Consolidated Financial Statements Together with
Report of Independent Certified Public Accountants

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES

As of June 30, 2012 and 2011

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Trustees
Harlem Children's Zone, Inc. and Subsidiaries:

We have audited the accompanying consolidated statements of financial position of Harlem Children's Zone, Inc. and Subsidiaries (collectively, the "Organization") as of June 30, 2012 and 2011, and the related consolidated statements of activities and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of June 30, 2012 and 2011 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the Organization's consolidated financial statements as a whole. The Schedule of Functional Expenses for the years ended June 30, 2012 and 2011 on pages 20 and 21 are presented for purposes of additional analysis and are not a required part of the financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Grant Thornton LLP

New York, New York
February 1, 2013

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Position
As of June 30, 2012 and 2011

ASSETS	2012	2011
CURRENT ASSETS		
Cash and cash equivalents	$ 18,538,132	$ 18,898,332
Grants and contributions receivable	52,503,853	54,574,426
Other receivables	14,710,698	5,196
Prepaid expenses	1,069,411	744,056
Total current assets	86,822,094	74,222,010
Grants and contributions receivable	83,344,155	76,904,199
Investments	176,894,542	149,987,927
Security deposits	582,624	521,363
Property and equipment, net	107,958,320	59,631,822
Total assets	$ 455,601,735	$ 361,267,321
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 8,563,125	$ 7,713,128
Deferred compensation payable	918,866	996,430
Due to related party - 457(f) plan	994,341	646,830
Total current liabilities	10,476,332	9,356,388
Deferred compensation payable, net of current portion	4,239,751	3,770,831
Due to related party - 457(f) plan, net of current portion	5,752,903	5,625,234
Other liabilities	66,528,562	25,760,854
Total liabilities	$ 86,997,548	$ 44,513,307
NET ASSETS		
Unrestricted:		
Board-designated	163,618,071	140,613,742
Undesignated	66,529,162	54,434,118
Total unrestricted	230,147,233	195,047,860
Temporarily restricted	136,835,792	121,706,154
Permanently restricted	1,621,162	-
Total net assets	368,604,187	316,754,014
Total liabilities and net assets	$ 455,601,735	$ 361,267,321

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

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Statement of Activities
For the year ended June 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Grants and contributions	$ 56,505,045	$ 60,760,587	$ 1,621,162	$ 118,886,794
Government grants	9,189,345	-	-	9,189,345
Special event, net of expenses totaling $270,363	5,115,661	-	-	5,115,661
Interest income	52,748	-	-	52,748
Other income	672,573	-	-	672,573
Gain on investments, net	8,642,545	-	-	8,642,545
	80,177,917	60,760,587	1,621,162	142,559,666
Net assets released from restrictions	45,630,949	(45,630,949)	-	-
Total revenues	125,808,866	15,129,638	1,621,162	142,559,666
EXPENSES				
Program services:				
Harlem Children's Zone	65,001,852	-	-	65,001,852
Preventive services	5,241,733	-	-	5,241,733
Beacon and after school services	9,526,713	-	-	9,526,713
Head Start Program	1,901,895	-	-	1,901,895
Total program services	81,672,193	-	-	81,672,193
Supporting services:				
Management and general	7,684,817	-	-	7,684,817
Fundraising	1,352,483	-	-	1,352,483
Total supporting services	9,037,300	-	-	9,037,300
Total expenses	90,709,493	-	-	90,709,493
Changes in net assets	35,099,373	15,129,638	1,621,162	51,850,173
Net assets, beginning of year	195,047,860	121,706,154	-	316,754,014
Net assets, end of year	$ 230,147,233	$ 136,835,792	$ 1,621,162	$ 368,604,187

The accompanying notes are an integral part of this consolidated statement.

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Statement of Activities
For the year ended June 30, 2011

	Unrestricted	Temporarily Restricted	Total
REVENUES			
Grants and contributions	$ 69,119,839	$ 124,690,162	$ 193,810,001
Government grants	10,134,793	-	10,134,793
Special event, net of expenses totaling $337,460	6,311,467	-	6,311,467
Interest income	203,243	-	203,243
Other income	107,377	-	107,377
Gain on investments, net	7,161,292	-	7,161,292
	93,038,011	124,690,162	217,728,173
Net assets released from restrictions	4,509,008	(4,509,008)	
Total revenues	97,547,019	120,181,154	217,728,173
EXPENSES			
Program services:			
Harlem Children's Zone	58,008,944	-	58,008,944
Preventive services	5,437,809	-	5,437,809
Beacon and after school services	7,854,771	-	7,854,771
Head Start Program	1,831,592	-	1,831,592
Total program services	73,133,116	-	73,133,116
Supporting services:			
Management and general	6,003,547	-	6,003,547
Fundraising	1,660,063	-	1,660,063
Total supporting services	7,663,610	-	7,663,610
Total expenses	80,796,726	-	80,796,726
Changes in net assets	16,750,293	120,181,154	136,931,447
Net assets, beginning of year	178,297,567	1,525,000	179,822,567
Net assets, end of year	$ 195,047,860	$ 121,706,154	$ 316,754,014

