

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

**Report of Independent Auditors
on Financial Statements
For the Years Ended June 30, 2007 and 2006**

**HARLEM CHILDREN’S ZONE
PROMISE ACADEMY CHARTER SCHOOL II**
June 30, 2007 and 2006

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REPORT OF INDEPENDENT AUDITORS

To the 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, 2007 and 2006, 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 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 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 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, 2007 and 2006, and the change in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* we have also issued our report, dated October 24, 2007, 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.

The schedule of functional expenses 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.

October 24, 2007

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

	2007	2006
ASSETS		
Cash	\$ 521,568	\$ 420,259
Due from HCZ Promise Academy Charter School I, net	102,382	431,217
Government receivables	28,095	-
Prepaid expenses	2,535	843
Property and equipment, net	91,143	19,420
Total Assets	\$ 745,723	\$ 871,739
LIABILITIES AND NET ASSETS		
Liabilities:		
Cash overdraft	\$ -	\$ 2,407
Accounts payable and accrued expenses	38,347	28,643
Due to HCZ	15,181	5,000
Total Liabilities	53,528	36,050
Net Assets:		
Unrestricted	692,195	835,689
Total Liabilities and Net Assets	\$ 745,723	\$ 871,739

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

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
 Statements of Activities
 For the years ended June 30,

	2007	2006
REVENUES AND SUPPORT		
Pupil enrollment	\$ 1,444,438	\$ 665,614
Federal and State funding	162,644	211,881
Contributions	-	535,450
Food service	-	470
Contributions in-kind	852,463	146,764
 Total revenues	 2,459,545	 1,560,179
EXPENSES		
Salaries and fringe benefits	1,957,079	510,340
FICA	130,631	31,972
Consulting fees	81,020	11,983
Administrative	22,590	64,304
Supplies	343,589	74,406
Training and development	3,949	3,117
Trips and transportation	31,407	5,216
Insurance	-	10,000
Uniforms	5,801	584
Occupancy	2,231	1,053
Depreciation	17,822	3,856
Food	4,501	3,539
Other	2,419	4,120
 Total expenses	 2,603,039	 724,490
 Change in net assets	 (143,494)	 835,689
 Unrestricted net assets, beginning of year	 835,689	 -
 Unrestricted net assets, end of year	 \$ 692,195	 \$ 835,689

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

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
 Statements of Cash Flows
 For the years ended June 30,

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (143,494)	\$ 835,689
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation expense	17,822	3,856
Decrease (increase) in due from HCZ Promise Academy Charter School I	329,956	(431,217)
Increase in government grant receivables	(29,216)	-
Increase in prepaid expenses	(1,692)	(843)
Increase in accounts payable	9,704	28,643
Increase in due to HCZ	10,181	5,000
	193,261	441,128
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment, representing cash used in investing activities	(89,545)	(23,276)
CASH FLOWS FROM FINANCING ACTIVITIES		
Bank overdraft facility, representing cash provided by financing activities	(2,407)	2,407
Net increase in cash	101,309	420,259
Cash, beginning of year	420,259	-
Cash, end of year	\$ 521,568	\$ 420,259

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

HARLEM CHILDRENS ZONE PROMISE ACADEMY II

Statement of Functional Expenses
For The Year Ended June 30, 2007
(with comparative totals for 2006)

	<u>Program Services</u>	<u>Management and General</u>	<u>2007 Total</u>	<u>2006 Total</u>
EXPENSES				
Salaries	\$ 1,653,083	\$ 56,817	\$ 1,709,900	\$ 417,930
Payroll Taxes	155,427	4,807	160,234	39,460
Employee benefits	183,619	5,679	189,298	70,728
Retirement plan contribution	<u>28,279</u>	<u>-</u>	<u>28,279</u>	<u>-</u>
Total Personnel Services	<u>2,020,407</u>	<u>67,303</u>	<u>2,087,710</u>	<u>528,118</u>
Admissions	12,849	-	12,849	3,371
Bank Fees	-	259	259	110
Client Travel	17,297	-	17,297	1,456
Consultants and professional fees	36,016	35,042	71,059	26,501
Depreciation	-	17,822	17,822	3,856
Classroom Supplies	226,646	-	226,646	65,784
Equipment rental and Maintenance, Software	-	408	408	1,889
Food	4,501	-	4,501	3,539
Insurance	-	-	-	10,000
Occupancy	-	665	665	-
Office Supplies	53,405	3,714	57,119	8,168
Payroll Processing	-	9,961	9,961	10,144
Printing, Publications, and Memberships	8,574	6,748	15,321	1,010
Software/Software Maintenance	58,834	565	59,399	50,658
Special Client Services/Incentives	2,419	-	2,419	3,495
Staff Travel	-	1,261	1,261	390
Telephone	-	1,516	1,516	1,053
Training	3,949	-	3,949	2,469
Uniforms	5,801	-	5,801	584
Miscellaneous	<u>3,648</u>	<u>3,429</u>	<u>7,077</u>	<u>1,895</u>
Total Other than Personnel Services	<u>433,940</u>	<u>81,389</u>	<u>515,329</u>	<u>196,372</u>
Total Expenses	<u>\$ 2,454,347</u>	<u>\$ 148,692</u>	<u>\$ 2,603,039</u>	<u>\$ 724,490</u>

The accompanying notes are an integral part of the financial statements

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II

Notes to Financial Statements

June 30, 2007 and 2006

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. Opening 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 of America 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

The 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

The class of net assets that is subject to donor-imposed stipulations and that may be fulfilled by action of the School to meet the stipulations or become unrestricted at the date specified by the donor.

