

PENCIL FOUNDATION  
FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITOR'S REPORT  
JUNE 30, 2018 AND 2017

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INDEPENDENT AUDITOR'S REPORT

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TABLE OF CONTENTS

	<u>PAGE</u>
<u>INDEPENDENT AUDITOR'S REPORT</u> .....	1 - 2
 <u>FINANCIAL STATEMENTS</u>	
Statements of Financial Position.....	3
Statements of Activities .....	4
Statements of Functional Expenses.....	5
Statements of Cash Flows .....	6
Notes to Financial Statements.....	7 - 20

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
PENCIL Foundation  
Nashville, Tennessee

### REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of PENCIL Foundation ("PENCIL"), a Tennessee not-for-profit corporation, which comprise the statements of financial position as of June 30, 2018 and 2017, and the related statements of activities, functional expenses and cash flows for the years 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 audits. We conducted our audits 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 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 entity'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 entity'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 Foundation as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Knapp CPAs PLLC*

Nashville, Tennessee  
October 25, 2018

PENCIL FOUNDATION

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
<u>ASSETS</u>		
Cash and cash equivalents	\$ 140,000	\$ 641,056
Contributions, grants and other receivables	311,955	324,873
Inventory	399,858	-
Prepaid expenses	39,802	14,989
Investments	621,449	277,227
Beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee	57,627	53,903
Property and equipment, net	<u>234,263</u>	<u>34,600</u>
TOTAL ASSETS	<u>\$ 1,804,954</u>	<u>\$ 1,346,648</u>
<u>LIABILITIES AND NET ASSETS</u>		
<u>LIABILITIES</u>		
Line of credit	\$ 39,824	\$ -
Accounts payable	8,191	25,955
Payroll liabilities	51,422	101,654
Other liabilities	<u>14,783</u>	<u>31,595</u>
TOTAL LIABILITIES	<u>114,220</u>	<u>159,204</u>
<u>NET ASSETS</u>		
Unrestricted:		
Designated for beneficial interest in agency endowment fund	57,627	53,903
Board designated	149,951	239,309
Undesignated	<u>1,180,036</u>	<u>622,498</u>
Total unrestricted	1,387,614	915,710
Temporarily restricted	<u>303,120</u>	<u>271,734</u>
TOTAL NET ASSETS	<u>1,690,734</u>	<u>1,187,444</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,804,954</u>	<u>\$ 1,346,648</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018		
	Unrestricted	Temporarily Restricted	Total
REVENUES AND SUPPORT			
Government grants and contracts	\$ 296,896	\$ -	\$ 296,896
Corporate and foundation contributions	349,098	246,494	595,592
Individual contributions	205,882	-	205,882
United Way and other grants	210,000	-	210,000
In-kind contributions	1,766,976	-	1,766,976
Special events	276,176	-	276,176
Consulting services	45,412	-	45,412
Other revenue	1,272	-	1,272
Investment income	7,961	-	7,961
Change in value of beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee	3,724	-	3,724
Net assets released from restrictions	215,108	(215,108)	-
TOTAL REVENUES AND SUPPORT	3,378,505	31,386	3,409,891
EXPENSES			
Program services	2,549,818	-	2,549,818
Supporting services:			
Management and general	67,902	-	67,902
Fundraising	288,881	-	288,881
TOTAL EXPENSES	2,906,601	-	2,906,601
CHANGE IN NET ASSETS	471,904	31,386	503,290
NET ASSETS - BEGINNING OF YEAR	915,710	271,734	1,187,444
NET ASSETS - END OF YEAR	\$ 1,387,614	\$ 303,120	\$ 1,690,734

See accompanying notes to financial statements.