The accompanying notes are an integral part of this consolidated statement.

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the years ended June 30, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	$ 51,850,173	$ 136,931,447
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation and amortization	1,520,322	1,480,100
Net realized and unrealized gain on investments	(8,642,545)	(7,161,292)
Increase in grants and contributions receivable	(4,369,383)	(128,541,737)
(Increase) decrease in other receivables	(14,705,502)	200,257
(Increase) decrease in prepaid expenses	(325,355)	37,657
Increase in accounts payable and accrued expenses	849,997	3,707,159
Increase in deferred compensation payable	391,356	90,801
Increase in due to related party	475,180	1,880,500
Increase in other liabilities	40,767,708	25,760,854
Net cash provided by operating activities	67,811,951	34,385,746
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(49,846,820)	(18,028,413)
Purchases of investments	(39,422,043)	(117,972,750)
Sales of investments	21,157,973	107,068,196
Security deposits paid	(61,261)	(122,851)
Net cash used in investing activities	(68,172,151)	(29,055,818)
Increase (decrease) in cash and cash equivalents	(360,200)	5,329,928
Cash and cash equivalents, beginning of year	18,898,332	13,568,404
Cash and cash equivalents, end of year	$ 18,538,132	$ 18,898,332

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

1. ORGANIZATION

Harlem Children's Zone, Inc. ("HCZ"), founded in 1970, is a pioneer non-profit community-based organization that works to enhance the quality of life for children and families in some of New York City's most devastated neighborhoods. Formerly known as Rheedlen Centers for Children and Families, HCZ's 15 centers serve 22,636 children and adults, including 11,746 at-risk children. The emphasis of HCZ's work is not just on education, social services, and recreation, but also on rebuilding the very fabric of community life.

The Internal Revenue Service determined HCZ to be a publicly supported organization, exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

Rheedlen 125th Street, LLC ("Rheedlen") and HCZ Promise LLC ("HCZ Promise") are subsidiaries of HCZ, their sole member.

Rheedlen and HCZ Promise (the "Subsidiaries") were organized in the State of New York in June 2000 and April 2010 respectively, under Section 203 of the Limited Liability Company Law of the State of New York to acquire, own, and operate real property. Rheedlen and HCZ Promise are the owners of real property that is currently used by HCZ.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statement presentation conforms with accounting principles generally accepted in the United States of America for non-profit organizations, which require that HCZ and Subsidiaries (collectively, the "Organization") report information regarding their consolidated financial position and changes in net assets according to three classes of net assets, as follows:

Unrestricted net assets
Net assets that are not subject to donor-imposed stipulations and are, therefore, available for the general operations of the Organization.

Temporarily restricted net assets
Net assets which include resources that have been limited by donor-imposed stipulations that either expire with the passage of time and/or can be fulfilled and removed by the actions of the Organization pursuant to those stipulations are considered temporarily restricted. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions.

Permanently restricted net assets
Net assets which include funds whereby the donors have stipulated that the principal contributed be invested and maintained in perpetuity. Income earned from these investments is available for expenditures according to restrictions, if any, imposed by donors.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Organization. Material intercompany transactions and balances have been eliminated in consolidation.

Functional Expenses

The costs of providing the various programs and other activities of the Organization have been summarized on a functional basis in the accompanying consolidated statement of activities, which includes all expenses incurred for the year. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Management allocates the direct costs of its operations to its programs and services based upon the percentage of direct labor costs charged to each program and supporting services by the Organization staff.

Cash and Cash Equivalents

The Organization considers money market fund investments and all highly liquid debt instruments with a maturity of three months or less on the date of acquisition to be cash equivalents.

