



Audited Financial Statements

September 30, 2016

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 September 30, 2016, 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.

Auditors' Responsibility

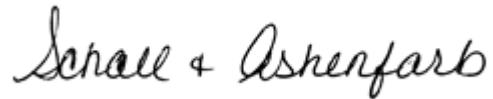
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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.

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 September 30, 2016, 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.



Schall & Ashenfarb
Certified Public Accountants, LLC

February 8, 2017

PENCIL, INC.
STATEMENT OF FINANCIAL POSITION
AT SEPTEMBER 30, 2016

Assets

Cash and cash equivalents	\$428,899
Investments (Note 4)	975,959
Government grants receivable	410,000
Pledges receivable (Note 3)	695,536
Security deposit	42,971
Fixed assets (Note 5)	<u>106,108</u>
Total assets	<u><u>\$2,659,473</u></u>

Liabilities and Net Assets

Liabilities:	
Accounts payable and accrued expenses	\$48,574
Advances	30,300
Deferred rent	<u>84,237</u>
Total liabilities	<u>163,111</u>
Net assets:	
Unrestricted	2,036,531
Temporarily restricted (Note 6)	<u>459,831</u>
Total net assets	<u>2,496,362</u>
Total liabilities and net assets	<u><u>\$2,659,473</u></u>

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

PENCIL, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenue:			
Contributions	\$725,711	\$317,000	\$1,042,711
Government grants	435,000		435,000
Special events (net of expenses with a direct benefit to donor) (Note 7)	1,274,836		1,274,836
In-kind contributions (Note 8)	323,929		323,929
Interest and other income	67,363		67,363
Net assets released from restrictions	<u>461,044</u>	<u>(461,044)</u>	<u>0</u>
Total public support and revenue	<u>3,287,883</u>	<u>(144,044)</u>	<u>3,143,839</u>
Expenses:			
Program services	<u>2,327,496</u>		<u>2,327,496</u>
Supporting services:			
Management and general	420,116		420,116
Fundraising	<u>703,203</u>		<u>703,203</u>
Total supporting services	<u>1,123,319</u>	<u>0</u>	<u>1,123,319</u>
Total expenses	<u>3,450,815</u>	<u>0</u>	<u>3,450,815</u>
Change in net assets from operating activities	<u>(162,932)</u>	<u>(144,044)</u>	<u>(306,976)</u>
Non-operating activities:			
Investment gains (Note 4)	<u>30,663</u>		<u>30,663</u>
Total non-operating activities	<u>30,663</u>	<u>0</u>	<u>30,663</u>
Change in net assets	(132,269)	(144,044)	(276,313)
Net assets - beginning of period	<u>2,168,800</u>	<u>603,875</u>	<u>2,772,675</u>
Net assets - end of period	<u>\$2,036,531</u>	<u>\$459,831</u>	<u>\$2,496,362</u>

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PENCIL, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 2016

	Supporting Services			Total Supporting Services	Total Expenses
	Program Services	Management and General	Fundraising		
Salaries	\$1,300,932	\$187,742	\$385,614	\$573,356	\$1,874,288
Payroll taxes and benefits	304,881	41,789	85,835	127,624	432,505
Occupancy	236,861	34,182	70,209	104,391	341,252
Program supplies and material	2,320			0	2,320
Office supplies and postage	26,360	3,804	7,813	11,617	37,977
Travel, training, and meetings	121,169	14,310	1,520	15,830	136,999
Telephone and information technology	62,987	9,090	18,670	27,760	90,747
Equipment	10,696	1,544	3,170	4,714	15,410
Depreciation	44,400	6,407	13,161	19,568	63,968
Professional fees (including in-kind) (Note 8)		76,758		76,758	76,758
Consulting	198,973	17,746	28,761	46,507	245,480
Staff recruiting		2,368		2,368	2,368
Insurance	16,269	2,348	4,822	7,170	23,439
Bank charges and admin fees		21,790		21,790	21,790
Indirect special events			83,140	83,140	83,140
Miscellaneous	1,648	238	488	726	2,374
Total expenses	\$2,327,496	\$420,116	\$703,203	\$1,123,319	\$3,450,815

