

**McGladrey & Pullen**

Certified Public Accountants

## **KIPP STAR College Prep Charter School**

Management Letter

June 30, 2008

# McGladrey & Pullen

Certified Public Accountants

The Audit Committee of the Board of Trustees  
and Management  
KIPP STAR College Prep Charter School  
433 West 123<sup>rd</sup> Street, 4<sup>th</sup> Floor  
New York, NY 10027

Dear Members of the Audit Committee and Management:

In planning and performing our audit of the financial statements of KIPP STAR College Prep Charter School (the "School") as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the School's internal control over financial reporting (internal control) 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. Accordingly, we do not express an opinion on the effectiveness of the School's internal control.

Our consideration of the internal control was limited for the purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses.

A *control deficiency* 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 misstatements on a timely basis. A deficiency in design exists when a control necessary to meet the control objective is missing, or when an existing control is not properly designed so that even if the control operates as designed, the control objective is not always met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A *significant deficiency* is a control deficiency, or a 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.

A *material weakness* is a significant deficiency, or a 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.

Observations A through C in Exhibit I of the attachment to this letter are identified as control deficiencies that we determined did not constitute significant deficiencies or material weaknesses. We consider Observation B in Exhibit II of the attachment to this letter to be a significant deficiency.

The School's written responses to the observations have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the audit committee, board of trustees and management and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss our comments with you at greater length and assist you in the implementation of any of our recommendations should you so desire.

Sincerely,

*McGladrey & Pullen, LLP*

October 23, 2008

## Contents

### Exhibit I - Current-Year Observations

- |   |       |
|---|-------|
| A. Maintenance of Student Records           | 1     |
| B. Missing Documentation in Personnel Files | 1 - 2 |
| C. Segregation of Duties                    | 2     |

### Exhibit II - Status of Prior-Year Observations

- |  |       |
|--|-------|
| A. Maintenance of Student Records            | 3     |
| B. *Missing Documentation in Personnel Files | 3 - 4 |
| C. Procurement of Goods and Services         | 4     |

### Exhibit III - Corrective Actions Taken During 2006 for Prior-Year Observations

- |   |       |
|---|-------|
| A. Inadequate Documentation for Services Rendered by Consultants                | 5     |
| B. Cancellation of Documents Supporting a Disbursement Transaction              | 5     |
| C. Accounting for Contract Funds - Claim for Reimbursement with Funding Sources | 5 - 6 |

---

\* Significant deficiency

## **Exhibit I - Current-Year Observations**

### **A. Maintenance of Student Records**

#### **Observation**

We noted out of 23 sampled students, 7 students were missing birth certificates, 1 student was missing medical forms, 5 students were missing proof of address, 5 students were missing registration forms and 10 students were missing documentation to evidence that these students were selected through the annual lottery process. Additionally, we noted that one registration form maintained in a student file was not signed by the parent of a student.

#### **Recommendations**

We recommend that adequate documentation pertaining to students be maintained in student files. Management should follow up with all of the students' parents or guardians currently to obtain missing information for students. Annually, all current and new student files should be reviewed by the School prior to the commencement of the new school year to ensure that adequate follow-up with the student's parent or guardian can be made to obtain missing student records.

#### **Response**

Although certain student's proof of residency was not maintained in student's files, KIPP Star's office manager maintains an ATS report with emergency contact information, including the student's address. This information is taken from a semi-annual emergency contact form that is mailed to the child's home to be checked and/or updated by the parents or guardians. The managing director of operations has implemented new procedures in an effort to achieve 100% compliance. New students are now required to produce all necessary documentation prior to attending school at KIPP STAR. Also, strong efforts are being made to acquire missing documentation from existing students, including a quarterly check on missing documentation followed by letters to the student's home requesting the documentation.

### **B. Missing Documentation in Personnel Files**

#### **Observation**

We noted out of 23 sampled employees, 12 employees were missing fingerprinting records, 8 employees were missing contract or offer letters, 5 employees' timesheets did not agree with the number of hours paid per the payroll register, 4 teachers were missing certifications, 2 employees were missing Employment Eligibility Verification Forms (Form I-9) and related forms of identification, and 6 employees' Employment Eligibility Verification Forms were not signed by an authorized School representative.

