



Audited Financial Statements

December 31, 2018

Independent Auditor's 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 December 31, 2018, 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.

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

Opinion

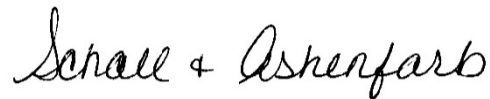
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pencil, Inc. as of December 31, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the financial statements, Pencil adopted Accounting Standards Update No. 2016-14, "Presentation of Financial Statements of Not-for-Profit Entities" Topic (958). Our opinion is not modified with respect to this matter.

Report on Summarized Comparative Information

We have previously audited Pencil's 2017 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated March 5, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived.



Schall & Ashenfarb
Certified Public Accountants, LLC

March 13, 2019

PENCIL, INC.
STATEMENT OF FINANCIAL POSITION
AT DECEMBER 31, 2018
(With comparative totals at December 31, 2017)

	<u>12/31/18</u>	<u>12/31/17</u>
Assets		
Cash and cash equivalents	\$326,693	\$534,994
Investments (Note 3)	1,340,188	1,237,170
Government grants receivable	157,500	3,318
Pledges receivable	439,775	309,970
Prepaid expenses and other assets	3,864	3,404
Security deposit	42,667	42,667
Fixed assets, net (Note 4)	<u>13,294</u>	<u>42,521</u>
 Total assets	 <u><u>\$2,323,981</u></u>	 <u><u>\$2,174,044</u></u>
 Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$17,608	\$22,635
Grants payable	0	20,000
Deferred rent	5,306	28,393
Total liabilities	<u>22,914</u>	<u>71,028</u>
Net assets:		
Without donor restrictions	1,840,567	1,708,516
With donor restrictions (Note 5)	<u>460,500</u>	<u>394,500</u>
Total net assets	<u>2,301,067</u>	<u>2,103,016</u>
 Total liabilities and net assets	 <u><u>\$2,323,981</u></u>	 <u><u>\$2,174,044</u></u>

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

PENCIL, INC.
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2018
(With comparative totals for the year ended December 31, 2017)

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total 12/31/18	Total 12/31/17
Public support and revenue:				
Contributions	\$820,958	\$755,000	\$1,575,958	\$1,173,435
Government grants	435,000		435,000	545,000
Special events (net of expenses with a direct benefit to donor) (Note 6)	1,030,280		1,030,280	1,121,650
In-kind contributions (Note 7)	139,226		139,226	220,947
Interest and other income	22,701		22,701	16,782
Net assets released from restrictions	689,000	(689,000)	0	0
Total public support and revenue	<u>3,137,165</u>	<u>66,000</u>	<u>3,203,165</u>	<u>3,077,814</u>
Expenses:				
Program services	2,082,912		2,082,912	2,047,028
Supporting services:				
Management and general	313,085		313,085	314,912
Fundraising	588,410		588,410	742,799
Total supporting services	<u>901,495</u>	<u>0</u>	<u>901,495</u>	<u>1,057,711</u>
Total expenses	<u>2,984,407</u>	<u>0</u>	<u>2,984,407</u>	<u>3,104,739</u>
Change in net assets from operating activities	<u>152,758</u>	<u>66,000</u>	<u>218,758</u>	<u>(26,925)</u>
Non-operating activities:				
Loss on sale of investments	(7,932)		(7,932)	(359)
Unrealized loss on investments	(12,775)		(12,775)	(11,991)
Total non-operating activities	<u>(20,707)</u>	<u>0</u>	<u>(20,707)</u>	<u>(12,350)</u>
Change in net assets	132,051	66,000	198,051	(39,275)
Net assets - beginning of year	<u>1,708,516</u>	<u>394,500</u>	<u>2,103,016</u>	<u>2,142,291</u>
Net assets - end of year	<u><u>\$1,840,567</u></u>	<u><u>\$460,500</u></u>	<u><u>\$2,301,067</u></u>	<u><u>\$2,103,016</u></u>

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

PENCIL, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2018
(With comparative totals for the year ended December 31, 2017)