2017		
<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
\$ 1,062,860	\$ -	\$ 1,062,860
369,547	271,734	641,281
143,590	-	143,590
216,252	-	216,252
1,073,618	-	1,073,618
372,437	-	372,437
37,294	-	37,294
1,243	-	1,243
4,031	-	4,031
3,681	-	3,681
<u>74,425</u>	<u>(74,425)</u>	<u>-</u>
<u>3,358,978</u>	<u>197,309</u>	<u>3,556,287</u>
3,158,257	-	3,158,257
82,109	-	82,109
<u>268,633</u>	<u>-</u>	<u>268,633</u>
<u>3,508,999</u>	<u>-</u>	<u>3,508,999</u>
(150,021)	197,309	47,288
<u>1,065,731</u>	<u>74,425</u>	<u>1,140,156</u>
<u>\$ 915,710</u>	<u>\$ 271,734</u>	<u>\$ 1,187,444</u>

PENCIL FOUNDATION

STATEMENTS OF FUNCTIONAL EXPENSES

FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	2018				
	<u>Supporting Services</u>			Total Supporting Services	Total
	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>		
Personnel	\$ 858,229	\$ 38,100	\$ 156,969	\$ 195,069	\$ 1,053,298
Equipment	37,363	1,713	3,260	4,973	42,336
Depreciation	41,448	-	-	-	41,448
Travel	20,920	289	777	1,066	21,986
Professional services	119,811	16,781	14,538	31,319	151,130
Professional services - donated	1,236	-	-	-	1,236
After school providers	21,304	270	980	1,250	22,554
Grant to Metro Nashville Public Schools	66,357	-	-	-	66,357
Supplies	2,678	109	149	258	2,936
Supplies - donated	1,109,144	-	-	-	1,109,144
Facility expenses	8,868	3,395	6,111	9,506	18,374
Communications	44,835	795	8,459	9,254	54,089
Commercial insurance	11,097	678	1,301	1,979	13,076
Staff development and community events	11,051	623	1,542	2,165	13,216
Donor cultivation	-	55	3,199	3,254	3,254
Events	1,783	6	35,752	35,758	37,541
Events - donated	-	-	52,338	52,338	52,338
Fees & bank charges	334	4,926	3,506	8,432	8,766
Miscellaneous	1,030	162	-	162	1,192
Occupancy - donated	192,330	-	-	-	192,330
 TOTAL EXPENSES	 <u>\$ 2,549,818</u>	 <u>\$ 67,902</u>	 <u>\$ 288,881</u>	 <u>\$ 356,783</u>	 <u>\$ 2,906,601</u>

See accompanying notes to financial statements.



2017

Program Services	Supporting Services		Total Supporting Services	Total
	Management and General	Fundraising		
\$ 1,135,956	\$ 58,755	\$ 115,822	\$ 174,577	\$ 1,310,533
20,278	4,403	1,549	5,952	26,230
932	-	-	-	932
13,226	706	728	1,434	14,660
86,012	5,160	19,321	24,481	110,493
13,034	-	-	-	13,034
477,059	342	1,815	2,157	479,216
293,325	-	-	-	293,325
5,358	330	3,861	4,191	9,549
833,522	-	-	-	833,522
16,828	4,344	1,352	5,696	22,524
50,220	1,505	13,385	14,890	65,110
13,808	317	570	887	14,695
7,960	1,547	1,116	2,663	10,623
2,002	285	9,543	9,828	11,830
141	-	53,127	53,127	53,268
-	-	40,782	40,782	40,782
2,818	1,305	5,572	6,877	9,695
1,338	3,110	90	3,200	4,538
184,440	-	-	-	184,440
<u>\$ 3,158,257</u>	<u>\$ 82,109</u>	<u>\$ 268,633</u>	<u>\$ 350,742</u>	<u>\$ 3,508,999</u>

PENCIL FOUNDATION

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 503,290	\$ 47,288
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	41,449	932
Net realized and unrealized gains on investments	5,391	8,297
Contributions made to agency endowment fund	-	(39,755)
Change in value of beneficial interest in agency endowment fund	(3,724)	(3,681)
(Increase) decrease in:		
Contributions, grants and other receivables	12,918	(147,132)
Prepaid expenses	(24,813)	2,295
Inventory	(399,858)	-
Increase (decrease) in:		
Accounts payable	(17,764)	(43,305)
Payroll liabilities	(50,232)	40,531
Other liabilities	(16,812)	(9,415)
TOTAL ADJUSTMENTS	(453,445)	(191,233)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	49,845	(143,945)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(241,112)	(35,532)
Proceeds from sale or maturity of investments	243,265	368,000
Purchases of investments	(592,878)	(327,105)
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(590,725)	5,363
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from line of credit	39,824	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	39,824	-
NET DECREASE IN CASH AND CASH EQUIVALENTS	(501,056)	(138,582)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	641,056	779,638
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 140,000	\$ 641,056

