

# **PENCIL, INC.**

## **Audited Financial Statements**

**June 30, 2012**

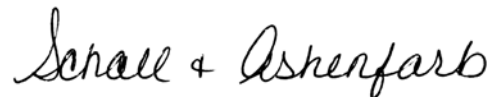
## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Pencil, Inc.

We have audited the accompanying statement of financial position of Pencil, Inc. as of June 30, 2012 and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of Pencil's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior-year summarized comparative information has been derived from Pencil's June 30, 2011 financial statements, and in our report dated November 29, 2011 we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of Pencil, Inc. as of June 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.



Schall & Ashenfarb  
Certified Public Accountants, LLC

November 27, 2012

**PENCIL, INC.**  
**STATEMENT OF FINANCIAL POSITION**  
**AT JUNE 30, 2012**  
(With comparative totals as of June 30, 2011)

	<u>6/30/12</u>	<u>6/30/11</u>
<b>Assets</b>		
Cash and cash equivalents (Note 2c)	\$287,365	\$277,966
Grants and pledges receivable (Notes 2e and 3)	1,131,569	161,069
Investments (Notes 2f and 4)	3,332,230	4,001,486
Prepaid expenses and other assets	36,173	21,626
Security deposit	42,971	42,971
Fixed assets, net (Notes 2g and 5)	441,561	514,945
Total assets	<u><u>\$5,271,869</u></u>	<u><u>\$5,020,063</u></u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued expenses	\$64,808	\$41,134
Advances (Note 2h)	51,842	63,750
Deferred rent (Note 2i)	206,146	220,102
Total liabilities	<u><u>322,796</u></u>	<u><u>324,986</u></u>
Net assets: (Note 2b)		
Unrestricted	4,071,474	4,613,652
Temporarily restricted (Note 6)	877,599	81,425
Total net assets	<u><u>4,949,073</u></u>	<u><u>4,695,077</u></u>
Total liabilities and net assets	<u><u>\$5,271,869</u></u>	<u><u>\$5,020,063</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 JUNE 30, 2012**  
(With comparative totals for the year ended June 30, 2011)

	Unrestricted	Temporarily Restricted	Total 6/30/12	Total 6/30/11
Public support and revenue:				
Contributions	\$1,112,930	\$1,127,599	\$2,240,529	\$716,581
Government grants			0	107,525
Fee income	31,326		31,326	60,700
Special event income (net of direct expenses of \$272,077 and \$212,688)	1,397,069		1,397,069	1,720,155
In-kind contributions (Notes 2j and 7)	1,972,582		1,972,582	291,000
Interest and other income	90,380		90,380	76,791
Net assets released from restrictions	331,425	(331,425)	0	0
Total public support and revenue	<u>4,935,712</u>	<u>796,174</u>	<u>5,731,886</u>	<u>2,972,752</u>
Expenses:				
Program services	4,376,165		4,376,165	2,169,961
Supporting services:				
Management and general	466,528		466,528	563,500
Fundraising	621,297		621,297	400,396
Total supporting services	<u>1,087,825</u>	<u>0</u>	<u>1,087,825</u>	<u>963,896</u>
Total expenses	<u>5,463,990</u>	<u>0</u>	<u>5,463,990</u>	<u>3,133,857</u>
Change in net assets from operating activities	<u>(528,278)</u>	<u>796,174</u>	<u>267,896</u>	<u>(161,105)</u>
Non-operating activities:				
Investment (loss)/gain (Note 4)	<u>(13,900)</u>		<u>(13,900)</u>	<u>211,551</u>
Total non-operating activities	<u>(13,900)</u>	<u>0</u>	<u>(13,900)</u>	<u>211,551</u>
Change in net assets	(542,178)	796,174	253,996	50,446
Net assets - beginning of year	<u>4,613,652</u>	<u>81,425</u>	<u>4,695,077</u>	<u>4,644,631</u>
Net assets - end of year	<u>\$4,071,474</u>	<u>\$877,599</u>	<u>\$4,949,073</u>	<u>\$4,695,077</u>

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**PENCIL, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
**FOR THE YEAR ENDED JUNE 30, 2012**  
(With comparative totals for the year ended June 30, 2011)

