

THIRD SECTOR CAPITAL PARTNERS, INC.

**FINANCIAL STATEMENTS
DECEMBER 31, 2013
TOGETHER WITH
INDEPENDENT AUDITOR'S REPORT**

THIRD SECTOR CAPITAL PARTNERS, INC.

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DECEMBER 31, 2013**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Third Sector Capital Partners, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Third Sector Capital Partners, Inc. (a Massachusetts corporation, not for profit) which comprise the statement of financial position as of December 31, 2013, and the related statements of activities and changes in net assets, cash flows and functional expenses 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 qualified audit opinion.

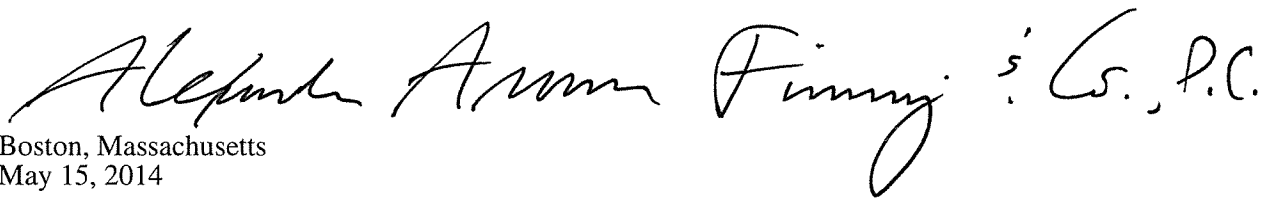
Basis for Qualified Opinion

The Agency's financial statements do not include the financial statements of Youth Services, Inc. (YSI) (see Note 1), which is a controlled affiliate of Third Sector Capital Partners, Inc. Management has elected not to consolidate YSI's financial statements because of the limited financial activity conducted by YSI during 2013. In our opinion, the consolidation of YSI's financial statements and related disclosures is required by accounting principles generally accepted in the United States of America. Quantification of the effects of this departure on the financial statements is not practicable.

Qualified Opinion

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Third Sector Capital Partners, Inc. as of December 31, 2013, 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.

Boston, Massachusetts
May 15, 2014

A handwritten signature in black ink that reads "Alexander Aron Finney, Esq., P.C." The signature is written in a cursive style with a large, sweeping initial 'A'.

THIRD SECTOR CAPITAL PARTNERS, INC.

**STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2013**

<u>ASSETS</u>	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
CURRENT ASSETS:			
Cash	\$ -	\$ 54,349	\$ 54,349
Accounts and grants receivable	160,311	28,000	188,311
Prepaid expenses and other	2,163	-	2,163
Due (to) from	<u>(80,138)</u>	<u>80,138</u>	<u>-</u>
Total assets	<u>\$ 82,336</u>	<u>\$ 162,487</u>	<u>\$ 244,823</u>
 <u>LIABILITIES AND NET ASSETS</u>			
CURRENT LIABILITIES:			
Accounts payable and accrued expenses	<u>\$ 12,886</u>	<u>\$ -</u>	<u>\$ 12,886</u>
NET ASSETS:			
Unrestricted	69,450	-	69,450
Temporarily restricted - for purpose	<u>-</u>	<u>162,487</u>	<u>162,487</u>
Total net assets	<u>69,450</u>	<u>162,487</u>	<u>231,937</u>
Total liabilities and net assets	<u>\$ 82,336</u>	<u>\$ 162,487</u>	<u>\$ 244,823</u>

The accompanying notes are an integral part of these statements.

THIRD SECTOR CAPITAL PARTNERS, INC.

**STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2013**

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUES:			
Grants	\$ 20,000	\$ 604,925	\$ 624,925
Program service fees	490,238	-	490,238
Donated services	456,088	-	456,088
Donated rent	22,875	-	22,875
Net assets released from time restrictions	442,438	(442,438)	-
	<u>1,431,639</u>	<u>162,487</u>	<u>1,594,126</u>
OPERATING EXPENSES:			
Program	1,068,572	-	1,068,572
Management and general	250,896	-	250,896
Fundraising	168,216	-	168,216
	<u>1,487,684</u>	<u>-</u>	<u>1,487,684</u>
Changes in net assets	(56,045)	162,487	106,442
NET ASSETS, beginning of year	<u>125,495</u>	<u>-</u>	<u>125,495</u>
NET ASSETS, end of year	<u><u>\$ 69,450</u></u>	<u><u>\$ 162,487</u></u>	<u><u>\$ 231,937</u></u>

The accompanying notes are an integral part of these statements.

THIRD SECTOR CAPITAL PARTNERS, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:	
Changes in net assets	\$ 106,442
Adjustments to reconcile changes in net assets to net cash used in operating activities:	
Changes in operating assets and liabilities:	
Accounts and grants receivable	(188,311)
Prepaid expenses and other	(2,163)
Accounts payable and accrued expenses	<u>(60,479)</u>
Net cash used in operating activities	<u>(144,511)</u>
NET DECREASE IN CASH	(144,511)
CASH, beginning of year	<u>198,860</u>
CASH, end of year	<u><u>\$ 54,349</u></u>

The accompanying notes are an integral part of these statements.

THIRD SECTOR CAPITAL PARTNERS, INC.

**STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2013**

	<u>PROGRAM</u>	<u>MANAGEMENT AND GENERAL</u>	<u>FUND- RAISING</u>	<u>TOTAL</u>
OPERATING EXPENSES:				
Salaries and related:				
Salaries	\$ 523,778	\$ 102,605	\$ 87,588	\$ 713,971
Payroll taxes	32,981	7,005	5,367	45,353
	<u>556,759</u>	<u>109,610</u>	<u>92,955</u>	<u>759,324</u>
Total salaries and related				
Other:				
Donated professional services	326,103	77,535	52,450	456,088
Consultants	60,170	37,566	5,099	102,835
Travel and parking	65,150	12,058	8,156	85,364
Donated rent	16,356	3,889	2,630	22,875
Office supplies	11,941	2,839	1,921	16,701
Professional fees	8,319	1,978	1,338	11,635
Meals	8,400	1,765	1,194	11,359
Miscellaneous	6,852	1,629	1,102	9,583
Occupancy	5,277	1,255	849	7,381
Conferences	2,122	505	341	2,968
Insurance	984	234	158	1,376
Filing fees	139	33	23	195
	<u>511,813</u>	<u>141,286</u>	<u>75,261</u>	<u>728,360</u>
Total other				
	<u>\$ 1,068,572</u>	<u>\$ 250,896</u>	<u>\$ 168,216</u>	<u>\$ 1,487,684</u>
Total operating expenses				

The accompanying notes are an integral part of these statements.

THIRD SECTOR CAPITAL PARTNERS, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013

(1) OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES

OPERATIONS

Third Sector Capital Partners, Inc. (the Agency), a Massachusetts not-for-profit corporation, was formed in October, 2012, as a successor agency to Third Sector Capital Partners, Ltd.

The Agency provides advisory services to government, human service providers, social investors, and project intermediaries pursuing Pay for Success and Social Innovation Financing initiatives. The Agency also helps high performing nonprofit organizations secure the growth capital they need to advance their missions. The Agency's mission is to accelerate America's transition to a performance-driven social sector. The Agency's team brings extensive experience in developing innovative financing and growth capital across the nonprofit, public and private sectors. In addition, the Agency is highly versed in evaluation methodologies and program management.

