FIRST BOOK

FINANCIAL STATEMENTS

DECEMBER 31, 2012

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FINANCIAL STATEMENTS
(AUDITED)

DECEMBER 31, 2012

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Mendelson & Mendelson
CERTIFIED PUBLIC ACCOUNTANTS A PROFESSIONAL CORPORATION

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of First Book
Washington, D.C.

Report on the Financial Statements
We have audited the accompanying statements of First Book (a nonprofit organization), which comprise the statement of financial position as of December 31, 2012, 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 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 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.

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Book as of December 31, 2012 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.

Potomac, Maryland
May 1, 2013

Mendelson & Mendelson

FIRST BOOK

STATEMENT OF FINANCIAL POSITION
(AUDITED)

DECEMBER 31, 2012

ASSETS

CURRENT ASSETS		
Cash and cash equivalents	$	3,122,394
Receivables		
Contributions		241,895
Other		97,368
Investments		7,933
Inventory		25,716,662
TOTAL CURRENT ASSETS		29,186,252
PROPERTY AND EQUIPMENT		
Furniture and equipment		97,199
Software		106,686
		203,885
Less accumulated depreciation and amortization		(133,951)
		69,934
TOTAL ASSETS	$	29,256,186

The accompanying notes are an integral part of the financial statements.

FIRST BOOK

STATEMENT OF FINANCIAL POSITION (CONTINUED)
(AUDITED)

DECEMBER 31, 2012

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES		
Accounts payable	$	661,117
Pension payable		185,643
Accrued expenses		94,071
TOTAL CURRENT LIABILITIES		940,831
NET ASSETS		
Unrestricted		26,414,652
Temporarily restricted		1,900,703
Permanently restricted		-
TOTAL NET ASSETS		28,315,355
TOTAL LIABILITIES AND NET ASSETS	$	29,256,186

The accompanying notes are an integral part of the financial statements.

FIRST BOOK

STATEMENT OF ACTIVITIES
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2012

CHANGES IN UNRESTRICTED NET ASSETS	
SUPPORT AND REVENUE	
Contributed goods	$ 89,272,315
Contributions	5,905,861
Interest and dividend income	4,298
Realized loss on investments	(65)
Unrealized gain on investments	413
TOTAL SUPPORT AND REVENUE	95,182,822
NET ASSETS RELEASED FROM RESTRICTIONS	6,711,085
TOTAL UNRESTRICTED SUPPORT AND REVENUE	101,893,907
EXPENSES	
Program services	95,694,108
Management and general	1,526,460
Fundraising	740,446
	97,961,014
CHANGES IN UNRESTRICTED NET ASSETS	$ 3,932,893

The accompanying notes are an integral part of the financial statements.

FIRST BOOK

STATEMENT OF ACTIVITIES (CONTINUED)
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2012

CHANGES IN TEMPORARILY RESTRICTED NET ASSETS	
Contributions	6,953,680
Net assets released from restrictions	(6,711,085)
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS	242,595
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS	-
CHANGES IN NET ASSETS	4,175,488
NET ASSETS AT BEGINNING OF YEAR	24,139,867
NET ASSETS AT END OF YEAR	$ 28,315,355

The accompanying notes are an integral part of the financial statements.

FIRST BOOK

STATEMENT OF FUNCTIONAL EXPENSES
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2012

	Program Services	Management and General	Fundraising	Total Expenses
Bank charges	$ 77,614	$ 21,079	$ -	$ 98,693
Consulting	366,854	60,593	32,171	459,618
Contract labor	-	13,438	-	13,438
Depreciation and amortization	-	12,042	-	12,042
Donated books	84,344,080	-	-	84,344,080
Dues and subscriptions	-	34,394	-	34,394
Equipment and technology	134,809	26,434	15,860	177.103
Fees, licenses and permits	-	32,179	-	32,179
Insurance	-	30,335	-	30,335
Meetings and conferences	52,258	-	-	52,258
Miscellaneous	-	83,007	-	83,007
Office supplies	56,094	16,499	9,899	82,492
Payroll	2,799,536	815,995	492,640	4,108,171
Payroll taxes and employee benefits	603,439	177,482	106,489	887,410
Payroll service	-	7,828	-	7,828
Postage and shipping	1,121,993	27,846	-	1,149,839
Printing and publications	40,313	5,840	3,504	49,657
Professional fees	-	27,142	-	27,142
Program expenses - Books	3,882,087	-	-	3,882,087
Program expenses - Other	356,107	-	-	356,107
Rent	268,264	78,901	47,341	394,506
Taxes	36,378	-	-	36,378
Telephone and utilities	61,270	19,209	10,812	91,291
Travel and lodging	123,140	36,217	21,730	181,087
Warehouse costs	1,369,872	-	-	1,369,872
TOTAL EXPENSES	$ 95,694,108	$ 1,526,460	$ 740,446	$ 97,961,014

The accompanying notes are an integral part of the financial statements.

