Project GRAD Houston

Financial Statements

For the Year Ended December 31, 2010

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To the Board of Directors
Project GRAD Houston
Houston, Texas

Independent Auditors' Report

We have audited the accompanying statement of financial position of Project GRAD Houston (a nonprofit organization) as of December 31, 2010, and the related statements of activity and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Project GRAD Houston as of December 31, 2010, and the changes in its net assets (deficit) and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Briggs & Veselka Co.

Briggs & Veselka Co.
A Professional Corporation
Certified Public Accountants

June 22, 2011

PROJECT GRAD HOUSTON
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2010

ASSETS	
Cash and cash equivalents	$ 623,417
Pledges receivable	374,500
Accounts receivable	519,819
Grants receivable	179,388
Prepaid expenses and other assets	1,226
TOTAL ASSETS	$ 1,698,350

LIABILITIES AND NET DEFICIT	
LIABILITIES	
Accounts payable and accrued liabilities	$ 537,426
Note payable	1,296,655
TOTAL LIABILITIES	1,834,081
NET DEFICIT	
Unrestricted	(722,121)
Temporarily restricted	586,390
TOTAL NET DEFICIT	(135,731)
TOTAL LIABILITIES AND NET DEFICIT	$ 1,698,350

The accompanying notes are an integral part of these financial statements.

PROJECT GRAD HOUSTON
STATEMENT OF ACTIVITY
FOR THE YEAR ENDED DECEMBER 31, 2010

	Unrestricted	Temporarily Restricted	Total
PUBLIC SUPPORT AND REVENUES			
Contributions	$ 315,258	$ 1,132,474	$ 1,447,732
Contracts and agreements	3,738,633	-	3,738,633
Government grants	267,343	-	267,343
Other income	36,195	-	36,195
TOTAL PUBLIC SUPPORT AND REVENUES	4,357,429	1,132,474	5,489,903
NET ASSETS RELEASED FROM RESTRICTIONS	1,096,517	(1,096,517)	-
TOTAL PUBLIC SUPPORT AND REVENUES	5,453,946	35,957	5,489,903
EXPENSES			
In school program delivery and training costs	1,605,751	-	1,605,751
Scholarships and college preparation	1,957,244	-	1,957,244
Fine Arts program	765,784	-	765,784
Fundraising costs	95,294	-	95,294
Administrative costs	623,920	-	623,920
TOTAL EXPENSES	5,047,993	-	5,047,993
CHANGE IN NET ASSETS	405,953	35,957	441,910
NET ASSETS (DEFICIT), BEGINNING OF YEAR	(1,128,074)	550,433	(577,641)
NET ASSETS (DEFICIT), END OF YEAR	$ (722,121)	$ 586,390	$ (135,731)

The accompanying notes are an integral part of these financial statements.

PROJECT GRAD HOUSTON
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2010

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net assets	$ 441,910
ADJUSTMENTS TO RECONCILE CHANGE IN NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
(Increase) decrease in assets:	
Pledges receivable	(129,500)
Accounts receivable	(268,180)
Grants receivable	223,153
Prepaid expenses and other assets	6,972
Decrease in liabilities:	
Accounts payable and accrued liabilities	139,589
TOTAL ADJUSTMENTS	(27,966)
NET CASH PROVIDED BY OPERATING ACTIVITIES	413,944
CASH FLOWS FROM FINANCING ACTIVITIES	
Principal payments on line of credit	(68,000)
NET CASH USED BY FINANCING ACTIVITIES	(68,000)
NET INCREASE IN CASH AND CASH EQUIVALENTS	345,944
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	277,473
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 623,417

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

CASH PAID FOR INTEREST	$ 19,299

The accompanying notes are an integral part of these financial statements.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Project GRAD Houston (the "Organization") is a nonprofit, 501(c)(3), tax-exempt corporation. It was incorporated on August 25, 1994. Project GRAD Houston provides programs to the Houston Independent School District ("HISD") that improve the instructional quality and culture of at-risk feeder systems (a high school and the elementary and middle schools that send students to it). The goal of Project GRAD Houston is to implement the most cost-effective and research-based methods for addressing the educational needs of inner-city school systems, thereby increasing the graduation and college attendance rates of their students. Initially established to work with schools in the Jefferson Davis High School feeder system, Project GRAD Houston has expanded to also serve schools in the Jack Yates, Phillis Wheatley, John Reagan, and Sam Houston feeder systems. Project GRAD Houston receives contributions from various foundations, corporations, and individual donors. In addition, Project GRAD Houston receives funding from HISD and from Federal and State grants.

