SCHALL & ASHENFARB Certified Public Accountants, LLC

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PENCIL, INC.

Audited Financial Statements

June 30, 2013

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Pencil, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Pencil, Inc., which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 organization'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 organization'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.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pencil, Inc. as of June 30, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Pencil's 2012 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 27, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Schall & Ashenfarb

Schall & Ashenfarb
Certified Public Accountants, LLC

November 26, 2013

PENCIL, INC.
STATEMENT OF FINANCIAL POSITION
AT JUNE 30, 2013
(With comparative totals as of June 30, 2012)

	6/30/13	6/30/12
Assets		
Cash and cash equivalents (Notes 2c and 2d)	$65,350	$287,365
Grants and pledges receivable (Notes 2e and 3)	2,006,453	1,131,569
Investments (Notes 2f and 4)	2,891,765	3,332,230
Prepaid expenses and other assets	8,636	36,173
Security deposit	42,971	42,971
Fixed assets, net (Notes 2g and 5)	332,721	441,561
Total assets	$5,347,896	$5,271,869
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	$75,631	$64,808
Advances (Note 2h)	49,859	51,842
Deferred rent (Note 2i)	186,247	206,146
Total liabilities	311,737	322,796
Net assets: (Note 2b)		
Unrestricted	3,881,060	4,071,474
Temporarily restricted (Note 6)	1,155,099	877,599
Total net assets	5,036,159	4,949,073
Total liabilities and net assets	$5,347,896	$5,271,869

The attached notes and auditors' report are an integral part of these financial statements.

PENCIL, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2013
(With comparative totals for the year ended June 30, 2012)

	Unrestricted	Temporarily Restricted	Total 6/30/13	Total 6/30/12
Public support and revenue:				
Contributions	$1,215,288	$777,500	$1,992,788	$2,240,529
Fee income	61,486		61,486	31,326
Special event income (net of direct expenses of $224,545 and $272,433)	1,448,506		1,448,506	1,397,069
In-kind contributions (Notes 2j and 7)	610,077		610,077	1,972,582
Interest and other income	96,398		96,398	90,380
Net assets released from restrictions	500,000	(500,000)	0	0
Total public support and revenue	3,931,755	277,500	4,209,255	5,731,886
Expenses:				
Program services	3,133,914		3,133,914	4,376,165
Supporting services:				
Management and general	392,237		392,237	466,528
Fundraising	704,052		704,052	621,297
Total supporting services	1,096,289	0	1,096,289	1,087,825
Total expenses	4,230,203	0	4,230,203	5,463,990
Change in net assets from operating activities	(298,448)	277,500	(20,948)	267,896
Non-operating activities:				
Investment gain/ (loss) (Note 4)	108,034		108,034	(13,900)
Total non-operating activities	108,034	0	108,034	(13,900)
Change in net assets	(190,414)	277,500	87,086	253,996
Net assets - beginning of year	4,071,474	877,599	4,949,073	4,695,077
Net assets - end of year	$3,881,060	$1,155,099	$5,036,159	$4,949,073

The attached notes and auditors' report are an integral part of these financial statements.

PENCIL, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2013
(With comparative totals for the year ended June 30, 2012)

		Supporting Services				
	Program Services	Management and General	Fundraising	Total Supporting Services	Total Expenses 6/30/13	Total Expenses 6/30/12
Salaries	$1,565,407	$201,003	$312,246	$513,249	$2,078,656	$1,849,678
Payroll taxes and benefits	355,592	45,659	70,929	116,588	472,180	424,028
Occupancy	245,992	18,683	46,707	65,390	311,382	303,018
Advertising and outreach (including in-kind of $142,579) (Notes 2d and 7)	121,579	2,113	21,000	23,113	144,692	1,616,601
Program supplies and material	18,569			0	18,569	11,579
Office supplies and postage	60,874	4,623	11,558	16,181	77,055	84,543
Travel and entertainment (including in-kind of $91,127) (Notes 2j, 2k and 7)	158,003	22,660	2,507	25,167	183,170	162,140
Telephone	11,728	891	2,227	3,118	14,846	21,758
Equipment	9,165	696	1,740	2,436	11,601	13,242
Depreciation	89,539	6,800	17,001	23,801	113,340	159,515
Professional fees (including in-kind of $76,371) (Notes 2j and 7)	60,333	19,582	11,456	31,038	91,371	58,085
Consulting (including in-kind of $300,000) (Notes 2j and 7)	394,737	18,927	93,724	112,651	507,388	543,026
Staff recruiting		3,407		3,407	3,407	5,409
Insurance	10,572	803	2,007	2,810	13,382	14,934
Bank charges and admin fees		30,848		30,848	30,848	39,919
Miscellaneous	6,158	953	2,557	3,510	9,668	18,385
Special event expenses (Note 8)	25,666		108,393	108,393	134,059	138,130
Bad debt expense		14,589		14,589	14,589	0
Total expenses	$3,133,914	$392,237	$704,052	$1,096,289	$4,230,203	$5,463,990

The attached notes and auditors' report are an integral part of these financial statements.

