YES Prep Public Schools, Inc.

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2019 and 2018

YES Prep Public Schools, Inc.

Table of Contents

Independent Auditors' Report

To the Board of Directors of
YES Prep Public Schools, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of YES Prep Public Schools, Inc. (YES Prep), which comprise the consolidated statements of financial position as of June 30, 2019 and 2018 and the related consolidated statements of activities and of cash flows for the years then ended, the related consolidated statement of functional expenses for the year ended June 30, 2019 with comparative totals for the year ended June 30, 2018, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform our audits 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 entity'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 entity'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 consolidated financial position of YES Prep as of June 30, 2019 and 2018 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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Adoption of New Accounting Standard

As discussed in Note 2 to the financial statements, YES Prep adopted the amendments of Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities,* as of and for the year ended June 30, 2019. These amendments have been applied on a retrospective basis to the financial statements as of and for the year ended June 30, 2018. Our opinion is not modified with respect to this matter.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2019 on our consideration of YES Prep'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 YES Prep'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 YES Prep's internal control over financial reporting and compliance.

Blazek & Vetterling

November 18, 2019

YES Prep Public Schools, Inc.

Consolidated Statements of Financial Position as of June 30, 2019 and 2018

	2019	2018
ASSETS		
Current assets:		
Cash and cash equivalents *(Notes 4 and 7)*	$ 34,381,817	$ 31,582,908
Receivables:		
Government agencies	22,532,329	22,467,184
Contributions receivable	1,050,740	829,208
Other	229,041	1,554,272
Beneficial interest in charitable trust	250,000	250,000
Prepaid expenses and other assets	1,777,815	1,025,282
Total current assets	60,221,742	57,708,854
Contributions receivable, net *(Note 5)*	697,335	424,667
Beneficial interest in charitable trust	1,505,501	1,674,262
Note receivable *(Note 6)*	10,422,800	10,422,800
Cash restricted for capital projects *(Note 4)*	1,800,639	6,941,457
Bond sinking fund investments *(Note 7)*	20,755,552	17,519,390
Property and equipment, net *(Note 8)*	153,547,303	133,323,373
TOTAL ASSETS	$ 248,950,872	$ 228,014,803
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	$ 3,552,524	$ 2,277,180
Accrued payroll expenses	9,234,179	9,776,001
Construction payable	2,162,455	4,650,106
Accrued interest	988,482	839,339
Current portion of bonds payable *(Note 9)*	1,546,667	1,546,667
Current portion of notes payable *(Note 9)*	4,233,751	2,856,774
Total current liabilities	21,718,058	21,946,067
Bonds payable, net *(Note 9)*	66,222,702	67,652,597
Notes payable, net *(Note 9)*	45,350,609	35,874,380
Total liabilities	133,291,369	125,473,044
Minority interest in YES Prep Holdings, Inc.	2,594	2,594
Commitments and contingencies *(Note 11)*		
Net assets:		
Without donor restrictions	82,517,956	77,872,574
With donor restrictions *(Note 10)*	33,138,953	24,666,591
Total net assets	115,656,909	102,539,165
TOTAL LIABILITIES AND NET ASSETS	$ 248,950,872	$ 228,014,803

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statement of Activities for the year ended June 30, 2019

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
OPERATING REVENUE:			
Government grants *(Note 12)*		$ 127,688,940	$ 127,688,940
Contributions	$ 848,752	7,161,514	8,010,266
Program service fees	15,429,122		15,429,122
Special events	2,339,526		2,339,526
Cost of direct donor benefits	(222,996)		(222,996)
Interest income *(Note 9)*	1,391,248		1,391,248
Other	41,519		41,519
Total operating revenue	19,827,171	134,850,454	154,677,625
Net assets released from restrictions:			
Program expenditures	123,124,860	(123,124,860)	
Capital expenditures	3,193,232	(3,193,232)	
Expiration of time restrictions	60,000	(60,000)	
Total	146,205,263	8,472,362	154,677,625
OPERATING EXPENSES:			
Program expenses:			
Instructional program	111,856,711		111,856,711
Auxiliary services	17,341,264		17,341,264
Total program expenses	129,197,975		129,197,975
General and administrative	11,489,941		11,489,941
Fundraising	871,965		871,965
Total operating expenses	141,559,881		141,559,881
CHANGES IN NET ASSETS	4,645,382	8,472,362	13,117,744
Net assets, beginning of year	77,872,574	24,666,591	102,539,165
Net assets, end of year	$ 82,517,956	$ 33,138,953	$ 115,656,909

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statement of Activities for the year ended June 30, 2018