Allowance for Doubtful Accounts

The carrying value of grants and contributions receivable are reduced by an appropriate allowance for uncollectible accounts, and therefore approximates net realizable value. The Organization determines its allowance by considering a number of factors, including the length of time receivables are past due, the Organization's previous loss history, the donor's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. Receivables outstanding longer than the payment terms are considered past due. The Organization writes off accounts receivables when they become uncollectible, and payments subsequently received on such receivables are recorded as income in the period received.

Investments

Investments are held in limited partnerships and are carried at fair value as determined by the respective general partners. Realized and unrealized gains and losses on investments are included in the accompanying statement of activities as increases or decreases in the unrestricted class of net assets, unless donor or relevant laws place temporary or permanent restrictions on these gains and losses. Dividends and interest are recognized as earned.

Fair Value of Financial Instruments

The carrying amounts of cash, receivables, prepaid expenses and other current assets, accounts payable and accrued expenses and other current liabilities approximate fair value due to the short-term maturity of these financial instruments.

Fair Value Measurements

The Organization follows guidance which establishes a framework for measuring fair value, expands disclosures about fair value measurements and provides a consistent definition of fair value, which focuses on an exit price between market participants in an orderly transaction. The guidance also prioritizes, within the measurement of fair value, the use of market-based information over entity-specific information and establishes a three-level hierarchy for fair value measurements based on the transparency of information used in the valuation of an asset or liability as of the measurement date. Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The type of investments in Level 1 include listed equities held in the name of the Organization, and exclude listed equities and other securities held indirectly through commingled funds.

Level 2 - Pricing inputs, including broker quotes, are generally those other than exchange quoted prices in active markets, which are either directly or indirectly observable as of the measurement date, and fair value is determined through the use of models or other valuation methodologies. Also included in Level 2 are investments using a net asset value ("NAV") per share, or its equivalent, that may be redeemed at NAV at the statement of financial position date or in the near term, which the Organization has determined to be within ninety days.

Level 3 - Pricing inputs are unobservable for the assets or liability and includes situations where there is little, if any, market activity for the assets or liability. The inputs into the determination of fair value require significant management judgment or estimation. Investments that are included in this category generally include privately held investments and partnership interests. Also included in Level 3 are investments measured using a NAV per share, or its equivalent, that can never be redeemed at NAV at the statement of financial position date or in the near term or for which redemption at NAV is uncertain due to lock-up periods or other investment restrictions.

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "observable" requires significant judgment by the Organization. The Organization considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Organization's perceived risk of that instrument.

Property and Equipment

Property and equipment purchased for a value greater than $1,000 and with depreciable lives greater than one year are carried at cost, net of depreciation. Significant additions or improvements extending asset lives are capitalized; normal maintenance and repair costs are expensed as incurred. Leasehold improvements are amortized based on the lesser of the estimated useful life or remaining lease term. Property and equipment used in operations are depreciated over their estimated useful lives using the straight-line method, as follows:

Asset Category	Estimated Useful Life
Automobiles	5 years
Equipment	5 years
Furniture	7 years
Building improvements	31.5 years
Buildings	40 years

Contributions

Contributions, both cash and in-kind, are recorded in the period received as unrestricted, temporarily restricted or permanently restricted revenue depending upon the existence or absence of donor-imposed stipulations. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying consolidated statement of activities as net assets released from restrictions. Temporarily restricted contributions are recorded as unrestricted contributions if the restriction is met in the same reporting period. Contributions to be received after one year are discounted at an appropriate discount rate. Amortization of the discount is recorded as additional contribution revenue in accordance with donor imposed restrictions, if any.

Government Contracts

Revenue from cost reimbursement-based government contracts is recognized when reimbursable costs are incurred under the terms of the contracts. Revenue from performance-based government contracts is recognized when performance objectives pursuant to the contract have been accomplished. Contract payments in excess of qualified cost or performance are accounted for as contract advances, if any.

Contributions in-Kind

Donated materials, equipment, and services are reflected as in-kind contributions (revenues and expenses) at their estimated fair value at the date of receipt.

Use of Estimates

The preparation of the consolidated 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 changes therein, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting for Income Taxes

The Organization follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if the position is "more-likely-than-not" to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged. Management has determined that there are no uncertain tax positions within its consolidated financial statements.

The Organization is exempt from federal income taxation by virtue of being an organization described in Section 501(c)(3) of the Internal Revenue Code. Nevertheless, the Organization may be subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. The tax years ending June 30, 2010, 2011 and 2012 are still open to audit for both federal and state purposes.