#### **Recommendation**

Management should ensure that policies and procedures are implemented requiring all employees to complete the Employment Eligibility Verification Form (Form I-9) no later than the first day of employment at the School. Additionally, all employees should provide original forms of identification (e.g., driver's license, social security card, etc.) to the authorized human resources representative and copies of the identification forms should be maintained in each employee's personnel file. These forms should also be updated when there are necessary changes. For existing employees, Form I-9 should also be completed and included in these individuals' personnel files currently missing this employment verification documentation along with copies of the identification documents. Also, the

employer section of all Form I-9's must be signed by an authorized School representative. Additionally, efforts should be made to obtain copies of teacher certifications, fingerprinting records and other pertinent information including employee timesheets and contract or offer letters and include them in the respective teacher's personnel files.

### **Response**

KIPP Star has seen significant growth in this area. Further, beginning October 15, 2008, the new manager of human resources will begin working for KIPP NYC Shared Services Team. This will result in a higher level of internal control with a concentrated effort to meet all compliance obligations.

## **C. Segregation of Duties**

### **Observation**

During our audit, we noted that certain incompatible duties were handled by one employee, such as authorizing wire transfers between the various KIPP schools, payroll processing and submission of payroll without any review done by an authorized individual independent of these functions, and the managing director of finance and human resources having the ability to initiate, authorize and record purchases and related payments into the accounts payable module while at the same time, having the authority to sign checks pertaining to these purchases related payment requests. During our review of the School's records and transactions and communication with various members of the accounting department, we did not note the managing director of finance and human resources directly accessing or recording transactions relating to payroll, purchases and related payments in the Fund EZ accounting system.

### **Recommendation**

Adequate internal control dictates that no one individual should have complete control of wire transfers and payroll processing functions. Accordingly, we recommend that the School adopt compensating controls, such as requiring at least two signatures by authorized personnel for wire transfers (or approval of the wire transfers by a second signatory evidenced by this individual's signature on the wire transfer request form) and assigning a different employee (in particular someone at the management level - e.g., superintendent or KIPP NYC shared services team executive director) to review the payroll submission prior to being submitted to the outside payroll service provider and obtaining fidelity bond coverage on employees in positions of trust. Additionally, the managing director of finance and human resources should not have the ability to initiate, authorize and record purchases and related payments into Fund EZ's accounts payable module.

### **Response**

A manager of human resources has been hired as of October 15, 2008 to help segregate the duties of the managing director of finance and human resources. The managing director's system access rights in Fund EZ have been reduced to "read-only." Reconciliation of payroll journal entries will be performed by the controller.

## **Exhibit II - Status of Prior-Year Observations**

In conjunction with the 2006 audit performed by Goldstein Golub Kessler LLP ("GGK"), independent accountants, certain of whose partners became partners of McGladrey & Pullen, LLP effective October 3, 2007, a significant deficiency regarding the accounting for contract funds and control deficiencies regarding the maintenance of student records and procurement of goods and services were identified. Efforts were put forth to correct these matters and the following is a status update:

### **A. Maintenance of Student Records**

#### **Observation**

The School was unable to locate the New York City Department of Education ("NYCDOE") files containing proof of address, copies of birth certificates and medical forms for all 30 sampled students. The School has a policy of not recreating these student enrollment records since the same information is available in each student's original NYCDOE file. However, during the audit, such files had not been received from the former NYCDOE public schools that these students attended prior to joining the School.

#### **Recommendation**

All student records should be properly maintained on file for reference purposes.

#### **Status Update**

Continued efforts are being made by the School's management to obtain the missing student record files. M&P auditor noted that more of the student files that were tested during the audit contained adequate documentation (out of 23 sampled students, 7 students were missing birth certificates, 1 student was missing medical forms and 5 students were missing proof of address) and current year's exceptions are fully described in Observation A in Exhibit I.

### **B. \*Missing Documentation in Personnel Files**

#### **Observation**

During our audit, we noted that certain required documentation, such as the Employee's Withholding Allowance Certificate (Form W-4) and Employment Eligibility Verification Form (Form I-9), were not completed and included in employee personnel files.

