

First 8 Memphis

Financial Statements

For the Year Ended December 31, 2019

Table of Contents

Independent Auditors' Report	1
Financial Statements:	
Statement of Financial Position	2
Statement of Activities and Functional Expenses	3
Statement of Cash Flows	4
Notes to Financial Statements	5



Independent Auditors' Report

Board of Directors
First 8 Memphis
Memphis, Tennessee

We have audited the accompanying financial statements of First 8 Memphis, LLC (a nonprofit organization, "the Organization"), which comprise the statement of financial position as of December 31, 2019, and the related statements of activities and 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.

Auditors' 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 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 the Organization as of December 31, 2019, 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.

Dixon Hughes Goodman LLP

Memphis, Tennessee
July 24, 2020

First 8 Memphis
Statement of Financial Position
December 31, 2019

ASSETS

Cash	\$	7,670,915
Escrow funds - restricted cash equivalents		2,596,568
Escrow funds - restricted certificates of deposit		<u>6,212,651</u>
Total assets	\$	<u><u>16,480,134</u></u>

LIABILITIES AND NET ASSETS

Accounts payable	\$	2,304,160
Accrued expenses		80,336
Contract liability - escrow agreement		5,796,000
Term loans		<u>6,827,000</u>
Total liabilities		<u>15,007,496</u>

Net assets:

Without donor restrictions		(797,362)
With donor restrictions		<u>2,270,000</u>
Total net assets		<u>1,472,638</u>
Total liabilities and net assets	\$	<u><u>16,480,134</u></u>

First 8 Memphis
Statement of Activities and Functional Expenses
Year Ended December 31, 2019

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Support and other revenues:			
Contributions	\$ 817,591	\$ 5,204,000	\$ 6,021,591
Net assets released from restrictions	2,934,000	(2,934,000)	-
	<u>3,751,591</u>	<u>2,270,000</u>	<u>6,021,591</u>
Total revenues	3,751,591	2,270,000	6,021,591
Expenses:			
Program services:			
Wages and related benefits	3,577,511	-	3,577,511
Consultant services	136,414	-	136,414
Office administration	301,717	-	301,717
Staff travel	19,647	-	19,647
Insurance	5,069	-	5,069
Occupancy	1,773	-	1,773
Legal and accounting	59,340	-	59,340
	<u>4,101,471</u>	<u>-</u>	<u>4,101,471</u>
Management and general:			
Wages and related benefits	88,015	-	88,015
Office administration	115,827	-	115,827
Staff travel	23	-	23
Meals and events	4,662	-	4,662
Insurance	12,409	-	12,409
Occupancy	2,659	-	2,659
Legal and accounting	145,281	-	145,281
Interest	78,606	-	78,606
	<u>447,482</u>	<u>-</u>	<u>447,482</u>
Total expenses	<u>4,548,953</u>	<u>-</u>	<u>4,548,953</u>
Change in net assets	(797,362)	2,270,000	1,472,638
Net assets, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>
Net assets, end of year	<u>\$ (797,362)</u>	<u>\$ 2,270,000</u>	<u>\$ 1,472,638</u>

See accompanying notes.

First 8 Memphis
Statement of Cash Flows
Year Ended December 31, 2019

Cash flows from operating activities:	
Change in net assets	\$ 1,472,638
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Changes in operating assets and liabilities:	
Accounts payable	2,304,160
Accrued expenses	80,336
Contract liability - escrow agreement	<u>(5,204,000)</u>
Total adjustments	<u>(2,819,504)</u>
Net cash used in operating activities	(1,346,866)
Cash flows used in investing activities:	
Changes in restricted certificates of deposit	<u>(6,212,651)</u>
Net cash used in investing activities	<u>(6,212,651)</u>
Cash flows from financing activities:	
Advances from governmental entities	11,000,000
Proceeds from long-term debt	7,568,000
Payments on long-term debt	<u>(741,000)</u>
Net cash provided by financing activities	<u>17,827,000</u>
Net increase in cash	10,267,483
Cash and cash equivalents, beginning of year	<u>-</u>
Cash and cash equivalents, end of year	<u>\$ 10,267,483</u>

1. Summary of Significant Accounting Policies

Organization and activities

First 8 Memphis, LLC (the “Organization”) was formed in October 2018, and is a Tennessee not-for-profit entity that manages private and public funds dedicated to the expansion of services for children from birth to age eight in Shelby County, Tennessee. The Organization was formed by Seeding Success, Inc., which acts as the sole member of the Organization, and an operating agreement governs the relationship. The Organization had no activity during the fiscal year ended December 31, 2018.

