

**YES Prep Public Schools, Inc.**

Consolidated Financial Statements  
and Independent Auditors' Report  
for the years ended June 30, 2018 and 2017

# YES Prep Public Schools, Inc.

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## 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, 2018 and 2017 and the related consolidated statements of activities and of cash flows for the years 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 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, 2018 and 2017 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.

## Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2018 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 13, 2018

# YES Prep Public Schools, Inc.

## Consolidated Statements of Financial Position as of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current assets:		
Cash and cash equivalents ( <i>Note 2</i> )	\$ 25,016,643	\$ 26,263,959
Receivables:		
Government agencies	22,467,184	17,717,993
Pledges restricted for capital expansion ( <i>Note 3</i> )	333,333	964,000
Operating pledges ( <i>Note 3</i> )	495,875	171,000
Other	1,554,272	795,707
Prepaid expenses and other assets	<u>1,025,282</u>	<u>395,801</u>
Total current assets	50,892,589	46,308,460
Operating pledges receivable, net ( <i>Note 3</i> )	8,000	50,000
Beneficial interest in charitable trust	1,924,262	2,136,762
Note receivable ( <i>Note 4</i> )	10,422,800	10,422,800
Cash restricted for capital projects ( <i>Note 2</i> )	13,507,722	5,730,739
Bond sinking funds ( <i>Note 2</i> )	17,519,390	14,389,425
Pledges receivable restricted for capital expansion ( <i>Note 3</i> )	416,667	420,000
Property and equipment, net ( <i>Note 5</i> )	<u>133,323,373</u>	<u>112,524,822</u>
TOTAL ASSETS	<u>\$ 228,014,803</u>	<u>\$ 191,983,008</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,277,180	\$ 3,633,890
Accrued payroll expenses	9,776,001	7,430,998
Construction payable	4,650,106	3,145,962
Accrued interest	839,339	795,389
Current portion of bonds payable ( <i>Note 6</i> )	1,546,667	602,000
Current portion of notes payable ( <i>Note 6</i> )	<u>2,856,774</u>	<u>1,960,010</u>
Total current liabilities	21,946,067	17,568,249
Bonds payable, net ( <i>Note 6</i> )	67,652,597	56,024,017
Notes payable, net ( <i>Note 6</i> )	<u>35,874,380</u>	<u>29,018,033</u>
Total liabilities	<u>125,473,044</u>	<u>102,610,299</u>
Minority interest in YES Prep Holdings, Inc.	2,594	12,815
Commitments ( <i>Note 8</i> )		
Net assets:		
Unrestricted	77,872,574	72,049,832
Temporarily restricted ( <i>Note 7</i> )	<u>24,666,591</u>	<u>17,310,062</u>
Total net assets	<u>102,539,165</u>	<u>89,359,894</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 228,014,803</u>	<u>\$ 191,983,008</u>

*See accompanying notes to consolidated financial statements.*

## YES Prep Public Schools, Inc.

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

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	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	<u>TOTAL</u>
<b>OPERATING REVENUE:</b>			
Government grants ( <i>Note 9</i> )		\$ 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 ( <i>Note 6</i> )	1,084,793		1,084,793
Other	47,911		47,911
	<hr/>	<hr/>	<hr/>
Total operating revenue	18,451,875	126,530,737	144,982,612
<b>Net assets released from restrictions:</b>			
Program expenditures	117,375,208	(117,375,208)	
Capital expenditures	1,629,000	(1,629,000)	
Expiration of time restrictions	170,000	(170,000)	
	<hr/>	<hr/>	<hr/>
Total	137,626,083	7,356,529	144,982,612
<b>OPERATING EXPENSES:</b>			
<b>Program expenses:</b>			
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
	<hr/>		<hr/>
Total program expenses	120,598,748		120,598,748
General and administrative	10,445,000		10,445,000
Fundraising	759,593		759,593
	<hr/>		<hr/>
Total operating expenses	131,803,341		131,803,341
<b>CHANGES IN NET ASSETS</b>			
	5,822,742	7,356,529	13,179,271
Net assets, beginning of year	<u>72,049,832</u>	<u>17,310,062</u>	<u>89,359,894</u>
Net assets, end of year	<u>\$ 77,872,574</u>	<u>\$ 24,666,591</u>	<u>\$ 102,539,165</u>

*See accompanying notes to consolidated financial statements.*

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## YES Prep Public Schools, Inc.

