

KIPP, Inc.

Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2011 and 2010

Independent Auditors' Report

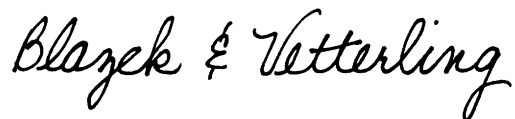
To the Board of Directors of
KIPP, Inc.:

We have audited the accompanying statements of financial position of KIPP, Inc. (KIPP) as of June 30, 2011 and 2010 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, 2011 and 2010 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 27, 2011, 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 27, 2011

KIPP, Inc.Statements of Financial Position as of June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Cash and cash equivalents <i>(Note 2)</i>	\$ 12,655,763	\$ 7,264,712
Receivables:		
Government agencies	11,556,734	8,593,232
Pledges, net <i>(Note 3)</i>	1,692,472	2,765,993
Other	170,908	413,925
Prepaid expenses	551,320	812,419
Investments in certificates of deposit	300,000	300,000
Capitalized bond issuance costs	3,322,465	3,168,489
Bond proceeds held in trust <i>(Note 5)</i>	21,531,419	18,100,707
Property and equipment, net <i>(Note 4)</i>	<u>111,214,248</u>	<u>85,693,515</u>
TOTAL ASSETS	<u>\$ 162,995,329</u>	<u>\$ 127,112,992</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	\$ 2,665,970	\$ 2,974,720
Accrued payroll expenses	6,814,000	3,204,833
Due to PHILO Finance Corporation	2,664,143	2,394,585
Construction payable	4,026,309	387,892
Accrued interest	2,629,158	2,422,884
Refundable advances	75,185	82,345
Bonds and notes payable <i>(Notes 5 and 10)</i>	<u>125,697,730</u>	<u>99,870,886</u>
Total liabilities	<u>144,572,495</u>	<u>111,338,145</u>
Commitments <i>(Note 12)</i>		
Net assets <i>(Note 8)</i> :		
Unrestricted	14,224,473	12,631,425
Temporarily restricted <i>(Note 7)</i>	4,008,361	2,953,422
Permanently restricted for scholarships	<u>190,000</u>	<u>190,000</u>
Total net assets	<u>18,422,834</u>	<u>15,774,847</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 162,995,329</u>	<u>\$ 127,112,992</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.**Statement of Activities for the year ended June 30, 2010**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Government grants <i>(Note 9)</i>	\$ 48,000,665			\$ 48,000,665
Contributions <i>(Note 10)</i>	5,100,585	\$ 3,590,463		8,691,048
Program service fees	4,513,615			4,513,615
Special events	826,403			826,403
Cost of direct donor benefits	(157,927)			(157,927)
Interest income	20,195	14,958		35,153
Other	<u>505,210</u>	<u> </u>		<u>505,210</u>
Total revenue	58,808,746	3,605,421		62,414,167
Net assets released from restrictions:				
Program expenditures	3,220,728	(3,220,728)		
Capital expenditures	1,156,646	(1,156,646)		
Expiration of time restrictions	<u>362,500</u>	<u>(362,500)</u>		<u> </u>
Total	<u>63,548,620</u>	<u>(1,134,453)</u>		<u>62,414,167</u>
EXPENSES:				
Program expenses:				
Instructional program	41,251,891			41,251,891
Auxiliary services	<u>7,467,332</u>			<u>7,467,332</u>
Total program expenses	48,719,223			48,719,223
General and administrative	8,331,423			8,331,423
Fundraising	<u>1,077,581</u>			<u>1,077,581</u>
Total expenses	58,128,227			58,128,227
Transfer of funds to PHILO Finance Corporation <i>(Note 10)</i>	<u>916,696</u>			<u>916,696</u>
Total expenses and other reductions	<u>59,044,923</u>			<u>59,044,923</u>
CHANGES IN NET ASSETS	4,503,697	(1,134,453)		3,369,244
Net assets, beginning of year	<u>8,127,728</u>	<u>4,087,875</u>	<u>\$ 190,000</u>	<u>12,405,603</u>
Net assets, end of year	<u>\$ 12,631,425</u>	<u>\$ 2,953,422</u>	<u>\$ 190,000</u>	<u>\$ 15,774,847</u>

See accompanying notes to financial statements.