PENCIL, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2013
(With comparative totals for the year ended June 30, 2012)

	6/30/13	6/30/12
Cash flows from operating activities:		
Change in net assets	$87,086	$253,996
Adjustments to reconcile change in net assets to net cash from operating activities:		
Donated stock	(45,545)	(75,463)
Realized and unrealized gain on investments	(108,034)	13,900
Depreciation expense	113,340	159,515
(Increase)/decrease in assets:		
Grants and pledges receivable	(874,884)	(970,500)
Prepaid expenses and other assets	27,537	(14,547)
Increase/(decrease) in liabilities:		
Accounts payable and accrued expenses	10,823	23,674
Advances	(1,983)	(11,908)
Deferred rent	(19,899)	(13,956)
Net cash flows used for operating activities	(811,559)	(635,289)
Cash flows from investing activities:		
Purchase of investments	(90,824)	(1,597,991)
Proceeds from the sale of investments	542,562	1,500,563
Transfers into investment account	(1,050,299)	(1,449,090)
Transfers from investment account	1,192,605	2,277,337
Purchases of property and equipment	(4,500)	(86,131)
Net cash flows provided by investing activities	589,544	644,688
Net (decrease)/increase in cash and cash equivalents	(222,015)	9,399
Cash and cash equivalents - beginning of year	287,365	277,966
Cash and cash equivalents - end of year	$65,350	$287,365
Interest and taxes paid	$0	$0

The attached notes and auditors' report are an integral part of these financial statements.

Note 1 - Organization

Pencil, Inc. was founded in 1995 to develop and coordinate meaningful corporate and community involvement in New York City public education. These financial statements do not reflect programs created by Pencil, Inc. or the contributions raised for those programs as they are run directly by the New York City schools. Pencil, Inc. derives its revenue from soliciting contributions from the general public in New York City, and from the annual fund-raising event.

Pencil, Inc. was incorporated in the State of New York and is exempt from Federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code. Pencil, Inc. has been designated as an organization which is not a private foundation.

Note 2 - Summary of Significant Accounting Policies

a. <u>Basis of Accounting</u>
The financial statements have been prepared on the accrual basis of accounting which is the process of recording revenue and expenses when earned or incurred, rather than when received or paid. All significant receivables, payables, and other liabilities have been presented.

b. <u>Basis of Presentation and Revenue Recognition Principles</u>
Pencil, Inc. reports information regarding their financial position and activities in the following classes of net assets:

- *Unrestricted* – represents all activity without donor imposed restrictions as well as activity with donor imposed restrictions, which expire within the same period.

- *Temporarily restricted* – relates to contributions of cash and other assets with donor stipulations that make clear the assets restriction, either due to a program nature or by passage of time.

Donor-restricted support is reported as an increase in temporarily restricted net assets, unless its restriction is satisfied in the period the contribution has been made, in which case it is recorded as unrestricted. When a 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 statement of activities as net assets released from restrictions. Contributions received without restrictions are recorded as unrestricted. Conditional contributions are recognized when the conditions on which they depend are substantially met.

c. <u>Cash and Cash Equivalents</u>
Cash and cash equivalents include cash held in checking accounts and money market funds, and exclude cash held as part of the investment portfolio.

d. Concentration of Credit Risk

Financial instruments which potentially subject Pencil, Inc. to concentration of credit risk consist of cash, money market accounts and investment securities which are placed with financial institutions that management deems to be creditworthy. At times, balances may exceed federally insured limits. A significant portion of the funds is not insured by the FDIC or related entity; however, Pencil, Inc. has not experienced any losses from these accounts due to failure of any financial institution.

e. Pledges Receivable

Pencil, Inc. records unconditional promises to give as revenue in the period received at net realizable value if due in less than one year. Long-term pledges are recorded at fair value based on a risk adjusted discount rate.

Based on a review of specific accounts and based on historical trends, management has deemed that no allowance for doubtful accounts is necessary.

f. Investments

Investments are recorded at fair value, which refers to the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Realized and unrealized gains and losses are recognized in the statement of activities.

g. Fixed Assets

Purchases of furniture, equipment, and leasehold improvements that have a useful life of greater than one year are capitalized at cost or, if donated, at their fair market value at the date of the gift. Property and equipment is depreciated using the straight-line method over the estimated useful life of the asset.

h. Advances

Pencil, Inc. received contributions where the donor specifies a particular school as the ultimate beneficiary. Those donations are treated as advances until they are paid out. Approximately $20,000 of donations of this type were received during the June 30, 2013 year.

i. Deferred Rent

Pencil, Inc. records rent expense on the straight-line method and recognizes deferred rent for the cumulative amount that expenses exceed actual payments. In latter stages of the lease, deferred rent will be reduced as the amount of payments exceeds the expense recorded.

j. In-Kind Services

Donated services are recognized in circumstances where those services either create or enhance non-financial assets or require specialized skills, are provided by individuals possessing those skills and would typically need to be purchased if not provided in-kind. Donated materials are recorded at the estimated fair value at the date of donation (see Note 7 for details).

