

PENCIL FOUNDATION  
FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITOR'S REPORT  
JUNE 30, 2016

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TABLE OF CONTENTS

	<u>PAGE</u>
<u>INDEPENDENT AUDITOR'S REPORT</u> .....	1 - 2
 <u>FINANCIAL STATEMENTS</u>	
Statement of Financial Position .....	3
Statement of Activities.....	4
Statement of Functional Expenses .....	5
Statement of Cash Flows .....	6
Notes to Financial Statements.....	7 - 17

## 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 statement of financial position as of June 30, 2016, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

### MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### 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 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, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Kraft CPAs PLLC*

Nashville, Tennessee  
October 27, 2016

PENCIL FOUNDATION

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2016

ASSETS

Cash and cash equivalents	\$ 779,638
Investments in certificates of deposit	326,419
Contributions, grants and other receivables	177,741
Prepaid expenses	17,284
Beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee	<u>10,467</u>
TOTAL ASSETS	<u>\$ 1,311,549</u>

LIABILITIES AND NET ASSETS

LIABILITIES	
Accounts payable	\$ 69,260
Payroll liabilities	61,123
Other liabilities	<u>41,010</u>
TOTAL LIABILITIES	<u>171,393</u>
NET ASSETS	
Unrestricted:	
Board designated	435,000
Undesignated	<u>630,731</u>
Total unrestricted	1,065,731
Temporarily restricted	<u>74,425</u>
TOTAL NET ASSETS	<u>1,140,156</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,311,549</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
REVENUES AND SUPPORT			
Corporate/foundation giving	\$ 704,300	\$ 73,975	\$ 778,275
Government grants/contracts	1,190,081	-	1,190,081
Individual giving	38,001	-	38,001
United Way and other grants	352,804	-	352,804
In-kind contributions	564,174	-	564,174
Special events	296,337	-	296,337
Consulting services	37,539	-	37,539
Other revenue	17,746	-	17,746
Interest income	7,465	-	7,465
Change in value of beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee	(227)	-	(227)
Net assets released from restrictions	<u>97,550</u>	<u>(97,550)</u>	<u>-</u>
TOTAL REVENUES AND SUPPORT	<u>3,305,770</u>	<u>(23,575)</u>	<u>3,282,195</u>
EXPENSES			
Program services	2,289,054	-	2,289,054
Supporting services:			
Management and general	152,126	-	152,126
Fundraising	<u>419,495</u>	<u>-</u>	<u>419,495</u>
TOTAL EXPENSES	<u>2,860,675</u>	<u>-</u>	<u>2,860,675</u>
CHANGE IN NET ASSETS	445,095	(23,575)	421,520
NET ASSETS - BEGINNING OF YEAR, as restated	<u>620,636</u>	<u>98,000</u>	<u>718,636</u>
NET ASSETS - END OF YEAR	<u>\$ 1,065,731</u>	<u>\$ 74,425</u>	<u>\$ 1,140,156</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEAR ENDED JUNE 30, 2016

	2016				
	Supporting Services				Total
	Program Services	Management and General	Fundraising	Total Supporting Services	
Wages	\$ 907,756	\$ 110,377	\$ 182,920	\$ 293,297	\$ 1,201,053
Payroll taxes	67,187	8,169	13,539	21,708	88,895
Employee benefits	105,023	12,770	21,163	33,933	138,956
Occupancy	49,684	6,211	6,211	12,422	62,106
Occupancy - donated	170,400	-	-	-	170,400
Equipment	13,854	1,732	1,732	3,464	17,318
Professional services	39,940	4,993	4,993	9,986	49,926
Professional services - donated	7,953	-	-	-	7,953
Travel	13,744	1,718	1,718	3,436	17,180
Supplies	10,598	-	-	-	10,598
Supplies - donated	350,520	-	-	-	350,520
Communication	33,543	4,193	4,193	8,386	41,929
General insurance	6,503	867	1,301	2,168	8,671
Professional development	3,997	533	799	1,332	5,329
Dues/memberships	4,503	563	563	1,126	5,629
Events	-	-	98,750	98,750	98,750
Events - donated	-	-	35,301	35,301	35,301
After school providers	503,849	-	-	-	503,849
Social enterprise project	-	-	46,312	46,312	46,312
TOTAL EXPENSES	<u>\$ 2,289,054</u>	<u>\$ 152,126</u>	<u>\$ 419,495</u>	<u>\$ 571,621</u>	<u>\$ 2,860,675</u>

See accompanying notes to financial statements.