Programs and special projects

In 2019, the Organization was engaged by the City of Memphis and Shelby County to act as the fiscal agent for a Pre-K program, in which the Organization will oversee and manage the education of pre-kindergarten students in Shelby County. Funds from the governmental entities for the Pre-K program are held in a controlled escrow account and are released from escrow upon the Organization meeting certain outcome measures. These outcome measures consist of the following: consistent attendance, development of early reading skills, and kindergarten readiness. The term of the agreement with the City of Memphis and Shelby County includes the following school years: 2019-2020, 2020-2021, and 2021-2022, unless otherwise terminated under the agreement.

Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), which requires the Organization to report information regarding its financial position and activities according to the following net asset classifications:

Net assets without donor restrictions: Net assets in which no payer or donor-imposed restrictions were stipulated beyond the general stated purposes of the Organization. At the discretion of the Organization’s management and board of directors, these net assets may be expended for any purpose in performing the primary objectives of the Organization.

Net assets without donor restrictions consist of two categories: undesignated funds and board designated funds. Undesignated funds are available for any purpose within the scope of the Organization’s activities. Designated funds have been appropriated by the Organization’s board of directors for a specific activity or group of activities. Such designations could be changed by action of the board of directors.

Net assets with donor restrictions: Net assets subject to stipulations imposed by donors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Organization pursuant to those stipulations, or by the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds to be maintained in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the statement of activities. The Pre-K program was the Organization’s only donor-restricted program in 2019. Donor-restricted revenues were \$5,204,000 for the year ended December 31, 2019.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

First 8 Memphis Notes to Financial Statements

Contributions and support

Contributions received are recorded as with donor restrictions or without donor restrictions depending upon the existence and/or nature of any donor restrictions. Net assets with donor restrictions are reclassified to net assets without donor restrictions upon satisfaction of the time or purpose restriction. When a donor restriction expires in the same year received, revenue first flows through donor restricted net assets as an increase and is also shown as a release during the same year.

The Organization recognizes contributions when cash, securities or other assets; an unconditional promise to give; or a notification of beneficial interest is received. Conditional promises to give – that is, those with a measurable performance or other barrier and a right of return – are not recognized until the conditions on which they depend have been met.

Consequently, at December 31, 2019, contributions approximating \$5,796,000, are recorded as contract liabilities and have not been recognized in the accompanying statement of activities because the conditions on which they depend have not yet been met. As discussed in the subsequent events section below, these outcome measures have been waived for the 2019-2020 school year.

Cash and cash equivalents

The Organization considers all highly liquid debt instruments with original maturities of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents consist of cash held in a bank and money market mutual funds. Certificates of deposits are excluded from cash equivalents.

In-kind donations

Donated supplies and services are recorded as contributions at their estimated fair values at the date of donation. The Organization received approximately \$28,000 of in-kind marketing services during 2019.

Functional expense allocation

The cost of providing various programs and supporting services have been reported on a functional basis in the statement of activities and functional expenses. Accordingly, certain costs have been allocated among the various programs and supporting services based on estimates made by management. The expenses that are allocated include wages and related benefits, consulting services, meals and events, office administration, and travel expenses. These expenses are allocated based on time and effort. Occupancy and depreciation are allocated based on square footage.

Income taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and is similarly exempt from Tennessee state income taxes under provisions of the Tennessee tax regulations. Accordingly, no provision for income taxes is included in the accompanying financial statements. The Organization files an exempt organization return in the United States federal jurisdiction.

The Organization believes that it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are material to the financial statements.

New accounting standards

On June 21, 2018, the FASB issued ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which applies to all entities that receive or make contributions, including business entities. The criteria for evaluating whether contributions are unconditional (and thus recognized immediately in income) or conditional (for which income recognition is deferred) have been clarified. The focus is whether a gift or grant agreement both (1) specifies a "barrier or hurdle" that the recipient must overcome to be entitled to the resources, and (2) releases the donor from its obligation to transfer resources (or if assets are

First 8 Memphis Notes to Financial Statements

advanced, a right to demand their return) if the barrier or hurdle is not achieved. An agreement that contains both is a conditional contribution. An agreement that omits one or both is unconditional. No new disclosures are required.

For federal and other government grants, ASU 2018-08 clarifies the definition of an exchange transaction. As a result, not-for-profit entities will account for most federal grants as donor-restricted conditional contributions, rather than as exchange transactions (the prevalent practice today). An accommodation ("simultaneous release" option) is provided which, if elected, would allow grants received and used within the same period to be reported in net assets without donor restrictions, consistent with where the grant revenue is reported on these statements.

The Organization has adopted the amendments of ASU 2018-08 on contributions received and made during 2019.

The Organization also adopted Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* effective January 1, 2019. The impact of applying this ASU for the year ended December 31, 2019 was determined to be immaterial.

Subsequent events

The Organization evaluated the effect subsequent events would have on the consolidated financial statements through July 24, 2020, which is the date the consolidated financial statements were available to be issued.