	Supporting Services			Total Supporting Services	Total Expenses 6/30/12	Total Expenses 6/30/11
	Program Services	Management and General	Fundraising			
Salaries	\$1,368,762	\$203,464	\$277,452	\$480,916	\$1,849,678	\$1,498,237
Payroll taxes and benefits	313,781	46,643	63,604	110,247	424,028	286,034
Occupancy	236,009	27,674	39,335	67,009	303,018	304,422
Advertising and outreach (including in-kind of \$1,611,247) (Notes 2j, 2k and 7)	1,616,601			0	1,616,601	73,281
Program supplies and material	11,579			0	11,579	1,096
Office supplies and postage	65,944	7,608	10,991	18,599	84,543	113,670
Travel and entertainment (including in-kind of \$44,250) (Notes 2j and 7)	106,790	41,037	14,313	55,350	162,140	151,855
Telephone	16,971	1,958	2,829	4,787	21,758	22,356
Equipment	10,329	1,192	1,721	2,913	13,242	17,790
Depreciation	124,422	14,356	20,737	35,093	159,515	188,130
Professional fees (including in-kind of \$43,585) (Notes 2j and 7)	28,330	25,396	4,359	29,755	58,085	121,937
Consulting (including in-kind of \$273,500) (Notes 2j and 7)	423,560	48,873	70,593	119,466	543,026	159,948
Staff recruiting		5,409		5,409	5,409	41,616
Insurance	11,649	1,344	1,941	3,285	14,934	8,970
Bank charges and admin fees		39,919		39,919	39,919	34,072
Miscellaneous	14,340	1,655	2,390	4,045	18,385	18,627
Special event expenses (Note 8)	27,098		111,032	111,032	138,130	84,191
Bad debt expense				0	0	7,625
<b>Total expenses</b>	<b>\$4,376,165</b>	<b>\$466,528</b>	<b>\$621,297</b>	<b>\$1,087,825</b>	<b>\$5,463,990</b>	<b>\$3,133,857</b>

*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, 2012**  
(With comparative totals for the year ended June 30, 2011)

	<u>6/30/12</u>	<u>6/30/11</u>
Cash flows from operating activities:		
Change in net assets	\$253,996	\$50,446
Adjustments to reconcile change in net assets to net cash from operating activities:		
Donated stock	(75,463)	(79,569)
Realized and unrealized gain on investments	13,900	(211,551)
Depreciation expense	159,515	188,130
(Increase)/decrease in assets:		
Grants and pledges receivable	(970,500)	342,538
Prepaid expenses and other assets	(14,547)	26,868
Increase/(decrease) in liabilities:		
Accounts payable and accrued expenses	23,674	7,118
Advances	(11,908)	30,492
Deferred rent	(13,956)	(8,638)
Net cash flows (used for)/provided by operating activities	<u>(635,289)</u>	<u>345,834</u>
Cash flows from investing activities:		
Purchase of investments	(1,597,991)	(1,899,557)
Proceeds from the sale of investments	1,500,563	1,839,390
Transfers into investment account	(1,449,090)	(850,000)
Transfers from investment account	2,277,337	710,000
Purchases of property and equipment	(86,131)	(2,018)
Net cash flows provided by/(used for) investing activities	<u>644,688</u>	<u>(202,185)</u>
Net increase in cash and cash equivalents	9,399	143,649
Cash and cash equivalents - beginning of year	<u>277,966</u>	<u>134,317</u>
Cash and cash equivalents - end of year	<u><u>\$287,365</u></u>	<u><u>\$277,966</u></u>
Interest and taxes paid	<u><u>\$0</u></u>	<u><u>\$0</u></u>

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

**PENCIL, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2012**

**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. Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities.

b. Basis of Presentation

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. Cash and Cash Equivalents

For purposes of financial reporting, 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.

Pencil, Inc. places its temporary cash, money market accounts and investments 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 market 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.

Pencil, Inc.'s policy is to imply a time restriction that expires over the useful life of donor restricted contributions of fixed assets.