3. CONCENTRATION OF CREDIT RISK

The Organization maintain cash and cash equivalent balances in financial institutions, which from time to time exceed the amount insured by the Federal Depository Insurance Corporation and subject the Organization to credit risk. The Organization monitors this risk on a regular basis and does not anticipate any losses with respect to these balances.

4. LINE OF CREDIT

HCZ has a $2,000,000 commercial line of credit (on demand) with a major bank, which matured on July 11, 2012 and was subsequently renewed and extended to mature on July 11, 2013. This line is collateralized by all of HCZ's unrestricted assets. There were no drawings on the line of credit during the years ending June 30, 2012 or June 30, 2011. The terms of the credit agreement state that future drawings, if any, will be subject to interest at the LIBOR Rate plus 1.645%.

5. GRANTS AND CONTRIBUTIONS RECEIVABLE

Grants and contributions receivable at June 30, 2012 and 2011 were due as follows

	2012	2011
Less than one year	$ 52,503,853	$ 54,574,426
More than one year (net of present value discount of $ 4,150,056 and $3,392,314, respectively)	83,344,155	76,904,199
Total	$ 135,848,008	$ 131,478,625

Contributions that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using a risk-adjusted interest rate of 2.39% and 2.41% for the years ended June 30, 2012 and 2011.

6. INVESTMENTS

Investments held at June 30, 2012 and 2011 were in limited partnership hedge funds with a fair value of $176,894,542 and $149,987,927, respectively. These investments were exposed to various risks. Due to the level of risk associated with these investments, it is at least reasonably possible that changes in the values of these investments will occur in the near term. These changes could materially affect the amounts reported in the consolidated financial statements. As of June 30, 2012 the investment balance of $176,894,542 includes $4,000,000 of cash held for investment that is made up of cash disbursed to an investment fund that had not yet been credited to HCZ's capital account in that fund. As of June 30, 2012, the Organization had a redemption in process for $11,011,000 from one of their investment funds. Although the redemption process began in fiscal 2012, the proceeds were not received until fiscal 2013 and, as such, this amount was included in other receivables as of June 30, 2012.

The Organization intends to maintain the investments as a reserve for capital expansion and for investment income intended to supplement operations to be determined by the Board of Trustees (the "Board").

Realized and unrealized gains, net, for the years ended June 30, 2012 and 2011 were $8,642,545 and $7,161,292.

The following table summarizes the fair values of HCZ's assets as of June 30, 2012 and 2011:

	2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Limited Partnerships, at fair value	$ -	$ 97,304,396	$ 75,590,146	$ 172,894,542
Cash held for investment				4,000,000
Total investments				$ 176,894,542

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Limited Partnerships, at fair value	$ -	$ 78,221,289	$ 71,766,638	$ 149,987,927

HCZ's investments at June 30, 2012 and 2011 consisted of the following:

	2012		2011	
	Number of Funds	**Fair Value**	**Number of Funds**	**Fair Value**
Alternative investments:				
Non-marketable alternative investments:				
Limited Partnerships (a)	8	$ 172,894,542	7	$ 149,987,927

(a) This category includes investments in multiple limited partnerships which represent various investment approaches. Some of the fund managers are focused primarily on long/short equity investments while others are operated for the purpose of trading predominantly in commodity interests. In some cases, managers may also invest a portion of the assets in securities for which there is no ready market such as private or restricted securities. In general, the goal of these funds is to achieve significant risk adjusted returns over time.

The following table lists investments by major category at June 30, 2012 and 2011:

2012	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Level 2	$ 97,304,396	$ -	Quarterly	30 to 90 days. In addition to the Notice Period, firms may hold back a portion of the redemption proceeds until completion of the investment firm's audit at the end of its fiscal year.
Level 3	$ 75,590,146	$ -	Quarterly/Semi-annually Some fund investments are subject to lockup periods that have not yet expired. In addition, some funds have investments in private companies that cannot be liquidated in the near term.	30 to 90 days. In addition to the Notice Period, firms may hold back a portion of the redemption proceeds until completion of the investment firm's audit at the end of its fiscal year.

2011	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Level 2	$ 78,221,289	$ -	Quarterly	30 to 90 days. In addition to the Notice Period, firms may hold back a portion of the redemption proceeds until completion of the investment firm's audit at the end of its fiscal year.
Level 3	$ 71,766,638	$ -	Quarterly/Semi-annually Some fund investments are subject to lockup periods that have not yet expired. In addition, some funds have investments in private companies that cannot be liquidated in the near term.	30 to 90 days. In addition to the Notice Period, firms may hold back a portion of the redemption proceeds until completion of the investment firm's audit at the end of its fiscal year.