	Supporting Services				Total Expenses 12/31/18	Total Expenses 12/31/17
	Program Services	Management and General	Fundraising	Special Event		
Salaries	\$1,235,474	\$133,555	\$284,049		\$417,604	\$1,629,766
Payroll taxes and benefits	312,029	32,013	68,087		100,100	400,765
Occupancy	265,356	28,685	61,008		89,693	319,514
Program supplies and material	1,874				0	1,881
Office supplies and postage (including in-kind)(Note 7)	7,363	2,296	1,693		3,989	6,369
Travel, training and meetings (including in-kind)(Note 7)	75,718	4,900	1,450		6,350	97,971
Telephone and information technology	72,956	7,887	16,773		24,660	85,795
Equipment	27,328	2,954	6,283		9,237	34,523
Depreciation	28,830	3,116	6,628		9,744	58,851
Professional fees (including in-kind)(Note 7)		58,123			58,123	77,347
Consulting (including in-kind)(Note 7)	23,394	6,333	665		6,998	209,041
Staff recruiting		1,967			1,967	1,395
Insurance	17,835	1,928	4,100		6,028	23,470
Bank charges and administrative fees	10,111	1,093	2,325		3,418	15,642
Special events (including in-kind)(Note 7)			134,281	\$120,346	254,627	256,037
Bad debt expense		21,575			21,575	0
Miscellaneous	4,644	6,660	1,068		7,728	16,752
Total expenses before direct event expenses netted with revenue	2,082,912	313,085	588,410	120,346	1,021,841	3,235,119
Less: direct special event expenses netted with revenue				(120,346)	(120,346)	(130,380)
Total expenses for statement of activities	\$2,082,912	\$313,085	\$588,410	\$0	\$901,495	\$3,104,739

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

PENCIL, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018
(With comparative totals for the year ended December 31, 2017)

	12/31/18	12/31/17
Cash flows from operating activities:		
Change in net assets	\$198,051	(\$39,275)
Adjustments to reconcile change in net assets to net cash (used for)/provided by operating activities:		
Loss on sale of investments	7,932	359
Unrealized loss on investments	12,775	11,991
Depreciation	38,574	58,851
Changes in assets and liabilities:		
Government grants receivable	(154,182)	431,682
Pledges receivable	(129,805)	155,911
Prepaid expenses and other assets	(460)	21,691
Security deposit	0	304
Accounts payable and accrued expenses	(5,027)	(13,529)
Grants payable	(20,000)	(10,300)
Deferred rent	(23,087)	(45,175)
Net cash flows (used for)/provided by operating activities	(75,229)	572,510
Cash flows from investing activities:		
Proceeds from the sale of investments	413,422	77,000
Purchase of investments	(503,647)	(349,752)
Transfers from investment account	(33,500)	50,000
Purchases of fixed assets	(9,347)	(7,222)
Net cash flows used for investing activities	(133,072)	(229,974)
Net (decrease)/increase in cash and cash equivalents	(208,301)	342,536
Cash and cash equivalents - beginning of year	534,994	192,458
Cash and cash equivalents - end of year	\$326,693	\$534,994
Supplemental information:		
Interest and taxes paid	\$0	\$0

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

PENCIL, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018

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 has been notified by the Internal Revenue Service that it is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code and has not been determined to be a private foundation as defined in Section 509(a).

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.

Effective, January 1, 2018, Pencil adopted the requirements of the Financial Accounting Standards Board's Accounting Standards Update No. 2016-14 – Not-for-Profit Entities (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities* (ASU 2016- 14). This update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return between not-for-profit entities. A key change required by ASU 2016-14 is the net asset classes used in these financial statements. Amounts previously reported as unrestricted net assets are now reported as net assets without donor restrictions and amounts previously reported as temporarily restricted net assets and permanently restricted net assets are now reported as net assets with donor restrictions. A footnote on liquidity has also been added (Note 10).

Implementation of ASU 2016-14 did not require any reclassification or restatement of any opening balances related to the periods presented.

b. Basis of Presentation and Revenue Recognition Principles

Pencil reports information regarding their financial position and activities in the following classes of net assets:

- *Net Assets Without Donor Restrictions* – represents all activity without donor-imposed restrictions as well as activity with donor-imposed restrictions, which expire within the same period.

- *Net Assets With Donor Restrictions* – 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

Contributions are reported as an increase in net assets without donor restrictions, unless they contain a restriction by the donor for a specific program or time period, in which case they are reported in the net asset class with donor restrictions. When a restriction expires (that is, when a stipulated time restriction ends, or purpose restriction is accomplished), net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statement of activities as net assets released from restrictions. However, if a restriction is satisfied in the period the contribution has been made, it is recorded as net assets without donor restrictions.

