

**HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**

**Financial Statements and Supplemental Information
For the Years Ended June 30, 2009 and 2008
With Report of Independent Auditors**

**HARLEM CHILDREN’S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
June 30, 2009 and 2008

TABLE OF CONTENTS

	<u>Page(s)</u>
REPORT OF INDEPENDENT AUDITORS	1–2
FINANCIAL STATEMENTS	
Statements of Financial Position	3
Statements of Activities	4
Statements of Cash Flows	5
Notes to Financial Statements	6–11
SUPPLEMENTAL INFORMATION	
Schedule of Functional Expenses	12
Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	13–14
Schedule of Findings and Questioned Costs	15

REPORT OF INDEPENDENT AUDITORS

Board of Trustees

The Harlem Children's Zone Promise Academy Charter School II

We have audited the accompanying statements of financial position of the Harlem Children's Zone Promise Academy Charter School II (the "School") as of June 30, 2009 and 2008, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the School's management. 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 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 the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the School's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we express no such opinion. 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 the Harlem Children's Zone Promise Academy Charter School II at June 30, 2009 and 2008, 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.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 30, 2009, on our consideration of the School'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 read in conjunction with this report in considering the results of our audit.

Our audits were performed for the purpose of forming an opinion on the financial statements of the School taken as a whole. The schedule of functional expenses on page 12 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Mitchell & Titus, LLP

October 30, 2009

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
 Statements of Financial Position
 As of June 30, 2009 and 2008

	2009	2008
ASSETS		
Cash	\$ 1,278,382	\$ 681,282
Restricted cash	70,041	-
Due from HCZ Promise Academy Charter School, net	1,859	129,547
Government grants receivable	93,697	78,967
Property and equipment, net	138,090	103,285
Total Assets	\$ 1,582,069	\$ 993,081
LIABILITIES AND NET ASSETS		
<i>Liabilities:</i>		
Accounts payable and accrued expenses	\$ 131,159	\$ 66,514
Contract advances	6,530	-
Due to HCZ	-	93,681
Total Liabilities	137,689	160,195
<i>Net Assets:</i>		
Unrestricted	1,444,380	832,886
Total Liabilities and Net Assets	\$ 1,582,069	\$ 993,081

The accompanying notes are an integral part of these financial statements.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
 Statements of Activities
 For the Years Ended June 30, 2009 and 2008

	2009	2008
SUPPORT AND REVENUE		
<i>Support:</i>		
Contributions in-kind	\$ 1,053,174	\$ 898,994
<i>Revenue:</i>		
Regular Education	3,773,172	2,175,313
Special Education	143,877	32,730
Federal and State funding	189,143	100,212
Food service	10,854	16,004
Interest	41	-
Total Revenue	4,117,087	2,324,259
Total Support and Revenue	5,170,261	3,223,253
EXPENSES		
<i>Program Services:</i>		
Regular Education	3,914,459	2,696,711
Special Education	252,742	172,130
Total Program Services	4,167,201	2,868,841
<i>Supporting Services:</i>		
Management and General	391,566	213,721
Total Expenses	4,558,767	3,082,562
Change in net assets	611,494	140,691
Unrestricted net assets at beginning of year	832,886	692,195
Unrestricted net assets at end of year	\$ 1,444,380	\$ 832,886

The accompanying notes are an integral part of these financial statements.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
 Statements of Cash Flows
 For the Years Ended June 30, 2009 and 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 611,494	\$ 140,691
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation expense	38,543	24,963
Increase in restricted cash	(70,041)	-
Decrease (increase) in due from HCZ Promise Academy Charter School	127,688	(27,123)
Increase in government grants receivables	(14,730)	(50,872)
Decrease in prepaid expenses	-	2,535
Increase in accounts payable	64,645	28,125
Increase in contract advances	6,530	-
(Decrease) increase in due to HCZ	(93,681)	78,500
Net cash provided by operating activities	670,448	196,819
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(73,348)	(37,105)
Net increase in cash	597,100	159,714
Cash, beginning of year	681,282	521,568
Cash, end of year	\$ 1,278,382	\$ 681,282

The accompanying notes are an integral part of these financial statements.