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
OPERATING REVENUE:			
Government grants *(Note 12)*		$ 116,584,396	$ 116,584,396
Contributions	$ 1,730,202	9,946,341	11,676,543
Program service fees	14,437,439		14,437,439
Special events	1,288,985		1,288,985
Cost of direct donor benefits	(137,455)		(137,455)
Interest income *(Note 9)*	1,084,793		1,084,793
Other	47,911		47,911
Total operating revenue	18,451,875	126,530,737	144,982,612
Net assets released from restrictions:			
Program expenditures	117,375,208	(117,375,208)	
Capital expenditures	1,629,000	(1,629,000)	
Expiration of time restrictions	170,000	(170,000)	
Total	137,626,083	7,356,529	144,982,612
OPERATING EXPENSES:			
Program expenses:			
Instructional program	100,718,275		100,718,275
Auxiliary services	15,585,281		15,585,281
Ancillary services – Harvey assistance	4,295,192		4,295,192
Total program expenses	120,598,748		120,598,748
General and administrative	10,445,000		10,445,000
Fundraising	759,593		759,593
Total operating expenses	131,803,341		131,803,341
CHANGES IN NET ASSETS	5,822,742	7,356,529	13,179,271
Net assets, beginning of year *(Note 2)*	72,049,832	17,310,062	89,359,894
Net assets, end of year	$ 77,872,574	$ 24,666,591	$ 102,539,165

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statement of Functional Expenses for the year ended June 30, 2019 with comparative totals for the year ended June 30, 2018

	INSTRUCTIONAL PROGRAM	AUXILIARY SERVICES	TOTAL PROGRAM EXPENSES	GENERAL AND ADMINISTRATIVE	FUNDRAISING	2019 TOTAL	2018 TOTAL
Salaries and related costs	$ 83,104,039	$ 3,081,288	$ 86,185,327	$ 8,722,495	$ 487,506	$ 95,395,328	$ 87,141,279
Materials and supplies	7,525,159	945,292	8,470,451	499,516	51,501	9,021,468	12,674,598
Contracted transportation services	563,830	7,005,764	7,569,594	11,584	5	7,581,183	7,345,491
Depreciation	5,392,937	354,426	5,747,363	260,394	19,891	6,027,648	4,940,605
Professional fees and other contracted services	2,801,442	1,238,307	4,039,749	1,025,389	222,486	5,287,624	4,333,055
Maintenance and repairs	4,541,047	320,499	4,861,546	218,182	16,749	5,096,477	5,298,436
Contracted food services	211,197	3,570,324	3,781,521	106,604	37,724	3,925,849	3,634,954
Utilities and occupancy	2,844,756	272,468	3,117,224	131,666	12,216	3,261,106	2,426,477
Travel	1,830,785	378,626	2,209,411	270,441	12,984	2,492,836	1,510,707
Interest, debt service and bank fees	1,952,528	128,321	2,080,849	94,277	7,201	2,182,327	1,726,135
Insurance	691,037	45,415	736,452	79,713	2,549	818,714	340,751
Other	397,954	534	398,488	69,680	1,153	469,321	430,853
Total expenses	$ 111,856,711	$ 17,341,264	$ 129,197,975	$ 11,489,941	$ 871,965	141,559,881	131,803,341
Cost of direct donor benefits						222,996	137,455
Total						$ 141,782,877	$ 131,940,796

See accompanying notes to consolidated financial statements.

YES Prep Public Schools, Inc.

Consolidated Statements of Cash Flows for the years ended June 30, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ 13,117,744	$ 13,179,271
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(5,223,765)	(3,336,000)
Depreciation	6,027,648	4,940,841
Amortization of bond and notes payable issuance costs	309,869	147,592
Changes in operating assets and liabilities:		
Receivables	1,232,554	(5,790,631)
Prepaid expenses and other assets	(752,533)	(629,481)
Beneficial interest in charitable trust	168,761	212,500
Accounts payable and accrued expenses	733,522	978,072
Accrued interest	149,143	43,950
Net cash provided by operating activities	15,762,943	9,746,114
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(28,739,229)	(14,793,601)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in bond sinking fund investments	(3,236,162)	(3,129,965)
Capitalized bond and notes payable issuance costs	(413,218)	(294,776)
Proceeds from bonds and notes payable	13,179,514	14,728,355
Principal repayments of bonds and notes payable	(3,652,854)	(3,696,460)
Proceeds from contributions restricted for expansion of facilities	4,757,097	3,970,000
Net cash provided by financing activities	10,634,377	11,577,154
NET CHANGE IN CASH AND CASH EQUIVALENTS	(2,341,909)	6,529,667
Cash and cash equivalents, beginning of year	38,524,365	31,994,698
Cash and cash equivalents, end of year	$ 36,182,456	$ 38,524,365

