

Pencils of Promise Inc.

Financial Statements

December 31, 2012 and 2011

INDEPENDENT AUDITORS' REPORT**The Board of Directors
Pencils of Promise Inc.**

We have audited the accompanying financial statements of Pencils of Promise Inc. (the "Organization"), which comprise the statements of financial position as of December 31, 2012 and 2011, 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.

Auditors' 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 auditors' 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 Pencils of Promise Inc. as of December 31, 2012 and 2011, 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.



Stamford, Connecticut
November 5, 2013

O'CONNOR DAVIES, LLP
One Stamford Landing, 62 Southfield Ave., Stamford, CT 06902 | Tel: 203.323.2400 | Fax: 203.967.8733 | www.odpkf.com

Pencils of Promise Inc.

Statements of Financial Position

	December 31,	
	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and cash equivalents	\$ 2,583,687	\$ 1,408,113
Pledges receivable, net	841,811	-
Other receivables	32,930	68,060
Inventory	-	5,015
Prepaid expenses	8,565	23,370
Security deposit	30,000	35,810
Property and equipment, net	<u>231,739</u>	<u>297,505</u>
	<u>\$ 3,728,732</u>	<u>\$ 1,837,873</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 63,888	\$ 26,578
Deferred revenue	<u>40,703</u>	<u>-</u>
Total Liabilities	<u>104,591</u>	<u>26,578</u>
Net Assets		
Unrestricted	2,888,997	1,572,707
Temporarily restricted	<u>735,144</u>	<u>238,588</u>
Total Net Assets	<u>3,624,141</u>	<u>1,811,295</u>
	<u>\$ 3,728,732</u>	<u>\$ 1,837,873</u>

See notes to financial statements

Pencils of Promise Inc.

Statements of Activities

	Year Ended December 31, 2012			Year Ended December 31, 2011		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
PUBLIC SUPPORT						
Contributions	\$ 3,101,282	\$ 735,144	\$ 3,836,426	\$ 1,297,398	\$ 238,588	\$ 1,535,986
In-kind contributions	-	-	-	125,843	-	125,843
Special events, net of direct donor benefit expenses of \$186,961 and \$174,725	1,163,548	-	1,163,548	523,633	-	523,633
Merchandise sales	7,298	-	7,298	4,985	-	4,985
Other income	9,223	-	9,223	633	-	633
Net assets released from restriction	<u>238,588</u>	<u>(238,588)</u>	<u>-</u>	<u>450,261</u>	<u>(450,261)</u>	<u>-</u>
 Total Revenue	 <u>4,519,939</u>	 <u>496,556</u>	 <u>5,016,495</u>	 <u>2,402,753</u>	 <u>(211,673)</u>	 <u>2,191,080</u>
 EXPENSES						
Program services	2,727,200	-	2,727,200	1,182,606	-	1,182,606
Management and general	190,356	-	190,356	93,807	-	93,807
Fundraising	<u>286,093</u>	<u>-</u>	<u>286,093</u>	<u>171,644</u>	<u>-</u>	<u>171,644</u>
 Total Expenses	 <u>3,203,649</u>	 <u>-</u>	 <u>3,203,649</u>	 <u>1,448,057</u>	 <u>-</u>	 <u>1,448,057</u>
 Change in Net Assets	 1,316,290	 496,556	 1,812,846	 954,696	 (211,673)	 743,023
 NET ASSETS						
Beginning of the year	<u>1,572,707</u>	<u>238,588</u>	<u>1,811,295</u>	<u>618,011</u>	<u>450,261</u>	<u>1,068,272</u>
 End of the year	 <u>\$ 2,888,997</u>	 <u>\$ 735,144</u>	 <u>\$ 3,624,141</u>	 <u>\$ 1,572,707</u>	 <u>\$ 238,588</u>	 <u>\$ 1,811,295</u>

See notes to financial statements

Pencils of Promise Inc.

