

PENCIL FOUNDATION

FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION

JUNE 30, 2007 AND 2006

PENCIL FOUNDATION

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Independent Auditors' Report

To the Board of Directors
PENCIL Foundation
Nashville, Tennessee

We have audited the accompanying statements of financial position of PENCIL Foundation (the "Foundation") as of June 30, 2007 and 2006, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Foundation'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PENCIL Foundation as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 10, 2007 on our consideration of the Foundation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

To the Board of Directors
PENCIL Foundation

Our audits were made for the purpose of forming an opinion on the basic financial statements of the PENCIL Foundation taken as a whole. The accompanying schedule of grant activity for the year ending June 30, 2007 and schedules of support and revenue, expenses and changes in net assets for the years ended June 30, 2007 and 2006 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Crosslin, Vaden & Associates, P.C.

Nashville, Tennessee
November 10, 2007

PENCIL FOUNDATION
STATEMENTS OF FINANCIAL POSITION

ASSETS

	<u>June 30,</u>	
	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$1,099,064	\$779,620
Contributions receivable	10,125	70,500
Contracts and grants receivable	32,574	86,728
Prepaid expenses and other assets	<u>13,357</u>	<u>14,058</u>
Total assets	<u>\$1,155,120</u>	<u>\$950,906</u>

LIABILITIES

Funds held for others	\$ 118,699	\$ 64,628
Accounts payable and accrued expenses	<u>71,461</u>	<u>37,791</u>
Total liabilities	<u>190,160</u>	<u>102,419</u>

NET ASSETS

Unrestricted	954,835	777,987
Temporarily restricted	<u>10,125</u>	<u>70,500</u>
Total net assets	<u>964,960</u>	<u>848,487</u>
Total liabilities and net assets	<u>\$1,155,120</u>	<u>\$950,906</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION
STATEMENTS OF ACTIVITIES
YEARS ENDED JUNE 30, 2007 AND 2006

	2007		
	Unrestricted	Temporarily Restricted	Total
Support and revenue:			
Contributions and grants	\$ 21,505	\$ 1,697,248	\$1,718,753
In-kind contributions	-	200,572	200,572
Special events income (net of related direct costs of \$30,447 and \$22,932 for 2007 and 2006, respectively)	116,680	-	116,680
Interest income	31,146	-	31,146
Net assets released from restrictions	<u>1,958,195</u>	<u>(1,958,195)</u>	<u>-</u>
Total support and revenue	<u>2,127,526</u>	<u>(60,375)</u>	<u>2,067,151</u>
Expenses:			
Program activities expense:			
Jobs for Tennessee Graduates	650,486	-	650,486
Monroe Harding Youth Initiative	5,902	-	5,902
Jobs Skills Training and Employment	465,405	-	465,405
PENCIL Partners	270,469	-	270,469
Reading Partners	128,962	-	128,962
Math Partners	96,119	-	96,119
Caterpillar Student Writers Showcase	30,008	-	30,008
Saint Thomas Science Scholars	5,084	-	5,084
Choices	7,518	-	7,518
Reading College	-	-	-
Maplewood	11,774	-	11,774
PENCIL Box	<u>259,990</u>	<u>-</u>	<u>259,990</u>
Total program activities expense	1,931,717	-	1,931,717
Administrative expenses	<u>18,961</u>	<u>-</u>	<u>18,961</u>
Total expenses	<u>1,950,678</u>	<u>-</u>	<u>1,950,678</u>
Net increase (decrease) in net assets	176,848	(60,375)	116,473
Net assets at beginning of year	<u>777,987</u>	<u>70,500</u>	<u>848,487</u>
Net assets at end of year	<u>\$ 954,835</u>	<u>\$ 10,125</u>	<u>\$ 964,960</u>

2006		
<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
\$ 33,967	\$ 1,585,348	\$ 1,619,315
-	74,101	74,101
71,413	-	71,413
18,125	-	18,125
<u>1,727,399</u>	<u>(1,727,399)</u>	<u>-</u>
<u>1,850,904</u>	<u>(67,950)</u>	<u>1,782,954</u>
668,422	-	668,422
3,177	-	3,177
435,223	-	435,223
227,602	-	227,602
132,929	-	132,929
100,254	-	100,254
29,991	-	29,991
4,998	-	4,998
9,864	-	9,864
16,881	-	16,881
-	-	-
<u>137,077</u>	<u>-</u>	<u>137,077</u>
1,766,418	-	1,766,418
<u>47,389</u>	<u>-</u>	<u>47,389</u>
<u>1,813,807</u>	<u>-</u>	<u>1,813,807</u>
37,097	(67,950)	(30,853)
<u>740,890</u>	<u>138,450</u>	<u>879,340</u>
<u>\$ 777,987</u>	<u>\$ 70,500</u>	<u>\$ 848,487</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION
STATEMENTS OF CASH FLOWS