	2019	2018
Reconciliation of cash balance:		
Cash and cash equivalents	$ 34,381,817	$ 31,582,908
Cash and cash equivalents restricted for capital projects	1,800,639	6,941,457
Total cash and cash equivalents	$ 36,182,456	$ 38,524,365

	2019	2018
Supplemental disclosure of cash flow information:		
Interest payments	$1,816,062	$1,489,102
Property and equipment acquired with bond proceeds		$9,441,647

See accompanying notes to consolidated financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – YES Prep Public Schools, Inc. (YES Prep) operates sixteen Texas Open-Enrollment Charter Schools under one state charter. The schools are located in Houston, Texas and serve approximately 13,000 students from 6^{th} through 12^{th} grade. Additionally, YES Prep operates two schools within Spring Branch Independent School District and two schools within Aldine Independent School District on a contract basis. These partnerships (Partnerships) are conducted outside of YES Prep's charter.

YES Prep Facilities, LLC (Facilities) was created in 2013 to operate buildings on YES Prep's Fifth Ward and Northside campuses and to construct improvements on those buildings. Facilities lease the buildings to YES Prep. Facilities hold New Markets Tax Credit debt incurred to improve the buildings. YES Prep owns 99% of Facilities. The remaining 1% interest is owned by YES Prep Holdings, Inc., a Texas non-profit corporation that is not under the control of YES Prep. The 1% interest owned by YES Prep Holdings, Inc. is reported as a minority interest on the consolidated statements of financial position of YES Prep.

Basis of consolidation – These financial statements include the assets, liabilities, net assets and activities of YES Prep Public Schools, Inc. and Facilities (collectively YES Prep). All balances and transactions between the consolidated entities have been eliminated.

Federal income tax status – YES Prep is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(1) and §170(b)(1)(A)(ii).

Cash equivalents include highly liquid investments with original maturities of three months or less.

Government grants and contributions receivable that are expected to be collected within one year are reported at net realizable value. Amounts expected to be collected in future years are discounted to estimate the present value of future cash flows. An allowance for uncollectible contributions receivable is provided when it is believed balances may not be collected in full. The adequacy of the allowance at the end of each period is determined using a combination of historical loss experience and donor-by-donor analysis of receivable balances each period.

Beneficial interest in charitable trust – YES Prep is the beneficiary of an irrevocable charitable trust that is reported at the fair value of the underlying assets. The purpose of the gift is to provide college scholarships to YES Prep graduates who attend out-of-state colleges. The inputs used to measure fair value are considered to fall within Level 3 of the fair value hierarchy.

Property and equipment is reported at cost if purchased or at fair value at the date of gift if donated. YES Prep recognizes depreciation using the straight-line method over the estimated useful lives of the assets, which range from 5 to 40 years for buildings and improvements and 2 to 12 years for furniture and equipment. YES Prep capitalizes additions and improvements that have a cost of more than $5,000.

Net asset classification – Net assets, revenue, gains, and losses are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Net assets without donor restrictions* are not subject to donor-imposed restrictions even though their use may be limited in other respects such as by contract or board designation.
- *Net assets with donor restrictions* are subject to donor-imposed restrictions. Restrictions may be temporary in nature, such as those that will be met by the passage of time or use for a purpose specified by the donor, or may be perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Net assets are released from restrictions when the stipulated time has elapsed, or purpose has been fulfilled, or both. Contributions of long-lived assets and of assets restricted for acquisition of long-lived assets are released when those assets are placed in service. Donor-restricted endowment earnings are released when those earnings are appropriated in accordance with spending policies and are used for the stipulated purpose.

Grants and contributions are recognized at fair value when an unconditional commitment is received from the donor. Grants and contributions received with donor stipulations that limit their use are classified as with donor restrictions. Conditional grants and contributions are recognized when the conditions are met. Funding received before conditions are met is reported as refundable grants and contributions.

Program service fees are recognized in the period in which services are provided.

