

Starlight Children's Foundation

Financial Statements

December 31, 2018



TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditor's Report	1
Statement of Financial Position	2
Statement of Activities	3
Statement of Functional Expenses	4
Statement of Cash Flows	5
Notes to Financial Statements	6 - 14



INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Starlight Children's Foundation
Culver City, California

We have audited the accompanying financial statements of Starlight Children's Foundation (a California nonprofit corporation) (the "Foundation"), which comprise the statement of financial position as of December 31, 2018, 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 (the "U.S."); 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 U.S. 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Starlight Children's Foundation as of December 31, 2018, 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 U.S.

A handwritten signature in black ink that reads "Armanino LLP". The signature is written in a cursive, flowing style.

Armanino^{LLP}
Los Angeles, California

May 29, 2019

Starlight Children's Foundation
Statement of Financial Position
December 31, 2018

ASSETS

Cash and cash equivalents	\$ 1,111,695
Investments	8,213,971
Contributions and pledges receivable	475,000
Inventory	626,605
Prepaid expenses and other assets	979,436
Property and equipment, net	<u>41,050</u>
 Total assets	 <u><u>\$ 11,447,757</u></u>

LIABILITIES AND NET ASSETS

Liabilities	
Accounts payable and accrued liabilities	\$ 963,827
Deferred rent	<u>103,373</u>
Total liabilities	<u><u>1,067,200</u></u>
 Commitments (Notes 8 and 10)	
Net assets	
Without donor restrictions	
Undesignated	4,073,480
Board-designated reserve	<u>2,000,000</u>
Total without donor restrictions	6,073,480
With donor restrictions	<u>4,307,077</u>
Total net assets	<u><u>10,380,557</u></u>
 Total liabilities and net assets	 <u><u>\$ 11,447,757</u></u>

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

Starlight Children's Foundation
Statement of Activities
For the Year Ended December 31, 2018

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Revenues, gains and other support			
Contributed goods, services, and use of facilities	\$ 5,978,164	\$ -	\$ 5,978,164
Contributions	4,445,138	6,808,366	11,253,504
Revenue from related parties	68,385	-	68,385
Proceeds from fundraising events, net of direct benefit to donors of \$47,500	21,987	-	21,987
Miscellaneous	290,094	-	290,094
Net assets released from restriction	<u>3,392,818</u>	<u>(3,392,818)</u>	<u>-</u>
Total revenues, gains and other support	<u>14,196,586</u>	<u>3,415,548</u>	<u>17,612,134</u>
Functional expenses			
Program services	12,782,190	-	12,782,190
Management and general	791,928	-	791,928
Fundraising	<u>817,896</u>	<u>-</u>	<u>817,896</u>
Total functional expenses	<u>14,392,014</u>	<u>-</u>	<u>14,392,014</u>
Change in net assets	(195,428)	3,415,548	3,220,120
Net assets, beginning of year	<u>6,268,908</u>	<u>891,529</u>	<u>7,160,437</u>
Net assets, end of year	<u>\$ 6,073,480</u>	<u>\$ 4,307,077</u>	<u>\$ 10,380,557</u>

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

Starlight Children's Foundation
Statement of Functional Expenses
For the Year Ended December 31, 2018

