

Child Development Center of the Hamptons Charter School, Inc.

Financial Statements Year Ended June 30, 2010

The report accompanying these financial statements was issued by BDO USA, LLP, a New York limited liability partnership and the U.S. member of BDO International Limited, a UK company limited by guarantee.

**Child Development Center
of the Hamptons Charter
School, Inc.**

Financial Statements
Year Ended June 30, 2010

Child Development Center of the Hamptons Charter School, Inc.

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Independent Auditors' Report

To the Board of Directors
Child Development Center of the
Hamptons Charter School, Inc.
New York, New York

We have audited the accompanying statement of financial position of Child Development Center of the Hamptons Charter School, Inc. (the "School") as of June 30, 2010, 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. Information for the year ended June 30, 2009 is presented for comparative purposes only and was extracted from financial statements of the School for the year ended June 30, 2009, on which we expressed an unqualified opinion dated October 14, 2009.

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 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of the School as of June 30, 2010, 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 27, 2010 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BDO USA, LLP

October 27, 2010

BDO USA, LLP, a New York limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

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Child Development Center of the Hamptons Charter School, Inc.

Statement of Financial Position (with comparative totals for 2009)

<i>June 30,</i>	2010	2009
Assets		
Cash and cash equivalents (Note 2)	\$ 377,046	\$ 314,644
Accounts receivable (net of allowance for doubtful accounts of \$143,931 and \$189,948 for 2010 and 2009, respectively)	172,022	298,939
Due from affiliates (Note 7)	10,865	132,791
Prepaid expenses	488	488
Fixed assets, net (Notes 2 and 3)	1,308,427	1,358,421
	\$1,868,848	\$2,105,283
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 56,893	\$ 53,154
Accrued salaries and fringes	120,191	88,203
Due to affiliate (Note 7)	926,264	1,328,998
Loan payable (Note 5)	300,000	312,882
Total liabilities	1,403,348	1,783,237
Net assets:		
Unrestricted	465,500	322,046
	\$1,868,848	\$2,105,283

See accompanying notes to financial statements.

Child Development Center of the Hamptons Charter School, Inc.

Statement of Activities (unrestricted) (with comparative totals for 2009)

<i>Year ended June 30,</i>	2010	2009
Public support and revenue:		
Public school district:		
Resident student enrollment	\$1,277,607	\$1,365,355
Students with disabilities enrollment	1,404,605	1,566,405
Private grants, contributors and other	57,269	50,067
Total public support and revenue	2,739,481	2,981,827
Expenses:		
Program services:		
Regular education	798,619	861,081
Special education	1,211,261	1,298,875
Management and general	586,147	642,677
Total expenses	2,596,027	2,802,633
Change in net assets	143,454	179,194
Net assets, beginning of year	322,046	142,852
Net assets, end of year	\$ 465,500	\$ 322,046

See accompanying notes to financial statements.

Child Development Center of the Hamptons Charter School, Inc.

Statement of Functional Expenses (with comparative totals for 2009)

Year ended June 30,

	Program services			Support services	Total	
	Regular education	Special education	Total	Management and general	2010	2009
Salaries and related expenses:						
Salaries	\$362,710	\$ 763,123	\$1,125,833	\$149,559	\$1,275,392	\$1,495,768
Payroll taxes and fringe benefits	114,756	241,440	356,196	48,444	404,640	426,435
Total salaries and related expenses	477,466	1,004,563	1,482,029	198,003	1,680,032	1,922,203
Other expenses:						
Contracted services	13,131	205,990	219,121	87,526	306,647	345,238
Rent	73,173	-	73,173	8,130	81,303	83,398
Supplies	35,693	708	36,401	10,970	47,371	61,231
Moving & storage	-	-	-	-	-	504
Equipment	994	-	994	-	994	726
Utilities	31,136	-	31,136	3,460	34,596	38,993
Travel	2,849	-	2,849	-	2,849	9,864
Advertising	39,740	-	39,740	2,374	42,114	5,281
Food	616	-	616	-	616	2,200
Maintenance	91,579	-	91,579	10,175	101,754	29,489
Telephone	4,100	-	4,100	456	4,556	4,468
Staff training	4,673	-	4,673	-	4,673	5,787
Printing	-	-	-	-	-	292
Insurance	7,147	-	7,147	-	7,147	11,635
Postage	-	-	-	3,086	3,086	4,904
Lease/rental equipment	16,322	-	16,322	-	16,322	15,382
Dues & subscriptions	-	-	-	750	750	1,568
Interest expense	-	-	-	21,184	21,184	44,058
Bank service charges	-	-	-	373	373	524
Payroll service charges	-	-	-	-	-	273
Miscellaneous	-	-	-	9,742	9,742	13,271
Management fees	-	-	-	164,996	164,996	128,956
Total expenses before depreciation and amortization	798,619	1,211,261	2,009,880	521,225	2,531,105	2,730,245
Depreciation and amortization	-	-	-	64,922	64,922	72,388
Total expenses	\$798,619	\$1,211,261	\$2,009,880	\$586,147	\$2,596,027	\$2,802,633