	<u>Year Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net increase (decrease) in net assets	\$ 116,473	\$(30,853)
Adjustments to reconcile net increase (decrease) in net assets to net cash provided by operating activities:		
Changes in assets and liabilities:		
Decrease in receivables	114,529	37,075
Decrease (increase) in prepaid expense and other	701	(139)
Increase in accounts payable and accrued expenses	<u>33,670</u>	<u>4,967</u>
Total adjustments	<u>148,900</u>	<u>41,903</u>
Net cash provided by operating activities	<u>265,373</u>	<u>11,050</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in funds held for others	<u>54,071</u>	<u>64,628</u>
Net cash provided by investing activities	<u>54,071</u>	<u>64,628</u>
Increase in cash and cash equivalents	319,444	75,678
Cash and cash equivalents at beginning of year	<u>779,620</u>	<u>703,942</u>
Cash and cash equivalents at end of year	<u>\$1,099,064</u>	<u>\$ 779,620</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and General

PENCIL Foundation (the "Foundation") is a nonprofit organization formed in 1982 to coordinate efforts by Nashville area businesses and civic organizations to support the Metropolitan Nashville Public School System. Descriptions of the Foundation's programs are as follows:

Jobs for Tennessee Graduates (JTG) places a counselor in high schools to provide job readiness instruction, opportunities for leadership development, interventions to aid in school completion and post-graduation assistance. This program serves students who have been identified by school officials as having one or more barriers to success. Primary funding is on a cost-reimbursement basis by the State Department of Education, Department of Labor and Nashville Career Advancement Center.

Job Skills Training and Employment (J-STEP) provides job readiness and placement assistance. Participants must be enrolled in the Families First program and meet federal income requirements. Those served are either unemployed or underemployed and in need of marketable job skills. This program is primarily funded on a cost reimbursement basis by the State Department of Human Services and the United Way.

Reading Partners supports volunteers who work with children in Metropolitan Nashville Public Schools, with the express goal of improving children's reading ability and enjoyment. The program focuses on students in kindergarten through grade four, with a particular emphasis on readers in second grade, and supports the President's America Reads Challenge as well as local and state goals for all children to read proficiently by the end of third grade. This program is funded by local businesses and foundations.

PENCIL Partners encourages a business or other community organization to "partner with" a specific school and conduct activities that enhance learning opportunities for the students. In addition, this program sponsors various other projects throughout the year. This program is primarily funded through corporate and individual donations.

Math Partners promotes student achievement in mathematics and links local businesses, organizations and individual volunteers with public education. The program provides academic assistance to students in grades five and six whose scores on Tennessee's standardized achievement test fall below the national norm. Funded by local corporations, volunteers instruct students in basic skills and concepts as they provide hands-on-activities that relate to real life math usage.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Caterpillar Student Writers Showcase is a writing competition for Metropolitan Nashville Public School students in grades 3 - 12. It is designed to encourage creativity, promote the importance of good communication skills, and complement and support the Metro language arts curriculum. The program is fully funded by Caterpillar.

Saint Thomas Hospital Science Scholars is designed to encourage among high school students, a love of science and a greater awareness of the role of science and math in the medical field through a unique, year-long learning project. It provides instruction from medical experts and exposes students to the career opportunities available in these fields. The program is fully funded by donations from Saint Thomas Hospital.

Choices is a program designed to help 8th grade students make thoughtful academic decisions that will expand their career and life options. Through two fast-paced, 50-minute classroom sessions trained volunteers engage students in role-playing exercises to illustrate that the decisions they make today shape their future.

Reading College is an approved Supplemental Educational Services (SES) program by the State of Tennessee. Due to changes in grant administration, PENCIL chose not to participate as an SES provider in fiscal 2007.

PENCIL Box provides basic school supplies to disadvantaged students whose teachers often purchase these materials with their own money. Funded by a grant from Louisiana Pacific, the program is a partnership between the Nashville business community and Nashville public schools. Companies are encouraged to donate both new and surplus school supplies by distribution through the program. Teachers “shop for free” at the center by using a voucher system by which they can redeem items essential to classroom instructions.