	Starlight Gowns	Starlight Fun Centers	Starlight Sites	Starlight Special Deliveries	Starlight Xperience	Program General	Total program services	Management and General	Fundraising	Total
Advertising	\$ 7,456	\$ 295	\$ 295	\$ 354	\$ 10,744	\$ 1,588	\$ 20,732	\$ 7,925	\$ 15,221	\$ 43,877
Bank charges	-	-	-	-	-	-	-	30	-	30
Depreciation	3,111	819	819	983	2,784	655	9,171	3,930	3,275	16,376
Donated professional services	114,809	-	-	-	230,661	6,116	351,586	26,928	-	378,514
Donated materials and supplies	1,887	-	-	5,496,467	-	-	5,498,354	-	-	5,498,353
Equipment for program use	1,920,244	636,427	-	-	661,640	4,561	3,222,872	-	-	3,222,872
Equipment rental and repair	177	23,778	47	56	159	37	24,254	224	187	24,664
Facilities rent and parking	35,715	9,399	9,399	11,279	31,956	7,519	105,267	45,113	37,595	187,975
Fees	-	-	-	-	-	-	-	1,999	36,009	38,008
Income taxes	500	132	132	158	448	105	1,475	632	527	2,634
Insurance	6,614	1,741	1,741	2,089	5,918	1,392	19,495	8,354	6,962	34,811
IT services	18,593	3,810	3,390	4,069	11,685	155,886	197,433	29,084	57,133	283,651
Membership dues	70	18	18	22	3,437	111	3,676	88	73	3,838
Miscellaneous	7,292	641	542	1,147	3,605	19,877	33,104	3,654	81,373	118,132
Postage, shipping, and delivery	69,520	61,643	14	457,496	3,652	38,626	630,951	620	3,318	634,889
Printing and publications	3,001	291	435	762	3,122	3,697	11,308	1,396	6,031	18,736
Professional services	219,743	5,777	5,777	6,932	348,759	2,129	589,117	97,498	74,880	761,496
Regulatory and other renewal fees	44	12	12	14	39	9	130	280	2,979	3,389
Renovation expense - Starlight Sites	-	-	642,309	-	-	7,611	649,920	-	-	649,920
Salaries and employee benefits	445,164	118,031	102,715	117,157	364,869	116,985	1,264,921	546,438	455,504	2,266,863
Supplies	1,486	208	217	408	1,311	336	3,966	1,072	1,601	6,636
Telephone	5,817	1,531	1,531	1,837	5,204	1,225	17,145	7,347	6,137	30,629
Travel and automobile	37,912	4,229	3,726	5,797	39,284	36,365	127,313	9,316	29,091	165,721
	<u>\$ 2,899,155</u>	<u>\$ 868,782</u>	<u>\$ 773,119</u>	<u>\$ 6,107,027</u>	<u>\$ 1,729,277</u>	<u>\$ 404,830</u>	<u>\$ 12,782,190</u>	<u>\$ 791,928</u>	<u>\$ 817,896</u>	<u>\$ 14,392,014</u>

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

Starlight Children's Foundation
Statement of Cash Flows
For the Year Ended December 31, 2018

Cash flows from operating activities	
Change in net assets	\$ 3,220,120
Adjustments to reconcile change in net assets to net cash provided by operating activities	
Depreciation and amortization	16,376
Deferred rent	49,520
Warranty reserve	(32,000)
Reinvested dividends and interest	(3,311)
Realized gains on investments	(102,908)
Unrealized gains on investments	(18,856)
Changes in operating assets and liabilities	
Contributions and pledges receivable	16,020
Inventory	(464,519)
Prepaid expenses and other assets	(394,709)
Accounts payable and accrued liabilities	415,732
Deferred revenue	(1,250,000)
Net cash provided by operating activities	<u>1,451,465</u>
Cash flows from investing activities	
Purchases of property and equipment	(9,548)
Purchases of investments	(29,395,990)
Proceeds from sales of investments	<u>28,340,000</u>
Net cash used in investing activities	<u>(1,065,538)</u>
Net increase in cash and cash equivalents	385,927
Cash and cash equivalents, beginning of year	<u>725,768</u>
Cash and cash equivalents, end of year	<u>\$ 1,111,695</u>

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

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

1. ORGANIZATION

Founded in 1982, Starlight Children's Foundation raises funds and awareness to deliver happiness to seriously ill children and their families through the provision of Starlight programs to more than 800 hospital partners and other health care facilities within the United States.

During 2018, in addition to its established programs including Starlight Fun Center® mobile entertainment units, Starlight Gowns™ and Starlight Sites, the Foundation launched a new program, Starlight Xperience™ virtual reality, a groundbreaking new technology program that offers seriously ill children a fun and exciting way to explore the world and beyond through the magic of virtual reality. In its first year, more than 900 Starlight Xperience kits were provided to hospital partners across the United States.

Starlight Children's Foundation also provides ongoing programs throughout the United Kingdom, Canada, and Australia through international affiliates (International Affiliates). Affiliate agreements entered into between each International Affiliate and the Foundation provide for common purposes and policy direction.