Consolidated Statement of Activities for the year ended June 30, 2017

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	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	<u>TOTAL</u>
<b>OPERATING REVENUE:</b>			
Government grants ( <i>Note 9</i> )		\$ 103,850,294	\$ 103,850,294
Contributions	\$ 449,111	7,217,565	7,666,676
Program service fees	12,017,587		12,017,587
Special events	1,691,130		1,691,130
Cost of direct donor benefits	(148,647)		(148,647)
Interest ( <i>Note 6</i> )	686,683		686,683
Other	34,292		34,292
	<hr/>	<hr/>	<hr/>
Total operating revenue	14,730,156	111,067,859	125,798,015
<b>Net assets released from restrictions:</b>			
Program expenditures	104,626,450	(104,626,450)	
Capital expenditures	6,369,000	(6,369,000)	
Expiration of time restrictions	100,000	(100,000)	
	<hr/>	<hr/>	<hr/>
Total	125,825,606	(27,591)	125,798,015
<b>OPERATING EXPENSES:</b>			
<b>Program expenses:</b>			
Instructional program	92,422,595		92,422,595
Auxiliary services	15,343,610		15,343,610
	<hr/>		<hr/>
Total program expenses	107,766,205		107,766,205
General and administrative	9,427,248		9,427,248
Fundraising	918,920		918,920
	<hr/>		<hr/>
Total operating expenses	118,112,373		118,112,373
<b>CHANGES IN NET ASSETS</b>			
	7,713,233	(27,591)	7,685,642
Net assets, beginning of year	64,336,599	17,337,653	81,674,252
	<hr/>	<hr/>	<hr/>
Net assets, end of year	\$ 72,049,832	\$ 17,310,062	\$ 89,359,894

*See accompanying notes to consolidated financial statements.*

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## YES Prep Public Schools, Inc.

### Consolidated Statements of Cash Flows for the years ended June 30, 2018 and 2017

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	<u>2018</u>	<u>2017</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Changes in net assets	\$ 13,179,271	\$ 7,685,642
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for expansion of facilities	(3,336,000)	(6,179,000)
Depreciation	4,940,841	4,591,788
Amortization of bond issuance costs	147,592	131,449
Changes in operating assets and liabilities:		
Receivables	(5,790,631)	(319,804)
Prepaid expenses and other assets	(629,481)	1,609,432
Beneficial interest in charitable trust	212,500	100,000
Accounts payable and accrued expenses	978,072	616,926
Accrued interest	<u>43,950</u>	<u>46,196</u>
Net cash provided by operating activities	<u>9,746,114</u>	<u>8,282,629</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	<u>(14,793,601)</u>	<u>(6,035,323)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Change in bond sinking funds	(3,129,965)	(3,020,304)
Change in cash restricted for capital projects	(7,776,983)	(1,916,358)
Capitalized bond issuance costs	(294,776)	(212,002)
Proceeds from bonds and notes payable	14,728,355	528,853
Principal repayments of bonds and notes payable	(3,696,460)	(2,792,698)
Proceeds from contributions restricted for expansion of facilities	<u>3,970,000</u>	<u>6,178,000</u>
Net cash provided (used) by financing activities	<u>3,800,171</u>	<u>(1,234,509)</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,247,316)</b>	<b>1,012,797</b>
Cash and cash equivalents, beginning of year	<u>26,263,959</u>	<u>25,251,162</u>
Cash and cash equivalents, end of year	<u>\$ 25,016,643</u>	<u>\$ 26,263,959</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest payments	\$1,489,102	\$1,343,676
Property and equipment acquired with bond proceeds	\$9,441,647	\$8,501,147

*See accompanying notes to consolidated financial statements.*

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## YES Prep Public Schools, Inc.

Notes to Consolidated Financial Statements for the years ended June 30, 2018 and 2017

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### NOTE 1 – ORGANIZATION AND SUMMARY OF ACCOUNTING POLICIES

Organization – YES Prep Public Schools, Inc. (YES Prep) operates thirteen Texas Open-Enrollment Charter Schools under one state charter. The schools are located in Houston, Texas and serve approximately 10,900 students from 6<sup>th</sup> through 12<sup>th</sup> grade. Additionally, YES Prep operates two schools within Spring Branch Independent School District and one school 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 leases the buildings to YES Prep. Facilities holds 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.