See accompanying notes to financial statements.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2018 AND 2017

NOTE 1 - GENERAL

PENCIL Foundation (“PENCIL”) is a not-for-profit organization formed in 1982 to link community resources to Nashville public schools to help young people achieve academic success and prepare for life.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements present the financial position and change in net assets of PENCIL on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Resources are classified as unrestricted, temporarily restricted or permanently restricted net assets, based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* are free of donor-imposed restrictions. All revenues, gains and losses that are not temporarily or permanently restricted by donors are included in this classification. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with donors’ stipulations results in the release of the restriction.

Board designated net assets consist of funds the Board has earmarked for educating future healthcare providers within Metro Nashville Public Schools, specifically at Maplewood High School, funds set aside for future use, and proceeds from the Purity Dairy Pure Dash to establish an endowment for the organization.

- *Temporarily restricted net assets* are limited as to use by donor-imposed restrictions that expire with the passage of time or that can be satisfied by use for the specific purpose.
- *Permanently restricted net assets* are amounts required by donors to be held in perpetuity, including gifts requiring that the principal be invested, and the income or specific portions thereof be used for operations. PENCIL had no permanently restricted net assets as of June 30, 2018 and 2017.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Support and Revenue

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. Contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are restricted by the donor for future periods or for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a restriction is fulfilled (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted and reported in the statement of activities as net assets released from restrictions. However, if a restriction is fulfilled in the same time period in which the contribution is received, the support is reported as unrestricted.

PENCIL receives grant revenue from various state and local agencies. Grant revenue is recognized in the period a liability is incurred for eligible expenditures under the terms of the grant. Grants received in advance of the expenditure are recorded as deferred revenue.

Contract revenue is recognized when services are rendered and/or reimbursable charges are incurred under the terms of the contract. Contract revenue received in advance of services provided and/or reimbursable charges being incurred are recorded as deferred revenue.

PENCIL reports gifts of equipment, materials, or facilities (in-kind contributions) at their fair value in the period received as unrestricted support unless explicit donor restrictions specify how the assets must be used. Gifts of long-lived assets with explicit restrictions as to how the assets are to be used or funds restricted for the acquisition of long-lived assets are reported as restricted support. Expirations of donor restrictions are recognized when the donated or acquired long - lived assets are placed in service.

Donated Services

Donated services are recognized if they create or enhance non-financial assets, or the donated service requires specialized skills, were performed by a donor who possesses such skills, and would have been purchased by PENCIL if not donated. Such services are recognized at fair value as support and expense in the period the services are performed and related primarily to public relations services for the years ended June 30, 2018 and 2017.

A substantial number of unpaid volunteers have made contributions of their time to serve as tutors, mentors, teacher supply store volunteers and in other capacities in order to serve Nashville public school students. The total value of time contributed by these volunteers for the year ended June 30, 2018 has been estimated to be approximately \$2,866,000. This amount has not been recorded in the accompanying financial statements.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Donated Services (Continued)

Other individuals volunteer their time and perform a variety of tasks that assist PENCIL with program services and fundraising events. No amounts have been reflected in the financial statements for volunteer time since these donated services do not meet the criteria for recognition under GAAP.

Cash and Cash Equivalents

PENCIL considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Contributions Receivable

Unconditional contributions receivable that are expected to be collected within one year are recorded at their net realizable value. Unconditional contributions receivable that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discount on those amounts is computed using a risk-free interest rate applicable to the year in which the promise is received. Management considered this amount to be immaterial, and it was not recorded. Conditional promises to give are not included as support until such time as the conditions are substantially met.

An allowance for uncollectible contributions is provided based on management's estimate of uncollectible pledges and historical trends. Contributions receivable are written off when deemed to be uncollectible. In management's opinion, no allowance for uncollectible contributions was necessary as of June 30, 2018 and 2017.