7. PROPERTY AND EQUIPMENT, NET

Property and equipment at June 30, 2012 and 2011 consisted of the following:

	2012	2011
Property used in operations:		
Automobiles	$ 102,266	$ 102,266
Equipment	2,545,716	2,479,431
Furniture	911,798	910,223
Leasehold improvements	7,881,557	7,193,520
Buildings	55,738,594	48,935,464
Construction in progress (Note 13)	52,762,726	10,474,933
	119,942,657	70,095,837
Less: accumulated depreciation and amortization	(11,984,337)	(10,464,015)
	$ 107,958,320	$ 59,631,822

Depreciation and amortization expenses for 2012 and 2011 were $1,520,322 and $1,480,100, respectively.

8. CONSULTING AND PROFESSIONAL FEES

The Organization paid fees to individuals and other agencies for providing services to children, including a mentor program, arts and health workshops, and program documentation. The total amounts paid for these services for the years ended June 30, 2012 and 2011 were $3,338,634 and $2,877,279, which is included in consulting and professional fees.

9. PROFIT-SHARING PLAN

The Organization maintains a non-contributory profit-sharing plan for all eligible employees. Employees become eligible once they have reached age 21 and have completed one year of service. Employees participating in the plan become fully vested after completing six years of service. The Organization makes discretionary contributions to the plan, which for the years ended June 30, 2012 and 2011 were $826,993 and $802,906, respectively.

10. 457(F) PLAN

The Organization maintains a 457(f) plan for certain eligible employees. Employees become eligible to participate in this plan based solely at the discretion of HCZ's Board of Trustees. The amounts contributed by the Organization vest after 5 years from the date of the initial contribution. At June 30, 2012 and 2011, the total liability relating to this plan was $5,158,617 and $4,767,261, respectively. The total expense recorded within the consolidated statement of activities totaled $803,922 and $929,238 for the years ended June 30, 2012 and 2011, respectively.

11. NET ASSETS AND ENDOWMENTS

The Organization's endowment consists of both donor-restricted endowment funds established for a variety of purposes and funds designated by the Board of Trustees to function as quasi-endowments. The Board designated an expansion and emergency reserve in prior years. The reserve is funded with the investments held which are described in note 6 and the return on those investments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

On September 17, 2010, New York State passed the New York State Prudent Management of Institutional Funds Act ("NYPMIFA"), its version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). All not-for-profit organizations formed in New York must apply this law. The Organization classifies donor-restricted endowment funds as permanently restricted net assets, unless otherwise stipulated by the donor: (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the funds.

From time to time, the fair value of assets associated with an individual donor-restricted endowment fund may fall below the fund's historic dollar value. Under NYPMIFA, the Organization may spend below the historical dollar value of its endowment funds, if determined to be prudent, unless specific donors have stipulated to the contrary. At June 30, 2012 and 2011, the Organization had not spent below the historical dollar value of its endowments.

The Organization classifies as permanently restricted net assets (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by NYPMIFA. In accordance with NYPMIFA, the Board considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Organization and the endowment funds
- General economic conditions
- The possible effects of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Organization
- Where appropriate, alternatives to expenditure of the endowment funds and the possible effects on the Organization
- The investment policies of the Organization.

Return Objectives, Risk Parameters and Strategies Employed for Achieving Objectives

As approved by the Board of Trustees, endowment assets are invested in a manner that is intended to produce returns that exceed the price and yield returns of appropriate benchmarks without putting the assets at imprudent risk.

The following table summarizes endowment net asset composition by type of fund as of June 30, 2012 and 2011:

	2012			2011
	Unrestricted	Permanently Restricted	Total	Unrestricted
Donor restricted (endowment)	$ (236,994)	$ 1,621,162	$ 1,384,168	$ -
Board designated (quasi)	163,618,071	-	163,618,071	140,613,742
Total	$ 163,381,077	$ 1,621,162	$ 165,002,239	$ 140,613,742

	2012			2011
	Unrestricted	Permanently Restricted	Total	Unrestricted
Endowment net assets, beginning of year	$ 140,613,742	$ -	$ 140,613,742	$ 131,922,081
Contributions	-	1,621,162	1,621,162	-
Net depreciation (realized and unrealized)	(236,994)	-	(236,994)	-
Investment income	8,797,192	-	8,797,192	6,886,368
Transfers in	14,207,137	-	14,207,137	1,805,293
Endowment net assets, end of year	$ 163,381,077	$ 1,621,162	$ 165,002,239	$ 140,613,742

