

Harlem Prep Charter School

Independent Auditors' Report on Communication of
Internal Control Matters

June 30, 2017

Independent Auditors Communication on Internal Control Matters

The Board of Trustees Harlem Prep Charter School

In planning and performing our audit of the financial statements of Harlem Prep Charter School (the "School") as of and for the year ended June 30, 2017, 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 audit procedures that are appropriate in the circumstances 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.

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

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We have other observations and recommendations that are opportunities for strengthening internal control and/or operating efficiency, presented in Addendum A to this letter.

This communication is intended solely for the information and use of management, audit committee, board of Trustees, The Department of Education of the City of New York, The State Education Department of the State University of New York, and others within the School, and is not intended to be and should not be used by anyone other than these specified parties.

We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by the Personnel of the School during the course of our audit.

PKF O'Connor Davies, LLP

October 27, 2017

Addendum A

Other Observations and Recommendations for Strengthening Internal Control and/or Operating Efficiency

1. Credit Card Transactions

During our test of credit card transactions, we noted that a significant portion of charges were not supported by receipts or other supporting documentations, and missing approvals.

The School should support all credit card charges with receipts, invoices, or other backup documentation. The School should also enforce the approval process for credit charges by authorized School personnel. The School identified credit card reconciliation as an area for improvement. As a result, they launched Concur, an automated expense management system, effective July 1, 2017, which is integrated with their accounting software. The School also implemented a new policy whereby all credit card holders are responsible for reconciling their credit cards by no later than the 15th of the following month.

2. General Ledger Maintenance and Account Analysis

During our audit, we noted that although schedules were prepared during our audit field work, these schedules and reconciliations were not prepared and updated throughout the fiscal year. This resulted in various adjustments to the general ledger during the year end closing and preparation of the audit package, which delayed the start and completion of the audit. Although we noted improvements during our 2017 audit, we still encountered delays to the start of the audit because analysis of schedules and account reconciliations were not prepared and updated throughout the fiscal year.

Management should be analyzing accounts and reconciling with the general ledger on a monthly or quarterly basis. The School transitioned from their former accounting software into a more robust program equipped with an amortization and depreciation module and reconciliation of inter-company balances.

Harlem Prep Charter School

Financial Statements

June 30, 2017 and 2016

Independent Auditors' Report

Board of Trustees Harlem Prep Charter School

We have audited the accompanying financial statements of Harlem Prep Charter School (the "School"), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the School's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the School as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The summarized comparative financial statements as of June 30, 2016 and for the year then ended, were audited by other auditors who ceased operations. Those auditors expressed an unmodified opinion on those financial statements in their report dated October 31, 2016.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2017, 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 solely 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 effectiveness of the School's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control over financial reporting and compliance.

PKF O'Connor Davies, LLP

Harrison, New York
October 27, 2017

Harlem Prep Charter School

Statement of Financial Position
June 30, 2017

(with comparative amounts at June 30, 2016)

	2017	2016
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 3,740,505	\$ 4,765,631
Grants and contracts receivable	916,490	674,683
Prepaid expenses and other current assets	88,421	54,201
Total Current Assets	4,745,416	5,494,515
Property and equipment, net	3,050,504	1,866,128
Restricted cash	75,548	75,548
Security deposit	62,745	-
	\$ 7,934,213	\$ 7,436,191
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and accrued expenses	\$ 614,518	\$ 464,687
Accrued payroll and payroll taxes	605,504	381,052
Due to related parties	173,646	159,101
Capital lease obligation	91,011	32,750
Refundable advances	701	5,898
Total Current Liabilities	1,485,380	1,043,488
Deferred rent	712,535	235,395
Capital lease obligation, less current portion	297,595	6,213
Total Liabilities	2,495,510	1,285,096
Net Assets		
Unrestricted		
Undesignated	5,114,061	5,830,552
Board-designated	320,543	320,543
Total Unrestricted	5,434,604	6,151,095
Temporarily restricted	4,099	-
Total Net Assets	5,438,703	6,151,095
	\$ 7,934,213	\$ 7,436,191

See notes to financial statements

Harlem Prep Charter School

Statement of Activities
Year Ended June 30, 2017
(with summarized totals for the year ended June 30, 2016)