Inventory

Inventory consists of donated school supplies received primarily from school supply drives and supply distributors. Inventory is recorded at its estimated fair value at the time the goods are received from the donor. Provision is made to reduce any excess, obsolete or slow-moving inventory to net realizable value. Inventory on hand at the end of fiscal year 2017 was minimal due to physical limitations of the facility, therefore no valuation was recorded.

Investments

Investments consist of money market funds, certificates of deposit, mutual funds, equities and exchange traded funds. Money market funds and certificates of deposit are carried at cash value plus accrued interest. Mutual funds, equities and exchange traded funds are carried at their quoted market value on the last business day of the reporting period. Interest and dividends, as well as changes in unrealized gains and losses are recognized currently in the statement of activities.

PENCIL has invested in certificates of deposit with a financial institution with maturities ranging from fiscal year 2019 to 2023. These certificates of deposits have an average yield of 3.30% as of June 30, 2018 (2.72% as of June 30, 2017).

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Agency Endowment Fund

PENCIL's beneficial interest in an agency endowment fund held by the Community Foundation of Middle Tennessee ("CFMT") is recognized as an asset. Investment income and changes in the value of the fund are recognized in the statement of activities, and distributions received from the fund are recorded as increases (decreases) in the beneficial interest.

Property and Equipment

Property and equipment are recorded at cost at the date of purchase, or at estimated fair value at the date of gift. Depreciation expense is calculated using the straight-line method over the estimated useful lives of the assets, except for leasehold improvements, which are depreciated over the shorter of their estimated useful lives or the expected lease term.

Fair Value Measurements

PENCIL classifies its assets based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs).

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis.

*Investments* - Mutual funds, equities and exchange traded funds are classified within Level 1 where quoted market prices are available in an active market for identical assets. If quoted market prices are unavailable, fair value is estimated using quoted market prices of investments with similar characteristics, and the investments are classified within Level 2.

*Beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee* - The agency endowment fund held at the CFMT represents PENCIL's interest in pooled investments with other participants in the funds. The CFMT prepares a valuation of the fund based on the fair value of the underlying investments using quoted market prices and allocates income or loss to each participant based on market results. PENCIL reflects this asset within Level 2 of the valuation hierarchy.

There have been no changes in the valuation methodologies used at June 30, 2018 or 2017.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements (Continued)

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while PENCIL believes its valuation methodologies are appropriate and consistent with that of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different fair value measurements at the reporting date.

Income Taxes

PENCIL qualifies as a not-for-profit organization exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, income taxes are not provided.

Management performs an evaluation of all income tax positions taken or expected to be taken in the course of preparing PENCIL's income tax returns to determine whether the income tax positions meet a "more likely than not" standard of being sustained under examination by the applicable taxing authorities. Management has performed its evaluation of all income tax positions taken on all open income tax returns and has determined that there were no positions taken that do not meet the "more likely than not" standard. Accordingly, there are no provisions for income taxes, penalties or interest receivable or payable relating to uncertain income tax positions in the accompanying financial statements.

Program and Supporting Services

The following program and supporting services are included in the accompanying financial statements:

Program Services

PENCIL Partners and PENCIL Academy Partners are businesses and organizations committed to student success through organized, coordinated activities that match the unique attributes of each Partner with the specific needs of each school or academy. Schools turn to us and our wide network of business contacts to help them find Partners that are a good match for their school. Businesses and organizations turn to us and our comprehensive knowledge of Nashville schools when they want to connect with a school where they can help students. PENCIL also serves as the coordinator of these ongoing Partnership relationships. We facilitate communication, provide activity ideas, advise on volunteer management and help the school and Partner develop a year-long strategic plan. In addition, PENCIL hosts the PENCILMeIn.org website where schools, Partners and individuals log their volunteer hours and in-kind gifts.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program Services (Continued)

PENCIL's Family Resource Centers (FRCs) act as a hub for community resources, helping families navigate outside agencies that can assist with social, emotional and physical needs. FRCs stock emergency food/clothing and develop services tailored to their school population, such as GED and English-language classes, parenting classes, eye exams and glasses, individual counseling and student leadership groups.