#### **Recommendation**

Management should ensure that policies and procedures are implemented requiring all employees to complete the Employee's Withholding Allowance Certificate (Form W-4) and Employment Eligibility Verification Form (Form I-9) no later than the first day of employment at the School. Additionally, all employees should provide original forms of identification (e.g., driver's license, social security card, etc.) to the authorized human resources representative and copies of the identification forms should be maintained in each employee's personnel file. These forms should also be updated when there are necessary changes. For existing employees, Forms W-4 and I-9 should also be completed and included in these individuals' personnel files along with copies of the identification documents.

---

\* Significant deficiency

### **Status Update**

Continued efforts are being made by the School's management to obtain the missing employee records. M&P auditor noted that all personnel files that were tested during the audit included copies of the Employee's Withholding Allowance Certificate (Form W-4) and there were fewer instances in which Employment Eligibility Verification Form (Form I-9) and related forms of identification were missing; see the current year's exceptions as more fully described in Observation B in Exhibit I.

### **C. Procurement of Goods and Services**

#### **Observation**

Our review of the School's procurement system disclosed that there was no documentation to support competitive bids that were obtained for major purchases of goods and services to provide evidence that the School obtained the most advantageous offer.

The School is substantially funded by cost-reimbursement contracts that generally require competitive bids and adequate documentation for procurement of goods and services. The failure to comply with such terms could result in disallowance of costs claimed for reimbursement by the School.

#### **Recommendations**

Accordingly, we recommend that the School should enforce the procurement policies and procedures that are outlined in its fiscal policies and procedures manual. Consistent implementation of the School's procurement policies and procedures serves a dual purpose of ensuring adequate internal controls and compliance with contract terms relative to procurement.

### **Status Update**

Obtaining competitive bids has been extended by the School to significant purchases of other types of goods and services beyond accounting services, technology equipment and copier leases. The School continues to utilize vendors from the KIPP NYC, KIPP Foundation and NYCDOE preferred vendor lists, but has not maintained competitive bidding documentation for all procurement transactions requiring such documentation to support its decision making process to proceed with vendors from these pre-approved lists.

## Exhibit III - Corrective Actions Taken During 2006 for Prior-Year Observations

### A. Inadequate Documentation for Services Rendered by Consultants

#### Observation

We noted that no formal services agreements are entered into between the School and outside consultants, leaving the potential for the School to be subject to penalties, back withholding taxes and assessments for unemployment benefit claims.

#### Corrective Action Taken

We noted that the School has issued Form 1099s to consultants during the year.

### B. Cancellation of Documents Supporting a Disbursement Transaction

#### Observation

We noted that invoices and other documents to support a disbursement transaction were not canceled by stamping the documents "paid." Additionally, during the fiscal 2007 audit, we noted in the School's fiscal policies and procedures manual that purchase orders are not required since vendor invoices are attached to the final check payment request for signatures and approval by the School's principal and the School's management implemented procedures requiring all invoices to be initialed and dated instead of using a stamp. We noted several instances in which invoices were missing initials and dates as indication of canceled invoice or were not properly authorized.

#### Corrective Action Taken

In lieu of the "paid" stamp, the School's fiscal staff initials, stamps "received", dates and approves invoices, and staples the check stubs to them to indicate that invoices were paid. The School has improved in maintaining adequate documentation for its disbursements which were tested on a sample basis and were being supported by proper authorizations and vendors' invoices.

### C. Accounting for Contract Funds

#### Observation

#### Claim for Reimbursement with Funding Sources

We reviewed sample charges for reimbursement claims to funding sources and noted the following:

- Salaries for professional and support staff amounting to \$110,234 were charged to the Title grants. The grant budget provides for a fixed daily and weekly rate and requires the School to maintain a "time and effort" record to support the claim. The School does not require its leadership employees and teachers to maintain time sheets.

Generally, for a cost-reimbursement claim to be valid, it must a) be reasonable and allocable to the grant or contract; b) conform to the limitations set forth in the grant or contract budget; c) be necessary for the performance of the grant or contract terms; and d) be adequately documented.

Upon further review of the New York State Education Department Fiscal Guidelines, time and effort records should consist of a) the name of the individual, b) title of position as it appears on the FS-10, c) period of employment and d) total amounts paid as well as the basis for allocating costs to federal or state projects. The School does not appear to maintain a separate schedule or report with this detailed time and effort records documentation and in lieu tags portions of specific payroll amounts from the related payroll registers as support of these cost-reimbursement claims.