	2017			2016
	Unrestricted	Temporarily Restricted	Total	Total
REVENUE AND SUPPORT				
State and local per pupil operating revenue	\$ 12,702,132	\$ -	\$ 12,702,132	\$ 10,217,413
State and local per pupil facilities funding	276,683	-	276,683	-
Federal grants	735,784	-	735,784	543,341
State and city grants	63,219	-	63,219	42,445
Contributions and grants	4,500	6,000	10,500	25,700
Donated services	-	-	-	16,098
Interest and other income	2,607	-	2,607	95
Net assets released from restrictions	1,901	(1,901)	-	-
Total Revenue and Support	<u>13,786,826</u>	<u>4,099</u>	<u>13,790,925</u>	<u>10,845,092</u>
EXPENSES				
Program Services				
Regular education	10,260,658	-	10,260,658	8,122,348
Special education	1,901,726	-	1,901,726	1,069,046
Other program	3,174	-	3,174	4,075
Total Program Services	<u>12,165,558</u>	<u>-</u>	<u>12,165,558</u>	<u>9,195,469</u>
Supporting Services				
Management and general	2,337,759	-	2,337,759	1,584,633
Total Expenses	<u>14,503,317</u>	<u>-</u>	<u>14,503,317</u>	<u>10,780,102</u>
Change in Net Assets	(716,491)	4,099	(712,392)	64,990
NET ASSETS				
Beginning of year	<u>6,151,095</u>	<u>-</u>	<u>6,151,095</u>	<u>6,086,105</u>
End of year	<u>\$ 5,434,604</u>	<u>\$ 4,099</u>	<u>\$ 5,438,703</u>	<u>\$ 6,151,095</u>

See notes to financial statements

Harlem Prep Charter School

Statement of Functional Expenses

Year Ended June 30, 2017

(with summarized totals for the year ended June 30, 2016)

	2017				Management and General	Total	2016 Total
	Regular Education	Special Education	Other Program	Total			
Personnel Services Costs							
Administrative staff personnel	\$ -	\$ -	\$ -	\$ -	\$ 526,710	\$ 526,710	\$ 429,108
Instructional personnel	4,711,833	944,797	-	5,656,630	716,789	6,373,419	4,992,510
Non-instructional personnel	380,023	46,969	-	426,992	-	426,992	282,710
Total Salaries and Staff	5,091,856	991,766	-	6,083,622	1,243,499	7,327,121	5,704,328
Fringe benefits and payroll taxes	792,652	154,389	-	947,041	193,576	1,140,617	969,203
Retirement	155,193	30,228	-	185,421	37,899	223,320	179,953
Management fees	1,193,849	232,532	-	1,426,381	291,553	1,717,934	1,429,493
Donated legal services	-	-	-	-	-	-	16,098
Accounting/audit services	-	-	-	-	20,800	20,800	20,250
Other purchased/professional/consulting services	223,608	45,259	-	268,867	4,484	273,351	205,577
Building and land rent/lease	873,133	170,064	-	1,043,197	213,488	1,256,685	394,221
Repairs and maintenance	208,983	29,099	-	238,082	26,453	264,535	207,753
Insurance	73,432	10,225	-	83,657	9,294	92,951	72,905
Utilities	60,400	8,410	-	68,810	7,645	76,455	69,623
Supplies and materials	658,402	91,676	3,174	753,252	83,343	836,595	735,650
Equipment/furnishings	-	-	-	-	42,725	42,725	33,767
Staff development	209,581	42,572	-	252,153	13,278	265,431	137,992
Marketing/recruitment	17,154	3,485	-	20,639	-	20,639	32,558
Technology	118,697	16,527	-	135,224	15,025	150,249	103,427
Food services	15,907	3,231	-	19,138	428	19,566	27,986
Student services	9,882	-	-	9,882	-	9,882	2,620
Office expense	-	-	-	-	50,246	50,246	41,959
Depreciation and amortization	491,424	63,003	-	554,427	75,605	630,032	364,587
Other	66,505	9,260	-	75,765	8,418	84,183	30,152
Total	\$ 10,260,658	\$ 1,901,726	\$ 3,174	\$ 12,165,558	\$ 2,337,759	\$ 14,503,317	\$ 10,780,102