Pledges 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 pledges 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 pledges 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 – Contributions, interest income and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations even though their use may be limited in other respects such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and interest income restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Grants and contributions are recognized at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are included in contribution revenue when the conditions are substantially met.

Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted revenue. Absent explicit donor stipulations about how long those long-lived assets must be maintained, YES Prep reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

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.

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 August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU are aimed at providing more useful information to users of not-for-profit financial statements. Under this ASU, net assets will be presented in two classes: *net assets with donor restrictions* and *net assets without donor restrictions* and underwater endowments will be grouped with *net assets with donor restrictions*. New or enhanced disclosures will be required about the nature and composition of net assets, and the liquidity and availability of resources for general operating expenditures within one year of the balance sheet date. Expenses will be required to be presented by both nature and function and investment return will be presented net of external and direct internal investment expenses. Absent explicit donor stipulations, restrictions on long-lived assets will expire when assets are placed in service. YES Prep is required to adopt this ASU for fiscal year 2019. Adoption of this ASU will impact the presentation and disclosures of 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 its fiscal year ending June 30, 2021. Management has not yet determined the impact adoption of this ASU will have on the financial statements.

In November 2016, the FASB issued 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, restricted cash and cash equivalents were excluded from beginning and ending cash and cash equivalents in the statement of cash flows. YES Prep is required to adopt this ASU for fiscal year 2020 and must be applied retrospectively. This change will have no impact on net assets or changes in net assets.

In June 2018, the FASB issued 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 fiscal year 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.

## NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2018</u>	<u>2017</u>
Demand deposits	\$ 37,863,263	\$ 30,041,145
TexPool, TexSTAR and LOGIC investment pools	<u>18,180,492</u>	<u>16,342,978</u>
Total	56,043,755	46,384,123
Less: Bond sinking funds	(17,519,390)	(14,389,425)
Less: Cash restricted for capital projects	<u>(13,507,722)</u>	<u>(5,730,739)</u>
Total cash and cash equivalents	<u>\$ 25,016,643</u>	<u>\$ 26,263,959</u>

YES Prep has deposits in the The Texas Short Term Reserve Program Cash Reserve Fund (TexSTAR), TexPool, and LOGIC, Texas Local Government Investment Pools. 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 uses the fair value method to report net position and to compute share prices.

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 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.

Bank deposits exceed the federally insured limit per depositor per institution and approximately \$6.5 million was not collateralized by a security agreement with a bank at June 30, 2018.

### NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are as follows:

	<u>2018</u>	<u>2017</u>
Total pledges receivable	\$ 1,253,875	\$ 1,605,000
Pledges receivable restricted for capital expansion	<u>(750,000)</u>	<u>(1,384,000)</u>
Operating pledges receivable	<u>\$ 503,875</u>	<u>\$ 221,000</u>

Pledges receivable at June 30, 2018 are expected to be collected as follows:

Due within one year	\$ 829,208
Due in one to five years	<u>424,667</u>
Total pledges receivable	<u>\$ 1,253,875</u>

*Concentration* – At June 30, 2018, 85% of pledges receivable were due from three donors. At June 30, 2017, 79% of pledges receivable were due from three donors. In 2018 and 2017, one donor provided 12% and three donors provided 35% of contribution revenue, respectively.

In 2015, YES Prep received a \$2,500,000 conditional pledge from the Charter School Growth Fund. The payments are contingent upon meeting certain milestones and conditions. At June 30, 2018, the amount outstanding on this gift totaled \$500,000. YES Prep recognized \$500,000 of contributions related to this pledge in 2018 and 2017. Additionally, a donor has communicated an intent to recommend a gift to YES Prep that is conditional upon growth and performance. The commitment has a remaining balance of \$4,500,000 at August 31, 2018.

