

FIRST BOOK

FINANCIAL STATEMENTS

DECEMBER 31, 2013

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FINANCIAL STATEMENTS
(AUDITED)

DECEMBER 31, 2013

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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, 2013, 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.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

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, 2013, 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
April 23, 2014

Mendelson + Mendelson

FIRST BOOK

STATEMENT OF FINANCIAL POSITION
(AUDITED)

DECEMBER 31, 2013

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$	4,809,787
Accounts receivable, net of allowance of \$51,714		448,119
Prepaid expenses		115,543
Investments		11,355
Inventory		
Donated books		30,984,271
Purchased books		<u>3,706,672</u>
<u>TOTAL CURRENT ASSETS</u>		40,075,747

PROPERTY AND EQUIPMENT

Furniture and equipment		112,878
Software		<u>2,759</u>
		115,637
Less accumulated depreciation and amortization		<u>(36,272)</u>
		<u>79,365</u>

<u>TOTAL ASSETS</u>	\$	<u><u>40,155,112</u></u>
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The accompanying notes are an integral part of the financial statements.

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STATEMENT OF FINANCIAL POSITION (CONTINUED)
(AUDITED)

DECEMBER 31, 2013

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable	\$ 1,688,876
Pension payable	211,904
Accrued expenses	<u>133,062</u>
<u>TOTAL CURRENT LIABILITIES</u>	2,033,842

NET ASSETS

Unrestricted - cash	5,047,424
Unrestricted - non cash	30,984,271
Temporarily restricted	2,089,575
Permanently restricted	<u>-</u>
<u>TOTAL NET ASSETS</u>	<u>38,121,270</u>

<u>TOTAL LIABILITIES AND NET ASSETS</u>	<u>\$ 40,155,112</u>
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The accompanying notes are an integral part of the financial statements.

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STATEMENT OF ACTIVITIES
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>SUPPORT AND REVENUE</u>				
Contributed goods and services	\$ 86,436,220	\$ -	\$ -	\$ 86,436,220
Contributions	6,558,977	11,857,256	-	18,416,233
Interest and dividend income	2,508	-	-	2,508
Realized gain on investments	1,726	-	-	1,726
Unrealized gain on investments	1,985	-	-	1,985
Other income (expense)	(420)	-	-	(420)
	93,000,996	11,857,256	-	104,858,252
<u>NET ASSETS RELEASED FROM RESTRICTIONS</u>	11,668,384	(11,668,384)	-	-
<u>TOTAL SUPPORT AND REVENUE</u>	104,669,380	188,872	-	104,858,252
<u>EXPENSES</u>				
Program services	92,514,073	-	-	92,514,073
Management and general	1,776,494	-	-	1,776,494
Fundraising	761,770	-	-	761,770
	95,052,337	-	-	95,052,337
CHANGES IN NET ASSETS	9,617,043	188,872	-	9,805,915
<u>NET ASSETS AT BEGINNING OF YEAR</u>	26,414,652	1,900,703	-	28,315,355
<u>NET ASSETS AT END OF YEAR</u>	\$ 36,031,695	\$ 2,089,575	\$ -	\$ 38,121,270

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

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STATEMENT OF FUNCTIONAL EXPENSES
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2013