HARLEM CHILDREN’S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 1 ORGANIZATION

The Harlem Children’s Zone Promise Academy Charter School II (the “School”) is a public charter school that is open to all New York City public school children via a lottery. Opened in 2005, the School features small class sizes, an extended day and year, high expectations, and access to an extended support system through its Institutional Partner, Harlem Children’s Zone, Inc. (“HCZ”).

HCZ is a not-for-profit organization that offers a wide array of education and social programs to the children and families of Harlem. Created in 1970 as a truancy prevention agency (then called Rheedlen), HCZ has expanded its services to address the needs of children from birth through college, and as part of that mission, it also works to strengthen families and the surrounding community.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis in accordance with accounting principles generally accepted in the United States for not-for-profit organizations.

Financial Statement Presentation

The School is required to report its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

Unrestricted Net Assets: Net assets of the School that have not been restricted by an outside donor or by law and are therefore available for use in carrying out the mission of the School.

Temporarily Restricted Net Assets: Net assets that are subject to donor-imposed stipulations which may be fulfilled by action of the School to meet the stipulations or which will expire at the date specified by the donor.

Permanently Restricted Net Assets: Net assets which are limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the School, except with the consent of the donor.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Normal replacement and maintenance costs are charged to earnings as incurred, and major renewals and improvements are capitalized. Upon disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss for the period is recognized. The School capitalizes assets with a cost of \$1,000 and over. Depreciation is calculated on a straight-line basis and is based on the useful lives of the property and equipment as follows:

	Useful Life (Years)
Furniture and fixtures	5
Leasehold improvements	5

Pupil Enrollment

The School records revenue from pupil enrollment as unrestricted revenue. Pupil enrollment revenue is based on the full-time equivalent number of students in attendance at the school at the New York State Department of Education authorized rate. Pupil enrollment revenue is recognized in the period incurred.

Contributions

The School records contributions of cash and other assets as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and nature of donor restrictions. The School records contributions as restricted support if they are received with donor stipulations that limit their use through purpose or time restrictions. When a restriction expires (that is, when a stipulated time restriction ends or a purpose restriction is accomplished) temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions. Contributions in-kind are recorded at fair value as of the date of donation.

All contributions received for the years ended June 30, 2009 and 2008, were unrestricted.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Government Contracts

Federal, state, and other grant awards received for specific purposes are recognized as support to the extent of the related expenses incurred. The unexpended funds are reported as contract advances.

Tax Status

The School is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code. Therefore, there is no provision for income tax.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 3 CASH

The School maintains all of its cash in a bank. The accounts in the bank are guaranteed by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000, which is the maximum allowed by law. The School's management monitors the balances in excess of FDIC coverage to limit any exposure to loss.

NOTE 4 RESTRICTED CASH

Pursuant to an addendum to the Charter Agreement and a memo dated August 4, 2008, from the New York City Department of Education ("NYCDOE"), the NYCDOE requires the School to set up an escrow of at least \$70,000. In the event of termination of the Charter, whether prematurely or otherwise, The School shall establish and follow procedures consistent with those required by Section 2851(2)(t) of the New York State Education Law in its use of the escrow.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 5 PUPIL ENROLLMENT AND OTHER REVENUES FROM GOVERNMENT AGENCIES

Under the School's charter school agreement and the Charter Schools Act, the School is entitled to receive funding from both state and federal sources that are available to public schools. These funds include state pupil enrollment funds, federal food subsidies, and Title I and II funds. The calculation of the amounts to be paid to the School under these programs is determined by the state and is based on complex laws and regulations, enrollment levels, and economic information related to the home school districts of the children enrolled in the School. If these regulations, some of which are relatively new in the State of New York, were to change, or other factors included in the calculations were to change, the level of funding that the School receives could vary significantly.