PENCIL FOUNDATION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net assets	\$ 421,520
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Change in value of beneficial interest in agency endowment fund	227
(Increase) decrease in:	
Contributions, grants and other receivables	(29,392)
Prepaid expenses	(5,935)
Increase (decrease) in:	
Accounts payable	60,682
Payroll liabilities	(14,728)
Other liabilities	(62,239)
TOTAL ADJUSTMENTS	(51,385)
NET CASH PROVIDED BY OPERATING ACTIVITIES	370,135
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from maturity of investments in certificates of deposit	101,123
Purchases of investments in certificates of deposit	(34,000)
NET CASH PROVIDED BY INVESTING ACTIVITIES	67,123
NET INCREASE IN CASH AND CASH EQUIVALENTS	437,258
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	342,380
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 779,638

See accompanying notes to financial statements.



PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2016

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.

- *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, 2016.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

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 relation services for the year ended June 30, 2016.

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, 2016 has been estimated to be approximately \$3,300,000. This amount has not been recorded in the accompanying financial statements.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

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 these donated services since the volunteer's time does 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. As of June 30, 2016, all contributions receivable were due within one year. 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, 2016.

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.

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.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value Measurements (Continued)

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

*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, 2016.

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.

Investments

PENCIL has invested in certificates of deposit with a financial institution with maturities ranging from fiscal year 2017 to 2019. These certificates of deposits have an average yield of 2.68% as of June 30, 2016.

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.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program and Supporting Services

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

Program Services

Jobs for Tennessee Graduates (JTG) is a year-long capstone class for students at high risk of dropping out of school. Supported by a PENCIL JTG specialist, students focus on core competencies necessary for college and the workplace as they build leadership skills, apply for colleges and complete a required capstone project. Additionally, they receive a year of follow-up services to help them transition to college or careers.

Financial Literacy educates and assists participants in obtaining the financial skills needed to build a good credit history, savings and/or emergency funds, creating the foundation for sustainable wealth and eventual homeownership. Those served include high school students and middle school students.

PENCIL Partners encourages business or other community organizations 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. The following are related programs offered under PENCIL Partners:

Reading Partners supports volunteers who work with children in Metropolitan Nashville Public Schools, with the goal of improving children’s reading ability and enjoyment. The program focuses on students in elementary and middle schools to support local and state goals for all children to read proficiently by the end of third grade.

Math Partners promotes student achievement in mathematics through trained volunteers. The program provides academic assistance to students in elementary and middle schools whose scores on Tennessee’s standardized achievement test fall below the national norm. Volunteers instruct students in basic skills and concepts as they provide hands-on-activities that relate to real life math usage.

Family Resource Centers serve as a hub of resources, support and opportunities for students 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. PENCIL provides all management for the Antioch, Bordeaux, Glenciff, Madison Middle, Maplewood, and Tusculum Family Resource Centers.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Program and Supporting Services (Continued)

Program Services (Continued)

LP PENCIL Box is a free teacher supply store which provides basic school supplies to students via their teachers who access a wide variety of supplies at the store. Companies and individuals are encouraged to donate both new and surplus school supplies, which are distributed through the program. Teachers “shop” for free at the PENCIL Box for items essential to classroom instruction and wellness.

Nashville After Zone Alliance (NAZA) is a network of afterschool providers that operate in different geographic zones. PENCIL is the coordinating agency for the South Central and McGavock Zones. NAZA is a partnership of the Mayor’s Office, Metropolitan Nashville Public Schools, and youth-serving organizations. The goal of NAZA is to create a network of quality afterschool programs in geographically designated zones. Students are exposed to enrichment activities within the visual and performance arts such as dance, painting and pottery. Other activities provide academic support, as well as team building and leadership opportunities.

PACE (PENCIL Academic & Career Enrichment) is a NAZA funded after-school program focused on career exploration with middle school students at six sites. The curriculum is a STEM-based approach with hands-on learning opportunities and engagement with community partners.

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.