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

PENCIL, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 2016

Cash flows from operating activities:	
Change in net assets	(\$276,313)
Adjustments to reconcile change in net assets to net cash used for operating activities:	
Realized and unrealized loss on investments	30,663
Depreciation	63,968
Donated securities	34,519
Changes in assets and liabilities:	
Government grants receivable	(410,000)
Pledges receivable	639,250
Prepaid expenses and other assets	5,807
Accounts payable and accrued expenses	(163,495)
Advances	(1,309)
Deferred Service Fee	(2,500)
Deferred rent	(37,774)
Net cash flows used for operating activities	<u>(117,184)</u>
Cash flows from investing activities:	
Proceeds from the sale of investments	842,492
Purchase of investments	(611,122)
Transfers from investment account	124,795
Purchases of fixed assets	(2,541)
Net cash flows provided by investing activities	<u>353,624</u>
Net increase in cash and cash equivalents	236,440
Cash and cash equivalents - beginning of year	<u>192,459</u>
Cash and cash equivalents - end of year	<u><u>\$428,899</u></u>
Supplemental information:	
Interest and taxes paid	<u>\$0</u>

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

PENCIL, INC.
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2016

Note 1 - Organization

Pencil, Inc. ("Pencil") 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 fundraising event.

Pencil 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 has been designated as an organization which is not a private foundation.

Note 2 - Summary of Significant Accounting Policies

a. Basis of Accounting

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.

b. Basis of Presentation and Revenue Recognition Principles

Pencil 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.

c. Recognition of Income

Donor-restricted support is reported as an increase in unrestricted net assets, unless it contains a restriction by the donor for a specific program or time period. However, if a restriction is satisfied in the period the contribution has been made, 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 of non-cash assets are recorded at fair value.

Government grants are reviewed to determine if they have traits more commonly associated with contributions or exchange transactions. All government grants have been treated as exchange transactions and revenue has been recognized when earned.

d. Cash and Cash Equivalents

Cash and cash equivalents include cash held in checking accounts and money market funds, but exclude cash held as part of the investment portfolio.

e. Concentration of Credit Risk

Financial instruments which potentially subject Pencil 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. The market value of investments is subject to market fluctuations.

Management believes that the investment policy is prudent for the long-term welfare of Pencil. At year end and at certain times during the year, a significant portion of the funds were in excess of federally insured levels; however, Pencil has not experienced any losses from these accounts due to failure of any financial institution.

f. Pledges Receivable

Pencil records unconditional promises to give in the period pledged 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, when material.

Conditional contributions are recognized when the conditions on which they depend are substantially met.

g. Investments

Investments are recorded at fair value, which refers to the price that would be received to sell an asset or paid to transfer a liability (i.e. "exit price") in an orderly transaction between market participants at the measurement date. Realized and unrealized gains and losses are recognized in the statement of activities.

h. 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 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.

i. Advances

Pencil received contributions where the donor specifies a particular school as the ultimate beneficiary. Those donations are treated as agency transactions and recorded advances until they are paid out.

j. Deferred Rent

Pencil 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.

k. In-Kind Contributions

Donated services are recognized in circumstances where those services 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 8).

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

l. Advertising

The cost of advertising is expensed as incurred.

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 financial statements. 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.

o. Accounting for Uncertainty of Income Taxes

Pencil does not believe its financial statements include any material, uncertain tax positions. Tax filings for periods ending September 30, 2013 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 December February 8, 2017, 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.

q. New Accounting Pronouncement

On August 18, 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. The ASU, which becomes effective for the September 30, 2019 year, with early implementation permitted, focuses on improving the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows.

In addition, FASB issued ASU No. 2016-02, *Leases*. The ASU which becomes effective for the September 30, 2021 year, requires the full obligation of long term leases to be recorded as a liability with a corresponding "right to use asset" on the statement of financial position.

Pencil has not yet evaluated the impact these standards will have on future financial statements.