Subsequent to the financial position date, the outbreak and spread of the COVID-19 virus was classified as a pandemic by the World Health Organization. The spread of the virus has disrupted the Organization's activities along with the activities of the Organization's vendors, service providers, donors, and grantors. These disruptions could adversely affect the Organization's ability to obtain and deliver certain services the program recipients expect. The economic uncertainty has not been fully determined but could have a significant impact on the Organization's financial condition, changes in net assets, and cash flows. The consolidated financial statements do not reflect any adjustments as a result of the subsequent increase in economic uncertainty.

In June 2020, the Organization determined that due to the challenges associated with the COVID-19 outbreak, available data will not be sufficient to fully determine the anticipated final outcomes of the Pre-K program for the 2019-2020 school year. The Organization has received authorization from the City of Memphis and Shelby County to distribute funds from escrow to repay the outstanding principal loan balance as scheduled (see note 3). Interest accrued on the outstanding principal balance has also been waived.

2. Availability and Liquidity

The following represents the Organization's financial assets available for general expenditure within one year of the statement of financial position date:

Cash and restricted escrow funds	\$ 16,480,134
Less amounts not available to be used within one year:	
Contract liability – escrow agreement	5,796,000
Assets with donor restrictions	<u>2,270,000</u>
	<u>8,066,000</u>
Financial assets available to meet general expenditures over the next twelve months	<u>\$ 8,414,134</u>

3. Fair Value Measurements

Fair value as defined under GAAP is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1:** Observable inputs such as quoted prices in active markets.
- Level 2:** Inputs other than quoted prices in active markets that are either directly or indirectly observable.
- Level 3:** Unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Organization’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following is a description of the valuation methodologies used for assets measured at fair value:

Money Market Mutual funds

Mutual funds are publicly traded investments and are valued daily at the closing price reported on the active market on which the funds are traded.

Certificates of deposit

These certificates are valued using pricing models maximizing the use of observable inputs for similar certificates.

The following table sets forth by level within the fair value hierarchy the Organization’s assets accounted for at fair value on a recurring basis as of December 31, 2019:

	Assets at Fair Value as of December 31, 2019			
	Level 1	Level 2	Level 3	Total
Money market mutual fund	\$ 2,596,568	\$ -	\$ -	\$ 2,596,568
Certificates of deposits	<u>6,212,651</u>	<u>-</u>	<u>-</u>	<u>6,212,651</u>
Escrow funds, at fair value	<u>\$ 8,809,219</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,809,219</u>

These cash equivalents and investments are subject to the escrow agreement discuss in Note 1.

4. Debt

On August 27, 2019, the Organization entered into a 24-month loan agreement with a senior lender and a subordinate lender to fund the Pre-K program. The loan has a simple interest rate of 7%, and all interest is due at maturity. The loan is collateralized by certain assets of the Organization and is subject to a Limited Recourse Carve-Out agreement executed by Seeding Success. Under the loan agreements and the Professional Services Agreement with the City of Memphis and Shelby County, funds are transferred from an escrow account directly to the lenders, on a quarterly basis, to satisfy the principal and interest requirements. As discussed in Note 1, the amount of the funds released

**First 8 Memphis
Notes to Financial Statements**

from escrow are contingent upon the Organization meeting certain outcome measures; however, subsequent to December 31, 2019, the Organization received a waiver for 2019-2020 school year outcome measures. Principal maturities of the loan as of December 31, 2019 are as follows:

2020	\$ 4,787,000
2021	<u>2,040,000</u>
	<u>\$ 6,827,000</u>

5. Net Assets with Donor Restrictions

Net assets with donor restrictions consists entirely of restrictions related to the Pre-K program. Net assets with donor restrictions at December 31, 2019 was \$2,270,000. For the year ended December 31, 2019, net assets released from restrictions totaled \$2,934,000.

6. Retirement Plan

The Organization participates in a 401(k) retirement plan, sponsored by its member, Seeding Success, for all full-time employees at least twenty-one (21) years of age who have completed four months of continuous employment. Optional employee contributions are withheld from the employees' compensation. The Plan Sponsor will make a matching contribution for each participant equal to 100% of the participant's salary contributions, up to 3% of annual compensation, and 50% of the participant's salary contributions, between 3-5% of annual compensation. Employer contributions for the year ended December 31, 2019, were \$875.

7. Related Party Transaction

For the year ended December 31, 2019, the Organization had expenses to its member for start-up costs totaling \$4,432. As of December 31, 2019, the Organization had a payable due to its member of \$1,232.

8. Concentrations of Risk

For the year ended December 31, 2019, the City of Memphis and Shelby County contribution accounted for approximately 87% of total contribution revenue.

The Organization has concentrated its credit risk for cash and restricted cash by maintaining deposits in a financial institution which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation. The Organization has not experienced any losses in such accounts and management believes the Organization is not exposed to significant credit risk to cash.