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.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Recent Authoritative Accounting Guidance

In May 2014, the Financial Accounting Standards Board ("FASB") issued guidance on revenue from contracts with customers, 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 Accounting Standards Update ("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 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, including interim periods within those fiscal years. PENCIL is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

Events Occurring After Reporting Date

PENCIL has evaluated events and transactions that occurred between June 30, 2016 and October 27, 2016, the date the financial statements were available to be issued, for possible recognition or disclosure in the financial statements.

NOTE 3 - 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.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 3 - AGENCY ENDOWMENT FUND (CONTINUED)

A schedule of changes in PENCIL's beneficial interest in this fund for the year ended June 30, 2016 follows:

Balance - beginning of year	\$ 10,694
Change in value of beneficial interest in agency endowment fund:	
Investment loss - net	(155)
Administrative expenses	<u>(72)</u>
	<u>(227)</u>
Balance - end of year	<u>\$ 10,467</u>

NOTE 4 - 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, 2016:

	<u>Level 1</u> <u>Inputs</u>	<u>Level 2</u> <u>Inputs</u>	<u>Level 3</u> <u>Inputs</u>	<u>Total</u> <u>Value</u>
Beneficial interest in agency endowment fund	<u>\$ -</u>	<u>\$ 10,467</u>	<u>\$ -</u>	<u>\$ 10,467</u>

NOTE 5 - LEASES

PENCIL leased office space under an operating leases which was to expire December 31, 2017. Subsequent to year end, PENCIL was able to terminate this office space lease agreement at no charge and entered into a one-year lease agreement with Metropolitan Nashville Public Schools for rent-free office space.

PENCIL also 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 (\$36,455 at June 30, 2016) which will be reduced as payments are made over the remainder of the original lease term.



PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 5 - LEASES (CONTINUED)

PENCIL also receives rent-free space for a School Supplies Center ("PENCIL Box"). The estimated fair market value of the space annually is \$170,400.

Lease expense for all operating leases was \$74,037 for the year ended June 30, 2016.

A summary of future minimum lease payments for equipment, net of amounts received from lessor to offset future required payments, as of June 30, 2016 follows:

<u>Year ending June 30,</u>	
2017	\$ 13,944
2018	13,944
2019	13,944
2020	13,944
2021	12,184
Thereafter	<u>1,972</u>
	<u>\$ 69,932</u>

NOTE 6 - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at June 30, 2016:

LP PENCIL Box	\$ 65,000
Technology	<u>9,425</u>
	<u>\$ 74,425</u>

NOTE 7 - 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 \$28,135 in 2016.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 8 - 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 9 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject PENCIL to concentrations of credit risk consist principally of cash and cash equivalents, investments in certificates of deposit, 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 \$1,432,000, comprising 61% of total contributions, grants and contract revenue received for the year ended June 30, 2016.

NOTE 10 - RELATED PARTIES

PENCIL has certain members of its board of directors who have financial interests in entities which engage in business transactions with PENCIL. These entities include financial institutions and a company from which PENCIL leases office space.

NOTE 11 - LINE OF CREDIT

PENCIL has a \$100,000 revolving line of credit with a bank which matures June 2017. Interest is payable monthly at a variable rate of Prime + 1.00% (4.5% at June 30, 2016), with the outstanding principal balance payable at maturity. The line is secured by PENCIL's investments in certificates of deposit. As of June 30, 2016, there was no outstanding balance under this line of credit.

PENCIL FOUNDATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2016

NOTE 12 - RESTATEMENT OF BEGINNING NET ASSETS

Net assets as of June 30, 2015 have been adjusted to properly account for various transactions. The effects of the restatement were to decrease unrestricted net assets by \$95,438 and increase temporarily restricted net assets by \$75,000 as of June 30, 2015. A schedule summarizing the restatement follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance - June 30, 2015, as previously reported	\$ 716,074	\$ 23,000	\$ -	\$ 739,074
To properly record accrued vacation	(27,782)	-	-	(27,782)
To adjust the value of beneficial interest in agency endowment fund held by the Community Foundation of Middle Tennessee	(2,656)	-	-	(2,656)
To recognize temporarily restricted contributions	-	10,000	-	10,000
To reclassify unrestricted net assets to temporarily restricted	<u>(65,000)</u>	<u>65,000</u>	<u>-</u>	<u>-</u>
Balance - June 30, 2015, as restated	<u>\$ 620,636</u>	<u>\$ 98,000</u>	<u>\$ -</u>	<u>\$ 718,636</u>