

**KIPP, Inc.**

Financial Statements  
and Independent Auditors' Report  
for the years ended June 30, 2014 and 2013

# **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, 2014 and 2013 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, 2014 and 2013 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 7, 2014 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 7, 2014

**KIPP, Inc.****Statements of Financial Position as of June 30, 2014 and 2013**

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	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents ( <i>Note 2</i> )	\$ 9,129,346	\$ 8,502,127
Receivables:		
Government agencies	14,782,134	15,977,208
Pledges ( <i>Note 3</i> )	860,400	465,465
Other	1,809,530	861,105
Prepaid expenses	<u>535,943</u>	<u>446,104</u>
Total current assets	27,117,353	26,252,009
Investments in certificates of deposit	300,000	300,000
Pledges receivable, net ( <i>Note 3</i> )	612,252	511,887
Capitalized bond issuance costs	3,520,101	3,663,740
Bond proceeds held in trust ( <i>Note 5</i> )	12,689,879	31,288,511
Property and equipment, net ( <i>Note 4</i> )	<u>152,853,994</u>	<u>133,283,463</u>
<b>TOTAL ASSETS</b>	<u><b>\$ 197,093,579</b></u>	<u><b>\$ 195,299,610</b></u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 7,033,126	\$ 5,627,394
Accrued payroll expenses	8,154,548	7,966,553
Construction payable	2,950,796	3,698,525
Accrued interest	3,016,667	3,226,647
Refundable advances	36,883	141,004
Current portion of bonds and notes payable ( <i>Note 5</i> )	<u>1,290,297</u>	<u>1,191,142</u>
Total current liabilities	22,482,317	21,851,265
Bonds and notes payable ( <i>Note 5</i> )	<u>146,565,813</u>	<u>147,874,979</u>
Total liabilities	<u>169,048,130</u>	<u>169,726,244</u>
Commitments ( <i>Note 12</i> )		
Net assets ( <i>Note 8</i> ):		
Unrestricted	25,153,980	23,170,088
Temporarily restricted ( <i>Note 7</i> )	2,701,469	2,213,278
Permanently restricted for scholarships	<u>190,000</u>	<u>190,000</u>
Total net assets	<u>28,045,449</u>	<u>25,573,366</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u><b>\$ 197,093,579</b></u>	<u><b>\$ 195,299,610</b></u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.**Statement of Activities for the year ended June 30, 2014

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	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
<b>REVENUE:</b>				
Government grants <i>(Note 9)</i>	\$ 89,692,297			\$ 89,692,297
Contributions <i>(Note 10)</i>	4,247,842	\$ 2,862,394		7,110,236
Program service fees	12,292,803			12,292,803
Special events	1,598,914			1,598,914
Cost of direct donor benefits	(148,414)			(148,414)
Interest income	36,601	5,158		41,759
Other	<u>428,576</u>	<u>                    </u>		<u>428,576</u>
Total revenue	108,148,619	2,867,552		111,016,171
Net assets released from restrictions:				
Program expenditures	1,504,361	(1,504,361)		
Capital expenditures	750,000	(750,000)		
Expiration of time restrictions	<u>125,000</u>	<u>(125,000)</u>		<u>                    </u>
Total	<u>110,527,980</u>	<u>488,191</u>		<u>111,016,171</u>
<b>EXPENSES:</b>				
Program expenses:				
Instructional program	78,678,242			78,678,242
Auxiliary services	<u>12,231,088</u>			<u>12,231,088</u>
Total program expenses	90,909,330			90,909,330
General and administrative	15,796,817			15,796,817
Fundraising	<u>1,837,941</u>			<u>1,837,941</u>
Total expenses	<u>108,544,088</u>			<u>108,544,088</u>
CHANGES IN NET ASSETS	1,983,892	488,191		2,472,083
Net assets, beginning of year	<u>23,170,088</u>	<u>2,213,278</u>	<u>\$ 190,000</u>	<u>25,573,366</u>
Net assets, end of year	<u>\$ 25,153,980</u>	<u>\$ 2,701,469</u>	<u>\$ 190,000</u>	<u>\$ 28,045,449</u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.****Statement of Activities for the year ended June 30, 2013**