	Program Services	Management and General	Fundraising	Total Expenses
Wages	\$ 3,304,340	\$ 967,498	\$ 504,383	\$ 4,776,221
Employee benefits and taxes	672,063	197,152	101,975	971,190
Consulting	1,028,132	105,692	43,858	1,177,682
Professional fees	-	68,295	-	68,295
Contract labor	-	15,443	-	15,443
Equipment and technology	117,724	34,534	17,863	170,121
Rent	299,305	87,801	45,415	432,521
Travel and lodging	189,980	55,731	28,826	274,537
Meetings and conferences	56,857	-	-	56,857
Telephone and utilities	68,694	20,152	10,423	99,269
Bank charges	149,914	11,440	-	161,354
Fees, licenses and permits	34,532	8,021	-	42,553
Dues and subscriptions	-	63,990	-	63,990
Office supplies	38,380	11,259	5,827	55,466
Printing and publications	21,087	6,186	3,200	30,473
Program supplies	141,510	-	-	141,510
Insurance	-	8,623	-	8,623
Depreciation and amortization	-	22,733	-	22,733
Bad debt	-	51,714	-	51,714
Miscellaneous	-	13,346	-	13,346
Donated books expense	77,645,648	-	-	77,645,648
Books purchased	6,174,800	-	-	6,174,800
Postage and shipping	1,399,602	26,884	-	1,426,486
Warehouse	1,171,505	-	-	1,171,505
<u>TOTAL FUNCTIONAL EXPENSES</u>	<u>\$ 92,514,073</u>	<u>\$ 1,776,494</u>	<u>\$ 761,770</u>	<u>\$ 95,052,337</u>

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

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STATEMENT OF CASH FLOWS
(AUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2013

Cash Flows From Operating Activities:

Changes in net assets	\$ 9,805,915
Adjustments to reconcile net assets to net cash provided by (used in) operating activities:	
Depreciation and amortization	22,733
Bad debt	51,714
Net realized/unrealized gain on investments	(3,711)
Contributed investments	(6,191)
Donated books	(8,552,235)
(Increase) Decrease in assets:	
Accounts receivable, net of allowance of \$51,714	(160,570)
Prepaid expenses	(115,543)
Purchased books	(422,046)
Increase (Decrease) in liabilities:	
Accounts payable	1,027,759
Pension payable	26,261
Accrued expenses	38,991
<u>Net Cash Provided By (Used In) Operating Activities</u>	<u>1,713,077</u>

Cash Flows From Investing Activities:

Proceeds from sales of investments	6,480
Purchase of property and equipment	(32,164)
<u>Net Cash Provided By (Used In) Investing Activities</u>	<u>(25,684)</u>

Cash Flows From Financing Activities

NET INCREASE (DECREASE) IN CASH	1,687,393
<u>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</u>	<u>3,122,394</u>
<u>CASH AND CASH EQUIVALENTS AT END OF YEAR</u>	<u>\$ 4,809,787</u>

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

FIRST BOOK

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013

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 or other reasons, have little or no access to books.

B. Income Taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) therefore no provision for federal income taxes has been made in the accompanying financial statements. The Organization has been classified as an organization that is not a private Organization under Section 509(a)(1) of the IRC.

The Organization believes it has appropriate support for income tax positions taken and management has not identified any uncertain income tax positions. Generally, income tax returns related to the years ended December 31, 2010 through 2013 remain open for examination by taxing authorities. No examinations existed as of the release of these financial statements.

C. Basis of Accounting

The Organization prepares its financial statements using the accrual method of accounting. Revenue, other than contributions, is recognized when earned and expense is recognized when the obligation is incurred.

D. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from estimates.

E. Cash and Cash Equivalents

For financial statement purposes, the Organization considers demand deposits to be cash equivalents. This includes checking, money market accounts and certificates of deposit with maturities of less than 90 days. Amounts held within the investment portfolio are not included in cash and cash equivalents because they are held for long-term or investment purposes.

F. Inventory

Purchased inventory is stated at the lower of cost or market and donated inventory is stated at estimated fair value. Revenue from the donated books is recognized at the time of donation. Expense is recognized at the time of distribution.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Contributions

Contributions are recorded at their net recognizable value as unrestricted, temporarily restricted, or permanently restricted support depending upon the existence and/or nature of donor restrictions. Support that is restricted by the donor is reported as an increase in temporarily or permanently restricted net assets, as applicable. Within temporarily restricted net assets, amounts are reclassified to unrestricted net assets when restrictions expire.