The grant amounts received and receivable from government agencies and included as revenue in the statements of activities consist of the following for the years ended June 30, 2009 and 2008:

	2009		2008	
	Revenues	Receivable	Revenues	Receivable
City of New York (Pupil enrollment)	\$ 3,917,049	\$ -	\$ 2,208,043	\$ -
Department of Youth and Community Development	31,280		31,280	24,409
State of New York	-	-	5,400	-
State of New York— Title I	157,863	90,847	60,032	46,420
Title II			3,500	1,971
Food Service				
State of New York	10,854	2,850	16,004	6,167
Total grants from government sources	\$ 4,117,046	\$ 93,697	\$ 2,324,259	\$ 78,967

In addition, the School also receives funding in the form of private and corporate contributions. No contributions were received for the years ended June 30, 2009 and 2008.

HARLEM CHILDREN’S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 6 PROPERTY/EQUIPMENT AND LEASEHOLD IMPROVEMENTS

At June 30, 2009 and 2008, property and equipment consisted of the following:

	<u>2009</u>	<u>2008</u>
Furniture and fixtures	\$ 223,274	\$ 149,927
Less: accumulated depreciation	<u>85,184</u>	<u>46,642</u>
Total	<u>\$ 138,090</u>	<u>\$ 103,285</u>

Depreciation expense for the years ended June 30, 2009 and 2008, amounted to \$38,543 and \$24,963, respectively.

NOTE 7 PROFIT-SHARING PLAN

The School maintains the Vanguard Profit Sharing Plan (the “Plan”) with Vanguard Fiduciary Trust Company for all eligible employees. Employees become eligible once they have reached age 21 and have completed one year of service. Employees participating in the plan will be fully vested after completing six years of service. Contributions made to the plan are discretionary. For the years ended June 30, 2009 and 2008, contributions amounted to \$88,632 and \$40,919, respectively.

NOTE 8 IN-KIND SUPPORT

Pursuant to the terms of a commitment letter between HCZ and the School, HCZ, as the School’s Institutional Partner, committed to provide the School, during the initial five-year term of its charter, certain services at no cost, including financial management, social, library, technology, fundraising, public relations, and teaching assistance services. In addition, HCZ committed to provide the School with the use of space in its premises located at 35 East 125th Street, New York, NY. Furthermore, HCZ’s trustees pledged its endowment to guarantee the funding of the School’s projected private contributions for the initial term of the charter.

HCZ’s in-kind services for the year ended June 30, 2009, amounted to \$1,053,174, including personnel services costs of \$950,765 and non-personnel services costs of

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2009 and 2008

NOTE 8 IN-KIND SUPPORT (continued)

\$102,409. For the year ended June 30, 2008, HCZ's in-kind services amounted to \$898,994, including personnel service costs of \$859,339 and non-personnel service costs of \$39,655. HCZ's in-kind support is valued at its cost.

NOTE 9 RELATED-PARTY TRANSACTIONS

Funds received for the School from any of the contract sources are electronically transferred into the bank account of the Harlem Children's Zone Promise Academy Charter School, the sister school of the School. Transfers are subsequently made to the School's bank account, from which expenses are paid. As of June 30, 2009 and 2008, \$1,859 and \$129,547, respectively, was receivable from Harlem Children's Zone Promise Academy Charter School.

As of June 30, 2008, \$93,681 was payable to HCZ.

NOTE 10 CONCENTRATION OF RISK

The School is dependent on various government agencies for funding and is responsible for meeting the requirements of such agencies. If the School were to lose students or the related government funding, it could have a substantial effect on its ability to continue operations.

As discussed in Note 8, HCZ is responsible for certain operations of the School and donates those services. If this relationship were to change or cease, such change could have a substantial effect on the School's ability to continue operations.

NOTE 11 CONTINGENCY

The School participates in a number of federal and state programs. These programs require that the School comply with certain requirements of laws, regulations, contracts, and agreements applicable to the programs in which it participates. All funds expended in connection with government grants and contracts are subject to audit by government agencies. While the ultimate liability, if any, from such audits of government contracts by government agencies is presently not determinable, it should not, in the opinion of the management, have a material effect on the financial position or results of operations. Accordingly, no provision for any such liability that may result has been made in the accompanying financial statements.