The LP PENCIL Box makes sure students have the school supplies necessary for success in the classroom - and that teachers do not have to spend their own money to buy those supplies. Through generous donations from businesses, organizations and individuals, the Box is stocked with school supplies such as pencils, pens, notebooks, crayons, scissors, reading books, backpacks and much more. Every Metro teacher can make two shopping trips per school year for free supplies.

PENCIL served as a coordinating agency and an anchor partner with NAZA (Nashville After Zone Alliance) during the 2017 fiscal year. NAZA contracts with a coordinating agency to establish afterschool zones which provide afterschool engagement for middle school students in Metro Nashville Public Schools. The coordinating agency is an established and qualified provider responsible for ensuring that high-quality comprehensive afterschool programming is delivered on-site at middle schools (or at convenient alternative sites where preferable). The coordinating agency implements the coordinated scheduling, marketing, recruitment, tracking, and transportation processes developed by NAZA. The coordinating agency uses its knowledge of the resources and barriers in that geographic area to maximize effectiveness of these processes and of implementation of the afterschool as a whole. Additionally, as an anchor partner PENCIL provides programming at individual afterschool sites and meets threshold tests of program quality with our PACE (PENCIL Academic & Career Enrichment) program. The curriculum is a STEM-based approach with hands-on learning opportunities and engagement with community partners. PENCIL ceased both NAZA and PACE work at the end of fiscal year 2017.

Supporting Services

Management and General relates to the overall direction of PENCIL. These expenses are not identifiable with a particular program or event, or with fundraising, but are indispensable to the conduct of those activities and are essential to PENCIL. Specific activities include organization oversight, business management, recordkeeping, budgeting, financing and other administrative activities.

Fundraising includes costs of activities directed toward appeals for financial support, including special events. Other activities include the creation and distribution of fundraising materials.



PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allocation of Functional Expenses

Expenses that can be directly attributed to a particular function are charged to that function. Certain costs have been allocated among more than one program or activity based on objectively evaluated financial and nonfinancial data or reasonable subjective methods determined by management.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made in the 2017 financial statements to conform to the 2018 presentation. These reclassifications had no effect on the results of operations previously reported.

Recent Authoritative Accounting Guidance

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14 which defers the effective date of ASU 2014-09 one year making it effective for annual reporting periods beginning after December 15, 2018. PENCIL has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2019. PENCIL is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Authoritative Accounting Guidance (Continued)

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows. Among other changes, the ASU replaces the three current classes of net assets with two new classes, “net assets with donor restrictions” and “net assets without donor restrictions,” and expands disclosures about the nature and amount of any donor restrictions. ASU 2016-14 is effective for annual periods beginning after December 15, 2017, with early adoption permitted. PENCIL is currently evaluating the impact the adoption of this guidance will have on its financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance on how certain cash receipts and cash payments should be presented and classified in the statement of cash flows with the objective of reducing existing diversity in practice with respect to these items. ASU 2016-15 will be effective for PENCIL on July 1, 2019. This standard will not have a material impact on PENCIL’s statement of cash flows.

Events Occurring After Reporting Date

PENCIL has evaluated events and transactions that occurred between June 30, 2018 and October 25, 2018, the date the financial statements were available to be issued, for possible recognition or disclosure in the financial statements.

NOTE 3 - CONTRIBUTIONS, GRANTS AND OTHER RECEIVABLES

Contributions, grants and other receivables consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Contributions receivable	\$ 132,500	\$ 189,884
Grants receivable	162,500	112,962
Other receivables	<u>16,955</u>	<u>22,027</u>
	<u>\$ 311,955</u>	<u>\$ 324,873</u>

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 3 - CONTRIBUTIONS, GRANTS AND OTHER RECEIVABLES (CONTINUED)

Contributions receivable were due as follows at June 30:

	<u>2018</u>	<u>2017</u>
Due in less than one year	\$ 118,500	\$ 133,258
One to five years	<u>14,000</u>	<u>56,626</u>
	<u>\$ 132,500</u>	<u>\$ 189,884</u>