The accompanying financial statements were prepared to present the financial information of Starlight Children's Foundation (referred to herein as the "Foundation") in the United States. The Foundation has agreements with International Affiliates in Australia, UK, and Canada. These affiliates operate independently, and the Foundation does not exercise control, nor does it have economic interests in the International Affiliates. Therefore, the financial results of the International Affiliates are not consolidated into the accompanying financial statements, based on Accounting Standards Codification (ASC) 958-810-25, *Consolidation*.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Net assets

The Foundation's net assets and changes therein are classified and reported as follows:

- *Without donor restrictions* - Net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. The governing board has designated, from net assets without donor restrictions, net assets for an operating reserve.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net assets (continued)

- *With donor restrictions* - Net assets subject to donor- (or certain grantor-) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

Cash and cash equivalents

The Foundation considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash and cash equivalents. The carrying value of cash and cash equivalents at December 31, 2018 approximates its fair value. The Foundation had no cash equivalents as of December 31, 2018.

The Foundation maintains its cash, cash equivalents, and investments in bank deposit accounts and other investment accounts, which, at times, may exceed federally insured limits. The Foundation has not experienced any losses in such accounts.

Investments

The Foundation maintains investments in short-term U.S. Government Treasury bills. The term of the bills is 90 days.

Contributions and pledges receivable

Contributions, including pledges, representing unconditional promises to give are recorded at estimated fair value, and recognized as revenue in the period received. The Foundation reports unconditional contributions as restricted support if they are received with donor stipulations that limit the use of the donated assets. Total pledges receivable are expected to be collected in their entirety within one year subsequent to the year-end, with the exception of one pledge receivable in the amount of \$50,000 which will be collected in 2020 after the completion of a campaign ending December 31, 2019.

The Foundation had three donors which made up 71% of total contributions for the year ended December 31, 2018.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventory

Inventory is comprised of materials that will be placed in hospital partner facilities for the use of hospitalized children. Inventory includes videogame players, monitors, and other electronics that make up the Starlight Fun Center units. Other inventory includes Starlight gowns, Starlight Xperience inventory to be distributed to hospitals, and Starlight Comfort Kit backpacks and other materials collected for distribution through the Foundation's programs. Purchased inventory is stated at cost. Donated inventory is recorded at estimated fair value, or wholesale values depending on the size of the donation, at the time of donation. The Foundation reviews the carrying value of its inventory for possible impairment whenever events or changes in circumstances indicate that the fair value may have declined since it was originally acquired. An impairment loss is recognized when the fair value of the inventory is lower than the carrying amount, in which case a writedown is recorded to reduce the related asset to its estimated fair value. No impairment losses were recognized during the year ended December 31, 2018 for donated materials and supplies.

Prepaid expenses and other assets

Prepaid expenses and other assets primarily include prepaid deposits for the manufacture of Starlight gowns of \$351,745, prepayment to Nintendo of America of \$262,538 as advance payment for the production and maintenance of Starlight Fun Centers and prepayment of Starlight Comfort Kits of \$135,313. All of these prepaid items will be placed in hospital partner facilities for hospitalized kids upon completion. Other prepaid expenses and other assets total \$229,840.

In December 2018, management determined that certain ordered goods were nonconforming and therefore recorded an impairment of the prepaid amount of \$544,500 and of inventory of \$109,800. In addition, management accrued approximately \$105,000 for costs related to the nonconforming goods. Management expects to recoup a significant percentage of these losses related to this order in subsequent years.

Property and equipment

Property and equipment having a useful life of more than one year are recorded at cost if purchased. Donated assets are capitalized at the estimated fair value at the date of receipt and restrictions are released once the asset has been placed into service. Depreciation is computed on the straight-line basis over the estimated useful lives of the related assets. Maintenance and repair costs are charged to expenses as incurred. Property and equipment are capitalized if the useful life is greater than one year. The estimated useful lives of property and equipment are as follows:

Software and computers	3 - 5 years
Furniture and fixtures	7 years

Leasehold improvements are amortized on the straight-line basis over the term of the lease.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Long-lived assets

The Foundation reviews the carrying values of its long-lived assets for possible impairment whenever events or changes in circumstances indicate that the book value of the assets may not be recoverable. An impairment loss is recognized when the sum of the undiscounted future cash flows is less than the carrying amount of the asset, in which case a write-down is recorded to reduce the related assets to its estimated fair value. No impairment losses were recognized during the year ended December 31, 2018.

Contributed goods, services, and use of facilities

Contributions of donated noncash assets are recorded at fair value, or wholesale value depending on the size of the donation, in the period received. Contributions of donated services that create or enhance nonfinancial assets or that require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at fair value in the period received. Contributed goods generally consist of materials for distribution to hospital partner facilities for hospitalized kids. For the year ended December 31, 2018, the Foundation received \$5,978,164 of contributed goods, services, and use of facilities.