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	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
<b>REVENUE:</b>				
Government grants <i>(Note 9)</i>	\$ 79,130,691			\$ 79,130,691
Contributions <i>(Note 10)</i>	2,931,687	\$ 7,588,408		10,520,095
Program service fees	9,222,581			9,222,581
Special events	1,177,341			1,177,341
Cost of direct donor benefits	(128,865)			(128,865)
Interest income	6,313	2,273		8,586
Other	<u>186,308</u>	<u>                    </u>		<u>186,308</u>
Total revenue	92,526,056	7,590,681		100,116,737
Net assets released from restrictions:				
Program expenditures	2,251,112	(2,251,112)		
Capital expenditures and debt repayment	7,268,556	(7,268,556)		
Expiration of time restrictions	<u>235,000</u>	<u>(235,000)</u>		<u>                    </u>
Total	<u>102,280,724</u>	<u>(2,163,987)</u>		<u>100,116,737</u>
<b>EXPENSES:</b>				
Program expenses:				
Instructional program	69,438,859			69,438,859
Auxiliary services	<u>11,075,275</u>			<u>11,075,275</u>
Total program expenses	80,514,134			80,514,134
General and administrative	14,496,603			14,496,603
Fundraising	<u>1,562,074</u>			<u>1,562,074</u>
Total expenses	96,572,811			96,572,811
Transfer of funds to PHILO Finance Corporation <i>(Note 10)</i>	<u>5,000</u>			<u>5,000</u>
Total expenses and other reductions	<u>96,577,811</u>			<u>96,577,811</u>
<b>CHANGES IN NET ASSETS</b>	5,702,913	(2,163,987)		3,538,926
Net assets, beginning of year	<u>17,467,175</u>	<u>4,377,265</u>	<u>\$ 190,000</u>	<u>22,034,440</u>
Net assets, end of year	<u>\$ 23,170,088</u>	<u>\$ 2,213,278</u>	<u>\$ 190,000</u>	<u>\$ 25,573,366</u>

*See accompanying notes to financial statements.*

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**KIPP, Inc.****Statements of Cash Flows for the years ended June 30, 2014 and 2013**

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	<u>2014</u>	<u>2013</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Changes in net assets	\$ 2,472,083	\$ 3,538,926
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(717,186)	(3,000,000)
Contributions restricted for repayment of loan		(2,906,540)
Gain on disposal of land	(148,081)	
Depreciation	6,505,816	5,488,358
Amortization of bond issuance costs	143,639	134,980
Amortization of bond issuance discounts	29,989	243,092
Changes in operating assets and liabilities:		
Receivables	251,349	(595,569)
Prepaid expenses	(89,839)	51,690
Accounts payable and accrued expenses	1,593,727	2,132,973
Accrued interest	(209,980)	619,518
Refundable advances	<u>(104,121)</u>	<u>39,348</u>
Net cash provided by operating activities	<u>9,727,396</u>	<u>5,746,776</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(27,924,076)	(14,731,102)
Proceeds from sale of land	<u>1,248,081</u>	<u>                    </u>
Net cash used by investing activities	<u>(26,675,995)</u>	<u>(14,731,102)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Change in bond proceeds held in trust	18,598,632	(18,556,939)
Proceeds from bonds and notes payable		29,209,775
Principal repayments of bonds and notes payable	(1,240,000)	(6,174,722)
Capitalized bond issuance costs		(593,424)
Proceeds from contributions restricted for expansion of facilities	217,186	3,005,000
Proceeds from contributions restricted for repayment of loan		<u>2,906,540</u>
Net cash provided by financing activities	<u>17,575,818</u>	<u>9,796,230</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>627,219</b>	<b>811,904</b>
Cash and cash equivalents, beginning of year	<u>8,502,127</u>	<u>7,690,223</u>
Cash and cash equivalents, end of year	<u>\$ 9,129,346</u>	<u>\$ 8,502,127</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$8,280,880	\$7,143,282

*See accompanying notes to financial statements.*

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## **KIPP, Inc.**

Notes to Financial Statements for the years ended June 30, 2014 and 2013

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

Organization – KIPP, Inc. (KIPP) operates nineteen Texas Open-Enrollment Charter Schools under one state charter. Prior to 2014, KIPP operated under two state charters. The two charters were merged in 2014. The schools are located in Houston, Texas and serve approximately 8,700 students from pre-kindergarten through 12<sup>th</sup> grade. Additionally, KIPP operates an elementary school and a middle school within Galveston Independent School District and 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). KIPP files annual federal information returns that are subject to routine examination; 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 ended before June 30, 2011.