Temporarily and Permanently Restricted

Net Assets released for the years ended June 30, 2012 and 2011 were as follow:

	2012	2011
Purpose restriction satisfied	$ -	$ 3,734,008
Timing restriction satisfied	45,630,949	775,000
Total net assets released from restrictions	$ 45,630,949	$ 4,509,008

Restricted net assets were available for the following purposes or periods as of June 30, 2012 and 2011:

	2012	2011
Temporary purpose restrictions	$ 20,718,597	$ -
Temporary time restrictions	116,117,195	121,706,154
Total temporary restrictions	136,835,792	121,706,154
Permanent restrictions	1,621,162	-
	$ 138,456,954	$ 121,706,154

The income from permanently restricted net assets is restricted for providing partial college scholarships to graduating Promise Academy students.

12. COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Organization leases space and equipment at various locations for its programs and administrative activities under non-cancellable operating leases expiring through May 2022.

As of June 30, 2012, minimum future annual rental obligations under the terms of these leases are as follows:

Year	
2013	$ 2,881,277
2014	2,781,365
2015	2,531,994
2016	2,394,850
2017	1,673,106
Thereafter	3,101,474
	$ 15,364,066

Rent expense for the years ended June 30, 2012 and 2011 was $3,030,432 and $2,354,332, respectively.

Government Agency Audits

Cost reimbursable grants applicable to various programs conducted for and on behalf of New York State and City governmental agencies are subject to adjustments, if any, based on the results of audits by these agencies. The management of the Organization is of the opinion that the results of any such audits would not have a material effect on the accompanying consolidated financial statements.

Lease Agreement with the Children's Health Fund

Rheedlen is the landlord of the building at 35 East 125th Street. The building is occupied by the HCZ Promise Academy Charter Schools, HCZ, and the Children's Health Fund ("CHF"), an unrelated party. CHF holds a 10-year lease agreement with Rheedlen which expires on December 31, 2015, for the use of clinic space in exchange for medical services it provides to the students of Promise Academy and the clients of HCZ.

Litigation

Various legal proceedings and claims are pending against the Organization. Although the Organization's liability with respect to such matters cannot be ascertained at June 30, 2012, in the opinion of management and its legal counsel, the ultimate liability, if any, from all pending legal proceedings and claims will not materially affect the Organization's financial position or the results of its operations.

13. RELATED-PARTY TRANSACTIONS

In the prior year, a significant portion of the money invested in limited partnerships was managed by members of the Board, who received no compensation for their services. As of June 30, 2012, a small portion of the money invested in limited partnerships was managed by members of the Board, who received no compensation for their services. In addition, the Organization receives a significant amount of contributions from members of the Board.

Commitment to the Promise Academy Charter Schools

Pursuant to the terms of a commitment letter between HCZ and the Promise Academy Charter Schools ("PACS"), HCZ, as the PACS' Institutional Partner, committed to provide the PACS certain services at no cost. These services include financial management, social, library, technology, fundraising, public relations, and teaching assistance services. In addition, HCZ committed to provide Promise Academy I with the use of space in its premises located at 35 East 125th Street, New York, NY. As of July 1, 2009, Promise Academy I renewed its charter for an additional five year term and HCZ renewed its commitment to the School to provide the same level of services through June 30, 2014. As of April 15, 2010, Promise Academy II renewed its charter for an additional five year term and HCZ renewed its commitment to the School to provide the same level of services through April 15, 2015. The commitments to the PACS can be cancelled by either party with one year's notice. HCZ has not cancelled the commitment and is not aware of either of the Schools opting to cancel the commitment.

457(f) Plan

The Organization includes, within its 457(f) plan, employees of the Promise Academy Charter Schools and provides PACS with an annual subsidy to cover this cost. PACS are two high-quality charter schools affiliated with the Organization. The amount due to PACS at June 30, 2012 and 2011 was $6,747,244 and $6,272,064, respectively. The total expense recorded within the consolidated statement of activities totaled $1,130,118 and $1,885,500 for the years ended June 30, 2012 and 2011, respectively.

New Building Construction

During the year ended June 30, 2011, the Organization entered into agreements for the construction of a new charter school (the "School Project"). The agreements provided that the New York School Construction Authority (the "SCA") contribute up to $60,000,000 towards the School Project, with the estimated balance of approximately $40,000,000, to be contributed by the Organization or other donors. Upon completion of construction and issuance of the certificate of occupancy, title to the School Project will be transferred to the New York City Department of Education (the "DOE") and leased back to the Organization. Although the lease will be between the Organization and the DOE, the lease agreement will designate the Promise Academy Charter School (the "School") as the initial user of the premises.