Summary of Significant Accounting Policies

A. Cash and Cash Equivalents

Cash and cash equivalents includes demand deposits and highly liquid investment instruments purchased with original maturities of three (3) months or less. In monitoring credit risk associated with uninsured deposits, the Organization evaluates the stability of its correspondent financial institutions.

B. Pledges and Accounts Receivable

Unconditional promises to give that are expected to be collected within one (1) year are recorded at their realizable value. Significant unconditional promises to give that are expected to be collected after one (1) year or more are recorded at the present value of estimated future cash flows. The discounts on those amounts are computed using a risk-free interest rate applicable to the year in which the promise is received. Amortization of the discount is included as contribution revenue. Conditional promises to give are not included as support until such time as the conditions are substantially met. Management believes that all receivables are collectible; therefore, no allowance for doubtful accounts has been recorded. If amounts become uncollectible, they will be charged to activities when that determination is made.

C. Property and Equipment

Property and equipment are stated at cost at the date of purchase or donation. Depreciation and amortization are recorded using the straight-line method over an estimated useful life of five (5) years. At December 31, 2010, property and equipment consisting of furniture, fixtures and software amounted to $57,425 and were fully depreciated, with a net book value of $-0-. The costs of ordinary maintenance and repairs are charged to expense as incurred.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Summary of Significant Accounting Policies (Continued)

D. Net Assets

Project GRAD Houston's funding sources include donors who have placed specific restrictions on the use of donated assets. Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of Project GRAD Houston and changes therein are classified and reported as follows:

- Unrestricted Net Assets – Net assets that are not subject to donor-imposed stipulations including unrestricted resources obtained in connection with Project GRAD Houston's educational projects and programs.

- Temporarily Restricted Net Assets – Net assets that are subject to donor-imposed stipulations that require the passage of time or the occurrence of a specific event.

- Permanently Restricted Net Assets – Net assets with donor-imposed restrictions that require them to be maintained in perpetuity, with only the income used for Project GRAD Houston's activities. Project GRAD Houston had no permanently restricted net assets at December 31, 2010 or during the year then ended.

E. Revenue Recognition

For services that Project GRAD Houston provides on a contract basis, revenue is recognized on the contracts as the qualifying expenses are incurred or services are provided.

Contributions are recognized when the donor makes a promise to give to Project GRAD Houston that is, in substance, unconditional. Contributions that are restricted by the donor for future periods or a specific purpose are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activity as net assets released from restrictions.

Project GRAD Houston reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. 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 support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, Project GRAD Houston reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Summary of Significant Accounting Policies (Continued)

F. Donated Materials and Services

Donated materials are recorded as contributions at fair value when an unconditional commitment is received from the donor. The related expense is recorded as the item is used. Donated 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. The Chairman and his wife, Co-Founders of Project GRAD Houston, have donated substantial amounts of time toward fund-raising and various other services supporting the ongoing operation of Project GRAD Houston. The value of these donated services has not been reflected in the financial statements.

G. Income Taxes

Project GRAD Houston is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). Accordingly, no provision for income taxes has been made. However, should Project GRAD Houston engage in activities unrelated to the purpose for which it was created, taxable income could result.

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic No. 740, *Accounting for Income Taxes*, prescribes accounting for and disclosure of uncertainty in tax positions. This interpretation defines the criteria that must be met for the benefits of a tax position to be recognized in the financial statements and the measurement of tax benefits recognized. For the year ended December 31, 2010, the Organization did not record any liabilities for uncertain tax positions, and did not recognize any interest or penalty expense related to uncertain tax positions or income taxes. The Organization does not expect the amounts of unrecognized tax benefits to significantly increase or decrease within the next twelve (12) months.

H. Use of Estimates

Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Actual results could differ from those estimates.

I. Functional Allocation of Expense

The costs of providing various programs and supporting services have been summarized on a functional basis. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Summary of Significant Accounting Policies (Continued)

J. Recent Accounting Pronouncements

Not-for-Profit Entities: Mergers and Acquisitions

In July 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions,* which amended FASB ASC Topic No. 958, *Not-for-Profit Entities*. This update provides guidance on a transaction or other event in which a not-for-profit entity that is the reporting entity combines with one or more other not-for-profit entities, businesses or nonprofit activities in a transaction that meets the definition of a merger of not-for-profit entities or an acquisition by a not-for-profit entity. The objective of this update is to improve the relevance, representational faithfulness, and comparability of the information that a not-for-profit entity that is a reporting entity provides in its financial reports about a combination with one or more other not-for-profit entities, businesses, or nonprofit activities. Management has concluded that the adoption of this guidance had no impact on the Organization's results of activities, financial position or liquidity for the year ended December 31, 2010.

