



Pencils of Promise Inc.

Financial Statements

December 31, 2017 and 2016



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, 2017 and 2016, 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 from 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, 2017 and 2016, 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.

PKF O'Connor Davies, LLP

Stamford, Connecticut
September 25, 2018

Pencils of Promise Inc.

Statements of Financial Position

	December 31,	
	<u>2017</u>	<u>2016</u>
ASSETS		
Cash	\$ 4,340,857	\$ 2,758,065
Contributions receivable, net	2,698,505	1,821,078
Prepaid expenses and other current assets	49,990	51,795
Security deposit	40,000	30,000
Property and equipment, net	<u>291,091</u>	<u>298,477</u>
	<u>\$ 7,420,443</u>	<u>\$ 4,959,415</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	\$ 287,464	\$ 123,899
Deferred revenue	<u>50,000</u>	<u>100,000</u>
Total Liabilities	<u>337,464</u>	<u>223,899</u>
Net Assets		
Unrestricted	4,665,893	2,886,235
Temporarily restricted	<u>2,417,086</u>	<u>1,849,281</u>
Total Net Assets	<u>7,082,979</u>	<u>4,735,516</u>
	<u>\$ 7,420,443</u>	<u>\$ 4,959,415</u>

See Notes to Financial Statements

Pencils of Promise Inc.

Statements of Activities

	Year Ended December 31, 2017			Year Ended December 31, 2016		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
PUBLIC SUPPORT						
Contributions	\$ 7,248,953	\$ 2,161,096	\$ 9,410,049	\$ 5,790,785	\$ 1,738,103	\$ 7,528,888
In-kind contributions	36,500	-	36,500	3,084	-	3,084
Special events, net of direct donor benefit expenses of \$646,271 and \$450,006	1,674,155	-	1,674,155	1,130,416	-	1,130,416
Merchandise sales	4,778	-	4,778	7,576	-	7,576
Other income	144	-	144	408	-	408
Net assets released from restriction	1,468,291	(1,468,291)	-	1,250,397	(1,250,397)	-
Total Revenue	<u>10,432,821</u>	<u>692,805</u>	<u>11,125,626</u>	<u>8,182,666</u>	<u>487,706</u>	<u>8,670,372</u>
OPERATING EXPENSES						
Program services						
School building	3,198,450	-	3,198,450	3,131,483	-	3,131,483
Teacher support	2,516,651	-	2,516,651	2,328,503	-	2,328,503
WASH	762,976	-	762,976	698,876	-	698,876
Other program services	525,830	-	525,830	464,284	-	464,284
Total Program Services	<u>7,003,907</u>	<u>-</u>	<u>7,003,907</u>	<u>6,623,146</u>	<u>-</u>	<u>6,623,146</u>
Management and general	602,143	-	602,143	643,066	-	643,066
Fundraising	1,045,673	-	1,045,673	1,243,554	-	1,243,554
Total Expenses	<u>8,651,723</u>	<u>-</u>	<u>8,651,723</u>	<u>8,509,766</u>	<u>-</u>	<u>8,509,766</u>
Excess (Deficiency) of Operating Revenue Over Expenses	<u>1,781,098</u>	<u>692,805</u>	<u>2,473,903</u>	<u>(327,100)</u>	<u>487,706</u>	<u>160,606</u>
NONOPERATING ACTIVITIES						
Loss on foreign currency exchange	(1,440)	-	(1,440)	(99,255)	-	(99,255)
Loss for uncollectible pledges receivable	-	(125,000)	(125,000)	-	(122,362)	(122,362)
Total Nonoperating Activities	<u>(1,440)</u>	<u>(125,000)</u>	<u>(126,440)</u>	<u>(99,255)</u>	<u>(122,362)</u>	<u>(221,617)</u>
Change in Net Assets	1,779,658	567,805	2,347,463	(426,355)	365,344	(61,011)
NET ASSETS						
Beginning of the year	<u>2,886,235</u>	<u>1,849,281</u>	<u>4,735,516</u>	<u>3,312,590</u>	<u>1,483,937</u>	<u>4,796,527</u>
End of the year	<u>\$ 4,665,893</u>	<u>\$ 2,417,086</u>	<u>\$ 7,082,979</u>	<u>\$ 2,886,235</u>	<u>\$ 1,849,281</u>	<u>\$ 4,735,516</u>

See Notes to Financial Statements

Pencils of Promise Inc.