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 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 general operations.

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.

## NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2014</u>	<u>2013</u>
Demand deposits	\$ 9,030,265	\$ 7,471,427
Money market mutual funds	<u>99,081</u>	<u>1,030,700</u>
Total cash and cash equivalents	<u>\$ 9,129,346</u>	<u>\$ 8,502,127</u>

Bank deposits exceed the \$250,000 federally insured limit per depositor per institution.

## NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are comprised of the following:

	<u>2014</u>	<u>2013</u>
Pledges receivable	\$ 1,491,400	\$ 1,019,465
Discount to net present value at 1% to 3.55%	<u>(18,748)</u>	<u>(42,113)</u>
Pledges receivable, net	<u>\$ 1,472,652</u>	<u>\$ 977,352</u>

Pledges receivable at June 30, 2014 are expected to be collected as follows:

Due within one year	\$ 860,400
Due in one to five years	<u>631,000</u>
Total pledges receivable	<u>\$ 1,491,400</u>

KIPP received a conditional pledge for approximately \$1.9 million from a foundation contingent upon meeting certain milestones and conditions. At June 30, 2014, the conditional pledge outstanding totaled approximately \$300,000.

#### NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	<u>2014</u>	<u>2013</u>
Land	\$ 32,624,540	\$ 30,013,078
Buildings and improvements	113,591,165	100,598,915
Furniture and equipment	7,154,215	6,176,042
Vehicles	559,802	548,048
Construction in progress	<u>28,446,769</u>	<u>18,964,061</u>
Total property and equipment, at cost	182,376,491	156,300,144
Accumulated depreciation	<u>(29,522,497)</u>	<u>(23,016,681)</u>
Property and equipment, net	<u>\$ 152,853,994</u>	<u>\$ 133,283,463</u>

#### NOTE 5 – BONDS AND NOTES PAYABLE

Bonds and notes payable consist of the following:

	<u>2014</u>	<u>2013</u>
Series 2009A bonds payable, issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of \$899,665 at June 30, 2014 and \$929,654 at June 30, 2013. 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.	\$ 64,275,335	\$ 64,245,346
Series 2006A bonds payable, issued by Texas Public Finance Authority Charter School Finance Corporation; interest at rates ranging from 4% to 5%; 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.	31,345,000	32,585,000
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.	22,477,775	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.

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. 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.

10,681,000      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 campus and are secured by pledged revenue.

6,732,000      6,732,000

Total bonds and notes payable

\$ 147,856,110      \$ 149,066,121

KIPP capitalized interest totaled approximately \$323,000 in 2014 and \$311,000 in 2013. Interest expense totaled approximately \$7,935,000 and \$7,452,000 in 2014 and 2013, respectively. The discount on the bonds is being amortized over the lives of the bonds.

The Texas Public Finance Authority, 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, 2014 are as follows:

2015	\$ 1,290,297
2016	2,887,899
2017	4,515,500
2018	4,580,500
2019	4,655,500
Thereafter	<u>129,926,414</u>
Total	<u>\$ 147,856,110</u>

KIPP had a \$6,000,000 line of credit with a financial institution that expires in April 2015. There were no amounts outstanding under this line of credit at June 30, 2014.

Bond proceeds held in trust include the following:

	<u>2014</u>	<u>2013</u>
Escrowed for debt service	\$ 2,094,242	\$ 2,112,649
Required for debt service reserve	4,857,839	4,861,776
Bond funds available for projects	<u>5,737,798</u>	<u>24,314,086</u>
Total bond proceeds held in trust	<u>\$ 12,689,879</u>	<u>\$ 31,288,511</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, 2014 and 2013. The fair value of bonds and notes payable at June 30, 2014 carried at \$147,856,450 was \$148,239,775. The fair value of bonds and notes payable at June 30, 2013 carried at \$149,066,121 was \$149,023,275.