Donated materials, use of facilities and services – Donated materials and use of facilities are recognized at fair value when an unconditional commitment is received from the donor. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

Functional allocation of expenses – Expenses are reported by their functional classification as program services or supporting activities. Program services are the direct conduct or supervision of activities that fulfill the purposes for which the organization exists. Fundraising activities include the solicitation of contributions of money, securities, materials, facilities, other assets, and time. Management and general activities are not directly identifiable with specific program or fundraising activities. Expenses that are attributable to more than one program or supporting activity are allocated among the activities benefitted. Salaries and related costs are allocated on the basis of estimated time and effort expended. Depreciation of building and improvements, maintenance and repairs, utility and occupancy costs and interest and debt service costs are allocated based on square footage.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

Recent financial accounting pronouncements – In June 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this ASU clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction and provide additional guidance on determining whether a contribution is conditional or unconditional. This ASU could impact the timing of revenue recognition and the financial statement disclosures related to such transactions. YES Prep is required to apply the amendments in its June 30, 2020 financial statements. The amendments should be applied on a modified prospective basis, but retrospective application also is permitted. Management has not determined the eventual method of adoption of the ASU or the impact on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under this ASU, a lessee should recognize in the statement of financial position a lease liability and a lease asset representing its right to use the underlying asset for the term of the lease for both finance and operating leases. An entity may make an accounting policy election not to recognize lease assets and lease liabilities for leases with a term of 12 months or less. Recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not changed significantly. Qualitative and quantitative disclosures are required by lessees and lessors to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The ASU is effective for fiscal periods beginning after December 15, 2019. YES Prep plans to adopt this ASU for fiscal year ending June 30, 2020, unless the FASB defers the requirement to adopt at a later period. Management has not yet determined the impact adoption of this ASU will have on the financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which replaces most existing revenue recognition guidance for exchange transactions not specifically covered by other guidance. This ASU does not apply to non-exchange transactions such as contributions. The core principle of the new guidance is that an entity should recognize revenue in an amount that reflects the consideration to which it expects to be entitled in exchange for transferred goods or services and establishes a 5-step process to determine when performance obligations are satisfied and revenue is recognized. YES Prep is required to adopt this ASU for fiscal year 2020 using an appropriate retrospective method. YES Prep has not yet determined the impact of adopting this ASU on its financial statements.

NOTE 2 – ADOPTION OF ACCOUNTING STANDARDS UPDATES 2016-14 AND 2016-18

YES Prep adopted the amendments of ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities,* as of and for the year ended June 30, 2019. These amendments have been applied on a retrospective basis to the financial statements for the year ended June 30, 2018, except that presenting expenses by both nature and function and information regarding liquidity and availability of resources has been omitted as permitted by the ASU. Adoption of this ASU resulted in reclassification of previously reported activities and net assets to conform to the 2019 presentation but had no impact on total net assets or total changes in net assets for 2018.

During 2019, YES Prep also adopted ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires the statement of cash flows to explain the change in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Prior to adoption, board-designated cash was excluded from beginning and ending cash in the statement of cash flows. The statement of financial position and the statement of cash flows for the year ended June 30, 2018 was restated to reflect the retrospective adoption. This change had no impact on net assets or changes in net assets.

NOTE 3 – LIQUIDITY AND AVAILABILITY OF RESOURCES

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of June 30, 2019 comprise the following:

Financial assets at June 30, 2019:	
Cash and cash equivalents	$ 36,182,456
Receivables, net	24,509,445
Bond sinking funds	20,755,552
Beneficial interest in charitable trust	1,755,501
Total financial assets	83,202,954
Less financial assets not available for general expenditure:	
Bond sinking funds	(20,755,552)
Cash and cash equivalents, contributions restricted and designated for long-term purposes	(5,179,762)
Beneficial interest in charitable trust, net of current portion	(1,505,501)
Restricted by donors for use in future periods or for future projects, net of expected amount to be satisfied in coming year	(14,000)
Total financial assets available for general expenditure	$ 55,748,139

YES Prep relies on state and federal grants and program fees from agreements with local public school districts to meet general expenditures related to operations. For purposes of analyzing resources available to meet general expenditures over a 12-month period, YES Prep considers all expenditures related to its ongoing activities of instructional program and auxiliary services, excluding capital and debt repayments, as well as the conduct of services undertaken to support these activities, to be general expenditures. See Note 9 for bond sinking fund requirements.

As part of YES Prep's liquidity management, financial assets have been structured to be available as its general expenditures, liabilities, and other obligations become due by maintaining a significant portion of its assets in cash. To help manage unanticipated liquidity needs, YES Prep has committed lines of credit of $5 million, of which none has been drawn upon at June 30, 2019.

NOTE 4 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	2019	2018
Demand deposits	$ 7,050,241	$ 20,343,873
TexPool, TexSTAR and LOGIC investment pools	29,132,215	18,180,492
Total cash and cash equivalents	$ 36,182,456	$ 38,524,365

Bank deposits exceed the federally insured limit per depositor per institution and approximately $1.4. million was not collateralized by a security agreement with a bank at June 30, 2019.