**Corrective Action Taken**

The School does not maintain timesheets for teachers (100% of their time is allocated to program services) or other professional staff as they are paid on a salary basis. However, the School's teachers are required to fill out timesheets for after-school activities. The School provided the annual and/or FTE salaries or details for professional staff and consultants fees charged to the Title grants in accordance with the requirements of the budgets required by the funding sources, along with a clear description of the functional responsibilities of the individuals. Therefore, the School is confident that its cost-reimbursement claims are adequately documented by employee and payroll records or consultant records and are in compliance with the requirements of the grants, thereby mitigating the risk of cost disallowance by the funding sources. No additional requests from the funding sources regarding employee time records nor cost disallowances occurred in fiscal 2008.

# McGladrey & Pullen

Certified Public Accountants

## KIPP Star College Prep Charter School

Financial Statements

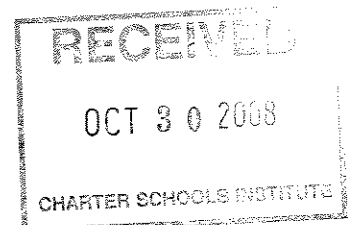
June 30, 2008

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

CONTENTS  
June 30, 2008

---

<b>Independent Auditor's Report</b>	1
<b>Financial Statements:</b>	
Statement of Financial Position	2
Statement of Activities	3
Statement of Functional Expenses	4 - 5
Statement of Cash Flows	6
Notes to Financial Statements	7 - 12
<b>Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i></b>	13 - 14
<b>Schedule of Findings and Recommendations</b>	15





# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

The Board of Trustees  
KIPP STAR College Prep Charter School  
New York, New York

We have audited the accompanying statements of financial position of KIPP STAR College Prep Charter School (the "School") as of June 30, 2008 and the related statements of activities, functional expenses, and cash flows for the year 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 audit. The financial statements of the School for the year ended June 30, 2007 were audited by Goldstein Golub Kessler LLP ("GGK"), independent accountants, certain of whose partners became partners of McGladrey & Pullen, LLP effective October 3, 2007. GGK's report, dated October 22, 2007, expressed an unqualified opinion on those financial statements.

We conducted our audit 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2008 financial statements referred to above present fairly, in all material respects, the financial position of KIPP STAR College Prep Charter School as of June 30, 2008 and the changes in its net assets and its cash flows for the year 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 23, 2008, 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 considered in assessing the results of our audit.

*McGladrey & Pullen, LLP*

New York, New York  
October 23, 2008

McGladrey & Pullen, LLP is a member firm of RSM International –  
an affiliation of separate and independent legal entities.

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## STATEMENT OF FINANCIAL POSITION

June 30,	2008	2007
<b>ASSETS</b>		
Cash	1,167,752	\$ 966,107
Grants and Contracts Receivable	31,399	243,667
Property and Equipment, net	243,061	233,895
Prepaid Expenses and Other Assets	16,857	56,317
<b>Total Assets</b>	<b>\$1,459,069</b>	<b>\$1,499,986</b>
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 89,796	\$ 92,127
Capital lease obligations	52,934	49,966
Refundable advances	108,635	125,034
Due to related parties	111,442	15,983
<b>Total liabilities</b>	<b>362,807</b>	<b>283,110</b>
Contingency		
Net Assets:		
Unrestricted	1,096,262	1,216,876
<b>Total net assets</b>	<b>1,096,262</b>	<b>1,216,876</b>
<b>Total Liabilities and Net Assets</b>	<b>\$1,459,069</b>	<b>\$1,499,986</b>