KIPP, Inc.Statements of Cash Flows for the years ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 2,647,987	\$ 3,369,244
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(2,234,806)	(1,195,359)
Depreciation	2,683,426	2,000,818
Amortization of bond issuance costs	122,525	172,181
Amortization of bond issuance discounts	36,271	24,180
Loss on sale of property and equipment		5,960
Changes in operating assets and liabilities:		
Receivables	(2,186,964)	(2,459,581)
Prepaid expenses	261,099	(448,674)
Accounts payable and accrued expenses	3,300,417	1,824,763
Due to PHILO Finance Corporation	(2,394,585)	1,450,674
Accrued interest	206,274	1,247,929
Refundable advances	<u>(7,160)</u>	<u>(934,511)</u>
Net cash provided by operating activities	<u>2,434,484</u>	<u>5,057,624</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(18,065,853)	(10,873,746)
Proceeds from sale of property and equipment	<u>1,500</u>	<u>1,500</u>
Net cash used by investing activities	<u>(18,065,853)</u>	<u>(10,872,246)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in bond proceeds held in trust	(3,430,712)	(18,100,707)
Proceeds from bonds and notes payable	23,436,000	65,595,532
Principal repayments of bonds and notes payable	(1,481,173)	(42,755,126)
Capitalized bond issuance costs	(276,501)	(1,523,845)
Proceeds from contributions restricted for expansion of facilities	<u>2,774,806</u>	<u>2,065,809</u>
Net cash provided by financing activities	<u>21,022,420</u>	<u>5,281,663</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	5,391,051	(532,959)
Cash and cash equivalents, beginning of year	<u>7,264,712</u>	<u>7,797,671</u>
Cash and cash equivalents, end of year	<u>\$ 12,655,763</u>	<u>\$ 7,264,712</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$6,243,099	\$2,559,157
Property and equipment purchased with debt to PHILO Finance Corporation	\$6,499,889	

See accompanying notes to financial statements.

KIPP, Inc.

Notes to Financial Statements for the years ended June 30, 2011 and 2010

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – KIPP, Inc. (KIPP) operates sixteen 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 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).

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.

Reclassifications – Certain reclassifications have been made to the prior year financial statements to conform with the current presentation.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2011</u>	<u>2010</u>
Demand deposits	\$ 11,189,414	\$ 5,145,173
Money market mutual funds	<u>1,466,349</u>	<u>2,119,539</u>
Total cash and cash equivalents	<u>\$ 12,655,763</u>	<u>\$ 7,264,712</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>2011</u>	<u>2010</u>
Pledges receivable	\$ 1,794,594	\$ 2,907,915
Discount to net present value at 1% to 5%	<u>(102,122)</u>	<u>(141,922)</u>
Pledges receivable, net	<u>\$ 1,692,472</u>	<u>\$ 2,765,993</u>

At June 30, 2011, amounts due from two contributors represent 54% of total pledges receivable.

Pledges receivable at June 30, 2011 are expected to be collected as follows:

Due within one year	\$ 819,594
Due in one to five years	865,000
Due in more than five years	<u>110,000</u>
Total pledges receivable	<u>\$ 1,794,594</u>

KIPP received approximately \$1.9 million of conditional grants from a foundation with payments contingent upon meeting certain milestones and conditions. At June 30, 2011, conditional pledges related to these grants totaled approximately \$280,000.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment are comprised of the following:

	<u>2011</u>	<u>2010</u>
Land	\$ 28,354,855	\$ 25,443,115
Buildings and improvements	72,498,071	55,611,413
Vehicles and equipment	4,813,826	3,384,995
Construction in process	<u>19,204,365</u>	<u>12,216,901</u>
Total property and equipment, at cost	124,871,117	96,656,424
Accumulated depreciation	<u>(13,656,869)</u>	<u>(10,962,909)</u>
Property and equipment, net	<u>\$ 111,214,248</u>	<u>\$ 85,693,515</u>

NOTE 5 – BONDS AND NOTES PAYABLE

Bonds and notes payable consist of the following:

	<u>2011</u>	<u>2010</u>
Series 2009A bonds payable issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of \$990,108 at June 30, 2011 and \$1,019,811 at June 30, 2010. 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.	\$ 64,184,892	\$ 64,155,189
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.	33,570,000	34,245,000

<p>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.</p>	12,345,000	
<p>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.</p>	10,681,000	
<p>Series 2009B bonds payable issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of \$218,908. At June 30, 2011 and \$225,476 at June 30, 2010, 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.</p>	1,081,092	1,464,524
<p>Uncollateralized note payable to PHILO Finance Corporation. The note bears interest at 0% and is due June 30, 2011.</p>	3,835,746	
<p>Notes payable to finance companies, interest at rates ranging from 4.6% to 12%, secured by vehicles.</p>		<u>6,173</u>
<p>Total bonds and notes payable</p>	<u>\$125,697,730</u>	<u>\$ 99,870,886</u>

KIPP capitalized interest of approximately \$470,000 in 2011 and \$725,000 in 2010. Interest expense totaled approximately \$6,449,000 and \$3,807,000 in 2011 and 2010, respectively. The discount on the bonds is being amortized over the lives of the bonds. Imputed interest expense of approximately \$36,000 and \$24,000 was reported in the accompanying statement of activities for the year ended June 30, 2011 and 2010, 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 2011 and 2010, respectively.