Maplewood Family Resource Center is a partnership between United Way, Metro Government, Nashville Public Schools and PENCIL Foundation. PENCIL Foundation provides all management responsibilities for the Maplewood Family Resource Center, which serves as a hub of resources, support and opportunities for students attending Maplewood High School and their families. The goal is to provide an accessible system of coordinated public and private sector services to strengthen families’ abilities to support the academic and life success of their children.

Monroe Harding Youth Initiative is a collaboration between the Foundation and Monroe Harding, Inc. to provide job skills training and placement for youth currently in foster care, those who have aged out of foster care or those who have left the educational system.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Accrual Basis and Financial Statement Presentation

The financial statements of the Foundation have been prepared on the accrual basis of accounting.

The Foundation classifies its net assets and its revenue, expenses, gains, and losses into three classes of net assets based on the existence or absence of donor-imposed restrictions. Net assets of the Foundation and changes therein are classified as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Foundation and/or the passage of time.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Foundation. Generally, the donors of these assets would permit the Foundation to use all or part of the income earned on related investments for general or specific purposes.

The amount for each of these classes of net assets is displayed in the statement of financial position and the amount of change in each class of net assets is displayed in the statement of activities. The Foundation had no permanently restricted net assets at June 30, 2007 or 2006.

Contributions

The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose of the 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.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions receivable are recorded at their estimated fair value and reflect discounts for payment terms greater than one year, if applicable. Contributions receivable are considered to be either conditional or unconditional promises to give. A conditional contribution is one which depends on the occurrence of some specified uncertain future event to become binding on the donor. Conditional contributions are not recorded as revenue until the condition is met, at which time they become unconditional. Unconditional contributions are recorded as revenue at the time verifiable evidence of the promise to give is received.

In the event a donor makes changes to the nature of a restricted gift which affects its classification among the net asset categories, such amounts are reflected as reclassifications in the statement of activities.

Cash and Cash Equivalents

The Foundation considers all highly liquid investments with an original maturity of less than 90 days to be cash equivalents.

Fair Value of Financial Instruments

The carrying value of cash, receivables, accounts payable and accrued expenses approximate fair value because of the short maturity of these instruments.

Income Taxes

The Foundation is exempt from income tax under Section 501(c)(3) of the U.S. Internal Revenue Code; and accordingly, no provision for income taxes is included in the accompanying financial statements.

Use of Estimates in the Preparation of Financial Statements

Judgment and estimation are exercised by management in certain areas of the preparation of financial statements. The most significant area is the collection of receivables. Management believes that such estimates have been based on reasonable assumptions and that such estimates are adequate. Actual results could differ from those estimates.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Office Equipment

Costs of office equipment are charged to expense. Where appropriate, such costs are reimbursed through program contracts. These amounts are not material to the financial statements of the Foundation.

Donated Services

A substantial number of unpaid volunteers have made contributions of their time to assist the Foundation's Partners, Math Partners and Reading Partners programs. The total value of time contributed by these volunteers for the year ended June 30, 2007 and June 30, 2006 has been estimated to be approximately \$531,000 and \$612,000, respectively. These amounts have not been recorded in the financial statements.

B. CONTRIBUTIONS RECEIVABLE

Contributions receivable are due within one year and totaled \$10,125 and \$70,500 at June 30, 2007 and 2006, respectively. No allowance for uncollectible contributions receivable was considered necessary at June 30, 2007 or 2006.

In 2006, the Foundation received a conditional promise to give in the amount of \$20,000. The funds were designated as a challenge matching grant to be received by the Foundation contingent upon the Foundation obtaining \$20,000 in new gifts/ or grants prior to May 2007 for the PENCIL Box program. During 2007, the conditions were met and the Foundation received the gift.

In 2007, the Foundation received a conditional promise to give in the amount of \$20,000. The funds were designated as a challenge matching grant to be received by the Foundation contingent upon the Foundation obtaining \$20,000 in new gifts/or grants in 2008. At June 30, 2007 the Foundation had not recognized any portion of the conditional gift.