See Notes to Financial Statements

**KIPP STAR COLLEGE PREP CHARTER SCHOOL**

**STATEMENT OF ACTIVITIES**

Year ended June 30,	2008			2007		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Operating revenue:						
State and local per pupil operating revenue	\$3,255,757		\$3,255,757	\$3,397,806		\$3,397,806
Government grants	162,985		162,985	149,435		149,435
<b>Total operating revenue</b>	<b>3,418,742</b>		<b>3,418,742</b>	<b>3,547,241</b>		<b>3,547,241</b>
Operating expenses:						
Program services:						
School operations	3,466,473		3,466,473	3,567,144		3,567,144
<b>Total program services</b>	<b>3,466,473</b>		<b>3,466,473</b>	<b>3,567,144</b>		<b>3,567,144</b>
Supporting services:						
Management and general	296,525		296,525	248,498		248,498
Fund-raising	97,406		97,406	74,838		74,838
<b>Total supporting services</b>	<b>393,931</b>		<b>393,931</b>	<b>323,336</b>		<b>323,336</b>
<b>Total operating expenses</b>	<b>3,860,404</b>		<b>3,860,404</b>	<b>3,890,480</b>		<b>3,890,480</b>
School operating deficit	(441,662)		(441,662)	(343,239)		(343,239)
Other revenue and expenses:						
Contributions and grants	176,087		176,087	268,959		268,959
Interest and other income - net	77,987		77,987	116,479		116,479
Donated services	66,974		66,974	40,389		40,389
Realized gain on marketable securities				17,692		17,692
Net assets released from restrictions				129,980	\$(129,980)	
Change in net assets	(120,614)		(120,614)	230,260	(129,980)	100,280
Net assets at beginning of year	1,216,876		1,216,876	986,616	129,980	1,116,596
<b>Net assets at end of year</b>	<b>\$1,096,262</b>	<b>\$ - 0 -</b>	<b>\$1,096,262</b>	<b>\$1,216,876</b>		<b>\$1,216,876</b>

See Notes to Financial Statements

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2008

	Program Services		Supporting Services		Total Expenses
	School Operations	Management and General	Fund-raising	Total Supporting Services	
Salaries	\$2,263,288	\$174,651	\$83,777	\$258,428	\$2,521,716
Payroll taxes and employee benefits	377,360	31,999	5,377	37,376	414,736
Equipment	65,381	839		839	66,220
Professional fees	5,625	61,463		61,463	67,088
Contracted services - other	114,929	4,626	5,688	10,314	125,243
Supplies	33,636	4,395	1,086	5,481	39,117
Instructional materials	44,735		4	4	44,739
Academic programming	53,742				53,742
Telephone and internet	28,992	128		128	29,120
Insurance	39,110				39,110
Food	25,322	46	22	68	25,390
Student trip	189,912				189,912
Field lessons	35,325				35,325
Staff development	83,152	18,378	1,284	19,662	102,814
Fees	4,601		168	168	4,769
Licensing fee	30,000				30,000
Depreciation and amortization	71,363				71,363
	<u>3,466,473</u>	<u>\$296,525</u>	<u>\$97,406</u>	<u>\$393,931</u>	<u>\$3,860,404</u>
Management and general	296,525				
Fund-raising	97,406				
Subtotal	<u>\$3,860,404</u>				
Total number of students	279				
Average cost per student	<u>\$ 13,837</u>				

See Notes to Financial Statements

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## STATEMENT OF FUNCTIONAL EXPENSES

Year ended June 30, 2007

	Program Services	Supporting Services		Total Supporting Services	Total Expenses
	School Operations	Management and General	Fund-raising		
Salaries	\$2,074,320	\$176,740	\$66,902	\$243,642	\$2,317,962
Payroll taxes and employee benefits	346,896	28,602	4,619	33,221	380,117
Equipment	53,357	18	377	395	53,752
Professional fees	1,100	35,201		35,201	36,301
Contracted services - other	112,099	886		886	112,985
Supplies	24,022	1,766	1,277	3,043	27,065
Instructional materials	49,750				49,750
Academic programming	63,172				63,172
Telephone and internet	38,328	35	182	217	38,545
Insurance	48,461	725		725	49,186
Food	35,125	58		58	35,183
Student trip	301,408				301,408
Field lessons	36,185				36,185
Staff development	84,216	4,467	1,355	5,822	90,038
High school placement	3,360				3,360
Fees	3,521		95	95	3,616
Licensing fee	30,000				30,000
Grant to KIPP New York, Inc.	50,000				50,000
Bad debts	91,957				91,957
Depreciation and amortization	119,867		31	31	119,898
	<b>3,567,144</b>	<b>\$248,498</b>	<b>\$74,838</b>	<b>\$323,336</b>	<b>\$3,890,480</b>
Management and general	248,498				
Fund-raising	74,838				
Subtotal	<b>\$3,890,480</b>				
Total number of students	314				
Average cost per student	<b>\$ 12,390</b>				