Statements of Functional Expenses

	Year Ended December 31, 2012				Year Ended December 31, 2011			
	Program Services	Management and General	Fundraising	Total	Program Services	Management and General	Fundraising	Total
EXPENSES								
School construction and planning costs	\$ 1,536,710	\$ -	\$ -	\$ 1,536,710	\$ 514,466	\$ -	\$ -	\$ 514,466
Salary and related expenses	515,060	101,560	186,758	803,378	321,466	61,329	102,311	485,106
Staff accommodations	29,140	-	-	29,140	9,750	-	-	9,750
Marketing	46,276	9,060	32,520	87,856	40,348	423	36,093	76,864
Occupancy	69,597	14,137	25,012	108,746	24,683	4,862	7,854	37,399
Travel and accommodation	191,865	1,603	616	194,084	77,632	1,603	616	79,851
Program consultants	42,555			42,555				
Website	17,599	-	-	17,599	39,386	-	-	39,386
Professional	-	34,702	-	34,702	-	10,950	-	10,950
Outreach	16,277	-	-	16,277	8,690	-	-	8,690
Office expense	38,165	7,525	13,841	59,531	13,392	2,985	4,424	20,801
Postage and printing	5,741	1,132	2,082	8,955	2,376	530	785	3,691
School sustainability costs	53,779	-	-	53,779	19,899	-	-	19,899
Merchandise	5,478	-	1,370	6,848	6,596	-	1,649	8,245
Registration fees and filing	-	10,007	-	10,007	-	6,285	-	6,285
Insurance	-	5,245	-	5,245	-	3,093	-	3,093
Online processing fees	-	-	19,823	19,823	-	-	15,272	15,272
Conferences and meetings	12,730	3,183	-	15,913	3,146	701	1,039	4,886
Depreciation	135,753	137	272	136,162	96,518	97	194	96,809
Miscellaneous	10,475	2,065	3,799	16,339	4,258	949	1,407	6,614
Total Expenses	<u>\$ 2,727,200</u>	<u>\$ 190,356</u>	<u>\$ 286,093</u>	<u>\$ 3,203,649</u>	<u>\$ 1,182,606</u>	<u>\$ 93,807</u>	<u>\$ 171,644</u>	<u>\$ 1,448,057</u>

See notes to financial statements

Pencils of Promise Inc.

Statements of Cash Flows

	Year Ended December 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 1,812,846	\$ 743,023
Adjustments to reconcile change in net assets to net cash from operating activities		
Donated property and equipment	-	(87,975)
Depreciation	136,161	96,809
Changes in operating assets and liabilities		
Pledges receivable, net	(841,811)	-
Other receivables	35,130	389,253
Inventory	5,015	(5,015)
Prepaid expenses	14,805	(4,023)
Security deposit	5,810	(32,810)
Accounts payable and accrued expenses	37,310	13,404
Deferred Income	40,703	-
Net Cash from Operating Activities	1,245,969	1,112,666
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(70,395)	(49,446)
Net Change in Cash and Cash Equivalents	1,175,574	1,063,220
CASH AND CASH EQUIVALENTS		
Beginning of year	1,408,113	344,893
End of year	\$ 2,583,687	\$ 1,408,113

See notes to financial statements

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2012 and 2011

1. The Organization

Pencils of Promise Inc. (the "Organization") was formed in 2008, and is a non-profit organization that believes that every child should have access to a quality education. It creates schools, programs and global communities around this common goal of education for all.

The Organization believes that every child should have access to a quality education. To achieve this, the Organization creates schools, programs and global communities around the common goal of education for all. Internationally in 2012 and 2011, the Organization continued its work in Laos, Nicaragua and Guatemala and expanded into Ghana. In each country, it identified several new communities in need of new and improved educational facilities and sanitation and health programming, as well as newly implementing its teacher training and scholarships programs. The Organization continued to support its already existing schools and other structures. To date, the Organization has completed 120 schools which have provided an estimated 5,000,000 instructional hours to over 9,000 students.

Domestically, the Organization continued to focus its efforts on training a new generation of philanthropists and empowering them to spread social good. Together with the Organization's guidance, these individuals believe that the ripple effect of individual efforts can create a movement that will lead to lasting impact and sustainable global change. Through a successful year round internship program involving 75 different students, special events and fundraising campaigns spread world-wide and an ever growing digital and social media presence, this movement of supporters has grown to nearly 300,000 dedicated followers and supporters.

Pursuant to a determination letter received from the Internal Revenue Service, the Organization is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Net assets and revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the Organization's net assets are classified as permanently restricted, temporarily restricted or unrestricted.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. 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 revenues and expenses during the reporting period. Accordingly actual results could differ from those estimates.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2012 and 2011

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

The Organization considers all highly liquid debt instruments with a maturity of three months or less at the time of purchase to be cash equivalents.

Allowance for Uncollectible Receivables

An allowance for uncollectible receivables is estimated based on a combination of write-off history, aging analysis and any specific known troubled accounts. At December 31, 2012 and 2011, management has concluded that an allowance is not required.

Property, Equipment and Depreciation

Property and equipment are recorded at cost, or if received by donation, at estimated fair value at the time such items are received. Depreciation is provided using the straight-line method over estimated useful lives of the assets which range from three to seven years.

Contributions

Contributions are recognized when the donor makes an unconditional promise to give to the Organization. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Contributed Goods and Services

For the years ended December 31, 2012 and 2011, donated services totaled \$0 and \$125,843. Such services are included in the financial statements as in-kind donations along with the corresponding asset or expense. Donated services in 2011 consisted of legal and web development. In addition, a substantial number of volunteers have contributed their time to the Organization's program and supporting services, none of which meet the requirements for financial statement recognition. For the years ended December 31, 2012 and 2011, there were donated auction items in the amount of \$0 and \$47,290; and donated advertising of \$33,362 and \$424,000 that did not meet the requirements for financial statement recognition.