FIRST BOOK

STATEMENT OF CASH FLOWS
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2012

Cash Flows From Operating Activities:	
Changes in net assets	$ 4,175,488
Adjustments to reconcile net assets to net cash provided by (used in) operating activities:	
Depreciation and amortization	12,042
Net realized/unrealized gain on investments	(348)
Contributed investments	(6,610)
Donated books less expenses	(4,241,287)
(Increase) Decrease in assets:	
Contribuitons receivable	(183,316)
Other receivables	(97,368)
Inventory	(613,724)
Deposits	8,394
Increase (Decrease) in liabilities:	
Accounts payable	161,944
Pension payable	49,620
Accrued expenses	20,451
Net Cash Provided By (Used In) Operating Activities	(714,714)
Cash Flows From Investing Activities:	
Proceeds from sale of investments	4,462
Purchase of property and equipment	(47,031)
Net Cash Provided By (Used In) Investing Activities	(42,569)
Cash Flows From Financing Activities	-
NET INCREASE (DECREASE) IN CASH	(757,283)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	3,879,677
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 3,122,394

The accompanying notes are an integral part of the financial statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

First Book (the Organization) was organized as a District of Columbia (DC) nonprofit organization in 1992 to provide children from low-income families the opportunity to read and own their first new books. This is done by working with existing literacy programs to distribute new books to children who, for economic reasons, have little or no access to books.

B. Net Asset Classes

The Organization reports in compliance with Accounting Standards Codification (ASC) 958, "Financial Statements of Not-for-Profit Entities". Under ASC 958, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted net assets. In addition, the Organization is required to present a statement of cash flows. The Organization has no permanently restricted net assets. Temporarily restricted net assets are those assets that have donor restrictions that will expire at or over a period of time, or upon the Organization's performance of a specified activity, such as expending resources on a specific program. Unrestricted net assets have no donor restrictions and may be used for any purpose consistent with the Organization's mission.

C. Basis of Accounting

The Organization prepares its financial statements using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The financial statements include the accounts maintained by and directly under the control of the Organization.

D. Use of Estimates

When preparing these financial statements in conformity with generally accepted accounting principles, management is required to make certain estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses in the reporting period. Actual results could differ from those estimates.

E. Cash and Cash Equivalents

Cash held in checking accounts, money market accounts, and certificates of deposit with maturities of less than 90 days are classified as cash and cash equivalents.

F. Concentrations of Credit and Market Risk

The Organization maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Organization has not incurred any loss on its cash and cash equivalents. The Organization had approximately $921,000 on deposit in excess of Federal Depository Insurance Corporation limit as of December 31, 2012. Cash and cash equivalents are held at multiple high-rated financial institutions and credit exposure is limited to three institutions. Investments are immaterial level one assets with no concentrations of market risk. No other financial instruments expose the Organization to concentrations of credit or market risk.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Inventory

Inventories are stated at their cost or publisher's stated value on the date of their purchase by, or contribution to, the Organization. The inventory at December 31, 2012 consisted of $22,432,036 of books donated and $3,284,626 of books purchased. Revenue from donated books is recognized at the time of the donation. Expense is recognized at the time of distribution.

H. Fair Value of Financial Instruments

The fair value of marketable securities approximates their respective quoted market prices. All other financial instruments' fair values approximate their carrying amounts due to their short maturities as they are represented on the balance sheet. Those assets and liabilities include: contributions and other receivables, investments, accounts payable, pension payable and accrued expenses. All financial instruments are level 1 of the fair value hierarchy.

I. Property and Equipment

The cost of property and equipment, in excess of $1,000, is depreciated using the straight-line method over the estimated useful lives of the assets. Depreciation and amortization expense is included in the statement of functional expenses.

Maintenance and repairs are charged and allocated to the functional expenses when incurred. When property and equipment are sold or otherwise disposed of, the asset account and related accumulated depreciation account are relieved, and any gain or loss is included in general and administrative costs.

J. Contributions

Contributions received, including unconditional promises to give, are measured at their net realizable values and recorded as increases in net assets. In the absence of donor restrictions, donated assets are reported as unrestricted support. The Organization expects to collect 100% of the contributions receivable within the next twelve months. Therefore, no allowance or discount has been included for the year ended December 31, 2012.

K. Public Relations and Marketing Costs

Cost associated with community relations and promoting public understanding and awareness of its programs are expensed as incurred. Approximately $268,000 was incurred during 2012 and is included in consulting.

L. Functional Allocation of Expenses

The costs of providing programs and activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited based on direct association or an allocation based on payroll. Shipping and handling, directly associated with the delivery of books, is classified as program expense and is included in postage and shipping on the statement of functional expenses.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

M. Contributed Goods and In-kind Contributions

The Organization received donated books of approximately $88,600,000 from a variety of publishers and booksellers which are distributed to children through the Organization's programs. Contributed goods are reflected in the financial statements at the publisher's stated value of the goods, and are recognized as unrestricted net assets. Such valuations typically are substantially lower than published retail prices.

The Organization received the use of warehouse space of approximately $642,000 from various other organizations for the storage of books prior to their distribution. The value of this donation is reflected in the financial statements at the donor's stated fair rental value of the space.