See Notes to Financial Statements

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## STATEMENT OF CASH FLOWS

Year ended June 30,	2008	2007
Cash flows from operating activities:		
Change in net assets	\$ (120,614)	\$ 100,280
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	71,363	119,898
Gain on disposal of equipment		(32,745)
Write-off of uncollectible receivables		91,957
Changes in operating assets and liabilities:		
Decrease (increase) in grants and contracts receivable	212,268	(189,175)
Decrease (increase) in prepaid expenses and other assets	39,460	(28,268)
Decrease in accounts payable and accrued expenses	(2,331)	(40,581)
(Decrease) increase in refundable advances	(16,399)	125,034
Increase (decrease) in due to related parties	95,459	(38,570)
<b>Net cash provided by operating activities</b>	<b>279,206</b>	<b>107,830</b>
Cash used in investing activity - purchases of property and equipment	(38,714)	(65,831)
Cash used in financing activity - payments made on capital lease obligations	(38,847)	(26,097)
Net increase in cash	201,645	15,902
Cash at beginning of year	966,107	950,205
Cash at end of year	\$1,167,752	\$ 966,107

**Supplemental disclosure of cash flow information:**

Cash paid during the year for interest	\$ 3,984	\$ 3,717
--	----------	----------

**Supplemental schedule of noncash investing and financing activity:**

Purchase of equipment financed by capital lease obligation	\$ 41,815
--	-----------

See Notes to Financial Statements

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

**1. PRINCIPAL  
BUSINESS  
ACTIVITY AND  
SUMMARY OF  
SIGNIFICANT  
ACCOUNTING  
POLICIES:**

KIPP STAR College Prep Charter School (the "School") is an education corporation that operates as a charter school in the borough of Manhattan (Harlem), New York City. On March 25, 2003, the Board of Regents of the University of the State of New York for and on behalf of the State Education Department granted the School a provisional charter valid for a term of five years from the effective date of March 25, 2003 and renewable upon expiration. After a review process on March 11, 2008, the charter was renewed for a full five-year term expiring on March 25, 2013. The School's mission is to equip students with the academic and character skills necessary to succeed in high school, college and the competitive world beyond.

In fiscal years 2008 and 2007, the School operated classes for students in grades five through eight.

The New York City Department of Food Services provides free and reduced-price lunches and New York City Department of Transportation provides transportation vouchers directly to a majority of the School's students. Amounts with respect to these items are not included in these financial statements.

The financial statements of the School have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America.

The financial statements of the School reflect contributions received from the public and other organizations.

The School reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or 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.

Unrestricted net assets are not restricted by donors or the donor-imposed restrictions have expired.

Temporarily restricted net assets contain donor-imposed restrictions that permit the organization to use or expend the assets as specified. The restrictions are satisfied either by the passage of time or by action of the organization.

Permanently restricted net assets contain donor-imposed restrictions that stipulate the resources be maintained permanently, but permit the organization to use, or expend, part or all of the income derived from the donated assets for either specified or unspecified purposes.

Revenue from the state and local governments resulting from the School's charter status and based on the number of students enrolled is recorded when services are performed in accordance with the charter agreement. Federal and state funds are recognized by the School when expenditures are incurred and billable.

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

---

Revenue from other government grants to which the School is entitled is recognized mostly on student enrollment. Some grants are provided for specific educational endeavors which are not based on student enrollment and are recorded when related expenditures are incurred by the School.

Federal and state funds received prior to the services provided or the related expenditures being incurred are deferred and recorded as refundable advances.

Contributed services are recorded at their fair value when such services are rendered. Contributed services are recognized as contributions if the services: (a) create or enhance nonfinancial assets or (b) require specialized skills and are performed by people with those skills and would otherwise be purchased by the School and (c) are measurable. Legal services were provided by individuals to the School at no charge. The value of such contributed legal services for the year ended June 30, 2008 amounted to \$28,335 and is included in donated services and professional fees in the accompanying financial statements.

A number of volunteers have made a contribution of their time to the School. These in-kind contributions have not been reflected in the financial statements since they do not meet the criteria for recognition under Statement of Financial Accounting Standards No. 116 ("SFAS 116"), *Accounting for Contributions Received and Contributions Made*.