NOTE 5 – CONTRIBUTIONS RECEIVABLE

Contributions receivable are as follows:

	2019	2018
Government grants	$ 22,532,329	$ 22,467,184
Other contributions receivable	1,748,075	829,208
Contributions receivable restricted for capital expansion	(1,216,668)	(750,000)
Operating contributions receivable	$ 23,063,736	$ 22,546,392

Contributions receivable at June 30, 2019 are expected to be collected as follows:

Due within one year	$ 23,583,069
Due in one to five years	697,335
Total contributions receivable	$ 24,280,404

NOTE 6 – NOTE RECEIVABLE

In 2012, YES Prep loaned $10,422,800 to COCRF Investor XIV, LLC (COCRF Investor). The loan matures on November 1, 2042 and bears interest at 1.31%, which is paid quarterly. The loan is interest only for the first seven years, until October 2019. Simultaneous to YES Prep making the loan, Capital One Bank, NA (the Bank) invested $3,577,200 in COCRF Investor, which in turn placed these combined funds as equity in the form of a Qualified Equity Investment under Section 45D of the Internal Revenue Code of 1986, as amended, into COCRF SubCDE XIV, LLC (COCRF CDE) and New Markets Investment 71, LLC (NMI 71). The loan from YES Prep to COCRF Investor is secured by COCRF Investor's interests in COCRF CDE and NMI 71. COCRF CDE and NMI 71 made loans to Facilities in the form of New Markets Tax Credit Qualified Low-Income Community Investments under Section 45D of the Internal Revenue Code of 1986, as amended, for the construction of YES Prep Fifth Ward and YES Prep Northside. Interest totaling $136,641 was earned on the note for the years ended June 30, 2019 and 2018.

Put and Call Options

The Bank holds a put option on its investment in COCRF Investor, whereby it may sell its ownership to YES Prep at a prearranged price ($178,860) during the six-month period commencing October 11, 2019 (the Put Option Period).

YES Prep holds a call option on the Bank's investment, whereby it may purchase the Bank's interest in COCRF Investor if the Put Option Period expires and the Bank does not exercise its put option. The call option may be exercised during the six months immediately following the expiration of the Put Option Period. If YES Prep exercises its call option, the Bank is obligated to sell its investment interest in COCRF Investor to YES Prep at the then determined market value of the Bank's interest in COCRF Investor.

NOTE 7 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity's assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at June 30, 2019 consist of the following:

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Cash equivalents held as investments:				
Pooled funds held in TexPool, LOGIC and TexSTAR	$ 29,132,215			$ 29,132,215
Repurchase agreements for bond sinking fund		$ 20,755,552		20,755,552
Total assets reported at fair value	$ 29,132,215	$ 20,755,552	$ 0	$ 49,887,767

Assets measured at fair value at June 30, 2018 consist of the following:

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
Cash equivalents held as investments:				
Pooled funds held in TexPool, LOGIC and TexSTAR	$ 18,180,492			$ 18,180,492
Repurchase agreements for bond sinking fund		$ 17,519,390		17,519,390
Total assets reported at fair value	$ 18,180,492	$ 17,519,390	$ 0	$ 35,699,882

Valuation methods used for assets measured at fair value are as follows:

- *TexPool* and *LOGIC* operate in a manner consistent with SEC Rule 2a-7 of the Investment Company Act of 1940, and fully comply with the Texas Public Funds Investment Act, Chapter 2256 of the Texas Government Code. These investment pools primarily include short term marketable securities and use amortized cost rather than market value to report net assets and to compute share prices. Accordingly, the fair value of the positions in TexPool and LOGIC are the same value as the number of shares owned.
- *TexSTAR* conforms with the Interlocal Cooperation Act, Chapter 791 of the Texas Government Code and the Texas Public Funds Investment Act, Chapter 2256 of the Texas Government Code. TexSTAR is a cash reserve fund that invests in low risk securities; it uses the fair value method to report net position and to compute share prices.
- *Repurchase agreements* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas which may include market-corroborated inputs for credit risk factors, interest rate and yield curves and broker quotes, to calculate fair values.

These valuation methods may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

Investments are exposed to various risks such as interest rate, market, and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

NOTE 8 – PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	2019	2018
Land	$ 15,608,352	$ 13,163,944
Buildings and improvements	156,538,070	131,576,327
Furniture and equipment	10,113,537	8,124,684
Construction in progress	12,728,337	15,871,763
Total property and equipment, at cost	194,988,296	168,736,718
Accumulated depreciation	(41,440,993)	(35,413,345)
Property and equipment, net	$ 153,547,303	$ 133,323,373

YES Prep has buildings and improvement purchased with TEA funds with a net book value of approximately $23 million. Texas statutes state that property purchased with funds received by a charter school holder is considered to be public property for all purposes under state law and is held in trust by the charter school holder for the benefit of the students of the open enrollment charter school and may be used only for those purposes.

