KIPP, Inc.

Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2015 and 2014

KIPP, Inc.

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Blazek & Vetterling
CERTIFIED PUBLIC ACCOUNTANTS

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, 2015 and 2014 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, 2015 and 2014 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.

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Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2015 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, 2015

KIPP, Inc.

Statements of Financial Position as of June 30, 2015 and 2014

	2015	2014
ASSETS		
Current assets:		
Cash and cash equivalents *(Note 2)*	$ 12,968,581	$ 9,129,346
Certificate of deposit	300,000	
Receivables:		
Government agencies	17,325,078	14,782,134
Pledges *(Note 3)*	1,204,758	860,400
Other	1,579,475	1,809,530
Prepaid expenses and other assets	659,066	535,943
Total current assets	34,036,958	27,117,353
Pledges receivable, net *(Note 3)*	438,739	612,252
Investments *(Note 4)*	797,035	300,000
Capitalized bond issuance costs	1,731,269	3,520,101
Bond proceeds held in trust *(Note 6)*	14,827,749	12,689,879
Property and equipment, net *(Note 5)*	165,013,096	152,853,994
TOTAL ASSETS	$ 216,844,846	$ 197,093,579
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	$ 4,765,249	$ 7,033,126
Accrued payroll expenses	9,618,933	8,154,548
Construction payable	3,548,165	2,950,796
Accrued interest	2,036,353	3,016,667
Refundable advances	61,683	36,883
Current portion of bonds and notes payable *(Note 6)*	4,593,801	1,290,297
Total current liabilities	24,624,184	22,482,317
Bonds and notes payable *(Note 6)*	178,676,605	146,565,813
Total liabilities	203,300,789	169,048,130
Commitments *(Note 12)*		
Net assets *(Note 9)*:		
Unrestricted	11,049,540	25,153,980
Temporarily restricted *(Note 8)*	2,304,517	2,701,469
Permanently restricted for scholarships	190,000	190,000
Total net assets	13,544,057	28,045,449
TOTAL LIABILITIES AND NET ASSETS	$ 216,844,846	$ 197,093,579

See accompanying notes to financial statements.

KIPP, Inc.

Statement of Activities for the year ended June 30, 2015

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Government grants *(Note 10)*	$ 105,796,192			$ 105,796,192
Contributions *(Note 11)*	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 *(Note 4)*	(4,817)	5,637		820
Other	346,450			346,450
Total 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	122,513	(122,513)		
Total	126,484,894	(396,952)		126,087,942
EXPENSES:				
Program expenses:				
Instructional program	90,765,383			90,765,383
Auxiliary services	14,669,848			14,669,848
Total program expenses	105,435,231			105,435,231
Loss on extinguishment of debt	16,819,644			16,819,644
General and administrative	16,195,636			16,195,636
Fundraising	2,138,823			2,138,823
Total expenses	140,589,334			140,589,334
CHANGES IN NET ASSETS	(14,104,440)	(396,952)		(14,501,392)
Net assets, beginning of year	25,153,980	2,701,469	$ 190,000	28,045,449
Net assets, end of year	$ 11,049,540	$ 2,304,517	$ 190,000	$ 13,544,057

See accompanying notes to financial statements.

KIPP, Inc.

Statement of Activities for the year ended June 30, 2014

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
REVENUE:				
Government grants *(Note 10)*	$ 89,692,297			$ 89,692,297
Contributions *(Note 11)*	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)
Investment return, net *(Note 4)*	36,601	5,158		41,759
Other	428,576			428,576
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	125,000	(125,000)		
Total	110,527,980	488,191		111,016,171
EXPENSES:				
Program expenses:				
Instructional program	78,678,242			78,678,242
Auxiliary services	12,231,088			12,231,088
Total program expenses	90,909,330			90,909,330
General and administrative	15,796,817			15,796,817
Fundraising	1,837,941			1,837,941
Total expenses	108,544,088			108,544,088
CHANGES IN NET ASSETS	1,983,892	488,191		2,472,083
Net assets, beginning of year	23,170,088	2,213,278	$ 190,000	25,573,366
Net assets, end of year	$ 25,153,980	$ 2,701,469	$ 190,000	$ 28,045,449

See accompanying notes to financial statements.

KIPP, Inc.