UNCONSOLIDATED AFFILIATE

The Agency is the sole member of Youth Services, Inc. (YSI), acting through its Board of Directors. YSI, a Massachusetts non-for-profit corporation, was formed in January, 2013, as a Section 509(a)(3) Type I supporting organization of the Agency to increase the strength and vitality of the nonprofit sector and thereby give all communities the opportunity to thrive. The main focus of YSI's activities is to serve as the intermediary organization for the Massachusetts Social Innovation Finance Juvenile Justice Project (the Project). YSI's role primarily involves coordinating agreements with each service provider, government agency, funding organization, and independent evaluator, and with any other important party involved in the Project; managing receipt and disbursement of funding from and among the involved parties; coordinating information exchange and reporting operations; and resolving any operational problems that arise in implementing the Project. YSI conducted nominal financial activity during 2013, but the Pay For Success agreement among the Commonwealth of Massachusetts, ROCA, Inc. and YSI was executed on January 7, 2014. YSI also closed on funding of approximately \$18,000,000 for the Project, including certain debt agreements on January 28, 2014. YSI entered into an advisory agreement with the Agency at that time.

NONPROFIT STATUS

The Agency is exempt from Federal income taxes as an organization (not a private foundation) formed for charitable purposes under Section 501(c)(3) of the Internal Revenue Code (IRC). The Agency is also exempt from state income taxes. Donors may deduct contributions made to the Agency within IRC requirements.

SIGNIFICANT ACCOUNTING POLICIES

The Agency prepares its financial statements in accordance with generally accepted accounting standards and principles established by the Financial Accounting Standards Board (FASB). References to U.S. GAAP in these notes are to the FASB Accounting Standards Codification. Because of the Agency's control of YSI, the financial statements of YSI are required to be consolidated with those of the Agency. The Agency has elected to exclude YSI's financial statements, including required disclosures, for the year ended December 31, 2013, because of the limited activity conducted by YSI during 2013.

THIRD SECTOR CAPITAL PARTNERS, INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2013

(Continued)

(1) **OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES**
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Assets

Unrestricted net assets represent amounts which are currently available for operations.

Temporarily restricted net assets represent grants and contributions whose use has been limited by donors to a specific time period or for a specified purpose. When a donor stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities and changes in net assets as net assets released from restrictions.

Revenue Recognition

Unrestricted grants are recorded as revenue when received or unconditionally committed. Program service fees are recorded as services are provided. All other revenue is recorded when earned.

Accounts and Grants Receivable and Allowance for Doubtful Accounts

Accounts and grants receivable are recorded at their net present value when earned or pledged. An allowance for uncollectible accounts and grants receivable is recorded based on management's analysis of specific accounts and their estimate of amounts that may become uncollectible. No allowance was deemed necessary as of December 31, 2013.

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. Actual results could differ from those estimates.

Expense Allocations

Expenses related directly to a function are distributed to that function, while other expenses are allocated based upon management's estimate of the percentage attributable to each function.

Donated Services

Professional service firms have contributed services to the Agency related to its formation and in support of various aspects of its programs. These services are reflected in the accompanying financial statements based upon the estimated value assigned to them by the donating firms or by management of the Agency. The value of these services for fiscal year 2013 was \$456,088.

Donated Rent

The Agency occupies office space in Boston, Massachusetts donated by New Profit Inc. (New Profit) (see Note 2), a Massachusetts nonprofit. The value of the space provided for 2013 as determined by New Profit was \$22,875.

THIRD SECTOR CAPITAL PARTNERS, INC.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013
(Continued)

(1) **OPERATIONS, NONPROFIT STATUS AND SIGNIFICANT ACCOUNTING POLICIES**
(Continued)

SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent Events

Subsequent events have been evaluated through May 15, 2014, which is the date the financial statements were available to be issued (see page 6 and Note 3).

Fair Value Measurement

ASC Topic, *Fair Value Measurements*, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance only applies when the fair value measurement of assets and liabilities is required or permitted. The Agency has determined that none of its financial or nonfinancial assets or liabilities is measured at fair value, therefore, the disclosure requirements do not currently apply.

Uncertainty in Income Taxes

The Agency follows the standards of *Accounting for Uncertainty in Income Taxes* standard, which requires the Agency to report uncertain tax positions, related interest and penalties, and to adjust its assets and liabilities related to unrecognized tax benefits and accrued interest and penalties accordingly. As of December 31, 2013, the Agency determined that there are no material unrecognized tax benefits to report. The Agency's information returns are subject to examination by the Federal and state jurisdictions and generally remain open for the most recent three years.