Statement of Functional Expenses
Year Ended December 31, 2017

	Program Services					Management and General	Fundraising	Total
	School Building	Teacher Support	WASH	Other Program Services	Total Program Services			
EXPENSES								
Construction and planning costs	\$ 2,017,258	\$ 20,437	\$ 256,712	\$ 2,323	\$ 2,296,730	\$ -	\$ -	\$ 2,296,730
Salary and related expenses	667,419	1,640,163	382,216	216,114	2,905,912	315,416	657,039	3,878,367
Staff accommodations	-	-	-	1,324	1,324	21,130	6,878	29,332
Marketing	841	1,921	325	82,382	85,469	-	36,915	122,384
Occupancy	55,632	127,149	21,522	14,450	218,753	33,605	67,702	320,060
Travel, meals, and accommodation	245,831	234,022	37,300	21,823	538,976	21,026	22,086	582,088
Website	-	-	-	4,345	4,345	-	1,952	6,297
Professional	1,958	4,474	1,461	508	8,401	167,073	1,790	177,264
Outreach	-	-	-	-	-	5,864	127,961	133,825
Office expense	30,238	69,111	11,698	7,855	118,902	14,043	16,985	149,930
Postage and printing	244	557	94	265	1,160	208	14,097	15,465
School sustainability costs	42,467	95,917	16,236	10,899	165,519	-	-	165,519
Merchandise	-	-	-	-	-	-	7,823	7,823
Registration fees and filing	-	-	-	-	-	11,977	-	11,977
Insurance	11,762	11,323	1,917	1,286	26,288	2,353	6,668	35,309
Online processing fees	-	-	-	-	-	-	63,839	63,839
Conferences and meetings	2,686	6,139	1,039	698	10,562	3,349	3,814	17,725
Depreciation	32,078	67,338	11,724	-	111,140	1,299	2,275	114,714
Miscellaneous	31,084	18,644	3,788	40,121	93,637	4,800	7,849	106,286
Program materials	-	189,640	11,897	-	201,537	-	-	201,537
Program monitoring & evaluation	13,046	29,816	5,047	3,388	51,297	-	-	51,297
Repairs	45,906	-	-	-	45,906	-	-	45,906
Student enrollment kits/fees	-	-	-	118,049	118,049	-	-	118,049
Total Expenses	\$ 3,198,450	\$ 2,516,651	\$ 762,976	\$ 525,830	\$ 7,003,907	\$ 602,143	\$ 1,045,673	\$ 8,651,723

See Notes to Financial Statements

Pencils of Promise Inc.

Statement of Functional Expenses
Year Ended December 31, 2016

	Program Services				Total Program Services	Management and Fundraising		Total
	School Building	Teacher Support	WASH	Other Program Services		General	Fundraising	
EXPENSES								
Construction and planning costs	\$2,319,166	\$ 21,641	\$284,756	\$ 1,517	\$ 2,627,080	\$ -	\$ -	\$2,627,080
Salary and related expenses	439,097	1,453,090	272,752	139,484	2,304,423	408,662	729,040	3,442,125
Staff accommodations	1,823	5,721	698	401	8,643	2,021	4,403	15,067
Marketing	165	519	63	84,051	84,798	-	37,745	122,543
Occupancy	33,593	105,442	12,857	7,391	159,283	37,274	81,146	277,703
Travel, meals, and accommodation	167,237	216,399	37,370	43,293	464,299	15,935	34,578	514,812
Website	-	-	-	4,319	4,319	-	1,941	6,260
Professional	1,068	3,351	409	235	5,063	81,603	2,579	89,245
Outreach	-	-	-	-	-	12,200	106,857	119,057
Office expense	32,226	101,152	12,334	7,089	152,801	29,902	11,364	194,067
Postage and printing	688	2,159	263	816	3,926	593	26,488	31,007
School sustainability costs	21,615	67,845	8,273	4,756	102,489	-	-	102,489
Merchandise	-	-	-	-	-	-	18,613	18,613
Registration fees and filing	-	-	-	-	-	11,750	-	11,750
Insurance	4,226	13,266	1,618	929	20,039	4,689	10,209	34,937
Online processing fees	-	-	-	-	-	-	76,262	76,262
Conferences and meetings	2,481	7,787	950	547	11,765	35,879	8,067	55,711
Depreciation	21,750	68,272	8,325	4,786	103,133	1,103	1,929	106,165
Miscellaneous	19,195	23,297	2,841	2,050	47,383	1,455	4,797	53,635
Program materials	-	209,373	53,356	-	262,729	-	-	262,729
Program monitoring & evaluation	5,255	29,189	2,011	1,156	37,611	-	-	37,611
Repairs	61,898	-	-	-	61,898	-	-	61,898
Bad debt expense	-	-	-	-	-	-	87,536	87,536
Student enrollment kits/fees	-	-	-	161,464	161,464	-	-	161,464
Total Expenses	<u>\$3,131,483</u>	<u>\$2,328,503</u>	<u>\$698,876</u>	<u>\$ 464,284</u>	<u>\$ 6,623,146</u>	<u>\$ 643,066</u>	<u>\$1,243,554</u>	<u>\$8,509,766</u>

See Notes to Financial Statements

Pencils of Promise Inc.