Note 3 - Pledges Receivable

Pledges receivable are due as follows:

Year ending	September 30, 2017	\$691,536
	September 30, 2018	<u>4,000</u>
Total		<u>\$695,536</u>

The amounts have not been discounted using present value techniques due to the immaterial nature.

Note 4 - Investments

Investments are recorded at fair value. Accounting standards have established a fair value hierarchy giving the highest priority to quoted market prices in active markets and the lowest priority to unobservable data.

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

Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that Pencil 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.

Investments can be summarized as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Certificates of deposit	\$0	\$117,603	\$117,603
Exchange traded funds	159,134	0	159,134
Fixed income	<u>0</u>	<u>534,810</u>	<u>534,810</u>
Subtotal	159,134	652,413	811,547
Money market funds and other cash	<u>0</u>	<u>164,412</u>	<u>164,412</u>
Total	<u>\$159,134</u>	<u>\$816,825</u>	<u>\$975,959</u>

Level 1 securities are valued at the closing price reported on the active market they are traded on. Level 2 securities are valued using observable market inputs for securities that are similar to those owned. This method produces a fair value calculation that may not be indicative of net realizable value or reflective of future values. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different fair value measurements.

Investment income can be summarized as follows:

Realized gain on sale of investments	\$26,158
Unrealized gain	<u>4,505</u>
Total	<u>\$30,663</u>

Note 5 - Fixed Assets

Fixed assets can be summarized as follows:

		<u>Useful Life</u>
Computer hardware and software	\$102,756	<i>5 years</i>
Furniture and equipment	198,962	<i>5 years</i>
Leasehold improvements	591,669	<i>5 years</i>
Website database and program	<u>387,840</u>	<i>3 years</i>
	1,281,227	
Less: accumulated depreciation	<u>(1,175,119)</u>	
Total	<u>\$106,108</u>	

Note 6 - Temporarily Restricted Net Assets

Temporarily restricted net assets can be summarized as follows:

	Balance <u>10/1/15</u>	<u>Contributions</u>	Released from <u>Restrictions</u>	Balance <u>9/30/16</u>
Program restrictions:				
Partnership program	\$155,000	\$267,000	(\$165,000)	\$257,000
Career awareness	15,000	40,000	(15,000)	40,000
Technology and comm.	<u>25,000</u>	<u>10,000</u>	<u>(32,169)</u>	<u>2,831</u>
Total program restrictions	195,000	317,000	(212,169)	299,831
Time restrictions	<u>408,875</u>	<u>0</u>	<u>(248,875)</u>	<u>160,000</u>
Total	<u>\$603,875</u>	<u>\$317,000</u>	<u>(\$461,044)</u>	<u>\$459,831</u>

Note 7 - Special Events

Pencil hosts an annual fundraising event. The special event proceeds and related expenses summarized as follows:

Gross revenue	\$1,445,236
Less: expenses with a direct benefit to donors	<u>(170,400)</u>
	1,274,836
Less: other event expenses	<u>(83,140)</u>
Total revenue	<u>\$1,191,696</u>

Note 8 - In-Kind Contributions

In-kind contributions were allocated as follows:

	<u>Programs</u>	Management and <u>General</u>	<u>Fundraising</u>	<u>Total</u>
Occupancy	\$16,095	\$2,050	\$4,305	\$22,450
Consultants	128,729	7,924	8,135	144,788
Training	96,208	0	0	96,208
Professional fees	<u>0</u>	<u>60,483</u>	<u>0</u>	<u>60,483</u>
Total	<u>\$241,032</u>	<u>\$70,457</u>	<u>\$12,440</u>	<u>\$323,929</u>

A member of the board of directors is a partner in a law firm that donated legal services valued at approximately \$13,853 during the year ended September 30, 2016. The revenue and related expense from these donations is recorded as an in-kind contribution.

Note 9 - Retirement Plan

Pencil has adopted 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 are made to the plan.

Note 10 - Commitments

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

Year ending:	September 30, 2017	\$300,945
	September 30, 2018	<u>254,953</u>
Total		<u>\$555,898</u>