NOTE 9 – BONDS AND NOTES PAYABLE

In March 2010, YES Prep entered into a Master Trust Indenture (the MTI) for the purpose of issuing bonds. Under the MTI, YES Prep has the ability to issue additional debt on a parity basis. The MTI is secured by a first lien on YES Prep's revenue, as well as on certain real property of YES Prep. YES Prep is required to maintain 1.2 times debt coverage at each quarter-end while MTI debt is still outstanding. With the exception of the New Markets Tax Credit and the Charter School Growth Fund loans, all bonds and notes held by YES Prep exist under, and are subject to, the MTI.

Bonds payable consist of the following:

	2019	2018
Qualified Zone Academy Bond, Taxable Series 2010Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $141,668 and $169,292 in 2019 and 2018, respectively. The investor earns 5.73% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 2% supplemental interest semi-annually. The bond is due April 1, 2025. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.	$ 15,858,332	$ 15,830,708

Qualified Zone Academy Bond, Taxable Series 2015Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $271,015 and $301,144 in 2019 and 2018, respectively. The investor earns 4.87% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 1% supplemental interest semi-annually. The bond is due April 1, 2030. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.	14,728,985	14,698,856
Qualified Zone Academy Bond, Taxable Series 2017Z-1, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $137,872 and $148,685 in 2019 and 2018, respectively. The investor earns 4.11% in annual tax credits as part of a federal tax credit bond program and YES Prep pays no interest. Principal payments are due annually through maturity on April 1, 2026. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.	12,142,795	13,076,648
Qualified Zone Academy Bond, Taxable Series 2011Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $101,224 and $115,348 in 2019 and 2018, respectively. The investor earns 5.18% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 2.21% supplemental interest semi-annually. The bond is due April 1, 2026. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.	8,650,376	8,636,252
Qualified Zone Academy Bond, Taxable Series 2017Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $178,938 and $194,213 in 2019 and 2018, respectively. The investor earns 4.57% in annual tax credits as part of a federal tax credit bond program and YES Prep pays no interest. The bond is due April 1, 2031. The proceeds were used to construct, rehabilitate, or repair specified campus facilities and are secured by real estate.	7,045,062	7,631,787
Qualified School Construction Bond, Taxable Series 2010Q, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $52,454 and $58,877 in 2019 and 2018, respectively. The investor earns 5.82% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 2% supplemental interest semi-annually. The bond is due April 1, 2025. The proceeds were used to construct specified campus facilities and are secured by real estate.	6,047,546	6,041,123
Qualified Zone Academy Bond, Taxable Series 2012Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of $103,727 and $116,110 in 2019 and 2018, respectively. The investor earns 4.49% in annual tax credits as part of a federal tax credit bond program and YES Prep pays 1% supplemental interest semi-annually. The bond is due April 1, 2027. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.	3,296,273	3,283,890
Total bonds payable, net	$ 67,769,369	$ 69,199,264

Interest on the bonds payable totaled approximately $816,000 and $757,000 at June 30, 2019 and 2018, respectively.

Maturities of bonds payable, including interest, at June 30, 2019 are as follows:

	PRINCIPAL	INTEREST	TOTAL
2020	$ 1,546,667	$ 816,834	$ 2,363,501
2021	1,546,667	816,834	2,363,501
2022	1,546,667	816,834	2,363,501
2023	1,546,667	816,834	2,363,501
2024	1,546,667	816,834	2,363,501
Thereafter	61,022,932	1,629,522	62,652,454
Total payments due	68,756,267	$ 5,713,692	$ 74,469,959
Unamortized debt issuance costs	(986,898)		
Total bonds payable, net	$ 67,769,369		

YES Prep entered into two repurchase agreements to fund the repayment of bonds as specified in the agreement upon maturity. YES Prep makes equal annual deposits into these accounts over the 15-year term of the underlying bonds, and earns interest at rates varying between 2.18% and 4.259%. The combination of the annual deposits and interest earned on the accounts will provide the full amount due upon maturity of the covered bonds.