In-kind contributions that meet the criteria for recognition under SFAS 116 have been included in the financial statements. Such amounts include a usage charge allocated to the School from a portion of a grant made to KIPP Academy Charter School in a prior year totaling \$500,000. The funds from this grant were used to purchase new technology equipment which has been recorded on KIPP Academy Charter School's books and records and for the benefit and use in equal proportions by all four KIPP New York City schools. The value of this usage charge recorded for each of the years ended June 30, 2008 and 2007 amounted to \$38,639, and is included in donated services and equipment in the accompanying financial statements.

The School maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The School has not experienced any losses in such accounts.

Property and equipment is recorded at cost. The School capitalizes purchases of furniture, fixtures and equipment that exceeds \$1,000. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets. Property and equipment acquired with certain government contract funds are recorded as expenses when the grantor retains title.

Fixed assets acquired under capital leases are recorded in property and equipment with corresponding obligations carried in liabilities. The amount capitalized is the lower of the present value of the minimum lease payments or the fair value of the leased asset. Amortization on assets leased under capital leases is recorded on a straight-line basis over the estimated useful life of the asset or the term of the lease, depending on the criteria used to capitalize the lease.

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

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 at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

In July 2006, the Financial Accounting Standards Board (the "FASB") issued interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. The cumulative effect of applying the provisions of FIN 48, if any, will be reported as an adjustment to the opening balance of net assets for the fiscal year of adoption. Additional disclosures about the amounts of such liabilities will also be required. In February 2008, the FASB delayed the effective date of FIN 48 for certain nonpublic enterprises to annual financial statements for fiscal years beginning after December 15, 2007. In October 2008, the FASB further delayed the effective date for an additional year for certain nonpublic enterprises. The School will be required to adopt FIN 48 in its June 30, 2010 financial statements. The adoption of FIN 48 is not expected to have a material impact on the School's financial position, change in net assets or cash flows.

### 2. RELATED PARTY TRANSACTIONS:

The Knowledge is Power Program Foundation ("KIPP Foundation") is a national, nonprofit organization that trains school leaders to open and run academically rigorous public schools.

The School is a member of KIPP Foundation's KIPP Network of Schools and, as such, is eligible for a range of benefits and fee-based services.

The School has entered into a trademark license agreement with KIPP Foundation subject to a license fee of 1% of annual per pupil operating revenue not to exceed \$30,000. The School incurred license fees amounting to \$30,000 for each of the years ended June 30, 2008 and 2007.

The back-office functions are centralized and handled by KIPP NYC's shared services team, whose salaries are paid by KIPP Academy Charter School. A portion of the costs of the shared services salaries are allocated to and reimbursed by the School. Amounts due to related parties represent short-term timing differences of pending settlements.

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

During the year ended June 30, 2007, the School granted \$50,000 to the general scholarship fund maintained by KIPP New York, Inc., a related entity by virtue of commonality of certain board members. No grant was made in 2008.

**3. PROPERTY AND EQUIPMENT, NET:**

Property and equipment, net, at cost, consists of the following:

	2008	2007	Estimated Useful Life
Furniture and fixtures	\$ 28,495	\$ 20,832	5 to 7 years
Equipment and other	511,015	438,149	3 to 5 years
Less accumulated depreciation and amortization	539,510	458,981	
	(296,449)	(225,086)	
	\$ 243,061	\$ 233,895	

Property and equipment includes three copiers acquired under capital leases. As of June 30, 2008 and 2007, the leased copiers are reflected at a cost of \$147,972 and \$106,158 respectively as well as related accumulated amortization amounting to \$87,679 and \$50,557, respectively. Additionally, during the year ended June 30, 2007, the School recorded a gain on disposal of fixed assets for \$32,745, relating to insurance proceeds received in connection with the replacement of certain stolen equipment, included in interest and other income in the accompanying statement of activities.

**4. TAX STATUS:**

The Internal Revenue Service has determined that the School is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

**5. AGREEMENT FOR SCHOOL FACILITY:**

The School occupies 24,000 square feet of space in its original facility since inception. The School has an agreement with the New York City Department of Education for this dedicated and shared space at P.S. 125, a New York City public school located at West 123<sup>rd</sup> Street, New York, New York. The facility is provided to the School at no cost. The School is responsible for any overtime-related costs for services provided beyond regular opening hours.