Statements of Cash Flows

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 2,347,463	\$ (61,011)
Adjustments to reconcile change in net assets to net cash from operating activities		
Depreciation	114,714	106,165
Loss for uncollectible pledges receivable	125,000	122,362
Changes in operating assets and liabilities		
Contributions receivable, net	(1,002,427)	254,017
Prepaid expenses and other current assets	1,805	(8,825)
Security Deposit	(10,000)	-
Accounts payable and accrued expenses	163,565	49,061
Deferred income	<u>(50,000)</u>	<u>50,000</u>
Net Cash from Operating Activities	1,690,120	511,769
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	<u>(107,328)</u>	<u>(86,624)</u>
Net Change in Cash	1,582,792	425,145
CASH		
Beginning of year	<u>2,758,065</u>	<u>2,332,920</u>
End of year	<u>\$ 4,340,857</u>	<u>\$ 2,758,065</u>

See Notes to Financial Statements

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2017 and 2016

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 quality education. The Organization creates schools, programs and global communities around this common goal of education for all.

Internationally, in 2017, the Organization continued its work in Laos, Guatemala and Ghana expanding both its geographic and programmatic reach within the regions it operates. In each country, it identified several new communities in need of new and improved educational facilities, sanitation and health programming, teacher support programs and scholarships programs for students. To date, the Organization has broken ground on 450 schools (unaudited) and impacted over 85,000 students (unaudited) across all geographies.

Domestically, the Organization continued to focus its efforts on supporting 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 communications strategy spread world-wide and an ever growing digital and social media presence, this movement of supporters has grown to over 670,000 dedicated followers and supporters (unaudited).

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 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, 2017 and 2016

2. Summary of Significant Accounting Policies (*continued*)

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.

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 five to seven years.

Website Development Costs

The Company accounts for website development costs in accordance with U.S. GAAP guidance. These costs are included in property, equipment and software and are amortized on a straight-line basis over a three-year period. As of December 31, 2017 and 2016, the website development costs were fully amortized. Amortization incurred during 2017 and 2016 was \$0.

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, 2017 and 2016, donated goods and services totaled \$166,500 and \$3,084. Such goods and services are included in the financial statements as in-kind donations along with the corresponding asset or expense. In 2017 and 2016, \$130,000 and \$0 of in-kind revenue and expenses were included in net special event income. For the years ended December 31, 2017 and 2016, 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.

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, 2017 and 2016

2. Summary of Significant Accounting Policies (*continued*)

Functional Expenses (*continued*)

Major programs consist of the following:

Teacher support – The Organization is changing the way teachers are supported and trained on an on-going basis to ensure that students are learning effectively. The Organization uses innovative teaching methods and technologies such as Digital Learning to create engaging, child-centered learning environments in full alignment with national curricula and standards.

School building – The Organization builds two to six room school buildings in Guatemala, Ghana, and Laos in communities that would not otherwise have the resources to finance and construct the buildings.

WASH (Water, Sanitation & Hygiene) – The Organization provides children with access to clean water, private bathrooms and good hygiene practices to foster the growth and development of students.

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 the applicable taxing jurisdictions for periods prior to 2014.

Foreign Currency Translation

Cash held in foreign currencies and liabilities payable in foreign currencies are translated at year-end exchange rates. Revenue earned and expenses incurred in foreign currencies are translated at the average exchange rates during the year. Gains and losses from foreign currency translation for the period are included in the statement of activities. Cash held in foreign currencies and liabilities payable in foreign currencies were less than 3% and 4% of cash reported on the statements of financial position for the years ended December 31, 2017 and 2016.

Reclassifications

Certain reclassifications have been made to the prior year financial statements in order for them to be in conformity with the current year financial presentations. The classifications on the statement of functional expenses for 2016 have been updated to conform to the current year presentation of the statement of functional expenses. There was no effect on the change in net assets for 2016 or the ending net assets as of December 31, 2016.

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 September 25, 2018.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2017 and 2016

3. Contributions Receivable

Contributions receivable as of December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Contributions receivable due in less than one year	\$ 1,761,705	\$ 1,487,000
Contributions receivable due in one to five years	<u>1,055,000</u>	<u>425,000</u>
	2,816,705	1,912,000
Unamortized discount on contributions receivable	(42,200)	(14,922)
Allowance for uncollectible contributions receivable	<u>(76,000)</u>	<u>(76,000)</u>
Contributions Receivable, Net	<u>\$ 2,698,505</u>	<u>\$ 1,821,078</u>

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

	<u>2017</u>	<u>2016</u>
Unrestricted	\$ 331,419	\$ 391,797
Temporarily restricted	<u>2,367,086</u>	<u>1,429,281</u>
	<u>\$ 2,698,505</u>	<u>\$ 1,821,078</u>

Unrestricted contributions receivable represent promises to give to fund current operations of the Organization for which payment was due as of December 31, 2017. Temporarily restricted contributions receivable are restricted by time or purpose.