See notes to financial statements

Harlem Prep Charter School

Statement of Cash Flows
Year Ended June 30, 2017
(with summarized amounts for the year ended June 30, 2016)

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (712,392)	\$ 64,990
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation and amortization	630,032	364,587
Deferred rent	477,140	(27,354)
Changes in operating assets and liabilities		
Grants and contracts receivable	(241,807)	107,596
Prepaid expenses and other current assets	(34,220)	(51,310)
Security deposit	(62,745)	-
Accounts payable and accrued expenses	149,831	142,445
Accrued payroll and payroll taxes	224,452	41,757
Due to related parties	14,545	(1,132,462)
Refundable advances	(5,197)	(26,478)
Net Cash from Operating Activities	439,639	(516,229)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(1,353,089)	(320,306)
Restricted cash	-	(76)
Net Cash from Investing Activities	(1,353,089)	(320,382)
CASH FLOWS FROM FINANCING ACTIVITY		
Payments made on capital lease obligation	(111,676)	(30,558)
Net Change in Cash and Cash Equivalents	(1,025,126)	(867,169)
CASH AND CASH EQUIVALENTS		
Beginning of year	4,765,631	5,632,800
End of year	\$ 3,740,505	\$ 4,765,631
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	\$ 33,738	\$ 3,506
Supplemental Schedule of Noncash Investing and Financing Activities		
Computers and equipment acquired under capital leases	461,319	9,290

See notes to financial statements

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

1. Organization and Tax Status

Harlem Prep Charter School (the "School") is a New York State, not-for-profit educational corporation that was incorporated on May 14, 2001 to operate a charter school pursuant to Article 56 of the Education Law of the State of New York. The School was granted a provisional charter on May 14, 2001, valid for a term of five years and renewable upon expiration by the Board of Regents of the University of the State of New York. The Board of Regents approved and issued several renewals to the School's charter expiring on July 31, 2021. The Charter School offers parents a free alternative to the public school system as provided by the New York State Charter School law. The School offers classroom instruction and programs that encourage and foster creativity and team planning while meeting the New York State educational standards. Classes commenced in New York, in September 2001, and the School provided education to approximately 817 students in kindergarten through ninth grade during the 2016-2017 academic year.

The New York City Department of Education provides free lunches and transportation directly to some of the School's students. Such costs are not included in these financial statements. The School covers a portion of the cost of lunches for children not entitled to the free lunches.

Except for taxes that may be due for unrelated business income, the School is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and from state and local income taxes under comparable laws.

2. Summary of Significant Accounting Policies

Basis of Presentation and Use of Estimates

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly actual results could differ from those estimates.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

2. Summary of Significant Accounting Policies (*continued*)

Net Asset Presentation

Resources for various purposes are classified for accounting and reporting purposes into net asset categories established according to nature and purpose as follows:

Unrestricted - consist of resources available for the general support of the School's operations. Unrestricted net assets may be used at the discretion of the School's management and Board of Trustees. Board designated net assets was established by the Board of Trustees for the Dream Dollar Scholarship Fund which is a college scholarship fund for students who graduate from the School.

Temporarily Restricted - represent amounts restricted by donors for specific activities of the School or to be used at some future date. The School records contributions as temporarily restricted if they are received with donor stipulations that limit their use either through purpose or time restrictions. When a donor restriction expires, that is, when a time restriction ends or a purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, when restrictions on donor-restricted contributions are met in the same accounting period in which they are received, such amounts are reported as unrestricted net assets.

Permanently Restricted - consist of net assets that are subject to donor imposed restrictions that require the School to maintain them permanently, including funds that are subject to restrictions of gift instruments requiring that the principal be invested in perpetuity and the income be used for specific or general purposes. Income and gains earned on endowment fund investments are available to be used in the unrestricted or temporarily restricted net asset classes based upon stipulations by the donors.

The School had no permanently restricted net assets at June 30, 2017 and 2016.

Cash and Cash Equivalents

Cash and cash equivalents include cash balances held in bank accounts and highly liquid financial instruments with maturities of three months or less at the time of purchase.