Technical Corrections to Various Topics

In February 2010, the FASB issued ASU No. 2010-08, *Technical Corrections to Various Topics*. The purpose of ASU 2010-08 is to eliminate GAAP inconsistencies, update outdated provisions, and provide needed clarifications. Management has concluded that the adoption of this guidance had no impact on the Organization's results of activities, financial position or liquidity for the year ended December 31, 2010.

NOTE 2 – PLEDGES RECEIVABLE

Pledges receivable are summarized as follows:

The Fondren Foundation	$ 250,000
AT&T	100,000
Other	24,500
PLEDGES RECEIVABLE	$ 374,500

NOTE 2 – PLEDGES RECEIVABLE (CONTINUED)

Pledges receivable are due as follows:

Amounts Due in	Amount
Less than one year	$ 267,750
One to three years	106,750
TOTAL	$ 374,500

The present value of cash flows from recorded contribution and grant receivables does not vary significantly from the stated value; therefore, no discount has been recorded.

NOTE 3 – DEBT

Effective October 4, 2008, Project GRAD Houston renewed a $1,500,000 line of credit with a financial institution. This was converted to a note payable and the unpaid principal on the note is due October 4, 2011. Interest payments are due monthly at a rate per year equal to the London Interbank Offered Rate ("LIBOR") Daily Floating Rate plus 1.15% percentage points (1.41% at December 31, 2010) and totaled $19,242 for the year ended December 31, 2010. The Founder and Chairman of Project GRAD Houston has guaranteed the amount outstanding under this note payable. At December 31, 2010, the outstanding balance was $1,296,655.

NOTE 4 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets that are subject to donor-imposed stipulations are available as follows at December 31, 2010:

Fine Arts program	$ 304,190
Scholarships and college preparation	265,000
Other programs	17,200
TOTAL	$ 586,390

NOTE 5 – RELEASE OF DONOR RESTRICTIONS

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows at December 31, 2010:

Fine Arts program	$ 120,110
Scholarships and college preparation	888,107
Other programs	88,300
TOTAL	$ 1,096,517

NOTE 6 – OPERATING LEASES

On January 18, 2008, Project GRAD Houston entered into an operating lease for office space through January 17, 2010. On January 18, 2010, Project GRAD Houston entered into a renewal of the operating lease agreement originally dated January 18, 2008. The renewal was for a one-year operating lease that expired on January 17, 2011. The terms of the lease required monthly rental payments of $2,358 for the remainder of the lease. As of May 31, 2010, the operating lease was terminated by the lessor under the termination provisions of the lease, so that the premises could be used for classroom space by the lessor. On April 29, 2010, Project GRAD Houston entered into a noncancelable operating lease agreement for office space with a term beginning on May 24, 2010 and expiring July 31, 2012. The terms of the lease require monthly rental payments of $7,196 through August 1, 2011 and monthly rental payments of $7,428 for the remainder of the lease.

Estimated annual minimum commitments for payment of rent under the noncancelable operating lease, with maturity in 2012 is as follows:

For the Year Ending December 31,	Amount
2011	$ 87,511
2012	51,996
TOTAL	$ 139,507

Rent expense for the year ended December 31, 2010 was $77,232.

NOTE 7 – EMPLOYEE BENEFIT PLANS

Project GRAD Houston has a qualified 401(k) plan which covers substantially all employees meeting certain eligibility requirements. Participants may contribute a portion of their compensation to the plan, up to the maximum amount permitted under Section 401(k) of the Internal Revenue Code. Project GRAD Houston's contribution to the plan, as determined by the Board of Directors, is discretionary but cannot exceed certain maximum defined limitations. Project GRAD Houston's matching contribution was $31,854 for the year ended December 31, 2010.

NOTE 8 – PROJECT FUNDING

During 2008, the U.S. Department of Education awarded Project GRAD Houston a four-year Federal grant (FAME) to continue funding certain fine arts programs. The grant award is $252,363 per year for the period 2008 – 2012. For the year ended December 31, 2010, Project GRAD Houston recorded revenue of $267,343, of which $40,910 is recorded as grants receivable. Total revenue under this grant is reported in government grants in the statement of activity.

Project GRAD Houston entered into an agreement to provide services to HISD in support of a six-year GEAR UP grant awarded to HISD from the U.S. Department of Education. The grant award is $3,122,400 per year for the period 2005 - 2011. The grant funds an initiative for students that entered the sixth grade in 2005 and 2006 through their completion of the eleventh grade. The GEAR UP cohort includes students in all of the high schools served by Project GRAD Houston. HISD is the fiscal agent for the grant and pays many of the program costs directly. Qualifying expenditures for services performed by Project GRAD Houston and invoiced to HISD in support of the grant for the calendar year 2010 amounted to $1,178,930, which is reported in contracts and agreements revenue in the statement of activity. This grant was extended for a one year period, through August 31, 2012, subsequent to year end (*Note 12)*.