The Organization is accounting for this arrangement as an agency transaction on behalf of the School as the School will be the ultimate beneficiary of the School Project. As such, the Organization is capitalizing the full cost of construction and recording any payments received or due from the SCA as well as any donor pledges that were restricted for the School Project as other liabilities on the financial statements. Construction in progress for the School Project at June 30, 2012 and 2011 was $52,762,726 and $10,474,933, respectively. Other liabilities arising from the School Project at June 30, 2012 and 2011, representing SCA and donor funding, were $66,528,562 and $25,760,854. Upon the transfer and execution of the leases, the Organization will derecognize the capitalized cost of construction of the School and the corresponding liability pertaining to SCA and donor funding, and record a grant expense for the portion of the School Project funded by the Organization.

As part of the agreement, the New York City Housing Authority (NYCHA) agreed to reimburse the Organization for certain site, street, and land transfer costs around the construction site of School Project that do not add value to the School Project and are therefore not being capitalized as construction in progress by the Organization. At June 30, 2012, the Organization was owed $2,671,032 in reimbursements from NYCHA, which has been included in other receivables.

14. SUBSEQUENT EVENTS

The Organization has evaluated subsequent events through February 1, 2013, which is the date the financial statements were available to be issued. The Organization is not aware of any subsequent events which would require recognition or disclosure in the consolidated financial statements.

SUPPLEMENTARY INFORMATION

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Schedule of Functional Expenses
For the year ended June 30, 2012

	Program Services					Supporting Services		
	Harlem Children's Zone	Preventive Services	Beacon and After School Services	Head Start Program	Total	Management and General	Fundraising	Total
Salaries	$ 37,338,676	$ 3,182,785	$ 6,304,522	$ 1,024,116	$ 47,850,099	$ 1,497,048	$ 956,077	$ 50,303,224
Payroll taxes	4,082,881	327,609	699,587	100,534	5,210,611	159,478	70,398	5,440,487
Employee benefits	5,117,525	736,382	604,656	246,057	6,704,620	222,838	118,450	7,045,908
Retirement plan contribution	520,726	47,517	85,134	15,337	668,714	129,668	28,611	826,993
Total personnel services	47,059,808	4,294,293	7,693,899	1,386,044	60,434,044	2,009,032	1,173,536	63,616,612
Admissions	446,166	12,889	99,172	8,983	567,210	2,591	-	569,801
Automobile	-	-	-	-	-	12,323	-	12,323
Bank fees	198	-	-	34	232	14,892	-	15,124
Client travel	959,871	17,182	57,101	13,061	1,047,215	7,662	-	1,054,877
Consulting and professional fees	1,482,696	126,586	60,140	37,917	1,707,339	1,618,869	12,426	3,338,634
Depreciation	1,049,023	91,219	152,032	30,406	1,322,680	167,236	30,406	1,520,322
Education supplies	498,779	5,006	25,905	10,032	539,722	24,195	1,161	565,078
Equipment rental and maintenance	511,507	26,252	78,932	9,959	626,650	197,945	2,319	826,914
Food	2,282,585	8,658	130,838	89,522	2,511,603	34,925	231	2,546,759
Fundraising costs	-	-	-	-	-	-	7,874	7,874
Insurance	160,796	13,982	23,304	4,661	202,743	25,634	4,661	233,038
Occupancy	3,530,038	438,499	238,836	256,841	4,464,214	1,106,345	-	5,570,559
Office supplies	505,314	18,646	22,631	5,511	552,102	75,570	3,227	630,899
Payroll processing	319,908	26,996	44,993	11,224	403,121	49,492	8,999	461,612
Postage	3,008	457	60	155	3,680	31,922	7,767	43,369
Printing, publications, and memberships	124,444	8,032	13,915	8,202	154,593	117,403	10,698	282,694
Software	120,035	5,243	4,880	2,621	132,779	197,363	15,385	345,527
Special client services/incentives	1,353,020	53,356	50,400	6,422	1,463,198	11,268	100	1,474,566
Promise Academy incentive provision	1,130,118	-	-	-	1,130,118	-	-	1,130,118
Staff travel	84,164	34,691	3,714	1,722	124,291	37,708	35,819	197,818
Stipends	2,655,291	-	762,969	-	3,418,260	-	-	3,418,260
Investment management fees (contributed services)	-	-	-	-	-	1,387,832	-	1,387,832
Telephone	235,795	55,080	35,864	7,679	334,418	197,879	8,193	540,490
Training	236,469	2,392	6,150	8,219	253,230	26,910	-	280,140
Miscellaneous	252,819	2,274	20,978	2,680	278,751	329,821	29,681	638,253
Total other than personnel	17,942,044	947,440	1,832,814	515,851	21,238,149	5,675,785	178,947	27,092,881
Total expenses	$ 65,001,852	$ 5,241,733	$ 9,526,713	$ 1,901,895	$ 81,672,193	$ 7,684,817	$ 1,352,483	$ 90,709,493