Maturities of bonds and notes payable at June 30, 2011 are as follows:

2012	\$ 4,209,476
2013	393,730
2014	3,143,730
2015	1,298,730
2016	1,358,730
Thereafter	<u>115,293,334</u>
Total	<u>\$ 125,697,730</u>

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, 2011 and 2010. The fair value of bonds 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>2011</u>	<u>2010</u>
KIPP Turbo expansion	\$ 1,434,745	\$ 38,713
KIPP future operations	697,877	811,177
KIPP scholarships	563,109	479,584
Teacher recruitment	355,115	393,155
Teacher excellence awards	280,000	560,000
Sunnyside future operations	250,000	
KIPP through college	192,500	436,250
Legacy future operations	166,681	
Zenith future operations		132,460
Other	<u>68,334</u>	<u>102,083</u>
Total temporarily restricted net assets	<u>\$ 4,008,361</u>	<u>\$ 2,953,422</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>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, July 1, 2009	\$ 0	\$ 210,000	\$ 190,000	\$ 400,000
Interest		14,958		14,958
Appropriation for distribution		<u>(14,958)</u>		<u>(14,958)</u>
Endowment net assets, June 30, 2010	<u>0</u>	<u>210,000</u>	<u>190,000</u>	<u>400,000</u>
Contributions		500		500
Interest		5,637		5,637
Appropriation for distribution		<u>(6,137)</u>		<u>(6,137)</u>
Endowment net assets, June 30, 2011	<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>2011</u>	<u>2010</u>
<i>State grants:</i>		
Texas Education Agency Foundation School Program Act	\$ 47,561,540	\$ 37,398,934
Pre-K Expansion Grant	674,260	661,036
Technology Allotment	162,459	127,801
Texas Science, Technology, Engineering, and Math Initiative	160,734	378,097
Intensive Summer Programs	144,770	159,233
Teacher Excellence Awards	117,891	168,164
Above and Beyond Grant	51,001	
SSI Intensive Math Initiative	47,042	96,953
FSP Investment Capital Fund	23,475	52,107
School Lunch Matching	19,469	15,288
Texas Fitness Now	10,297	26,309
APIB Technical Training	3,600	
21 st Century Community Learning Centers		194,692
Texas Education Excellence Grant		122,863
Governor's Educator Excellence		21,146
KIPP Coastal Village		11,000
Grants for Student Clubs		7,345
	<u>48,976,538</u>	<u>39,440,968</u>
Total state grants		
<i>Federal grants:</i>		
U. S. Department of Education	8,267,172	5,389,299
U. S. Department of Agriculture	<u>4,223,641</u>	<u>3,170,398</u>
Total federal grants	<u>12,490,813</u>	<u>8,559,697</u>
Total government grants	<u>\$ 61,467,351</u>	<u>\$ 48,000,665</u>

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, 2011, KIPP has transferred a cumulative amount of \$29,550,000 to PHILO. KIPP transferred approximately \$550,000 and \$920,000 of *KIPP Turbo* funds raised in 2011 and 2010, respectively. These transactions are reported in the statements of activities as transfers to PHILO.

During 2011 and 2010, PHILO made land and building purchases and building construction expenditures on behalf of KIPP totaling approximately \$10,300,000 and \$2,600,000, respectively. Approximately \$6,404,000 of the 2011 amount was repaid to PHILO during the year with proceeds from the Qualified

Zone Academy Bonds and Qualified School Construction Bonds. Additionally, in 2010, PHILO made approximately \$277,000 of non-capital expenditures on behalf of KIPP. The amounts related to 2011 are reported as bonds and notes payable at June 30, 2011 in the accompanying statement of financial position.

KIPP received a grant of \$4,165,000 and \$3,500,000 from PHILO for operating purposes during 2011 and 2010, respectively. 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:

2012	\$ 253,124
2013	205,327
2014	169,834
2015	131,384
Thereafter	<u>33,997</u>
Total	<u>\$ 793,666</u>

Rental expense was approximately \$952,000 and \$847,000 in 2011 and 2010, respectively.

NOTE 12 – CONSTRUCTION COMMITMENTS

In 2011, KIPP had entered into several contracts totaling approximately \$9.4 million for construction projects at certain schools. As of June 30, 2011, outstanding commitments totaled approximately \$3.4 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 and \$80,000 to these plans in 2011 and 2010, respectively.

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 liability of the State of Texas. Plan members contribute 6.5% of their annual covered salary. KIPP contributed \$1,269,509 and \$511,586 to the plan during 2011 and 2010, respectively.

Health benefits – Beginning in December 2010, 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 \$527,000 in the accompanying statements of financial position for its share of claims arising from incidents occurring on or before June 30, 2011.

NOTE 14 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 27, 2011, 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.