Restricted Cash

Under the provisions of its charter, the School established an escrow account to pay for legal and audit expenses that would be associated with a dissolution should it occur.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

2. Summary of Significant Accounting Policies (*continued*)

Property and Equipment

The School follows the practice of capitalizing all expenditures for property and equipment with costs in excess of \$1,000 and a useful life in excess of one year. Leasehold improvements are amortized over the shorter of the term of the lease, inclusive of all renewal periods, which are reasonably assured, or the estimated useful life of the asset. Purchased property and equipment are recorded at cost at the date of acquisition. Minor costs of maintenance and repairs are expensed as incurred. All property and equipment purchased with government funding is capitalized, unless the government agency retains legal title to such assets, whereby such assets are expensed as incurred.

Depreciation and amortization is recognized on the straight-line method over the estimated useful lives of such assets as follows:

Computers and equipment	3 and 5 years
Furniture and fixture	3 and 5 years

Property and equipment are reviewed for impairment if the use of the asset significantly changes or another indicator of possible impairment is identified. If the carrying amount for the asset is not recoverable, the asset is written down to the fair value. There were no asset impairments for the years ended June 30, 2017 and 2016.

Refundable Advances

The School records certain government operating revenue as refundable advances until related services are performed, at which time they are recognized as revenue.

Revenue and Support

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 other state and local funds are recorded when expenditures are incurred and billable to the government agency.

Contributions are recognized when the donor makes a promise to give to the School that is, in substance, unconditional. Grants and other contributions of cash are reported as temporarily restricted support if they are received with donor stipulations. Restricted contributions and grants that are made to support the School's current year activities are recorded as unrestricted revenue. Contributions of assets other than cash are recorded at their estimated fair value at the date of donation.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

2. Summary of Significant Accounting Policies *(continued)*

Functional Expense Allocation

The majority of expenses can generally be directly identified with the program or supporting service to which they relate and are charged accordingly. Other expenses by function have been allocated among program and supporting services classifications on the basis of periodic time and expense studies and other basis as determined by management of the School to be appropriate.

Accounting for Uncertainty in Income Taxes

The School recognizes the effect of income tax positions only if those positions are more likely than not to be sustained. Management has determined that the School had no uncertain tax positions that would require financial statement recognition or disclosure. The School is no longer subject to examinations by the applicable taxing jurisdictions for years prior to June 30, 2014.

Prior Year Summarized Comparative Financial Information

The financial statements include prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with the School's financial statements for the year ended June 30, 2016, from which the summarized information was derived.

Subsequent Events Evaluation by Management

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which date is October 27, 2017.

Effective July 1, 2017, The School, Democracy Preparatory Charter School and Democracy Preparatory Harlem Charter School merged into a single legal entity under Bronx Preparatory Charter School. The School, Democracy Preparatory Charter School and Democracy Preparatory Harlem Charter School were dissolved and ceased to exist as legal entities in conjunction with the merger effective date. The plan of merger was approved by the New York State Board of Regents on April 4, 2017.

3. Grants and Contracts Receivable

Grants and contracts receivable consists of federal, state, and city entitlements and grants. The School expects to collect these receivables within one year.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

4. Property and Equipment

Property and equipment consists of the following at June 30:

	<u>2017</u>	<u>2016</u>
Computers and equipment	\$ 1,741,274	\$ 1,115,552
Furniture and fixtures	435,102	278,993
Leasehold improvements	6,127,601	6,117,200
Construction in progress	<u>1,022,175</u>	<u>-</u>
	9,326,152	7,511,745
Accumulated depreciation and amortization	<u>(6,275,648)</u>	<u>(5,645,617)</u>
	<u>\$ 3,050,504</u>	<u>\$ 1,866,128</u>

Construction in progress at June 30, 2017 consists of build out costs associated with the facility lease entered into on September 1, 2016 (Note 9) and is projected to be completed in August 2018.

5. Related Party Transactions (not disclosed elsewhere)

Harlem Prep Charter School (“HPCS”) is affiliated with five charter schools: Democracy Preparatory Charter School (“DPCS”), Democracy Preparatory Harlem Charter School (“DPH”), Democracy Prep Endurance Charter School (“DPE”), and Bronx Preparatory Charter School (“BPCS”), all New York State not-for-profit organizations. Democracy Prep Congress Heights (“DPCH”) is a Washington, DC not-for-profit organization. All are managed by Democracy Prep Public School (“DPPS”).