#### **NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes:

	<u>2014</u>	<u>2013</u>
KIPP scholarships	\$ 640,567	\$ 577,179
KIPP through college	422,771	39,575
KIPP future operations	406,252	507,887
Teacher recruitment	292,140	337,140
Administrative costs – Government Affairs Grant	244,997	178,290
STEM lab and teacher development	206,048	
Courage future operations	159,967	47,755
Fort Bend students	100,000	
Technology purchases	80,230	
<i>KIPP Turbo</i> expansion	67,186	100,000
Parent education	25,000	
College Readiness Model		228,157
Northeast High School future operations		150,816
Other	<u>56,311</u>	<u>46,479</u>
Total temporarily restricted net assets	<u>\$ 2,701,469</u>	<u>\$ 2,213,278</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, 2012	\$ 0	\$ 210,000	\$ 190,000	\$ 400,000
Contribution		100,000		100,000
Interest		2,273		2,273
Appropriation for distribution		<u>(2,273)</u>		<u>(2,273)</u>
Endowment net assets, June 30, 2013	<u>0</u>	<u>310,000</u>	<u>190,000</u>	<u>500,000</u>
Interest		5,158		5,158
Appropriation for distribution		<u>(10,981)</u>		<u>(10,981)</u>
Endowment net assets, June 30, 2014	<u>\$ 0</u>	<u>\$ 304,177</u>	<u>\$ 190,000</u>	<u>\$ 494,177</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. 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>2014</u>	<u>2013</u>
State grants:		
Texas Education Agency Foundation School Program Act	\$ 75,719,792	\$ 64,403,781
Textbook and Kindergarten Materials	619,629	270,678
Expanding 3E (Texas Department of Agriculture)		50,003
School Lunch Matching	<u>28,098</u>	<u>25,090</u>
Total state grants	<u>76,367,519</u>	<u>64,749,552</u>
Federal grants:		
U. S. Department of Education	8,359,584	9,747,885
U. S. Department of Agriculture	4,878,733	4,610,683
U. S. Department of Health and Human Services	<u>86,461</u>	<u>22,571</u>
Total federal grants	<u>13,324,778</u>	<u>14,381,139</u>
Total government grants	<u>\$ 89,692,297</u>	<u>\$ 79,130,691</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 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*.

KIPP's Board of Directors authorized a transfer to PHILO of up to \$55,000,000 raised in connection with *KIPP Turbo*. KIPP transferred approximately \$5,000 of *KIPP Turbo* funds raised in 2013. These transactions are reported in the statements of activities as transfers to PHILO. As of June 30, 2014, KIPP has transferred a cumulative amount of \$29,578,000 to PHILO.

In 2014, PHILO contributed a total of \$1,500,000 to KIPP for unrestricted purposes and \$300,000 for restricted purposes. In 2013, PHILO contributed a total of \$5,906,540 to KIPP for capital projects and repayment of debt. These amounts are included in unrestricted and temporarily restricted contributions in the statements of activities and represent 25% and 56% of total contributions in 2014 and 2013, respectively.

## NOTE 11 – LEASE COMMITMENTS

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

2015	\$ 525,002
2016	474,771
2017	403,418
2018	141,065
2019	<u>69,818</u>
Total	<u>\$ 1,614,074</u>

Rental expense was approximately \$703,000 and \$1,040,000 in 2014 and 2013, respectively.

## NOTE 12 – CONSTRUCTION COMMITMENTS

In 2014, KIPP entered into several contracts totaling approximately \$15.7 million for construction projects at certain schools. As of June 30, 2014, outstanding commitments totaled approximately \$801,000.

## NOTE 13 – RELATED PARTY TRANSACTION

In 2014 and 2013, approximately \$82,000 and \$585,000, respectively, was paid for travel services to a company that is owned by an immediate family member of a KIPP employee.

## 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 up to a maximum of \$1,200 per employee per year. KIPP contributed approximately \$289,000 to these plans in 2014 and \$203,000 in 2013.

KIPP's full-time employees participate in the Teacher Retirement System of Texas, a public employee retirement system. It is a cost-sharing, multiple employer defined benefit pension plan. All risks and costs are the responsibility of the State of Texas, with the exception of KIPP's required contributions for certain categories of teachers. Plan members contribute 6.5% of their annual covered salary. KIPP contributed \$927,695 and \$903,072 to the plan during 2014 and 2013, 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 \$549,000 and \$429,000 in the accompanying statements of financial position for its share of claims arising from incidents occurring on or before June 30, 2014 and 2013, respectively.

## **NOTE 15 – SUBSEQUENT EVENTS**

Management has evaluated subsequent events through October 7, 2014, 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.

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