H. Program Services

The Organization provides access to new books for children in need through programs and schools throughout the United States serving children from low-income families.

I. Administrative and General Services

Administrative and general service expenditures include expenses necessary to provide for the management of staff and facilities and the financial controls of the Organization.

J. Functional Allocation of Expenses

The costs of providing various program and supporting services have been summarized on a functional basis and allocated among the program and supporting services in the proportion benefited in the statement of activities.

K. Public Relations and Marketing Costs

The Organization's policy is to expense as incurred the costs associated with community relations and promoting public understanding and awareness of its programs. The Organization incurred \$417,702 in 2013, which is included with consulting in the statement of functional expenses.

L. Contributed Goods and Services

The Organization receives goods and services as non-cash and in-kind contributions. These goods and services are booked at their estimated fair value on the date of contribution. The Organization records book contributions at fair value using discounted wholesale publisher list values. The Organization received the following non-cash and in-kind contributions during the year ended December 31, 2013:

Non-cash contributions of books	\$ 86,197,884
In-kind contributions of warehouse space	<u>238,336</u>
Total contributed goods and services	<u>\$ 86,436,220</u>

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 2 **CONCENTRATIONS AND RISKS**

A. Credit Risk

The Organization maintains demand deposits and money market funds at financial institutions. At times, certain balances held within these accounts may not be fully guaranteed or insured by the U.S. Government. The uninsured portions of cash and money market accounts are backed solely by the assets of the underlying institution. The failure of an underlying institution could result in financial loss to the Organization, however, the Organization has not experienced losses on these accounts in the past, and management believes the risk of loss, if any, to be minimal.

B. Concentration

The Organization received 77% of its non-cash book donations from a single corporate donor during 2013. This corporate donor has a long-term relationship with the Organization and Management does not anticipate a change in this relationship.

NOTE 3 **INVESTMENTS**

In accordance with generally accepted accounting principles, the Organization uses the following prioritized input levels to measure fair value. These levels are not necessarily an indication of risk.

Level 1 – Observable inputs that reflect quoted prices for identical assets or liabilities in active markets, such as stock quotes;

Level 2 – Includes inputs other than Level 1 inputs that are directly or indirectly observable in the marketplace, such as yield curves or other market data;

Level 3 – Unobservable inputs which reflect the reporting entity's assessment of the assumptions that market participants would use in pricing the asset or liability including assumptions about risk, such as bid/ask spreads and liquidity discounts.

The following is a summary of the fair values of investments, which are measured on a recurring basis using Level 1 inputs at December 31, 2013:

Mutual Funds	\$ 7,378
Cash and cash equivalents	<u>3,977</u>
	<u>\$ 11,355</u>

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 4 **ACCRUED EXPENSES**

Accrued expenses at December 31, 2013, consists of accrued vacation expenses of \$123,242 and employee benefits of \$9,820.

NOTE 5 **NON-REVOLVING MASTER BORROWING LOAN**

On June 21, 2013, the Organization renewed a non-revolving master borrowing loan with SunTrust in the amount of \$2,500,000. At December 31, 2013, there was no balance outstanding. Once loan advances are taken, the advances bear interest at a per annum rate equal to the LIBOR rate plus 2.25% percentage points. The loan requires payments of interest due on the 15th of each month through June 15, 2014, followed by thirty-five monthly payments of principal plus accrued interest in the amount of \$59,524 (assuming the full advance of the loan). The note is due and payable on June 15, 2017, in full. The borrowing provision terminates on June 15, 2014, and thereafter no new advances may be made.

The loan is collateralized by all assets of the Organization now existing or hereafter acquired.

The Organization must maintain certain financial covenants. It must have \$2,000,000 in minimum liquidity (as defined) at the end of each fiscal 6-month period and its debt service coverage ratio (as defined) at the end of each fiscal 6-month period must equal 1.25 to 1.0. The Organization met these financial covenants at December 31, 2013.