In July 2009, Project GRAD Houston and HISD entered into a one-year agreement with HISD for $2,009,137 to provide services to HISD's 66 campuses within the following five high school feeder systems: Jefferson Davis, Phillis Wheatley, Jack Yates, John Reagan and Sam Houston High Schools for the school year 2009/2010. Several of the program components include college access programs for grades PK-16; college summer institutes for grades 9-12; college scholarships for grades 9-16; parent and community engagement programs for grades PK-16; classroom management/educational climate support for grades PK-12; aligned academic support services for grades PK-12; and fine arts program PK-12 for the Jefferson Davis feeder pattern schools. Services performed by Project GRAD Houston and invoiced to HISD in support of the program for the calendar year 2010 under this agreement amounted to $1,067,131, which is reported in contracts and agreements revenue in the statement of activity.

In July 2010, Project GRAD Houston and HISD renewed their one-year service agreement for $1,860,257 to provide the same services as the original contract for the school year 2010/2011. Services performed by Project GRAD Houston and invoiced to HISD in support of the program for the calendar year 2010 under this agreement amounted to $847,684. This service agreement is expected to renew effective July 1, 2011 in the amount of $1,425,000 for a one year period.

NOTE 8 – PROJECT FUNDING (CONTINUED)

Project GRAD Houston administers the scholarship program for graduates of all partnering high schools. Scholarships for graduates of John Reagan and Sam Houston High Schools are available from a Trust maintained by HISD. The Trust was initially funded by GEAR UP grants in 2001 – 2002 and the balance at December 31, 2010 was $10,092,076. In 2010, Project GRAD Houston paid $551,938 to universities for the benefit of John Reagan and Sam Houston High School graduates. This amount was subsequently reimbursed to Project GRAD Houston from the Trust and is reported in contracts and agreements revenue in the statement of activity.

NOTE 9 – CONTINGENCIES

Amounts received or receivable from federal grantor agencies are subject to oversight by the funding agencies and could potentially be subject to reimbursement in subsequent periods. Approximately six percent (6%) of total revenues were provided by direct federal awards during the year ended December 31, 2010. Additionally, services and amounts receivable in the future from HISD are dependent upon the execution of contracts with HISD and available funding by HISD and the GEAR UP grant program.

In the normal course of business, Project GRAD Houston may become subject to lawsuits and other claims and proceedings. Such matters are subject to uncertainty and outcomes are not predictable with assurance. Management is not aware of any pending or threatened lawsuits or proceedings that would have a material adverse effect on Project GRAD Houston's financial position, liquidity or results of operations.

NOTE 10 – CONCENTRATIONS

For the year ended December 31, 2010, revenues derived from service contracts with HISD accounted for approximately fifty-seven percent (57%) of the total public support and revenues. An additional ten percent (10%) of revenues are reimbursements from the HISD Trust for scholarships discussed in *Note 8*.

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash investments. The Organization maintains its cash balances in financial institutions, which at times exceed the amount insured by the Federal Deposit Insurance Corporation ("FDIC"). Effective November 9, 2010, the FDIC issued a Final Rule providing unlimited insurance coverage of noninterest-bearing transaction accounts for the period from December 31, 2010 through December 31, 2012. Effective July 21, 2010, the standard maximum deposit insurance amount ("SMDIA") of $250,000 was made permanent. The SMDIA of $250,000 currently applies to all interest-bearing accounts. Management periodically assesses the financial condition of the financial institutions and believes that any possible credit risk is minimal. At December 31, 2010, the Organization did not hold funds in excess of federally insured amounts.

NOTE 11 – LIQUIDITY

The ability of Project GRAD Houston to offer its existing programs is dependent upon the continued support from the Founder and Chairman including his guaranty of the existing bank line of credit, and the ability of management to control operating expenses and develop new sources of funding.

NOTE 12 – SUBSEQUENT EVENTS

The Organization evaluates subsequent events in accordance with FASB ASC Topic No. 855, *Subsequent Events*. The guidance requires an entity to disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. In preparing these financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through June 22, 2011, the date the financial statements were available to be issued. The Organization has determined the following to be a subsequent event requiring disclosure.

The final year for the GEAR UP grant was to end on August 31, 2011, however not all funds were expended in the six (6) year grant period. Subsequent to year end, the Department of Education has extended the term of the grant. The extended term of the grant begins on September 1, 2011, with expiration on August 31, 2012. The carryover amount is approximately $1,600,000, of which approximately $1,300,000 represents revenues to Project GRAD Houston.