NOTE 4 - INVESTMENTS

Investments consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Money market funds	\$ 28,000	\$ -
Certificates of deposit	213,989	277,227
Mutual funds	143,343	-
Equities	27,274	-
Exchange traded funds	<u>208,843</u>	<u>-</u>
	<u>\$ 621,449</u>	<u>\$ 277,227</u>

Investment income consisted of the following for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Interest and dividends	\$ 13,352	\$ 12,328
Realized and unrealized losses	<u>(5,391)</u>	<u>(8,297)</u>
	<u>\$ 7,961</u>	<u>\$ 4,031</u>

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Vehicle	\$ 35,532	\$ 35,532
Leasehold improvements	<u>241,112</u>	<u>-</u>
	276,644	35,532
Less: Accumulated depreciation	<u>(42,381)</u>	<u>(932)</u>
	<u><u>\$ 234,263</u></u>	<u><u>\$ 34,600</u></u>

NOTE 6 - AGENCY ENDOWMENT FUND

PENCIL established and holds a beneficial interest in an agency endowment fund held by CFMT. PENCIL has granted variance power to CFMT and CFMT has the ultimate authority and control over the Fund and the income derived therefrom. The Fund is charged a .4% administrative fee by CFMT annually. Upon request by PENCIL, income may be distributed to PENCIL annually.

A schedule of changes in PENCIL's beneficial interest in this fund for the years ended June 30, 2018 and 2017 follows:

	<u>2018</u>	<u>2017</u>
Beginning balance	\$ 53,903	\$ 10,467
Change in value of beneficial interest in agency endowment fund:		
Contributions to the fund	-	39,755
Investment income - net	4,093	3,909
Administrative expenses	<u>(369)</u>	<u>(228)</u>
	<u>3,724</u>	<u>43,436</u>
Ending balance	<u><u>\$ 57,627</u></u>	<u><u>\$ 53,903</u></u>

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 7 - FAIR VALUE MEASUREMENTS

The following table summarizes financial assets measured at fair value on a recurring basis, segregated by level of valuation inputs within the fair value hierarchy utilized to measure fair value as of June 30:

2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Value
<u>Investments:</u>				
Mutual Funds:				
High Yield Bond	\$ 5,703	\$ -	\$ -	\$ 5,703
Emerging Markets Bond	10,945	-	-	10,945
Convertible Bond	3,411	-	-	3,411
Multicurrency	12,308	-	-	12,308
Bank Loan	10,753	-	-	10,753
Market Neutral	11,947	-	-	11,947
Foreign Large Blend	14,261	-	-	14,261
Allocation - 50-70% Equity	14,043	-	-	14,043
Foreign Large Value	4,971	-	-	4,971
Multialternative	17,113	-	-	17,113
Engergy Limited Partnership	4,535	-	-	4,535
Foreign Stock	13,895	-	-	13,895
World Allocation	6,313	-	-	6,313
Diversified Emerging Market	4,107	-	-	4,107
Mid-Cap Growth	9,038	-	-	9,038
	<u>143,343</u>	<u>-</u>	<u>-</u>	<u>143,343</u>
Equities:				
Communication Services	11,908	-	-	11,908
Utilities	11,720	-	-	11,720
Basic Materials	3,646	-	-	3,646
	<u>27,274</u>	<u>-</u>	<u>-</u>	<u>27,274</u>
Exchange Traded Funds:				
Commodities Broad Basket	6,000	-	-	6,000
Foreign Large Blend	61,052	-	-	61,052
Diversified Emerging Markets	18,684	-	-	18,684
Ultrashort Bond	25,085	-	-	25,085
Financial	5,318	-	-	5,318
Large Growth	41,198	-	-	41,198
Large Value	37,378	-	-	37,378
Mid-Cap Blend	7,882	-	-	7,882
Real Estate	2,851	-	-	2,851
Small Value	3,395	-	-	3,395
	<u>208,843</u>	<u>-</u>	<u>-</u>	<u>208,843</u>
Total Investments	<u>\$ 379,460</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 379,460</u>

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 7 - FAIR VALUE MEASUREMENTS (CONTINUED)