This schedule should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

HARLEM CHILDREN'S ZONE, INC. AND SUBSIDIARIES
Consolidated Schedule of Functional Expenses
For the year ended June 30, 2011

	Program Services					Supporting Services		
	Harlem Children's Zone	Preventive Services	Beacon and After School Services	Head Start Program	Total	Management and General	Fundraising	Total
Salaries	$ 31,866,321	$ 3,199,101	$ 5,219,650	$ 879,817	$ 41,164,889	$ 958,760	$ 1,196,508	$ 43,320,157
Payroll taxes	3,506,175	302,066	590,881	85,268	4,484,390	103,766	70,352	4,658,508
Employee benefits	4,805,932	847,160	590,313	223,376	6,466,781	151,691	123,346	6,741,818
Retirement plan contribution	563,033	73,076	92,305	21,856	750,270	21,931	30,705	802,906
Total personnel services	40,741,461	4,421,403	6,493,149	1,210,317	52,866,330	1,236,148	1,420,911	55,523,389
Admissions	390,248	10,713	74,385	10,723	486,069	-	-	486,069
Automobile	-	-	-	-	-	7,367	-	7,367
Bank fees	15,406	1,532	2,251	420	19,609	3,557	-	23,166
Client travel	655,253	14,314	56,169	12,942	738,678	-	-	738,678
Consulting and professional fees	2,341,144	198,638	72,732	159,094	2,771,608	76,304	29,367	2,877,279
Depreciation	1,004,244	27,249	39,750	9,235	1,080,478	390,137	9,485	1,480,100
Education supplies	557,174	1,060	34,707	9,897	602,838	-	112	602,950
Equipment rental and maintenance	761,850	75,561	83,737	40,580	961,728	416,296	2,537	1,380,561
Food	1,940,889	10,441	96,078	92,329	2,139,737	36,746	3,350	2,179,833
Fundraising costs	-	-	-	-	-	-	4,955	4,955
Insurance	135,082	13,039	18,992	4,410	171,523	28,954	4,533	205,010
Occupancy	2,411,670	443,424	223,606	212,194	3,290,894	867,879	-	4,158,773
Office supplies	366,446	35,311	43,845	14,642	460,244	96,676	698	557,618
Payroll processing	259,693	27,231	39,990	9,562	336,476	63,200	-	399,676
Postage	23,731	2,654	3,230	644	30,259	4,844	1,491	36,594
Printing, publications, and memberships	115,425	9,440	3,644	17,072	145,581	91,700	10,283	247,564
Software	174,656	15,645	6,720	1,868	198,889	9,482	100,683	309,054
Special client services/incentives	1,270,687	20,126	23,534	1,084	1,315,431	-	1,324	1,316,755
Promise Academy incentive provision	1,885,500	-	-	-	1,885,500	-	-	1,885,500
Staff travel	83,056	31,701	3,787	1,074	119,618	55,300	35,299	210,217
Stipends	1,991,380	-	457,976	-	2,449,356	-	-	2,449,356
Investment management fees (contributed services)	-	-	-	-	-	2,350,182	-	2,350,182
Telephone	350,123	56,689	45,949	9,013	461,774	21,752	9,357	492,883
Training	299,225	10,984	15,257	11,437	336,903	30,811	485	368,199
Miscellaneous	234,601	10,654	15,283	3,055	263,593	216,212	25,193	504,998
Total other than personnel	17,267,483	1,016,406	1,361,622	621,275	20,266,786	4,767,399	239,152	25,273,337
Total expenses	$ 58,008,944	$ 5,437,809	$ 7,854,771	$ 1,831,592	$ 73,133,116	$ 6,003,547	$ 1,660,063	$ 80,796,726

This schedule should be read in conjunction with the accompanying consolidated financial statements and notes thereto.