Permanently Restricted Net Assets

The class of net assets which is 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, 2007 and 2006

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 \$500 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

Revenue Recognition

The School records contributions of cash and other assets as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any 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. All contributions received for the year ended June 30, 2007 and 2006 were unrestricted.

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.

Contributions In-Kind

The costs assumed by HCZ in providing certain services and facilities to the School are reflected in the statement of activities as contributions in-kind at their actual cost.

Tax Status

The School is exempt from Federal income tax under Section 501(c)(3) of the United States Internal Revenue Code.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2007 and 2006

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Functional Allocation of Expenses

The cost of providing the various programs and other activities has been summarized on a functional basis in the statement of activities, which includes all expenses incurred for the year. Accordingly, certain costs have been allocated, based upon management's estimates, on a direct/indirect cost basis, among the operational and management activities. Included in operating costs are certain allocated management and general administration expenses.

NOTE 3 CASH

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 I, the sister school of the School. Transfers are subsequently made to the School's bank account from which expenses are paid. The accounts in the bank are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000, 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.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2007 and 2006

NOTE 4 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 and Federal food subsidies and Title I, II, IV and V 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, 2007 and 2006:

	2007		2006	
	Revenues	Receivable	Revenues	Receivable
City of New York (Pupil enrollment)	\$ 1,444,438	\$ -	\$ 665,614	\$ -
Department of Youth and Community Development	38,445	-	79,226	-
State of New York	64,734	-	91,891	-
State of New York - Implementation Grant	-	-	35,000	-
Title I	57,295	27,628	5,690	-
Title II	2,128	467	360	-
Title V	42	-	-	-
Total grants from government sources	<u>\$ 1,607,082</u>	<u>\$ 28,095</u>	<u>\$ 877,781</u>	<u>\$ -</u>

In addition, the School also receives funding in the form of private and corporate contributions. The amount received for the year ended June 30, 2006 was \$535,450. No contributions were received in 2007.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2007 and 2006

NOTE 5 PROPERTY AND EQUIPMENT

At June 30, 2007 and 2006, property and equipment consisted of the following:

	2007	2006
Furniture and fixtures	\$ 112,821	\$ 23,276
Less: accumulated depreciation	21,678	3,856
Total	\$ 91,143	\$ 19,420

Depreciation expense for the years ended June 30, 2007 and 2006 amounted to \$17,822 and \$3,856, respectively.

NOTE 6 PROFIT SHARING PLAN

The School maintains a noncontributory profit sharing plan for all eligible employees. Employees become eligible once they have reached age twenty-one 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 year ended June 30, 2006, the School's employees were not yet eligible for the plan, therefore there were no contributions made. For the year ended June 30, 2007, contributions were \$28,279.

NOTE 7 IN-KIND SUPPORT

Pursuant to the terms of a commitment letter, dated and signed by HCZ and the School on April 15, 2005, HCZ, as the School's Institutional Partner, committed to provide the School, during the initial 5-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 providing 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.

In-kind services for the years ended June 30, 2007 and 2006 amounted to \$852,463 and \$146,764, respectively.

HARLEM CHILDREN'S ZONE
PROMISE ACADEMY CHARTER SCHOOL II
Notes to Financial Statements
June 30, 2007 and 2006

NOTE 8 RELATED PARTY TRANSACTIONS

As discussed in Note 3, as of June 30, 2007 and 2006, \$101,531 and \$431,217, respectively was receivable from Harlem Children's Zone Promise Academy Charter School I.

As of June 30, 2007 and 2006, \$15,181 and \$5,000, respectively was payable to HCZ.

NOTE 9 CONCENTRATIONS 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 7, 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 10 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.

**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**

To the Board of Trustees
The Harlem Children's Zone Promise Academy Charter School II

We have audited the financial statements of Harlem Children's Zone Promise Academy Charter School II (the "School") as of and for the years ended June 30, 2007 and 2006 and have issued our report thereon dated October 24, 2007. 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.

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 control deficiency exists when the design or operation of a control does not allow management or employees, in normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weakness. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the School in a separate letter dated October 30, 2007.

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 the 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, management and State of New York awarding agencies, and others within the Organization and is not intended to be and should not be used by anyone other than these specified parties.

October 24, 2007