See accompanying notes to financial statements.

Child Development Center of the Hamptons Charter School, Inc.

Statement of Cash Flows (with comparative totals for 2009)

<i>Year ended June 30,</i>	2010	2009
Cash flows from operating activities:		
Change in net assets	\$ 143,454	\$ 179,194
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	64,922	72,388
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	126,917	111,270
Due from affiliates	121,926	(74,154)
Prepaid expenses	-	12,320
Increase (decrease):		
Accounts payable and accrued expenses	3,739	(195,538)
Accrued salaries and fringes	31,988	66,890
Due to affiliate	(402,734)	(50,649)
Net cash provided by operating activities	90,212	121,721
Cash flows from investing activities:		
Purchase of fixed assets	(14,928)	(38,108)
Cash flows from financing activities:		
Payments of loan payable	(12,882)	68,283
Net increase in cash and cash equivalents	62,402	151,896
Cash and cash equivalents, beginning of year	314,644	162,748
Cash and cash equivalents, end of year	\$ 377,046	\$ 314,644
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 21,184	\$ 44,058

See accompanying notes to financial statements.

Child Development Center of the Hamptons Charter School, Inc.

Notes to Financial Statements

- 1. Description of School**

Child Development Center of the Hamptons Charter School, Inc. (the “School”), an educational organization formed in 1999, is dedicated to providing parents and students with expanded choices in the types of educational opportunities that are available within the public school system and to improve student learning and achievement through the use of different and innovative teaching methods. All services are provided by New York State licensed and certified professionals, including special educators, speech pathologists, psychologists, social workers and physical and occupational therapists. The School is a New York State registered charity.

- 2. Summary of Significant Accounting Policies**

 - (a) Basis of Presentation*

The financial statements of the School have been prepared on the accrual basis.

In June 2009, the Financial Accounting Standards Board (the “FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles” (“Codification” or “ASC”) to become the source of authoritative U.S. generally accepted accounting principles (“U.S. GAAP”) recognized by the FASB to be applied by nongovernmental entities. All other accounting literature not included in the Codification will be considered nonauthoritative. The Codification does not change current U.S. GAAP. References to authoritative U.S. GAAP literature in the financial statements and the notes thereto have been updated to reflect new Codification references. Subsequent revisions to U.S. GAAP will be incorporated into the ASC through FASB Accounting Standards Update (“ASU”).

Child Development Center of the Hamptons Charter School, Inc.

Notes to Financial Statements

(b) *Financial Statement Presentation*

The classification of a not-for-profit organization's net assets and its support, revenue and expenses is based on the existence or absence of donor-imposed restrictions. It requires that the amounts for each of three classes of net assets, permanently restricted, temporarily restricted, and unrestricted, be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities.

These classes are defined as follows:

- (i) **Permanently Restricted** –Net assets resulting from contributions and other inflows of assets whose use by the School 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.
- (ii) **Temporarily Restricted**–Net assets resulting from contributions and other inflows of assets whose use by the School is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the School pursuant to those stipulations. When such stipulations end or are fulfilled, such temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities.
- (iii) **Unrestricted**–The part of net assets that is neither permanently nor temporarily restricted by donor-imposed stipulations.

(c) *Cash and Cash Equivalents*

The School considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents.

