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. Interest income may be used to support scholarships.

Government grants are recognized as revenue in the period in which the services are provided. Amounts collected in advance are reported 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 classified 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.

Recent accounting pronouncements – In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, *Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*. This amendment requires that debt issuance costs related to a recognized debt liability be presented in the statement of financial position as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The ASU is effective for fiscal periods beginning after December 15, 2015 and is to be applied retrospectively. KIPP will adopt this ASU for the fiscal year ended June 30, 2017.

In August 2016, FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU are the first phase of changes aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions*. New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. The ASU is effective for fiscal periods beginning after December 15, 2017, but early adoption is permitted. Adoption of this ASU will significantly impact the presentation and disclosures of the financial statements. KIPP will adopt this ASU effective for the fiscal year ended June 30, 2019.

## NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2016</u>	<u>2015</u>
Demand deposits	\$ 16,962,005	\$ 12,863,852
Money market mutual funds		<u>104,729</u>
Total cash and cash equivalents	<u>\$ 16,962,005</u>	<u>\$ 12,968,581</u>

Bank deposits exceed the federally insured limit per depositor per institution.

### NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are comprised of the following:

	<u>2016</u>	<u>2015</u>
Pledges receivable	\$ 1,306,749	\$ 1,659,758
Discount to net present value at 0.11% to 3.55%	<u>(13,479)</u>	<u>(16,261)</u>
Pledges receivable, net	<u>\$ 1,293,270</u>	<u>\$ 1,643,497</u>

Pledges receivable at June 30, 2016 are expected to be collected as follows:

Due within one year	\$ 956,749
Due in one to five years	<u>350,000</u>
Total pledges receivable	<u>\$ 1,306,749</u>

### NOTE 4 – INVESTMENTS AND INVESTMENT RETURN

Investments consist of the following:

	<u>2016</u>	<u>2015</u>
Equity securities	\$ 559,622	\$ 526,152
Cash	176,327	140,795
Mortgage-backed securities	<u>130,052</u>	<u>130,088</u>
Total investments	<u>\$ 866,001</u>	<u>\$ 797,035</u>

Investment return includes earnings on cash and cash equivalents and consists of the following:

	<u>2016</u>	<u>2015</u>
Interest and dividends	\$ 12,302	\$ 16,589
Realized and unrealized gain (loss)	<u>10,762</u>	<u>(15,769)</u>
Investment return, net	<u>\$ 23,064</u>	<u>\$ 820</u>

### NOTE 5 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity's assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at June 30, 2016 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity securities:				
Domestic – large cap	\$ 538,871			\$ 538,871
International – large cap	20,751			20,751
Mortgage-backed securities	<u>                    </u>	<u>\$ 130,052</u>		<u>130,052</u>
Total investments	<u>559,622</u>	<u>130,052</u>		<u>689,674</u>
Bond proceeds held in trust:				
U. S. Treasury mutual fund	<u>6,199,966</u>			<u>6,199,966</u>
Total bond proceeds held in trust	<u>6,199,966</u>			<u>6,199,966</u>
Total assets measured at fair value	<u>\$ 6,759,588</u>	<u>\$ 130,052</u>	<u>\$ 0</u>	<u>\$ 6,889,640</u>

Assets measured at fair value at June 30, 2015 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Investments:				
Equity securities:				
Domestic – large cap	\$ 513,519			\$ 513,519
International – large cap	12,633			12,633
Mortgage-backed securities	<u>                    </u>	<u>\$ 130,088</u>		<u>130,088</u>
Total investments	<u>526,152</u>	<u>130,088</u>		<u>656,240</u>
Bond proceeds held in trust:				
U. S. Treasury mutual fund	14,186,730			14,186,730
Money market mutual fund	<u>641,019</u>			<u>641,019</u>
Total bond proceeds held in trust	<u>14,827,749</u>			<u>14,827,749</u>
Total assets measured at fair value	<u>\$15,353,901</u>	<u>\$ 130,088</u>	<u>\$ 0</u>	<u>\$15,483,989</u>

Valuation methods used for assets measured at fair value are as follows:

- *Mutual funds* are valued at the reported net asset value of shares held.
- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Mortgage-backed securities* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas that may include market-corroborated inputs for credit risk factors, interest rate and yield curves and broker quotes to calculate fair values.