Statements of Cash Flows for the years ended June 30, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$(14,501,392)	$ 2,472,083
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(4,500,000)	(717,186)
Net realized and unrealized loss on investments	15,769	
Gain on disposal of land		(148,081)
Depreciation	8,333,250	6,505,816
Amortization of bond issuance costs	156,928	143,639
Loss on extinguishment of debt	16,819,644	
Amortization of bond issuance discounts (premiums)	(33,295)	29,989
Changes in operating assets and liabilities:		
Certificate of deposit	(300,000)	
Receivables	(2,233,734)	251,349
Prepaid expenses and other assets	(123,123)	(89,839)
Accounts payable and accrued expenses	(803,492)	1,593,727
Accrued interest	(980,314)	(209,980)
Refundable advances	24,800	(104,121)
Net cash provided by operating activities	1,875,041	9,727,396
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	89,476	
Purchases of investments	(761,485)	
Net change in cash and certificate of deposit held as investments	159,205	
Purchases of property and equipment	(10,545,519)	(9,325,444)
Proceeds from sale of land		1,248,081
Net cash used by investing activities	(11,058,323)	(8,077,363)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bonds payable	8,812,517	
Principal repayments of bonds and notes payable	(40,000)	(1,240,000)
Proceeds from contributions restricted for expansion of facilities	4,250,000	217,186
Net cash provided (used) by financing activities	13,022,517	(1,022,814)
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,839,235	627,219
Cash and cash equivalents, beginning of year	9,129,346	8,502,127
Cash and cash equivalents, end of year	$ 12,968,581	$ 9,129,346

Supplemental disclosure of cash flow information:		
Bonds defeased with bond proceeds	$110,812,335	
Interest payments	$8,326,295	$8,280,880
Property and equipment acquired with bond proceeds	$2,137,870	$18,586,655

See accompanying notes to financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – KIPP, Inc. (KIPP) operates twenty-one Texas Open-Enrollment Charter Schools under one state charter. The schools are located in Houston, Texas and serve approximately 11,500 students from pre-kindergarten through 12th grade. Additionally, KIPP operates a middle school within Spring Branch Independent School District on a contract basis. KIPP operated an elementary school and a middle school within Galveston Independent School District until June 2014.

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, 2012.

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 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 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.

Recent accounting pronouncement – In April 2015, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2015-03, *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.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	2015	2014
Demand deposits	$ 12,863,852	$ 9,030,265
Money market mutual funds	104,729	99,081
Total cash and cash equivalents	$ 12,968,581	$ 9,129,346

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

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are comprised of the following:

	2015	2014
Pledges receivable	$ 1,659,758	$ 1,491,400
Discount to net present value at 0.11% to 3.55%	(16,261)	(18,748)
Pledges receivable, net	$ 1,643,497	$ 1,472,652

Pledges receivable at June 30, 2015 are expected to be collected as follows:

Due within one year	$ 1,204,758
Due in one to five years	455,000
Total pledges receivable	$ 1,659,758

NOTE 4 – INVESTMENTS AND FAIR VALUE MEASUREMENT

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, 2015 are as follows:

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

At June 30, 2015, investments include $140,795 of cash held for investment and at June 30, 2014, investments were held in a non-negotiable bank certificate of deposit.

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.

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

	2015	2014
Interest and dividends	$ 16,589	$ 41,759
Realized and unrealized loss	(15,769)	
Investment return, net	$ 820	$ 41,759

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	2015	2014
Land	$ 32,609,171	$ 32,624,540
Buildings and improvements	141,731,286	113,591,165
Furniture and equipment	10,254,834	7,154,215
Vehicles	594,539	559,802
Construction in progress	17,679,013	28,446,769
Total property and equipment, at cost	202,868,843	182,376,491
Accumulated depreciation	(37,855,747)	(29,522,497)
Property and equipment, net	$ 165,013,096	$ 152,853,994

NOTE 6 – BONDS AND NOTES PAYABLE

Bonds and notes payable consist of the following:

	2015	2014
Series 2015A bonds payable, issued by the City of Houston Higher Education Finance Corporation, including an unamortized premium of $2,867,430 at June 30, 2015. 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.	$ 79,537,430	
Series 2014A bonds payable, issued by the City of Houston Higher Education Finance Corporation, including an unamortized premium of $1,692,301 at June 30, 2015. 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.	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.	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 campuses and are secured by pledged revenue.	6,732,000	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 $40,100. 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.	5,154,900	

	2015	2014
Series 2009A bonds payable, issued by La Vernia Higher Education Finance Corporation, net of unamortized discount of $899,655 at June 30, 2014. The bonds bore interest at rates from 4.0% to 6.4% and were used to refinance certain existing obligations and to fund construction, debt service, and debt service reserve. They were retired in 2015 with the issuance of the Series 2015A bonds.		64,275,335
Series 2006A bonds payable, issued by Texas Public Finance Authority Charter School Finance Corporation; interest at rates ranging from 4% to 5%. The proceeds were used to refinance certain existing obligations and to fund construction, debt service, and debt service reserve. They were retired in 2015 with the issuance of the Series 2015A and the Series 2014A bonds.		31,345,000
Total bonds and notes payable	$ 183,270,406	$ 147,856,110