<u>2018</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Value</u>
Beneficial interest in agency endowment fund	<u>\$ -</u>	<u>\$ 57,627</u>	<u>\$ -</u>	<u>\$ 57,627</u>
<u>2017</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Value</u>
Beneficial interest in agency endowment fund	<u>\$ -</u>	<u>\$ 53,903</u>	<u>\$ -</u>	<u>\$ 53,903</u>

NOTE 8 - LINE OF CREDIT

PENCIL has a \$100,000 revolving line of credit with a bank which matured October 2018 and was extended through December 2018. Interest is payable monthly at a variable rate of Prime + 1.00% (5.25% at June 30, 2018), with the outstanding principal balance payable at maturity. The line is secured by PENCIL's investments. As of June 30, 2018 and 2017, there was an outstanding balance of \$39,824 and \$0, respectively under this line of credit.

NOTE 9 - LEASES

PENCIL leases certain office equipment under non-cancelable operating leases which expire at various dates through August 2021. During 2016, PENCIL entered into a new office equipment lease for which the lessor advanced PENCIL funds to offset future payments required under an existing lease agreement for similar equipment. The funds received from the lessor are recorded as a liability on PENCIL's books which will be reduced as payments are made over the remainder of the original lease term. The remaining liability as of June 30, 2018 was \$14,783 (\$25,980 as of June 30, 2017).

During fiscal year 2018, PENCIL received rent-free office space from Metropolitan Nashville Public Schools ("MNPS"). The estimated fair market value of the space monthly was \$1,170 and is recorded as an in-kind contribution. PENCIL also received rent-free space from MNPS for a free teacher supply store (LP PENCIL Box). The estimated fair market value of the space was \$14,200 per month and was recorded as an in-kind contribution. PENCIL terminated both these agreements in April 2018 and began utilizing a different rent-free office and warehouse space that PENCIL had been renovating since October 2017. The lease renews annually unless either party provides written notice to terminate the agreement. The estimated fair market value of the space is \$6,000 per month and is recorded as an in-kind contribution.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 9 - LEASES (CONTINUED)

Lease expense paid for all operating leases was \$11,832 for the year ended June 30, 2018 (\$18,977 for the year ended June 30, 2017).

A summary of future minimum lease payments for equipment, net of amounts received from lessor to offset future required payments, as of June 30, 2018 follows:

Year ending June 30,

2019	\$ 11,832
2020	11,832
2021	11,832
2022	<u>1,972</u>
	<u>\$ 37,468</u>

NOTE 10 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Future year partnerships	\$ 159,126	\$ 200,884
LP PENCIL Box	60,000	65,000
Capacity campaign	62,787	-
Technology	-	5,000
Back to School Breakfast	12,000	-
Eyecare	9,207	-
College guide	<u>-</u>	<u>850</u>
	<u>\$ 303,120</u>	<u>\$ 271,734</u>

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2018 AND 2017

NOTE 11 - RETIREMENT PLAN

PENCIL sponsors a Section 401(k) defined contribution plan for the benefit of eligible employees. The plan provides for PENCIL to make a matching contribution for each employee deferral contribution, subject to limitations. Total contributions by PENCIL to the plan amounted to \$12,609 in 2018 (\$24,158 in 2017).

NOTE 12 - COMMITMENTS AND CONTINGENCIES

PENCIL has received federal and state grants and contracts 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 PENCIL.

NOTE 13 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject PENCIL to concentrations of credit risk consist principally of cash and cash equivalents, and various contributions, grants, contracts and related receivables. PENCIL maintains cash and cash equivalents and investments in certificates of deposit at reputable financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC") up to statutory limits. PENCIL's balances may, at times, exceed statutory limits. PENCIL has not experienced any losses in these accounts and management considers this to be a normal business risk.

Contributions received from two sources totaled approximately \$217,000, or 25%, of total contribution revenue received for the year ended June 30, 2018 (\$286,000, or 36%, of total contribution revenue received for the year ended June 30, 2017)

NOTE 14 - RELATED PARTIES

PENCIL has certain members of its board of directors who are employed by or have financial interests in entities which engage in business transactions with PENCIL. These entities include financial institutions, higher education institutions, a construction company, an entertainment facility, insurance brokers, and a company from which PENCIL receives free rent (see Note 9 for lease details).