These valuation methods may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while KIPP believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

Investments are exposed to various risks such as interest rate, market, and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

## NOTE 6 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	<u>2016</u>	<u>2015</u>
Land	\$ 32,743,734	\$ 32,609,171
Buildings and improvements	158,180,870	141,731,286
Furniture and equipment	11,341,112	10,254,834
Vehicles	642,323	594,539
Construction in progress	<u>17,178,627</u>	<u>17,679,013</u>
Total property and equipment, at cost	220,086,666	202,868,843
Accumulated depreciation	<u>(47,263,918)</u>	<u>(37,855,747)</u>
Property and equipment, net	<u>\$ 172,822,748</u>	<u>\$ 165,013,096</u>

## NOTE 7 – BONDS AND NOTES PAYABLE

Bonds and notes payable consist of the following:

	<u>2016</u>	<u>2015</u>
Series 2015A bonds payable, issued by the City of Houston Higher Education Finance Corporation, including an unamortized premium of \$2,768,553 at June 30, 2016. The bonds bear interest at rates from 4% to 5% and are due in installments through August 15, 2044. The proceeds were used to defease a portion of the 2006A and the 2009A Series bonds. The bonds are secured by pledged revenues and future operating revenue.	\$ 77,778,553	\$ 79,537,430
Series 2014A bonds payable, issued by the City of Houston Higher Education Finance Corporation, including an unamortized premium of \$1,632,922 at June 30, 2016. The bonds bear interest at rates from 2% to 5% and are due in installments through February 15, 2044. The proceeds were used to defease a portion of the 2006A Series bonds, as well as to fund construction. The bonds are secured by real property.	45,057,922	46,342,301
Qualified Zone Academy Bond, Taxable Series 2012, issued by the City of Houston Higher Education Finance Corporation. The Laura and John Arnold Foundation 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 4.19% is paid every six months to the bondholder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2035. The proceeds are being used to rehabilitate or repair specified campus facilities and provide school program course materials and training and are secured by pledged revenue.	21,648,777	22,477,775
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. In December 2012, this bond was sold to The Laura and John Arnold Foundation. Interest on the bond of 5.42% is paid every		

six months to the bondholder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2029. The proceeds are being used to rehabilitate or repair specified campus facilities and provide school program course materials and training and are secured by pledged revenue.

11,904,107      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. In December 2012, this bond was sold to The Laura and John Arnold Foundation. Interest on the bond of 5.42% is paid every six months to the bondholder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2029. The proceeds are being used for building construction on specified campuses and are secured by pledged revenue.

10,299,536      10,681,000

Qualified School Construction Bond, Taxable Series 2012, issued by the City of Houston Higher Education Finance Corporation. The Laura and John Arnold Foundation 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 4.19% is paid every six months to the bondholder by the Federal government as part of a federal tax credit bond program. The bond is due August 15, 2035. The proceeds are being used for building construction on specified campuses and are secured by pledged revenue.

6,563,700      6,732,000

Qualified School Construction Bond, Taxable Series 2014Q, issued by the City of Houston Higher Education Finance Corporation, net of an unamortized discount of \$38,043. Interest on the bond of 4.509% is paid every six months to the bondholder by the Federal government as part of a federal tax credit bond program. The bond is due February 15, 2035. The proceeds are being used for building construction on specified campuses and are secured by assets of KIPP.

5,156,957      5,154,900

Total bonds and notes payable

\$ 178,409,552      \$ 183,270,406

KIPP capitalized interest of approximately \$738,000 in 2016 and \$261,000 in 2015. Interest recognized as expense totaled approximately \$6,864,000 and \$8,145,000 in 2016 and 2015, respectively. The discounts or premiums on the bonds are being amortized over the lives of the bonds.

The Series 2015A, Series 2014A, and Series 2014Q bonds issued in 2015 are guaranteed by the Permanent School Fund of the State of Texas under the Charter District Bond Guarantee Program.

Maturities of bonds and notes payable at June 30, 2016 are as follows:

2017	\$ 5,401,403
2018	5,481,403
2019	5,571,403
2020	5,661,403
2021	5,776,403
Thereafter	<u>150,517,537</u>
Total	<u>\$ 178,409,552</u>

Bond proceeds held in trust are held primarily in money market mutual funds and include the following:

	<u>2016</u>	<u>2015</u>
Escrowed for debt service	\$ 3,737,374	\$ 3,351,666
Bond funds available for projects	<u>2,462,592</u>	<u>11,476,083</u>
Total bond proceeds held in trust	<u>\$ 6,199,966</u>	<u>\$ 14,827,749</u>

KIPP has a \$9,000,000 line of credit with a financial institution that expires in October 2016. There were no draws on the line of credit during the years ended June 30, 2016 and 2015. There were no amounts outstanding under this line of credit at June 30, 2016.

#### **NOTE 8 – 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, 2016 and 2015. The fair value of bonds and notes payable at June 30, 2016 carried at \$178,409,552 was \$178,678,739. The fair value of bonds and notes payable at June 30, 2015 carried at \$183,270,406 was \$182,682,724.