KIPP capitalized interest totaled approximately $261,000 in 2015 and $323,000 in 2014. Interest expense totaled approximately $8,145,000 and $7,935,000 in 2015 and 2014, 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, 2015 are as follows:

2016	$ 4,593,801
2017	5,401,403
2018	5,481,403
2019	5,571,403
2020	5,661,403
Thereafter	156,560,993
Total	$ 183,270,406

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

	2015	2014
Escrowed for debt service	$ 3,351,666	$ 2,094,242
Required for debt service reserve		4,857,839
Bond funds available for projects	11,476,083	5,737,798
Total bond proceeds held in trust	$ 14,827,749	$ 12,689,879

KIPP had a $9,000,000 line of credit with a financial institution that expires in October 2015. There were no draws on the line of credit during the years ended June 30, 2015 and 2014. There were no amounts outstanding under this line of credit at June 30, 2015.

NOTE 7 – 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, 2015 and 2014. The fair value of bonds and notes payable at June 30, 2015 carried at $183,270,406 was $182,682,724. The fair value of bonds and notes payable at June 30, 2014 carried at $147,856,110 was $148,239,775.

NOTE 8 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	2015	2014
KIPP scholarships	$ 569,230	$ 640,567
Wellness	350,000	
KIPP future operations	313,739	406,252
Teacher recruitment	247,140	292,140
Fort Bend students	200,000	100,000
Administrative costs – Government Affairs Grant	157,971	244,997
KIPP through college	134,351	422,771
Blended Learning grant	72,000	
KIPP Turbo expansion	58,254	67,186
Professional and curriculum development	34,698	
Athletics	29,423	
Courage future operations	26,096	159,967
Technology purchases	25,000	80,230
Family assistance	21,507	
STEM lab and teacher development	14,667	206,048
Parent education		25,000
Other	50,441	56,311
Total temporarily restricted net assets	$ 2,304,517	$ 2,701,469

NOTE 9 – 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:

	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Endowment net assets, July 1, 2012	$ 0	$ 310,000	$ 190,000	$ 500,000
Interest		5,158		5,158
Appropriation for distribution		(10,981)		(10,981)
Endowment net assets, June 30, 2013	0	304,177	190,000	494,177
Interest		5,637		5,637
Appropriation for distribution		(6,477)		(6,477)
Endowment net assets, June 30, 2014	$ 0	$ 303,337	$ 190,000	$ 493,337

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 10 – GOVERNMENT GRANTS

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

	2015	2014
State grants:		
Texas Education Agency Foundation School Program Act	$ 89,690,683	$ 75,719,792
Textbook and Kindergarten Materials	710,934	619,629
School Lunch Matching	29,443	28,098
Total state grants	90,431,060	76,367,519
Federal grants:		
U. S. Department of Education	8,507,634	8,359,584
U. S. Department of Agriculture	6,786,638	4,878,733
U. S. Department of Health and Human Services	70,860	86,461
Total federal grants	15,365,132	13,324,778
Total government grants	$105,796,192	$ 89,692,297

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 11 – 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 2015, PHILO contributed a total of $3,500,000 to KIPP for restricted purposes. In 2014, PHILO contributed a total of $1,500,000 to KIPP for unrestricted purposes and $300,000 for restricted purposes. These amounts are included in unrestricted and temporarily restricted contributions in the statements of activities and represent 34% and 25% of total contributions in 2015 and 2014, respectively.

NOTE 12 – 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:

2016	$ 494,156
2017	421,758
2018	162,161
2019	80,141
2020	16,639
Total	$ 1,174,855

Rental expense was approximately $724,000 and $703,000 in 2015 and 2014, respectively.

Construction commitments – In 2015, KIPP entered into several contracts totaling approximately $11 million for construction projects at certain schools. As of June 30, 2015, outstanding commitments totaled approximately $3,868,000.

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 $353,000 to these plans in 2015 and $289,000 in 2014.

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 6.7% of their annual covered salary. KIPP contributed $1,799,655 and $927,695 to the plan during 2015 and 2014, respectively.

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 $793,000 and $549,000 in the accompanying statements of financial position for its share of claims arising from incidents occurring on or before June 30, 2015 and 2014, respectively.

NOTE 14 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 19, 2015, 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.