Contributions of donated non-cash assets were approximately $45,000 and are recorded at their fair values in the year received.

In-kind contributions, or donated services, that create or enhance physical assets and essential services that require and are donated by persons with specialized skills are measured at their fair value and reported as increases in unrestricted net assets during the period provided. There were no such in-kind contributions in 2012.

N. Income Taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and, therefore, has made no provision for federal income taxes in the accompanying financial statements, and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the IRC. Under ASC 740-10 a tax position includes, among other things, (a) a decision not to file a tax return (b) an allocation or a shift of income between jurisdictions (c) the characterization of income or a decision to exclude reporting taxable income in a tax return (d) a decision to classify a transaction, entity, or other position in a tax return as tax exempt and (e) an entity's status, including its status as a tax-exempt not-for-profit entity. Based on its interpretation of the requirements of ASC 740-10, management believes that the Organization has no significant uncertain tax positions.

O. Pension

The Organization sponsors a defined contribution plan with a 401(k) and 403(b) cash or deferred tax option. The plan covers all full-time employees, not considered leased employees, who have completed one year of service, are employed on the last day of the year, and have completed 1,000 hours of service. The Organization, on behalf of each eligible participant, according to employee class, makes contributions to the plan. The pension expense for the year ended December 31, 2012 was $196,328. Participants become 50% vested in contributions after the completion of two years of employment and 100% vested after the completion of the third year of employment.

NOTE 2 NON-REVOLVING MASTER BORROWING LOAN

At December 31, 2012, the Organization entered into an agreement under a non-revolving master borrowing loan with SunTrust in the amount of $2,500,000. At December 31, 2012 there was no balance outstanding under the loan. Once draws are taken, the loan will bear interest at a per annum rate equal to the LIBOR rate plus 2.25% percentage points (for an effective loan rate of 2.46% at December 31, 2012). The loan calls for interest only payments through June 30, 2013, followed by forty-two monthly payments of the principal borrowed amortized over the 42 months, plus accrued interest. The borrowing provision terminates on June 30, 2013, and thereafter no new advances may be made. The loan is collateralized by all assets of the Organization. The loan has the following financial covenants: the Organization must have $2,000,000 minimum liquidity at the end of each fiscal 6-month period, and the debt service coverage ratio of the borrower shall not at the end of each fiscal 6-month period be less than 1.25 to 1.0. The Organization meets the financial covenants at December 31, 2012.

NOTE 3 OTHER RECEIVABLE

The Organization accepts orders for books from schools and other programs. The amount reflected in other receivable represents orders that have been filled by the Organization, but not yet paid.

NOTE 4 RESTRICTED NET ASSETS

Temporarily restricted net assets consist of cash available for the following purposes:

Corporate contributions for 2013 programs	$ 25,000
Books to be distributed in 2013 for recipient groups	1,875,703
Total temporarily restricted net assets	$ 1,900,703

There are no permanently restricted net assets.

NOTE 5 RELATED PARTY

The Organization lends support to an affiliated organization in Canada, First Book/Le Premiere Livre (LPL), which provides books to children in need throughout Canada. The financial statements of the Organization do not include the accounts of LPL. LPL is a registered charity under paragraph 149(1)(f) of the Income Tax Act in Canada, and operates as a separate entity to undertake activities that may or may not be consistent with all the requirements of Section 501(c)(3) of the Internal Revenue Code governing certain tax-exempt entities. LPL maintains a separate Board of Directors structure, with its current board membership predominantly that of the Organization's board

NOTE 5 RELATED PARTY (CONTINUED)

members. The LPL Board is expected to elect independent Canadian based board members and reduce the Organization's representation on the LPL Board in 2013, and these events are fully supported by the Organization. The direct financial support provided by the Organization to LPL for 2012 was approximately $249,000, and is included in the statement of functional expenses under program expenses-other. As discussed in note 6, the Organization has also signed as indemnifier for the LPL office lease agreement.

NOTE 6 COMMITMENTS

A. The Organization was obligated on a five year lease for 8,446 square feet of office space. On November 5, 2010 a lease amendment was signed extending the term of the lease and expanding the premises to include 2,618 additional square feet. The lease amendment for 11,064 square feet of office space commenced on December 1, 2011 and expires on July 31, 2016.

B. On May 13, 2011 the Organization, as the indemnifier, signed a lease for 3,098 square feet of office space for a similar Organization in Canada. The commencement date is September 1, 2011. The lease granted the first two months rent free. The first rent payment was made in November 2011. The lease expires on August 31, 2014.

Minimum future rental payments under non-cancellable operating leases having remaining terms in excess of one year as of December 31, 2012 for each of the next four years are:

Year Ending December 31,	Amount
2013	$ 433,121
2014	439,429
2015	439,800
2016	260,717
Total minimum future rental payments	$ 1,573,067

NOTE 7 SUBSEQUENT EVENTS

The Organization has evaluated subsequent events through May 1, 2013, the date through which the financial statements are available to be issued, and determined that no subsequent events have occurred that require adjustment or disclosure in the financial statements.