NOTE 6 **RETIREMENT PLANS**

The Organization sponsors a defined contribution plan with a 401(k) and a 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, 2013 was \$236,961, and is included in payroll taxes and employee benefits. 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 7 **PREPAID EXPENSES**

Prepaid expense represent contracts, mainly insurances, which provide economic benefit beyond the current year end.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 8 ACCOUNTS RECEIVABLE

Accounts receivable consist of amounts owed to the Organization for program related purchases and contributions. Accounts receivable are recorded at their net realizable value. The Organization provides for probable losses on accounts receivable using the allowance method. The allowance is determined based on management's experience and collection efforts. Balances that remain outstanding after the Organization has used reasonable collection efforts are written off.

Accounts receivable consisted of the following at December 31, 2013:

Contributions receivable	\$ 218,974
Purchase orders receivable	217,011
Accounts receivable related party	<u>63,848</u>
	499,833
 Less allowance for doubtful accounts	 <u>51,714</u>
	 <u>\$ 448,119</u>

NOTE 9 PROPERTY AND EQUIPMENT

Property and equipment purchases of \$1,000, or greater, are recorded at cost, while donated assets are recorded at fair value on the date of donation. Depreciation and amortization is calculated using the straight-line method over the following estimated useful lives:

Furniture and equipment – 5 years
Software – 3 years

Depreciation and amortization expense for the year ended December 31, 2013 was \$22,733.

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

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 10 NET ASSETS

A. Unrestricted net assets:

Unrestricted net assets include those net assets whose use is not restricted by donors, even though their use may be limited in other respects, such as by board designations. Non-cash unrestricted net assets represents the fair value of donated books held in inventory as of December 31, 2013.

B. Temporarily restricted net assets:

Temporarily restricted net assets include those net assets whose use by the Organization has been donor restricted by specific time or purpose limitations.

Temporarily restricted net assets consist of the following at December 31, 2013:

Corporate contributions for 2014 programs	\$	1,009,703
Contributions designated for books in local communities for 2014		<u>1,079,872</u>
	\$	<u><u>2,089,575</u></u>

C. Permanently restricted net assets:

Permanently restricted net assets generally are comprised of endowment funds which the corpus is to be maintained indefinitely. The Organization has no net assets that are permanently restricted.

NOTE 11 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 United States Internal Revenue Code governing certain tax-exempt entities in the United States. LPL maintains a separate Board of Directors structure, with two of the Organization's Board members represented, and the LPL Board is expected to further elect independent Canadian-based board members in May 2014 to achieve majority representation. These events are fully supported by the Organization.

LPL was invoiced by and reimbursed the Organization for direct expenses of \$91,854 in 2013. In addition, as of December 31, 2013, the Organization's balance sheet reflects a receivable from LPL of \$63,848 for 2013 expenses. These expenses were subsequently paid by LPL in the first quarter of 2014. In 2013, the Organization transferred donated books with an estimated fair value of \$1.4 million to LPL in support of its mission. As discussed in note 12, the Organization signed as indemnifier for the LPL office lease agreement.

FIRST BOOK

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2013

NOTE 12 COMMITMENTS & CONTINGENCIES

A. Office Lease

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 12,245 square feet of office space commenced on December 1, 2011 and expires on July 31, 2016.

B. Indemnifier for Related Party Office Lease

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 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, 2013 for each of the next three years are:

<u>Year Ending December 31,</u>	<u>Amount</u>
2014	\$ 471,487
2015	476,141
2016	<u>282,266</u>
Total minimum future rental payments	<u>\$ 1,229,894</u>

NOTE 13 SUBSEQUENT EVENTS

The Organization has evaluated subsequent events through April 23, 2014 the date through which the financial statements are available to be issued.

On February 27, 2014, the Organization amended the office lease agreement, in note 12 A, to increase the square footage from 12,245 to 13,257. The minimal future rental payments include the increased rent figures.