The School is an affiliate of DPPS, a New York State not-for-profit charter management organization. The School entered into a management agreement with DPPS to assume responsibility for the School’s educational process, management, and operations. As compensation to DPPS for these services rendered, the School shall pay to DPPS an annual fee equal to 15% of the School’s non-competitive public revenue in the initial term. The initial term is for two years beginning July 1, 2011 and ending June 30, 2013. The percentage will decrease by one-half percent (0.5%) in each renewal term until it reaches a minimum of 12% of the non-competitive public revenue of the School and will remain in effect for all subsequent renewal terms. Following the initial term, the agreement will automatically extend for successive one-year periods unless terminated by either party. The percentage will decrease by one-half percent (0.5%) in each renewal term until it reaches a minimum of 12% of the non-competitive public revenue of the School and will remain in effect for all subsequent renewal terms. Following the initial term, the agreement will automatically extend for successive one-year periods unless terminated by either party. For the years ended June 30, 2017 and 2016, DPPS charged an annual management fee to the School of 13% and 13.5%. For the years ended June 30, 2017 and 2016, the School incurred \$1,717,934 and \$1,429,493 in management fees.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

5. Related Party Transactions (not disclosed elsewhere) (continued)

For operational efficiency and purchasing power, the School shares expenses with the related charter schools and charter management organization. The net balance due from (to) related parties consists of the following at June 30:

	2017	2016
DPCS	\$ (74,587)	\$ (32,710)
DPH	(349)	(1,668)
DPE	24,023	-
DPPS	(122,733)	(124,723)
Net balance due (to) related parties	<u>\$ (173,646)</u>	<u>\$ (159,101)</u>

6. Concentration of Credit Risk

Financial instruments that potentially subject the School to concentrations of credit and market risk consist principally of cash and cash equivalents on deposit with financial institutions, which from time to time may exceed the Federal Deposit Insurance Corporation ("FDIC") limit. The School does not believe that a significant risk of loss due to the failure of a financial institution presently exists. As of June 30, 2017, approximately \$1,700,000 of cash was maintained with an institution in excess of FDIC limits.

7. Concentration of Revenue and Support

The School receives a substantial portion of its support and revenue from the New York City Department of Education. For the years ended June 30, 2017 and 2016, the school received approximately 94% of total revenue and support from the New York City Department of Education. If the charter school laws were modified, reducing or eliminating these revenues, the School's finances could be materially adversely affected.

8. Temporarily Restricted Net Assets

Temporarily restricted net assets of \$4,099 at June 30, 2017 were restricted for the Korean dual language program. \$1,901 of net assets were released from the same restriction for the year ended June 30, 2017.

9. Commitments

On June 4, 2001, the School entered into a non-cancelable operating lease for office and instructional space that expired on June 30, 2011, with a renewal option for an additional 5 years. The School exercised its option until June 30, 2016. During fiscal year 2017, the lease was renewed for another 5 years expiring on June 30, 2021.

On June 1, 2005, the School entered into a non-cancelable operating lease for additional office and instructional space expiring on June 30, 2021, with a renewal option for an additional 10 years.

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

9. Commitments *(continued)*

On September 1, 2016, the School entered into a non-cancelable operating lease for additional office and instructional space expiring on June 29, 2047.

The future minimum lease payments under the operating leases are as follows for the year ending June 30:

2018	\$ 1,323,518
2019	1,377,206
2020	1,396,842
2021	1,396,842
2022	953,433
Thereafter	<u>26,559,747</u>
	<u>\$ 33,007,588</u>

Rent expense under the leases was \$1,253,468 and \$393,371 for the years ended June 30, 2017 and 2016.

10. Capital Lease Obligation

The School leases computers and equipment under capital leases that expire at various dates through June 2021. The asset and liability under the capital lease are recorded at the present value of the minimum lease payments. The asset is being depreciated over its estimated useful life.