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(d) *Fixed Assets*

Fixed assets are stated at cost. The School capitalizes expenditures for additions, renewals and betterments. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Furniture and equipment	5-7 years
Building improvements	25 years

(e) *Contributions and Promises to Give*

Contributions and promises to give are recorded as revenue when either unsolicited cash is received or when donors make a promise to give. Contributions and promises to give are classified as either unrestricted, temporarily restricted, or permanently restricted support.

Contributions of property and services are recorded at the fair market value of the property and services at the time of contribution.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor.

(f) *Fair Value Measurements*

ASC 820, "Fair Value Measurements and Disclosures" (formerly SFAS No. 157, "Fair Value Measurements") establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that inputs that are most observable be used when available. Observable inputs are inputs that market participants operating within the same marketplace as the School would use in pricing the School's asset or liability based on independently derived and observable market data. Unobservable inputs are inputs that can not be sourced from a broad-active market in which assets or liabilities identical or similar are traded. The input hierarchy is broken down

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into three levels based on the degree to which the exit price is independently observable or determinable as follows:

Level 1 – Valuation based on quoted market prices in active markets for identical assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 – Valuation based on quoted market prices of investments that are not actively traded or for which certain significant inputs are not observable, either directly or indirectly.

Level 3 – Valuation based on inputs that are unobservable and reflect management's best estimate of what market participants would use as fair value.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of an input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

(g) *Third-party Reimbursement and Revenue Recognition*

The School receives substantially all its revenue for services provided to approved participants from third-party reimbursement primarily by the State Education Department of New York. These revenues are subject to audit and retroactive adjustment by the respective third-party fiscal intermediaries. In the opinion of management, retroactive adjustments, if any, would not be material to the financial position or results of operations of the School.

Revenue is recognized as earned from third parties and when promises to give are received for contributions, special events and fundraising activities.

Child Development Center of the Hamptons Charter School, Inc.

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(h) *Income Taxes*

The School is incorporated under a charter granted by the Board of Regents on behalf of the New York State Education Department and is exempt from Federal, state and local income taxes under Section 501(c)(3) of the Internal Revenue Code (the “IRC”) and, therefore, has made no provision for income taxes in the accompanying financial statements. In addition, the School has been determined by the Internal Revenue Service not to be a “private foundation” within the meaning of Section 509(a) of the IRC. There was no unrelated business income for 2010.

In addition, the School has not taken an uncertain tax position that would require provision of a liability under ASC 740, “Income Taxes”. See Note 2(i).

(i) *Accounting for Uncertainty in Income Taxes*

The School adopted the provisions of ASC 740, “Income Taxes” (relevant portions of which were previously addressed in FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”), and ASU 2009-06, “Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities”, on July 1, 2009. Under ASC 740, an organization must recognize the tax benefit associated with tax positions taken for tax return purposes when it is more likely than not the position will be sustained upon examination by a taxing authority. The School does not believe it has taken any material uncertain tax positions and, accordingly, it has not recorded any liability for unrecognized tax benefits. The School has filed for and received income tax exemptions in the jurisdictions where it is required to do so. Additionally, the School has filed Internal Revenue Service (“IRS”) Form 990 information returns, as required, and all other applicable returns in jurisdictions where so required. No interest or penalties were accrued as of July 1, 2009 as a result of adopting ASC 740. For the year ended June 30, 2010, there was no interest

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or penalties recorded or included in the statements of activities.

(j) *Use of Estimates*

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reported period. Actual results could differ from those estimates.

(k) *Comparative Financial Information*

The financial statements include certain prior year summarized comparative information. With respect to the statement of activities, the prior year information is presented in total, not by net asset class. With respect to the statement of functional expenses, the prior year expenses are presented by expense classification in total rather than functional category. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the School's financial statements for the year ended June 30, 2009 from which the summarized information was derived.

(l) *Reclassifications*

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation. These reclassifications have no effect on net assets or the operating results of the prior year.

(m) *Concentration of Credit Risk*

The financial instruments that potentially subject the School to concentration of credit risk consist primarily of cash and cash equivalent accounts in financial institutions which, from time to time, may exceed the Federal Depository Insurance Coverage ("FDIC") limit.