Functional Expenses

The Organization allocates its expenses on a functional basis among its program and supporting services. Expenses that can be specifically identified with a program or support service are allocated directly according to their natural classifications. Other expenses that are common to several functions are allocated based on estimates made by management.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2012 and 2011

2. Summary of Significant Accounting Policies (continued)

Accounting for Uncertainty in Income Taxes

The Organization recognizes the effect of tax positions when they are more likely than not to be sustained. Management has determined that the Organization had no uncertain tax positions that would require financial statement recognition or disclosure. The Organization is no longer subject to examinations by applicable taxing jurisdictions prior to 2009.

Subsequent Events Evaluation by Management

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which date is November 5, 2013.

3. Pledges Receivable

Pledges receivable as of December 31 are as follows:

	<u>2012</u>
Pledges receivable due in less than one year	\$ 444,207
Pledges receivable due in one to five years	<u>412,500</u>
	856,707
Less unamortized discount on pledges receivable	<u>(14,896)</u>
Pledges Receivable, Net	<u>\$ 841,811</u>

The aforementioned pledges have been included in the following net asset categories at December 31:

	<u>2012</u>
Unrestricted	\$ 106,667
Temporarily restricted	<u>735,144</u>
	<u>\$ 841,811</u>

Unrestricted pledges receivable represent promises to give to fund current operations of the Organization for which payment was due as of December 31, 2012. Temporarily restricted pledges receivable are restricted by both time and use.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2012 and 2011

4. Concentrations of Credit Risk and Related Party Transactions

Cash and Cash Equivalents

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash and cash equivalents and contributions receivable. Management believes that the Organization is not exposed to any significant credit risk.

Contributions

At December 31, 2012 approximately 80% of contributions receivable were from four donors. At December 31, 2011 approximately 92% of contributions receivable were from five donors.

For the years ended December 31, 2012 and 2011, the Organization received contributions and gross special events revenues from board members totaling approximately \$57,000 and \$8,000 representing 1% and 1% of total contribution and special event revenues. As of December 31, 2012 and 2011 3% and 0% of contributions receivable were due from board members.

5. Property and Equipment

At December 31 property and equipment and related accumulated depreciation consisted of the following:

	<u>2012</u>	<u>2011</u>
Website	\$ 351,903	\$ 351,903
Vehicles	106,083	55,375
Computer equipment	6,045	4,413
Furniture and fixtures	<u>22,260</u>	<u>4,205</u>
	486,291	415,896
Less accumulated depreciation	<u>(254,552)</u>	<u>(118,391)</u>
	<u>\$ 231,739</u>	<u>\$ 297,505</u>

6. Restrictions of Net Assets

Temporarily restricted net assets released from restrictions and disbursed during the years ended December 31, 2012 and 2011 by incurring expenses that satisfy the time restricted were \$238,588 and \$450,261.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2012 and 2011

6. Restrictions of Net Assets (continued)

Temporarily restricted net assets are restricted for the following purposes or by the occurrence of other events specified by donors at December 31, as follows:

	<u>2012</u>	<u>2011</u>
Contributions restricted for future periods	<u>\$ 735,144</u>	<u>\$ 238,588</u>

7. Lease Commitments

The Organization leased space under a lease that expired on January 31, 2012. The Organization signed a new lease which expires on February 28, 2020. For the years ended December 31, 2012 and 2011, rent expense amounted to \$82,924 (net of sub-tenant rental income of \$41,797) and \$29,476 (net of subtenant rental income of \$0). As of December 31, 2012, the Organization received advance payments for subtenant rental income of \$4,000 which is reported in deferred revenue.

The future minimum annual rental payments at December 31, 2012 under the lease obligations are payable as follows:

2013	\$ 125,000
2014	125,000
2015	158,333
2016	169,125
2017	174,199
Thereafter	<u>395,184</u>
	<u>\$ 1,146,841</u>

8. Contingent Pledges

During 2012, the Organization received pledges of \$300,000 contingent upon meeting donor stipulations and continuing approval of the specific program by the donor. The remaining pledges can be cancelled by the donor at anytime with 3 months notice. The Organization received \$80,000 in 2012 for the program and spent \$43,297 towards the specified program. The remaining \$36,703 was recorded as deferred revenue as of December 31, 2012. The remaining \$220,000 is expected to be received as follows: \$140,000 in 2013 and \$80,000 in 2014.

9. Related Party Transactions

In 2013, an officer of the Organization was appointed to an advisory board of one of its vendors (the "Vendor") and received an ownership interest in the Vendor. In 2012 and 2011, the Organization paid \$6,700 and \$12,265 to the Vendor. In 2012, the Organization subleased part of its office space to a company partly owned by an officer of the Organization (the "Company"). The Company paid \$14,012 to the Organization in 2012.