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 \$124,000 of donations of this type was received during the June 30, 2012 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, 2011, 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. has adopted the provisions of FASB ASC 740, *Income Taxes*, which applies to positions taken or expected to be taken in a tax return. Organizations are required to recognize the effects of tax positions if they are more likely than not of being sustained. Pencil, Inc. does not believe its financial statements include any uncertain tax positions.

p. Subsequent Events

Management has evaluated for potential recognition and disclosure events subsequent to the date of the statement of financial position through November 27, 2012, 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, 2013	\$638,970
June 30, 2014	250,000
June 30, 2015	<u>250,000</u>
	1,138,970
Less: discount of 1% to fair value	<u>(7,401)</u>
Total	<u>\$1,131,569</u>

#### 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, 2012, investments consisted of the following:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Money market funds and other cash	\$754,505	\$754,505	\$0
Equities	1,189,781	1,189,781	0
Fixed income	<u>1,387,944</u>	<u>0</u>	<u>1,387,944</u>
	<u>\$3,332,230</u>	<u>\$1,944,286</u>	<u>\$1,387,944</u>

During the year ended June 30, 2012, investment income consisted of the following:

Unrealized gains	\$13,323
Realized losses	<u>(27,223)</u>
Total	<u>(\$13,900)</u>

#### Note 5 - Property and Equipment

At June 30, 2012, property and equipment consisted of the following:

	<u>Life</u>	<u>Amount</u>
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	<u>383,340</u>
Total net assets		1,253,251
Less: accumulated depreciation		<u>(811,690)</u>
Net property and equipment		<u>\$441,561</u>

#### Note 6 - Temporarily Restricted Net Assets

The following summarizes the changes in temporarily restricted net assets:

	<u>Balance</u> <u>7/1/11</u>	<u>Contributions</u>	<u>Released</u> <u>from</u> <u>Restrictions</u>	<u>Balance</u> <u>6/30/12</u>
Program restrictions:				
Partnership program	\$40,000	\$0	\$(40,000)	\$0
PENCIL exchange	<u>41,425</u>	<u>35,000</u>	<u>(41,425)</u>	<u>35,000</u>
Total program restrictions	81,425	0	(81,425)	0
Time restrictions	<u>0</u>	<u>1,092,599</u>	<u>(250,000)</u>	<u>842,599</u>
Total	<u>\$81,425</u>	<u>\$1,127,599</u>	<u>(\$331,425)</u>	<u>\$877,599</u>

**Note 7 - In-Kind Contributions**

In-kind services of \$1,972,582 were allocated as follows:

	<u>Programs</u>	Management and <u>General</u>	<u>Fundraising</u>	<u>Total</u>
Advertising and outreach	\$1,611,247	\$0	\$0	\$1,611,247
Travel and entertainment	21,065	9,792	13,393	44,250
Professional fees	28,330	10,896	4,359	43,585
Consulting	<u>213,330</u>	<u>24,615</u>	<u>35,555</u>	<u>273,500</u>
Total in-kind services	<u>\$1,873,972</u>	<u>\$45,303</u>	<u>\$53,307</u>	<u>\$1,972,582</u>

During the year, Pencil, Inc. conducted an extensive marketing campaign to support its long-term goal of building 750 partnerships between business volunteers and NYC public school principals. This one-time project incurred significant media expenses, which were provided in-kind. The financial statements reflect the value of these in-kind donations at fair market value under advertising and outreach expense.

**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 \$138,129 of joint costs, which are not specifically attributable to particular components of the activities (joint costs). These joint costs were allocated as follows:

Fundraising	\$111,032
Program services	<u>27,097</u>
Total	<u>\$138,129</u>

**Note 9 - Commitments**

On August 31, 2008, Pencil, Inc. extended its lease for its office space which expires July 31, 2018. Future minimum payments are as follows:

<u>Year ending</u>	<u>Amount</u>
June 30, 2013	\$277,169
June 30, 2014	282,230
June 30, 2015	287,827
June 30, 2016	293,583
June 30, 2017	299,455
Thereafter	<u>330,939</u>
Total	<u>\$1,771,203</u>

Rent expense for the year ended June 30, 2012 was \$260,900.

**Note 10 - Retirement Plan**

In January 2012, Pencil, Inc. initiated 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. The plan administrator is in the process of making distributions to all participants that have balances. The goal is to terminate the plan once all distributions have been made.