Discount rates on contributions receivable ranged from 3.5 percent to 4.0 percent for 2017.

4. Concentrations of Credit Risk and Related Party Transactions

Concentrations of Credit Risk

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.

The Organization maintains cash balances in banks. Balances held in banks located in the United States of America ("U.S. Banks") are insured by the Federal Deposit Insurance Corporation ("FDIC"). At times, cash balances may be in excess of the balances insured by the FDIC. As of December 31, 2017, the uninsured deposits held in U.S. Banks were approximately \$3,290,000.

Cash held in foreign banks was approximately \$181,000 and \$151,000 as of December 31, 2017 and 2016.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2017 and 2016

4. Concentrations of Credit Risk and Related Party Transactions

Concentrations of Credit Risk

At December 31, 2017, approximately 60% of contributions receivable were from two donors.

For the year ended December 31, 2017, two donors represented approximately 27% of contributions. For the year ended December 31, 2016, one donor represented approximately 20% of gross revenue from special events.

Related Party Transactions

For the years ended December 31, 2017 and 2016, the Organization received contributions and gross special events revenues from members of the Board of Directors (the "Board") totaling approximately \$373,000 and \$370,000 representing 3% and 4% of total contribution and special event revenues. As of December 31, 2016, one Board member accounted for 11% of contributions receivable. Additional Board members accounted for another 4% and 4% of contributions receivable as of December 31, 2017 and 2016.

5. Property and Equipment

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

	2017	2016
Website	\$ 351,903	\$ 351,903
Vehicles	613,996	522,721
Computer equipment	69,528	53,475
Furniture and fixtures	34,466	34,466
	<u>1,069,893</u>	<u>962,565</u>
Accumulated depreciation and amortization	<u>(778,802)</u>	<u>(664,088)</u>
	<u>\$ 291,091</u>	<u>\$ 298,477</u>

6. Line of Credit

On July 12, 2017, the Organization obtained a variable interest rate revolving line of credit ("Line of Credit") with a borrowing limit of \$750,000 that matures on October 12, 2018. The interest rate is based on the U.S. Prime Rate as published in the Wall Street Journal with a minimum interest rate of 3.75% per annum. The Line of Credit is secured by substantially all assets of the Organization. As of December 31, 2017, the Organization had no outstanding balance and has not drawn money from the line of credit during 2017.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2017 and 2016

7. Restrictions of Net Assets

Temporarily restricted net assets released from restrictions during the years ended were as follows for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Contributions restricted for future periods	\$ 943,291	\$ 1,250,397
School constructions in Ghana, Guatemala, and Laos	<u>525,000</u>	<u>-</u>
	<u>\$ 1,468,291</u>	<u>\$ 1,250,397</u>

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>2017</u>	<u>2016</u>
Contributions restricted for future periods	\$ 2,367,086	\$ 1,324,281
Teacher support	50,000	-
School constructions in Ghana, Guatemala, and Laos	<u>-</u>	<u>525,000</u>
	<u>\$ 2,417,086</u>	<u>\$ 1,849,281</u>

8. Lease Commitments

The Organization leases various office space in the United States of America and in foreign countries. For the years ended December 31, 2017 and 2016, rent expense amounted to \$238,844 (net of sub-tenant rental income of \$0) and \$191,304 (net of subtenant rental income of \$10,600).

The Organization leases space under a lease that expires on February 28, 2020. The future minimum annual rental payments at December 31, 2017 under the lease obligations are payable as follows:

2018	\$ 179,425
2019	184,807
2020	<u>30,951</u>
	<u>\$ 395,183</u>

9. Deferred Revenue

During 2017 and 2016, the Organization received payments for future special events, which are required to be refunded if the events are not held, unless the payments purpose is subsequently redirected by the payer. As of December 31, 2017, the deferred revenue is to be recognized as follows: \$25,000 in 2018 and \$25,000 in 2019.

Pencils of Promise Inc.

Notes to Financial Statements
December 31, 2017 and 2016

10. Pension Plan

In 2016, the Organization established a 401(k) plan (the "Plan") covering substantially all employees. The Plan allows employees to make elective deferrals to the Plan. The Organization can make discretionary contributions to the Plan. The Organization contributed \$61,481 and \$41,884 to the Plan in 2017 and 2016.