### NOTE 4 – 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, 2018 and 2017.

### *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 5 – PROPERTY AND EQUIPMENT**

Property and equipment is comprised of the following:

	<u>2018</u>	<u>2017</u>
Land	\$ 13,163,944	\$ 12,669,107
Buildings and improvements	131,576,327	117,659,921
Furniture and equipment	8,124,684	7,778,506
Construction in progress	<u>15,871,763</u>	<u>4,889,792</u>
Total property and equipment, at cost	168,736,718	142,997,326
Accumulated depreciation	<u>(35,413,345)</u>	<u>(30,472,504)</u>
Property and equipment, net	<u>\$ 133,323,373</u>	<u>\$ 112,524,822</u>

### **NOTE 6 – 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:

	<u>2018</u>	<u>2017</u>
Qualified Zone Academy Bond, Taxable Series 2010Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$169,292 and \$196,915 in 2018 and 2017, 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.	\$ 15,830,708	\$ 15,803,085

<p>Qualified Zone Academy Bond, Taxable Series 2015Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$301,144 and \$323,916 in 2018 and 2017, 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.</p>	14,698,856	14,676,084
<p>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 \$148,685 in 2017. 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.</p>	13,076,648	
<p>Qualified Zone Academy Bond, Taxable Series 2011Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$115,348 and \$129,473 in 2018 and 2017, respectively. The investor earns 5.18% 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, 2026. The proceeds were used to rehabilitate or repair specified campus facilities and are secured by real estate.</p>	8,636,252	8,622,127
<p>Qualified Zone Academy Bond, Taxable Series 2017Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$194,213 and \$209,486 in 2018 and 2017, 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.</p>	7,631,787	8,218,514
<p>Qualified School Construction Bond, Taxable Series 2010Q, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$58,877 and \$65,300 in 2018 and 2017, 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.</p>	6,041,123	6,034,700
<p>Qualified Zone Academy Bond, Taxable Series 2012Z, issued by the City of Houston Higher Education Finance Corporation, net of unamortized debt issuance costs of \$116,110 and \$128,493 in 2018 and 2017, 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.</p>	3,283,890	3,271,507
	<u>\$ 69,199,264</u>	<u>\$ 56,626,017</u>
Total bonds payable, net		

Interest on the bonds payable totaled approximately \$757,000 at June 30, 2018 and 2017.

Maturities of bonds payable, including interest, at June 30, 2018 are as follows:

	<u>PRINCIPAL</u>	<u>INTEREST</u>	<u>TOTAL</u>
2019	\$ 1,546,667	\$ 757,274	\$ 2,303,941
2020	1,546,667	757,274	2,303,941
2021	1,546,667	757,274	2,303,941
2022	1,546,667	757,274	2,303,941
2023	1,546,667	757,274	2,303,941
Thereafter	<u>62,569,598</u>	<u>2,274,504</u>	<u>64,844,102</u>
Total payments due	70,302,933	<u>\$ 6,060,874</u>	<u>\$ 76,363,807</u>
Unamortized debt issuance costs	<u>(1,103,669)</u>		
Total	<u>\$ 69,199,264</u>		

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:

2019	\$ 2,558,713
2020	2,558,713
2021	2,558,713
2022	2,558,713
2023	2,558,713
Thereafter	<u>9,305,076</u>
Total	<u>\$ 22,098,641</u>

Notes payable consist of the following:

	<u>2018</u>	<u>2017</u>
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 \$138,458 in 2017. Proceeds were used to acquire land and construct buildings. The loan is secured by real estate.	\$ 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 \$224,272 and \$233,520 in 2018 and 2017, respectively. Principal payments begin 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.	8,440,728	\$ 8,431,480

Series 2013 loan agreement for \$9,740,000 with a bank issued by Dickinson Education Finance Corporation, net of unamortized debt issuance costs of \$132,031 and \$145,018 in 2018 and 2017, respectively. The loan bears interest at 3.25% 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.	7,065,895	7,651,487
Series 2015 loan agreement for \$7,000,000 with a bank issued by Dickinson Education Finance Corporation, net of unamortized debt issuance costs of \$140,106 and \$151,390 in 2018 and 2017, 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.	5,459,894	5,915,277
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 \$161,181 and \$167,828 in 2018 and 2017, 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.	4,838,819	4,832,172
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.	1,500,000	1,500,000
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 matures on June 30, 2019, with interest due at that time. The loan is unsecured.	200,000	200,000
Loan agreement with a bank for \$7,890,935 dated June 2012, net of unamortized debt issuance costs of \$12,143 and \$13,337 in 2018 and 2017, 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.	<u>9,276</u>	<u>402,627</u>
Total notes payable, net	<u>\$ 38,731,154</u>	<u>\$ 30,978,043</u>



Interest on the notes payable totaled approximately \$721,000 and \$614,000 for the years ended June 30, 2018 and 2017, respectively.