C. CONTRACTS AND GRANTS RECEIVABLE

Contracts and grants receivable are due within one year and no allowance for uncollectible amounts was considered necessary at June 30, 2007 and 2006.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

D. FUNDS HELD FOR OTHERS

In fiscal 2006, the Foundation entered into an agreement to serve as agent and custodian for contributions, grants, and other income of Alignment Nashville, a collaboration between Metro Public Schools and local businesses, non-profit agencies, government and universities. The purpose is to create a system to bring community organizations and resources into alignment so that their coordinated support to Metropolitan Nashville Public School's and District priorities have a positive impact on student achievement and public school success. The contributions, grants, and other income received are deposited into the Foundation's operating account. All program and administrative expenses of the organization are paid by the Foundation when notified by Alignment Nashville. As of June 30, 2007 and 2006, the Foundation was serving as agent and custodian for \$118,699 and \$64,628, respectively, which represents the unexpended net assets of Alignment Nashville. This amount has been recorded as a liability in the financial statements of the Foundation. For the year ended June 30, 2007, the activity in this account is summarized as follows:

Beginning balance - agency fund cash	\$ 64,628
<u>Receipts</u>	
Contribution and grants	<u>456,500</u>
Total support and revenue	<u>456,500</u>
<u>Disbursements</u>	
Salaries and wages	192,541
Payroll taxes	14,729
Telephone	117
Postage	292
Purchased equipment	3,827
Office supplies	9,417
Travel	1,500
Program activities/committee grants	18,289
Professional development	7,946
Publications and promotions	2,969
Professional services	118,166
Contracted services	900
Copier expense	369
Internet	11,837
Miscellaneous	<u>19,530</u>
Total expenses	<u>402,429</u>
Ending balance - agency fund cash	<u>\$118,699</u>

The Foundation earned administrative fees of \$19,530 and \$4,501 for providing these services in fiscal 2007 and 2006, respectively.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

E. INDIRECT COST ALLOCATION

The Foundation's policy is to record contributions to individual programs based on the designation of the contributor and to maintain individual expense accounts for each program. General overhead expenses are allocated from PENCIL to the various programs based on the estimated time and expenses expended for each individual program and other appropriate allocation methods.

F. LEASES

The Foundation leases office space and certain office equipment under non-cancelable operating leases which expire at various dates through June 2012. Lease expense for all operating leases was \$98,347 and \$94,019 for the years ended June 30, 2007 and 2006, respectively. At June 30, 2007, the aggregate future minimum rentals for all non-cancelable leases were as follows:

<u>Year Ended June 30,</u>	
2008	\$ 99,513
2009	102,098
2010	104,741
2011	103,858
2012	<u>95,922</u>
	<u>\$506,132</u>

G. RETIREMENT PLAN

The Foundation established a retirement plan in September 2001 for essentially all employees pursuant to Internal Revenue Code 401(k). The amount of matching contributions by the Foundation is based upon the amounts contributed by plan participants. Contributions by the Foundation to the plan for the years ended June 30, 2007 and 2006 were \$31,392 and \$28,035, respectively.

H. COMMITMENTS AND CONTINGENCIES

The Foundation has received federal and state grants for specific purposes that are subject to review and audit by grantor agencies. Although such audits could generate expenditure disallowance under terms of the grants, management believes any required reimbursements would not be material to the financial statements of the Foundation.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

I. CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Foundation to concentrations of credit risk consist principally of cash held by the Foundation. Cash at June 30, 2007 includes demand deposits at high credit quality financial institutions. The deposits carry credit risk to the extent they exceed federally insured limits. An accounting risk also extends to receivables, all of which are uncollateralized.

J. NET ASSETS AND NET ASSETS RELEASED FROM DONOR RESTRICTIONS

Temporarily restricted net assets totaling \$10,125 and \$70,500 at June 30, 2007 and 2006 were available for the PENCIL Box, Partners, and Math Partners programs.

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by donors.

Purpose restrictions accomplished:

	<u>2007</u>	<u>2006</u>
JTG	\$ 652,313	\$ 649,246
Monroe Harding	6,838	2,670
J-STEP	534,069	458,305
PENCIL Partners	177,551	199,456
Reading Partners	111,705	133,195
Math Partners	102,112	98,830
Caterpillar Student Writers Showcase	30,000	30,000
Saint Thomas Science Scholars	5,000	5,000
Choices	5,375	10,000
Maplewood	10,537	-
PENCIL Box	322,695	134,747
PENCIL	<u>-</u>	<u>5,950</u>
Total restrictions released	<u>\$1,958,195</u>	<u>\$1,727,399</u>

K. RELATED PARTIES

The Foundation has certain members of its board of directors who have financial interests in entities which engage in business transactions with the Foundation. These entities include financial institutions, a company from which the Foundation leases office space, a technological support company, a telecommunications company and a public relations firm.

PENCIL FOUNDATION
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

L. FUND RAISING COSTS

For fiscal years ended June 30, 2007 and 2006, expenses totaling \$113,934 and \$126,398 respectively, were associated with fundraising and are classified in the statement of activities in the program's activities expenses.