(2) **FUNDING**

The Agency receives approximately 56% of its income through grants from various organizations as well as approximately 44% of its income from program service fees for advisory services provided to government, human service providers, social investors, and project intermediaries.

(3) **FISCAL AGENT**

New Profit (see Note 1) is the fiscal agent for the Agency, while the Agency's tax exempt status application is awaiting the Internal Revenue Service's (IRS) approval (see Note 1). New Profit receives and disburses certain funds on behalf of the Agency. There were no funds held by New Profit on behalf of the Agency at December 31, 2013.

(4) **CONDITIONAL GRANT**

A foundation has awarded the Agency a conditional grant up to \$210,000, of which \$80,000 was received and recognized during 2013 and \$100,000 was received subsequent to year-end for conditions met and recognized by December 31, 2013. The remainder of the grant is conditional based upon certain performance milestones expected to be accomplished by March 31, 2014. The Agency received the \$30,000 subsequent to year-end after meeting such conditions. This amount has not been reflected in the accompanying financial statements.

(5) **CONCENTRATIONS**

The Agency received 66% of its total revenues from four organizations during the year ended December 31, 2013.

THIRD SECTOR CAPITAL PARTNERS, INC.

**NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013**

(Continued)

(6) SUBLEASE AGREEMENT

The Agency leases space under a sublease agreement in San Francisco, California. The term of the sublease commenced on December 1, 2013, on a month-to-month basis. Rent expense under the sublease was \$3,000 for the year ended December 31, 2013. The facility sublease requires the Agency to maintain certain insurance coverage and pay for its proportionate share of phones, internet, printers, and copiers.

(7) CONCENTRATIONS OF CREDIT RISK

The Agency maintains its operating cash balances in one bank in Massachusetts, which are insured by the Federal Deposit Insurance Corporation (FDIC) up to certain amounts. At certain times during the year, cash balances exceeded the insured amounts. The Agency has not experienced any losses in such accounts and management monitors the condition of the bank to mitigate the potential for loss.

(8) CONTINGENCIES

The Agency has agreed to be liable to YSI's Senior and Junior Lenders to the Project for obligations on a full recourse basis. This includes the loss of principal or Senior Interest payments with respect to the Senior Loan or principal or Junior Interest payments with respect to the Junior Loans resulting from either a loss of the Incarceration Success Payment and/or Employment Success Payment or a failure of the Incarceration Success Payment and/or Employment Success Payment to be applied to the obligations of YSI to the lenders in accordance with the Subordination and Intercreditor Agreement, in each case caused by any of the following:

- Termination by YSI of any of the prohibited Core Agreements;
- An event of default of the Senior and Junior Loan agreements;
- YSI's knowing and intentional breach of any Core Agreement;
- Fraud, gross negligence or willful misconduct or knowing and intentional misrepresentation by YSI or the Agency or any of YSI's or the Agency's officers, directors or employees in connection with the Senior Loan Documents, Junior Loan Documents or any Core Agreements;
- Misappropriation or conversion by YSI or the Agency or any of the borrower's or the Agency's officers, directors or employees of any proceeds of the Senior Loan, Junior Loans, Incarceration Success Payment and/or Employment Success Payment;
- Knowing and intentional acts or omissions on the part of YSI that cause the loss of the borrower's status as a Massachusetts not-for-profit corporation and after receipt by YSI of a letter from the IRS that it qualifies as a Type I supporting organization of the Agency under 509(a)(3) of the IRC and an organization described in Section 501(c)(3) of the IRC;
- Knowing and intentional acts or omissions on the part of YSI or the Agency or any of YSI's and the Agency's officers, directors or employees that result in the failure by YSI to maintain insurance as required by the Senior Loan Agreement.

The Agency's maximum obligation under this commitment is \$12,000,000 and remains in place for the term of the Project agreements.