#### **NOTE 9 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes:

	<u>2016</u>	<u>2015</u>
KIPP scholarships	\$ 709,641	\$ 569,230
KIPP future operations	596,274	313,739
Administrative costs – Government Affairs Grant	382,190	157,971
KIPP Climb Academy	250,000	
Wellness	222,605	350,000
Teacher recruitment	222,140	247,140
STEM programs	96,707	14,667
Family assistance	57,621	21,507
Blended Learning grant	38,077	72,000
Professional and curriculum development	34,698	34,698
Summer internships for students	31,440	
Athletics	29,385	29,423
KIPP through college	28,776	134,351
Technology purchases	20,163	25,000
Playground at KIPP Connect	15,725	
Fort Bend students		200,000
<i>KIPP Turbo</i> expansion		58,254
Courage future operations		26,096
Other	<u>41,549</u>	<u>50,441</u>
Total temporarily restricted net assets	<u>\$ 2,776,991</u>	<u>\$ 2,304,517</u>

## NOTE 10 – 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>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, July 1, 2014	\$ 0	\$ 304,177	\$ 190,000	\$ 494,177
Interest and dividends		5,637		5,637
Appropriation for distribution		(6,477)		(6,477)
Endowment net assets, June 30, 2015	<u>0</u>	<u>303,337</u>	<u>190,000</u>	<u>493,337</u>
Contributions		57,323		57,323
Interest and dividends		16,300		16,300
Unrealized loss		(2,550)		(2,550)
Appropriation for distribution		(17,705)		(17,705)
Endowment net assets, June 30, 2016	<u>\$ 0</u>	<u>\$ 356,705</u>	<u>\$ 190,000</u>	<u>\$ 546,705</u>

### Investment and Spending Policies

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. Distributions are determined annually by the Superintendent.

## NOTE 11 – GOVERNMENT GRANTS

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

	<u>2016</u>	<u>2015</u>
State grants:		
Texas Education Agency Foundation School Program Act	\$ 102,735,761	\$ 89,690,683
Textbook and Kindergarten Materials	1,119,444	710,934
School Lunch Matching	<u>36,201</u>	<u>29,443</u>
Total state grants	<u>103,891,406</u>	<u>90,431,060</u>
Federal grants:		
U. S. Department of Education	9,340,770	8,507,634
U. S. Department of Agriculture	7,365,285	6,786,638
U. S. Department of Health and Human Services	<u>591</u>	<u>70,860</u>
Total federal grants	<u>16,706,646</u>	<u>15,365,132</u>
Total government grants	<u>\$ 120,598,052</u>	<u>\$ 105,796,192</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 12 – 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 Co-Founder 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*.

In 2016, PHILO contributed a total of \$210,000 to KIPP for unrestricted purposes. In 2015, PHILO contributed a total of \$3,500,000 to KIPP for restricted purposes. These amounts are included in unrestricted and temporarily restricted contributions in the statements of activities and represent 3% and 34% of total contributions in 2016 and 2015, respectively.

## NOTE 13 – COMMITMENTS

*Lease commitments* – KIPP leases modular buildings for educational space and certain equipment under noncancellable operating leases. Future minimum lease payments are due as follows:

2017	\$ 457,979
2018	198,382
2019	137,699
2020	47,322
2021	<u>7,761</u>
Total	<u>\$ 849,143</u>

Rental expense was approximately \$673,000 and \$724,000 in 2016 and 2015, respectively.

*Construction commitments* – In 2015, KIPP entered into several contracts totaling approximately \$11 million for construction projects at certain schools. As of June 30, 2016, outstanding commitments totaled approximately \$2,005,000.

#### **NOTE 14 – 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 to the §457 deferred compensation plan up to a maximum of \$1,200 per employee, per year. KIPP contributed approximately \$357,000 to this plan in 2016 and \$353,000 in 2015.

*Health benefits* – KIPP is 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 \$520,000 and \$793,000 in the accompanying statements of financial position for its share of claims arising from incidents occurring on or before June 30, 2016 and 2015, respectively.

#### **NOTE 15 – MULTIEMPLOYER PENSION PLAN**

KIPP's full-time employees participate in the Teacher Retirement System of Texas (TRS), a public employee retirement system. TRS is a cost-sharing, multiemployer, defined benefit pension plan. All risks and costs are not shared by KIPP, but are the liability of the State of Texas. For 2016, plan members contribute 7.2% of their annual covered salary, KIPP contributes 6.8% for new members the first 90 days of employment, and the State of Texas contributes 6.8%. Additionally, KIPP makes a 1.5% non-OASDI payment on all TRS eligible employees. KIPP's contributions do not represent more than 5% of the pension plan's total contributions. KIPP contributed \$2,073,693 and \$1,799,655 to the plan during fiscal year 2016 and 2015, respectively, equal to the required contribution for each year.

The risks of participating in a multiemployer, defined benefit plan are different from single-employer plans because (a) amounts contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers and (b) if an employer stops contributing to TRS, unfunded obligations of TRS may be required to be borne by the remaining employers. There is no withdrawal penalty for leaving TRS.

Total TRS plan assets as of August 31, 2015 and 2014 were \$149.8 billion and \$157.3 billion, respectively. Accumulated benefit obligations as of August 31, 2015 and 2014 were \$163.9 billion and \$159.5 billion, respectively. The plan was 78.43% funded at August 31, 2015 and 83.25% funded at August 31, 2014.

#### **NOTE 16 – SUBSEQUENT EVENTS**

Management has evaluated subsequent events through October 19, 2016, 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.