Contributions of non-cash assets are recorded at fair value.

Government grants are recorded as revenue when earned based on incurring expenses that are reimbursable under the terms of the grant. The difference between cash received and revenue earned is reflected as government grants receivable or refundable advances.

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

Pledges are recorded at net realizable value if expected it be received within one year or at fair value using risk-adjusted present value techniques, if material and expected to be received in more than one year. Pledges receivable in the amounts of \$414,775 and \$25,000 are due by December 31, 2019 and 2020, respectively. Management has determined that the present value adjustment is not material and has not discounted future pledges to fair value. Conditional contributions are recognized when the conditions on which they depend are substantially met.

All receivables are assessed for collectability. Based on a review of several factors, including the credit worthiness of the donor and historical experience, no allowance for doubtful accounts has been established.

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. Grants Payable

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 7).

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. Such allocations are determined by management on an equitable basis.

The following expenses were allocated using time and effort as the basis:

- Salaries, payroll tax and benefits
- Occupancy
- Office supplies and postage
- Telephone & information technology
- Equipment
- Depreciation
- Consulting
- Insurance
- Bank charges and administrative fees
- Miscellaneous

All other expenses have been charged directly to the applicable program or supporting services.

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, 2015 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 March 13, 2019, 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

FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The ASU, which becomes effective for the December 31, 2019 year, focuses on a principle-based model. It highlights the identification of performance obligations of the contract, determining the price and allocating that price to the performance obligation so that revenue is recognized as each performance obligation is satisfied.

FASB issued ASU No. 2016-02, *Leases*. The ASU which becomes effective for the December 31, 2020 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 is in the process of evaluating the impact these standards will have on future financial statements.

Note 3 - 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>December 31, 2018</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Certificates of deposit		\$191,357	\$191,357
Exchange traded funds:			
Short-term bonds	\$433,330		433,330
Corporate fixed income:			
Communication services		49,764	49,764
Energy		25,435	25,435
Consumer cyclical		82,138	82,138
Manufacturing		25,445	25,445
Healthcare		48,744	48,744
Subtotal	<u>433,330</u>	<u>422,883</u>	<u>856,213</u>
Money market funds and other cash		483,975	483,975
Total	<u>\$433,330</u>	<u>\$906,858</u>	<u>\$1,340,188</u>

	<u>December 31, 2017</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Certificates of deposit		\$484,154	\$484,154
Exchange traded funds:			
Short-term bonds	\$115,778		115,778
Corporate fixed income:			
Financial services		25,733	25,733
Communication services		25,156	25,156
Energy		26,242	26,242
Consumer cyclical		51,914	51,914
Healthcare		25,384	25,384
Subtotal	<u>115,778</u>	<u>638,583</u>	<u>754,361</u>
Money market funds and other cash		482,809	482,809
Total	<u>\$115,778</u>	<u>\$1,121,392</u>	<u>\$1,237,170</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.

Note 4 - Fixed Assets

Fixed assets can be summarized as follows:

	<u>12/31/18</u>	<u>12/31/17</u>
Computer hardware and software (5 years)	\$122,676	\$113,329
Furniture and equipment (5 years)	198,962	198,962
Leasehold improvements (5 years)	591,669	591,669
Website database and program (3 years)	<u>387,840</u>	<u>387,840</u>
	1,301,147	1,291,800
Less: accumulated depreciation	<u>(1,287,853)</u>	<u>(1,249,279)</u>
Total	<u>\$13,294</u>	<u>\$42,521</u>

Note 5 - Net Assets With Donor Restrictions

Net assets with donor restrictions can be summarized as follows:

	<u>December 31, 2018</u>			
	Balance		Released	Balance
	<u>1/1/18</u>	<u>Contributions</u>	from	<u>12/31/18</u>
			<u>Restrictions</u>	
Program restrictions:				
Partnership program	\$237,500	\$482,500	(\$469,500)	\$250,500
Internship program	<u>154,500</u>	<u>272,500</u>	<u>(217,000)</u>	<u>210,000</u>
Total program restrictions	392,000	755,000	(686,500)	460,500
Time restrictions	<u>2,500</u>	<u>0</u>	<u>(2,500)</u>	<u>0</u>
Total	<u>\$394,500</u>	<u>\$755,000</u>	<u>(\$689,000)</u>	<u>\$460,500</u>
	<u>December 31, 2017</u>			
	Balance		Released	Balance
	<u>1/1/17</u>	<u>Contributions</u>	from	<u>12/31/17</u>
			<u>Restrictions</u>	
Program restrictions:				
Partnership program	\$275,000	\$259,500	(\$297,000)	\$237,500
Career awareness	40,000	0	(40,000)	0
Internship program	<u>121,000</u>	<u>156,700</u>	<u>(123,200)</u>	<u>154,500</u>
Total program restrictions	436,000	416,200	(460,200)	392,000
Time restrictions	<u>155,500</u>	<u>0</u>	<u>(153,000)</u>	<u>2,500</u>
Total	<u>\$591,500</u>	<u>\$416,200</u>	<u>(\$613,200)</u>	<u>\$394,500</u>

Note 6 - Special Events

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

	<u>12/31/18</u>	<u>12/31/17</u>
Gross revenue	\$1,150,626	\$1,252,030
Less: expenses with a direct benefit to donors	<u>(120,346)</u>	<u>(130,380)</u>
	1,030,280	1,121,650
Less: other event expenses	<u>(124,606)</u>	<u>(119,216)</u>
Total	<u>\$905,674</u>	<u>\$1,002,434</u>

Note 7 - In-Kind Contributions

In-kind contributions were allocated as follows:

	<u>December 31, 2018</u>			
	Management and			
	<u>Programs</u>	<u>General</u>	<u>Fundraising</u>	<u>Total</u>
Office Supplies	\$0	\$1,500	\$0	\$1,500
Travel, training and meetings	54,258	4,700	1,450	60,408
Professional fees	0	41,123	0	41,123
Consulting	20,500	6,020	0	26,520
Special Events	<u>0</u>	<u>0</u>	<u>9,675</u>	<u>9,675</u>
Total	<u>\$74,758</u>	<u>\$53,343</u>	<u>\$11,125</u>	<u>\$139,226</u>
	<u>December 31, 2017</u>			
	Management and			
	<u>Programs</u>	<u>General</u>	<u>Fundraising</u>	<u>Total</u>
Travel, training and meetings	\$47,355	\$5,925	\$0	\$53,280
Professional fees	0	59,847	0	59,847
Consulting	<u>73,400</u>	<u>25,620</u>	<u>8,800</u>	<u>107,820</u>
Total	<u>\$120,755</u>	<u>\$91,392</u>	<u>\$8,800</u>	<u>\$220,947</u>

Note 8 - 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. Effective, April 1, 2017, Pencil began providing matching contributions by contributing up to 1% of employee's salary to the plan. During 2018 and 2017 Pencil made contributions totaling \$11,632 and \$7,007 to the plan.

Note 9 - Commitments

Pencil has a lease for office space which was set to expire on July 31, 2018 but was extended until 2023. Future minimum payments are as follows:

Year ending:	December 31, 2019	\$314,663
	December 31, 2020	320,957
	December 31, 2021	327,376
	December 31, 2022	333,923
	July 31, 2023	<u>197,042</u>
Total		<u>\$1,493,961</u>

Note 10 - Liquidity and Availability of Financial Resources

The following reflects Pencil's financial assets at December 31, 2018, reduced by amounts that have donor-imposed restrictions within one year of the balance sheet date. Pencil maintains cash on hand to be available for its general expenditures, liabilities, and other obligations for on-going operations. In addition, Pencil has a goal of maintaining a reserve in short-term investments to cover 5 to 6 months of normal operating expenses. As part of its liquidity management plan, Pencil operates its programs within a balanced budget and relies on grants and contributions to fund its operations and program activities. As indicated in Note 5, included in restricted funds are contributions for Partnerships and Internship Training & Development activities which are part of on-going operations.

Cash and cash equivalents	\$326,693
Investments	1,340,188
Government grants receivable	157,500
Pledges receivable due in less than one year	<u>414,775</u>
Total financial assets	<u>2,239,156</u>
Less amounts not available to be used within one year:	
Contributions restricted – purpose restrictions	<u>(435,500)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$1,803,656</u>

Note 11 - Related Party Transactions

All donated legal services were performed by two law firms of which two members of the Board of Directors are partners.