YES Prep's minimum cash commitments under the repurchase agreements are as follows:

2020	$ 2,558,713
2021	2,558,713
2022	2,558,713
2023	2,558,713
2024	2,558,713
Thereafter	7,584,375
Total	$ 20,377,940

Notes payable consist of the following:

	2019	2018
Loan agreement with a bank for $13,440,000 dated December 2018. Interest and principal due annually through maturity on April 1, 2034 with an interest rate of 3.92%, net of unamortized debt issuance costs of $386,986 in 2019. Proceeds were used for acquiring, constructing, and renovating buildings at YES Prep Hobby. The loan is secured by real estate.	$ 13,053,015	
Loan agreement with a bank for $10,000,000 dated October 2017. Interest and principal due annually through maturity on April 1, 2032 with an interest rate of 2.93%, net of unamortized debt issuance costs of $131,794 and $138,458 in 2019 and 2018, respectively. Proceeds were used to acquire land and construct buildings. The loan is secured by real estate.	8,628,206	$ 9,171,542

Note payable to New Markets Investment 71, LLC, issued in October 2012. Interest at 1% is paid quarterly, net of unamortized debt issuance costs of $211,558 and $224,272 in 2019 and 2018, respectively. Principal payments began on October 9, 2019 and are paid quarterly through maturity on November 1, 2042. Proceeds were used to finance buildings at YES Prep Fifth Ward and YES Prep Northside. The loan is secured by real estate. *(see Note 6)*	8,453,442	8,440,728
Series 2013 loan agreement for $9,740,000 with a bank issued by Dickinson Education Finance Corporation, net of unamortized debt issuance costs of $119,044 and $132,031 in 2019 and 2018, respectively. The loan bears interest at 3.95% and payments are due in semi-annual installments through April 1, 2028. The proceeds were used to retire existing debt and to provide funding for expansions at YES Prep Southwest and YES Prep Fifth Ward. The loan is secured by real estate.	6,510,779	7,065,895
Series 2015 loan agreement for $7,000,000 with a bank issued by Dickinson Education Finance Corporation, net of unamortized debt issuance costs of $128,822 and $140,106 in 2019 and 2018, respectively. The loan bears interest at 2.93% and payments are due in semi-annual installments through April 1, 2030. The proceeds were used to renovate the YES Prep North Forest campus and to construct the YES Prep System Office. The loan is secured by real estate and revenue streams.	5,001,918	5,459,894
Note payable to COCRF SubCDE XIV, LLC issued in October 2012. Interest at 1% per annum is paid quarterly, net of unamortized debt issuance costs of $158,000 and $161,181 in 2019 and 2018, respectively. Principal payments begin on December 23, 2019 and are paid quarterly through maturity at November 1, 2042. Proceeds were used to finance buildings at YES Prep Fifth Ward and YES Prep Northside. The loan is secured by real estate. *(see Note 6)*	4,842,000	4,838,819
Loan agreement for $2,500,000 with Charter School Growth Fund amended December 2014. Interest at 1%. Principal payments are due in annual installments in June 2020 and June 2021. The loan is unsecured.	1,045,000	1,045,000
Loan agreement for $1,000,000 with Charter School Growth Fund dated December 2014. Interest at 1%. Principal payments are due in annual installments in June 2021 and June 2022, with interest due in June 2022. The loan is unsecured.	1,000,000	1,000,000
Loan agreement for $200,000 with Charter School Growth Fund dated July 2013. Interest at 1%. Loan matured on June 30, 2019, with interest due at that time. The loan is unsecured.	200,000	200,000
Loan agreement for $100,000 with Charter School Growth Fund dated May 2019. Interest is at 1%. Loan matures on June 28, 2024, with interest due at that time. The loan is unsecured.	100,000	

Loan agreement for $2,300,000 with Charter School Growth Fund dated April 2015. Interest is at 0%. Principal payments are due in annual installments from June 2015 to June 2020. The loan is unsecured.	750,000	1,500,000
Loan agreement with a bank for $7,890,935 dated June 2012, net of unamortized debt issuance costs of $0 and $12,143 in 2019 and 2018, respectively. Interest and principal due monthly through maturity on June 8, 2019. Proceeds were used to acquire land and construct buildings. The loan is secured by real estate.		9,276
Total notes payable, net	$ 49,584,360	$ 38,731,154

Interest on the notes payable totaled approximately $1,148,000 and $721,000 for the years ended June 30, 2019 and 2018, respectively.