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- 3. Fixed Assets** The School's fixed assets consist of the following:

<i>June 30, 2010</i>	
Furniture and equipment	\$ 50,371
Computers	76,920
Leasehold improvements	1,519,143
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	1,646,434
Less: Accumulated depreciation	338,007
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	\$1,308,427

For the year ended June 30, 2010, depreciation expense was \$64,922.

- 4. Revenue Concentrations** During the year ended June 30, 2010, the School earned 98% of its revenue from the New York State Education Department.
- 5. Loan Payable** The School has a loan with the Marty and Dorothy Silverman Foundation. The loan bears a floating interest rate of the prime rate plus 3%. The loan is collateralized by any vouchers or receivables for the School. The total amount outstanding as of June 30, 2010 was \$300,000. The School incurred \$19,835 in related interest expense during the year ended June 30, 2010.

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- 6. Commitments** The School is obligated under a lease agreement for space occupied. The School has the option to renew certain leases upon expiration. The minimum future annual rental payments are as follows:

<i>Year ending June 30,</i>	
2011	\$123,077
2012	123,077
2013	123,077
2014	123,077
2015	41,026
	<hr/>
	\$533,334

- 7. Transactions with Related Parties** Services for the Underserved, Inc. (“SUS”) is the sole member of both the School and Child Development Center of the Hamptons, Inc. (“CDCH Preschool”). SUS is also related to the Child Development Center of the Hamptons Foundation for Special Children (“CDCH Foundation”) through common management. The School is affiliated with CDCH Preschool and CDCH Foundation. The School engaged in related party transactions with the aforementioned entities as follows:
- (a) SUS is reimbursed for costs incurred in managing the School. For the year ended June 30, 2010 these costs amounted to \$164,996.
 - (b) The amount due by the School to SUS was \$926,264 at June 30, 2010.
 - (c) In accordance with a facilities cost sharing agreement with CDCH Preschool, the School allocates approximately 34% of the facilities’ related costs to CDCH Preschool. Total expenses allocated to CDCH Preschool were \$163,041 for the year ended June 30, 2010.
 - (d) The amount due to the School from CDCH Preschool was \$10,865 at June 30, 2010.

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- (e) CDCH Foundation has a building lease agreement with the School. Under the terms of the lease agreement, the School is responsible for the base rent and all related costs of operating the leased building. The lease expired on October 19, 2009, with a renewable option to extend the lease for up to three additional five-year terms at monthly rent equal to the amount of CDCH Foundation's monthly mortgage obligation. Accordingly, on September 25, 2009, the School exercised the first option to renew the lease agreement with CDCH Foundation for an additional five years. The School's rental expense under this agreement was \$123,077 for the year ended June 30, 2010.

- 8. Subsequent Events** On September 1, 2010, SUS and Family Residences & Essential Enterprises, Inc. ("FREE") entered into an agreement that substitutes FREE for SUS as sole member of the School and CDCH Preschool. The agreement also provides that FREE replace SUS in its relationship with CDCH Foundation. The agreement with respect to CDCH Preschool closed on September 1, 2010, and the remaining parts of the agreement will close on the granting of certain regulatory approvals related to the School which are expected to be received in the fourth quarter of 2010. As consideration for the agreement, FREE will pay SUS the balances due to SUS by the School and CDCH Preschool at closing, subject to a ten-year promissory note of \$500,000 issued at prime plus 1.5%.

The School's management has performed subsequent event procedures through October 27, 2010, which is the date the financial statements were available to be issued and there were no other subsequent events requiring adjustment to the financial statements or disclosures as stated herein.



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

To the Board of Directors
Child Development Center of the
Hamptons Charter School, Inc.

We have audited the financial statements of Child Development Center of the Hamptons Charter School, Inc. (the “School”) as of and for the year ended June 30, 2010 and have issued our report thereon dated October 27, 2010. 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* 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 financing 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 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 over financial reporting that might be deficiencies, 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*.

This report is intended solely for the information and use of the audit committee, management, the Charter Schools Institute of the State University of New York and the State Education Department 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. However, this report is a matter of public record and its distribution is not limited.

BDO USA, LLP

Certified Public Accountants

New York, New York

October 27, 2010