Following is a summary of property and equipment held under capital lease:

	<u>2017</u>	<u>2016</u>
Computers and Equipment	\$ 555,088	\$ 93,769
Accumulated Depreciation	<u>(239,494)</u>	<u>(54,465)</u>
	<u>\$ 315,594</u>	<u>\$ 39,304</u>

The future minimum lease payments are as follows:

Year ending June 30,	2018	\$ 117,185
	2019	111,351
	2020	111,054
	2021	<u>111,055</u>
Total minimum lease payments		450,645
Amounts representing interest		<u>(62,039)</u>
Present value of minimum lease payments		388,606
Current portion		<u>(91,011)</u>
Capital lease obligation, less current portion		<u>\$ 297,595</u>

Harlem Prep Charter School

Notes to Financial Statements
June 30, 2017 and 2016

11. Donated Services

Donated services are recognized as contributions in accordance with FASB ASC 958-605, "Accounts for Contributions Received and Contributions Made," if the services (a) create or enhance non-financial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by the School, and (c) are measurable.

Two entities provided legal services to the School at no charge. The value of these services meets the criteria for recognition in the financial statements and was recorded at fair value of \$0 and \$16,098 for the years ended June 30, 2017 and 2016.

12. Employee Benefit Plan

The School maintains a retirement plan qualified under Internal Revenue Code 403(b) for the benefit of its eligible employees. Under the plan, the School provided matching contributions up to 5% of the participant's annual compensation. Employer match for the years ended June 30, 2017 and 2016 amounted to \$222,603 and \$177,583 for the years ended June 30, 2017 and 2016.

13. Contingency

Certain grants and contracts may be subject to audit by the funding sources. Such audits might result in disallowances of costs submitted for reimbursements. 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.

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*

Independent Auditors' Report

**Board of Trustees
Harlem Prep Charter School**

We have audited, in accordance with the 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, the financial statements of Harlem Prep Charter School (the "School"), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 27, 2017

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the School's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free from 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 27, 2017.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the School's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PKF O'Connor Davies, LLP
Harrison, New York
October 27, 2017

Harlem Prep Charter School

Independent Auditors' Report on Communication of
Internal Control Matters

June 30, 2017

Independent Auditors Communication on Internal Control Matters

The Board of Trustees Harlem Prep Charter School

In planning and performing our audit of the financial statements of Harlem Prep Charter School (the "School") as of and for the year ended June 30, 2017, 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 audit procedures that are appropriate in the circumstances 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.

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

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We have other observations and recommendations that are opportunities for strengthening internal control and/or operating efficiency, presented in Addendum A to this letter.

This communication is intended solely for the information and use of management, audit committee, board of Trustees, The Department of Education of the City of New York, The State Education Department of the State University of New York, and others within the School, and is not intended to be and should not be used by anyone other than these specified parties.

We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by the Personnel of the School during the course of our audit.

PKF O'Connor Davies, LLP

October 27, 2017

Addendum A

Other Observations and Recommendations for Strengthening Internal Control and/or Operating Efficiency

1. Credit Card Transactions

During our test of credit card transactions, we noted that a significant portion of charges were not supported by receipts or other supporting documentations, and missing approvals.

The School should support all credit card charges with receipts, invoices, or other backup documentation. The School should also enforce the approval process for credit charges by authorized School personnel. The School identified credit card reconciliation as an area for improvement. As a result, they launched Concur, an automated expense management system, effective July 1, 2017, which is integrated with their accounting software. The School also implemented a new policy whereby all credit card holders are responsible for reconciling their credit cards by no later than the 15th of the following month.

2. General Ledger Maintenance and Account Analysis

During our audit, we noted that although schedules were prepared during our audit field work, these schedules and reconciliations were not prepared and updated throughout the fiscal year. This resulted in various adjustments to the general ledger during the year end closing and preparation of the audit package, which delayed the start and completion of the audit. Although we noted improvements during our 2017 audit, we still encountered delays to the start of the audit because analysis of schedules and account reconciliations were not prepared and updated throughout the fiscal year.

Management should be analyzing accounts and reconciling with the general ledger on a monthly or quarterly basis. The School transitioned from their former accounting software into a more robust program equipped with an amortization and depreciation module and reconciliation of inter-company balances.