Maturities of notes payable, including interest, at June 30, 2018 are as follows:

	<u>PRINCIPAL</u>	<u>INTEREST</u>	<u>TOTAL</u>
2019	\$ 2,856,774	\$ 821,924	\$ 3,678,698
2020	3,113,750	762,407	3,876,157
2021	3,247,273	701,458	3,948,731
2022	14,980,526	638,045	15,618,571
2023	1,786,744	439,090	2,225,834
Thereafter	<u>13,554,278</u>	<u>1,519,374</u>	<u>15,073,652</u>
Total payments due	39,539,345	<u>\$ 4,882,298</u>	<u>\$ 44,421,643</u>
Unamortized debt issuance costs	<u>(808,191)</u>		
Total	<u>\$ 38,731,154</u>		

#### **NOTE 7 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes:

	<u>2018</u>	<u>2017</u>
State funds for future educational expenses	\$ 16,622,813	\$ 13,188,317
Redefining Possible Growth campaign	3,100,000	1,393,000
College scholarships for YES Prep graduates	2,118,028	2,254,833
Teaching Excellence	974,867	144,182
National School Lunch Program	697,605	
Professional development	572,950	30,691
Innovation Fund	224,892	8,537
Hurricane Harvey assistance	78,846	
YES Prep future operations	60,000	221,000
College initiatives	24,565	69,502
Other	<u>192,025</u>	<u>                    </u>
Total temporarily restricted net assets	<u>\$ 24,666,591</u>	<u>\$ 17,310,062</u>

#### **NOTE 8 – COMMITMENTS**

*Lease commitments* – YES Prep leases certain equipment under noncancelable operating leases. Operating lease payments for the years ended June 30, 2018 and 2017 were approximately \$1,027,000 and \$871,000, respectively. Future minimum lease payments are due as follows:

2019	\$ 1,067,973
2020	436,866
2021	<u>49,076</u>
Total	<u>\$ 1,553,915</u>

*Construction commitments* – In 2018, YES Prep entered into several contracts totaling approximately \$18.6 million for construction projects at certain schools. As of June 30, 2018, outstanding commitments totaled approximately \$5.3 million.

**NOTE 9 – GOVERNMENT GRANTS**

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

	<u>2018</u>	<u>2017</u>
State grants:		
Texas Education Agency Foundation School Program Act	\$ 103,071,368	\$ 89,660,257
Textbook and Kindergarten Materials	178,744	1,297,143
Teacher Training Reimbursement	570	
School Lunch Matching	<u>304</u>	<u>24,958</u>
Total state grants	<u>103,250,986</u>	<u>90,982,358</u>
Federal grants:		
U. S. Department of Education	9,353,385	8,633,019
U. S. Department of Agriculture	<u>3,980,025</u>	<u>4,234,917</u>
Total federal grants	<u>13,333,410</u>	<u>12,867,936</u>
Total government grants	<u>\$ 116,584,396</u>	<u>\$ 103,850,294</u>

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 10 – 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 2018, 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 \$2,268,208 and \$1,404,772 to the plan during fiscal years 2018 and 2017, respectively, equal to the required contribution for each year.

The risks of participating in a multiemployer, defined benefit plan is 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, 2017 and 2016 were \$146.3 billion and \$138.8 billion, respectively. Accumulated benefit obligations as of August 31, 2017 and 2016 were \$181.8 billion and \$174.2 billion, respectively. The plan was 80.50% funded at August 31, 2017 and 79.70% funded at August 31, 2016.

#### **NOTE 11 – SUBSEQUENT EVENTS**

In July 2018, YES Prep entered into a \$5.0 million line of credit with a bank.

Management has evaluated subsequent events through November 13, 2018, which is the date that the financial statements were available for issuance. As a result of this evaluation, no other events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.

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