SUPPLEMENTAL INFORMATION

HARLEM CHILDREN'S ZONE PROMISE ACADEMY II

Schedule of Functional Expenses
For the Year Ended June 30, 2009
(With Comparative Totals for 2008)

	Program Services	Special Education	Management and General	2009 Total	2008 Total
EXPENSES					
Salaries	\$ 2,727,470	\$ 163,924	\$ 204,330	\$ 3,095,724	\$ 2,020,552
Payroll Taxes	231,233	14,760	16,208	262,201	193,807
Employee Benefits	505,643	32,275	50,680	588,598	360,535
Retirement Plan Contribution	77,932	4,974	5,725	88,632	40,919
Total Personnel Services	3,542,279	215,933	276,943	4,035,155	2,615,813
Admissions	7,946	786	3,425	12,157	16,653
Bank Fees	19	2	866	886	32
Student Travel	38,209	3,779	-	41,987	18,520
Consultants and Professional Fees	77,857	7,700	50,359	135,916	87,119
Depreciation	34,022	3,365	1,156	38,543	24,963
Classroom Supplies	80,060	7,918	-	87,978	146,862
Equipment Rental and Maintenance	31,376	3,103	448	34,927	6,306
Food	15,017	1,485	87	16,589	9,681
Insurance			20,000	20,000	10,600
Occupancy	7,119	704	1,017	8,840	4,771
Office Supplies	30,807	3,047	19,819	53,673	44,540
Payroll Processing	3,787	375	6,107	10,269	7,355
Printing, Publications, and Memberships	3,228	319	3,463	7,011	9,109
Postage	1,073	106	130	1,309	-
Software/Software Maintenance	21,724	2,149		23,873	44,360
Special Services/Incentives	4,539	449	500	5,488	6,521
Staff Travel	1,433	142	25	1,599	480
Telephone	1,070	106	761	1,937	253
Training	3,390	335	3,486	7,211	10,747
Uniforms	6,799	672	-	7,471	12,241
Miscellaneous	2,705	268	2,975	5,948	5,636
Total Other than Personnel Services	372,180	36,809	114,623	523,612	466,749
Total Expenses	\$ 3,914,459	\$ 252,742	\$ 391,566	\$ 4,558,767	\$ 3,082,562

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED
ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Board of Trustees

The Harlem Children's Zone Promise Academy Charter School II

We have audited the financial statements of the Harlem Children's Zone Promise Academy Charter School II (the "School") as of and for the year ended June 30, 2009, and have issued our report thereon dated October 30, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal control over financial reporting

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting. The related finding is referenced as 09-01. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and other matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The School's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the School's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



October 30, 2009

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

09-01 Financial Statement Closing Process

Criteria: An effective financial closing process provides the School with accurate financial statements that meet the requirements of the various stakeholders on a timely basis.

Condition: During the preparation of the year-end financial statements, we noted that improvements are needed in the financial statement closing processes to address the accuracy and timeliness of the School's year-end financial reporting.

Effect: The School's system of internal control is not effective for managing its resources. In addition, the deficiencies in the financial statement closing process have resulted in difficulties with meeting external deadlines for submission of audited financial statements which, consequently, does not provide management and those charged with governance the opportunity to critically review the School's financial statements.

Cause: The personnel that perform finance and accounting functions in the fiscal department are few and continual training is required to enable a good understanding of generally accepted accounting principles and effective internal control.

Recommendation: We recommend that the School assess the adequacy of resources in the fiscal department in relation to its periodic reporting responsibility. For example, the School may want to consider an increased level of financial analysis of significant accounts on a regular basis, as well as providing additional support to the Chief Financial Officer in the area of financial reporting.

Management Response:

Harlem Children's Zone Promise Academy II Charter School has hired a Business Manager experienced in the financial functions of schools. We know this position will not only support the schools but will also provide the high level of financial analysis needed to assist with the management of the financial functions of the School.