Maturities of notes payable, including interest, at June 30, 2019 are as follows:

	PRINCIPAL	INTEREST	TOTAL
2020	$ 4,233,751	$ 1,334,788	$ 5,568,539
2021	3,947,274	1,254,659	5,201,933
2022	15,705,526	1,172,659	16,878,185
2023	2,541,744	929,262	3,471,006
2024	2,714,850	842,856	3,557,706
Thereafter	21,577,418	3,505,338	25,082,756
Total payments due	50,720,563	$ 9,039,562	$ 59,760,125
Unamortized debt issuance costs	(1,136,203)		
Total notes payable, net	$ 49,584,360		

YES Prep has a line of credit with a bank for $5 million with an interest rate of 2.40% as of June 30, 2019. No amounts were drawn from the line of credit during fiscal year 2019.

NOTE 10 – NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are restricted as follows:

	2019	2018
State resources for future educational expenses	$ 23,229,111	$ 16,622,813
Redefining Possible Growth campaign	5,029,000	3,100,000
College scholarships for YES Prep graduates	2,058,189	2,118,028
National School Lunch Program	1,286,292	697,605
Teaching Excellence	956,650	974,867
Innovation Fund	263,675	224,892
Professional development	77,480	572,950
College initiatives	77,401	24,565
YES Prep future operations	20,000	60,000
Hurricane Harvey assistance		78,846
Other	141,155	192,025
Total net assets with donor restrictions	$ 33,138,953	$ 24,666,591

NOTE 11 – COMMITMENTS

Lease commitments – YES Prep leases certain equipment under noncancelable operating leases. Operating lease payments for the years ended June 30, 2019 and 2018 were approximately $1,367,000 and $1,027,000, respectively. Future minimum lease payments are due as follows:

2020	$ 1,058,436
2021	714,196
2022	617,235
2023	50,482
2024	583
Total	$ 2,440,932

Construction commitments – In 2019, YES Prep entered into a contract totaling approximately $10.3 million for construction projects at certain schools. As of June 30, 2019, outstanding commitments totaled approximately $1.02 million for the related contracts.

NOTE 12 – GOVERNMENT GRANTS

YES Prep is the recipient of government grants from various federal, state and local agencies. Government grants include the following:

	2019	2018
State grants:		
Texas Education Agency Foundation School Program Act	$ 110,795,298	$ 103,071,368
Textbook and Kindergarten Materials	1,078,621	178,744
School Lunch Matching	27,094	304
Teacher Training Reimbursement		570
Total state grants	111,901,013	103,250,986
Federal grants:		
U. S. Department of Education	10,098,185	9,353,385
U. S. Department of Agriculture	4,921,839	3,980,025
U. S. Department of Homeland Security	767,903	
Total federal grants	15,787,927	13,333,410
Total government grants	$ 127,688,940	$ 116,584,396

The grants from government funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by YES Prep with the terms of the contracts. Management believes such disallowances, if any, would not be material to YES Prep's financial position or changes in net assets.

NOTE 13 – MULTIEMPLOYER PENSION PLAN

YES Prep's full-time employees participate in the Teacher Retirement System of Texas (TRS), a public employee retirement system. TRS is a cost-sharing, multiemployer, defined benefit pension plan. All risks and costs are not shared by YES Prep, but are the liability of the State of Texas. For 2019, plan members contribute 7.7% of their annual covered salary, YES Prep contributes 6.8% for new members the first 90 days of employment, and the State of Texas contributes 6.8%. Additionally, YES Prep makes a 1.5% non-OASDI payment on all TRS eligible employees. YES Prep's contributions do not represent more than 5% of the pension plan's total contributions. YES Prep contributed $2,327,362 and $2,268,208 to the plan during fiscal years 2019 and 2018, respectively, equal to the required contribution for each year.

The risks of participating in a multiemployer, defined benefit plan are different from single-employer plans because (a) amounts contributed to a multiemployer plan by one employer may be used to provide benefits to employees of other participating employers and (b) if an employer stops contributing to TRS, unfunded obligations of TRS may be required to be borne by the remaining employers. There is no withdrawal penalty for leaving TRS.

Total TRS plan assets as of August 31, 2018 and 2017 were $176.9 billion and $146.3 billion, respectively. Accumulated benefit obligations as of August 31, 2018 and 2017 were $209.6 billion and $181.8 billion, respectively. The plan was 76.90% funded at August 31, 2018 and 80.50% funded at August 31, 2017.

NOTE 14 – SUBSEQUENT EVENTS

Subsequent to June 30, 2019, the New Market Tax Credit *(Note 6)* was called by the bank and YES Prep became sole owner of the property. The impact of this transaction is to retire the debt to COCRF and to NMI 71, LLC totaling $13,295,442 and cancel the note receivable to COCRF Investor totaling $10,442,800. Additionally, the School entered into a $35 million line of credit agreement for future construction projects.

Management has evaluated subsequent events through November 18, 2019, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.