Board members and other individuals volunteer their time and perform a variety of tasks that assist Pencil, Inc. These services have not been recorded in the financial statements, as they do not meet the criteria outlined above.

k. Advertising
The cost of advertising is expensed as incurred.

l. Summarized Comparative Information
The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with Pencil, Inc.'s financial statements for the year ended June 30, 2012, from which the summarized information was derived.

m. Management Estimates
The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

n. Expense Allocation
The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Management and general expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of Pencil, Inc.

o. Accounting for Uncertainty of Income Taxes
Pencil, Inc. does not believe its financial statements include any material, uncertain tax positions. Tax filings for periods ending June 30, 2010 and later are subject to examination by applicable taxing authorities.

p. Subsequent Events
Management has evaluated for potential recognition and disclosure events subsequent to the date of the statement of financial position through November 26, 2013, the date the financial statements were available to be issued. No events have occurred subsequent to the statement of financial position date through our evaluation date that would require adjustment to or disclosure in the financial statements.

Note 3 - Pledges Receivable

Pledges receivable are due as follows:

For the year ended:	June 30, 2014	$1,507,090
	June 30, 2015	442,500
	June 30, 2016	62,500
		2,012,090
Less: discount		(5,637)
Total		$2,006,453

Note 4 - Investments

Accounting standards establish a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. That would include data obtained from sources independent of Pencil, Inc.

The fair value hierarchy is categorized into three levels based on these inputs as follows:

Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that Pencil, Inc. has the ability to access.
Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

At June 30, 2013, investments consisted of the following:

	Total	Level 1	Level 2
Money market funds and other cash	$616,963	$616,963	$0
Certificates of deposit	626,135	0	626,135
Exchange traded funds	1,253,576	1,253,576	0
Fixed income	395,091	0	395,091
	$2,891,765	$1,870,539	$1,021,226

During the year ended June 30, 2013, investment income consisted of the following:

Unrealized gains	$103,811
Realized gains	4,223
Total	$108,034

Note 5 - Property and Equipment

At June 30, 2013, property and equipment consisted of the following:

	Life	Amount
Computer hardware and software	5 years	$87,176
Furniture and equipment	5 years	196,616
Leasehold improvements	5 years	586,119
Website database and program	3 years	387,840
Total property and equipment - cost		1,257,751
Less: accumulated depreciation		(925,030)
Total property and equipment - net		$332,721

Note 6 - Temporarily Restricted Net Assets

The following summarizes the changes in temporarily restricted net assets:

	Balance 7/1/12	Contributions	Released from Restrictions	Balance 6/30/13
Program restrictions:				
Partnership program	$0	$70,000	$0	$70,000
Career awareness	0	45,000	(15,000)	30,000
Technology & communications	0	200,000	(100,000)	100,000
Downtown initiative	0	75,000	0	75,000
PENCIL exchange	35,000	0	(35,000)	0
Total program restrictions	35,000	390,000	(150,000)	275,000
Time restrictions	842,599	387,500	(350,000)	880,099
Total	$877,599	$777,500	($500,000)	$1,155,099

Note 7 - In-Kind Contributions

In-kind services of $610,077 were allocated as follows:

	Programs	Management and General	Fundraising	Total
Professional fees	$60,333	$4,582	$11,456	$76,371
Advertising and outreach	121,579	0	21,000	142,579
Travel and entertainment	91,127	0	0	91,127
Consulting	255,000	0	45,000	300,000
Total in-kind services	$528,039	$4,582	$77,456	$610,077

Note 8 - Allocation of Joint Costs

During the year, Pencil, Inc. conducted a special event that included requests for contributions, as well as program components. The costs of conducting the special event included a total of $134,059 of joint costs, which are not specifically attributable to particular components of the activities (joint costs). These joint costs were allocated as follows:

Fundraising	$108,393
Program services	25,666
Total	$134,059

Note 9 - Commitments

Pencil, Inc. has a lease for office space which expires July 31, 2018. Future minimum payments are as follows:

Year ending	Amount
June 30, 2014	$282,230
June 30, 2015	287,827
June 30, 2016	293,583
June 30, 2017	299,455
Thereafter	330,939
Total	$1,494,034

Rent expense for the year ended June 30, 2013 was $268,859.

Note 10 - Retirement Plan

Pencil, Inc. has a tax deferred 401(k) retirement plan for their employees. All employees are eligible to participate and can designate a percentage of their salaries, subject to regulatory limits, to be contributed to the plan on a pre-tax basis. No contributions by Pencil, Inc. are made to the plan.

Prior to the 401(k) plan, Pencil, Inc. maintained a similar tax deferred retirement plan under 403 (b). Employees are no longer eligible to contribute to this plan. As of June 30, 2013 the plan has been terminated.