**6. OPERATING EXPENSES:**

Operating expenses are presented in the statement of functional expenses classified according to the significant program activity related to the purpose for which the School exists or supporting service.

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

---

The significant activities are:

School operations

Represents work (time and materials) that is specifically related to or necessary for the programming aspects of the School. The activities and related costs directly affecting students or parents fall under this program.

The significant supporting services are:

Management and general

Represents work (time and materials) that is specifically related to running the non-programmatic/back-end operational functions of the School including, but not limited to, human resources, finance, technology and payroll.

Fund-raising

Represents work (time and materials) associated with the School's fund-raising efforts including, but not limited to, annual mailings, donor meetings and events.

**7. CAPITAL LEASE OBLIGATIONS:**

The School leases two copiers under capital leases expiring in July 2008 and September 2009. The leases require monthly payments of principal and interest ranging from \$1,009 to \$1,475, at imputed interest rates of 5.7% and 6.0% per annum.

In fiscal 2008, the School obtained an additional copier under a capital lease expiring in May 2011. The lease requires a monthly payment of principal and interest amounting to \$941 at an annual interest rate of 4% per annum.

Future minimum lease payments under the leases are as follows:

Year ending June 30,	
2009	\$28,990
2010	15,716
2011	10,351
	<hr/>
	55,057
Less amount representing interest	(2,123)
	<hr/>
	\$52,934
	<hr/>

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## NOTES TO FINANCIAL STATEMENTS June 30, 2008

---

8. **CONTINGENCY:** Certain grants and contracts may be subject to audit by the funding sources. Such audits might result in disallowances of costs submitted for reimbursement. Management is of the opinion that such cost disallowances, if any, will not have a material effect on the accompanying financial statements. Accordingly, no amounts have been provided in the accompanying financial statements for such potential claims.
9. **NET ASSETS  
RELEASED FROM  
RESTRICTIONS:** During the year ended June 30, 2007, net assets were released from donor restrictions upon incurring expenses amounting to \$129,980 for School programming for the fiscal 2005-2006 school year.

# McGladrey & Pullen

Certified Public Accountants

## Report 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

The Board of Trustees  
KIPP STAR College Prep Charter School  
New York, New York

We have audited the financial statements of KIPP STAR College Prep Charter School (the "School") as of and for the year ended June 30, 2008, and have issued our report thereon dated October 23, 2008. We conducted our audit 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 the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a 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 material 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 weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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*.

We noted certain matters that we reported to the management of the School in a separate letter dated October 23, 2008.

This report is intended solely for the information and use of the audit committee, board of trustees, management, the New York State Education Department and the Board of Regents of the University of the State of New York and is not intended to be and should not be used by anyone other than these specified parties.

*McGladrey & Pullen, LLP*

New York, New York  
October 23, 2008

# KIPP STAR COLLEGE PREP CHARTER SCHOOL

## SCHEDULE OF FINDINGS AND RECOMMENDATIONS

---

### Compliance and Other Matters Findings

#### Section I - Prior Year's Findings

##### 2007-01

##### Criteria

Organizations must ensure compliance to all applicable labor laws, including making sure that all their employees are legally authorized to work in the United States and that proper federal tax withholding forms are completed.

##### Condition

During our audit, we noted that certain required documentation, such as Employee's Withholding Allowance Certificate (Form W-4) and Employment Eligibility Verification Form (Form I-9), were not completed and included in employee personnel files.

##### Cause and Effect

This condition can be attributed to limited oversight and lack of familiarity with the administrative requirements pertaining to applicable labor laws and tax withholding requirements.

##### Recommendation

Management should ensure that policies and procedures are implemented requiring all employees to complete the Employee's Withholding Allowance Certificate (Form W-4) and Employment Eligibility Verification Form (Form I-9) no later than the first day of employment at the School. Additionally, all employees should provide original forms of identification (e.g., driver's license, social security card, etc.) to the authorized human resources representative and copies of the identification forms should be maintained in each employee's personnel file. These forms should be updated when there are necessary changes. For existing employees, Forms W-4 and I-9 should be completed and included in these individuals' personnel files along with copies of the identification documents.

##### Status Update

We have noted personnel files included Employee's Withholding Allowance Certificates (Form W-4) and we noted some minor instances in which the Employment Eligibility Verification Form (Form I-9) as noted in the prior year's comment were not completed and included in the employees' files.