Deferred rent

Deferred rent represents the difference between the lease payments made on its facilities and the lease expense. The lease expense is recognized on a straight-line basis giving consideration to planned lease escalations and free rent concessions.

Fair value of financial instruments

Fair value determination - The fair value of the Foundation's financial instruments as of December 31, 2018 represents management's best estimates of the amounts that would be received to sell those assets in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there are little, if any, observable inputs, management's own judgments about the assumptions of market participants were used in pricing the asset. Although the Foundation uses its best judgment in determining the fair value of financial instruments, there are inherent limitations in any methodology. Therefore, the values presented herein are not necessarily indicative of the amount the Foundation could realize in a current transaction. Future confirming events could affect the estimates of fair value and could be material to the financial statements. These events could also affect the amount realized upon liquidation of the financial instruments.

Fair value hierarchy - The Foundation's fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair value hierarchy (continued)

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets that the Foundation has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other observable inputs that can be corroborated by observable market data.
- Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

Due to the short-term nature of cash equivalents, receivables, other assets, accounts payable, and accrued liabilities, fair value approximates carrying value.

Income taxes

The Foundation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Service Code and corresponding California provisions. However, the Foundation remains subject to income taxes on any net income that is derived from a trade or business, regularly carried on and not in furtherance of the purpose for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

In 2018, Federal taxes were paid as required by the new tax laws which require payment of tax on Qualified Taxable Fringe benefits for employees. The benefits to employees for which the tax was assessed was employer-paid parking.

ASC Topic 740, *Income Taxes* (ASC 740), prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, disclosure, and transition. Management believes that there are no such uncertain tax positions for the Foundation at December 31, 2018.

The Foundation's federal income tax and informational returns for tax years ended December 31, 2015 and subsequent remain open to examination by the Internal Revenue Service. The returns for California, the Foundation's only state tax jurisdiction, remain open to examination by the California Franchise Board for tax years ended December 31, 2014 and subsequent.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 the reported amounts of assets and liabilities, revenues and expenses as of the date and for the period presented. Actual results could differ from those estimates.

Functional allocation of expenses

The costs of providing the Foundation's programs and other activities have been presented in the statement of functional expenses. Indirect or shared costs are allocated among program and support services by a method that best measures the relative degree of benefit.

3. INVESTMENTS

The following table sets forth by level, within the fair value hierarchy, the Foundation's assets at fair value as of December 31, 2018:

	Level 1	Level 2	Level 3	Fair Value
U.S. Treasury bills	\$ 8,213,971	\$ -	\$ -	\$ 8,213,971

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

Software and computers	\$ 682,108
Furniture and fixtures	31,824
Leasehold improvements	14,708
Total	728,640
Accumulated depreciation and amortization	(687,590)
Property and equipment, net	\$ 41,050

Depreciation and amortization expense was \$16,376 for the year ended December 31, 2018.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

Accounts payable	\$ 461,692
Accrued payroll	20,515
Accrued paid time off	98,232
Accrued warranty reserve - Starlight Fun Center units	168,000
Other accrued liabilities	<u>215,388</u>
 Total accounts payable and accrued liabilities	 <u><u>\$ 963,827</u></u>

The \$168,000 warranty reserve relates to Starlight Fun Center units purchased from Nintendo of America. The Foundation is required to repair Starlight Fun Center units donated to healthcare facilities for 3 years after the units are distributed to the respective facilities.

6. CONTRIBUTED GOODS, SERVICES, AND USE OF FACILITIES

Contributed goods, services, and use of facilities consist of the following:

Donated professional services	\$ 378,514
Donated materials and supplies	<u>5,599,650</u>
 Total	 <u><u>\$ 5,978,164</u></u>

7. NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions comprise the following:

Purpose restricted	\$ 3,602,077
Time-restricted	<u>705,000</u>
	<u><u>\$ 4,307,077</u></u>

8. DEFINED CONTRIBUTION PENSION PLAN

The Foundation maintains a 403(b) defined contribution pension plan to which employees may contribute. The Foundation matches all contributions up to a maximum of 3% of annual salary. The Foundation made \$41,357 in matching contributions for the year ended December 31, 2018.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

9. RELATED PARTY TRANSACTIONS

The accounts of the Foundation's International Affiliates in the United Kingdom, Australia and Canada are not included in the accompanying 2018 financial statements. During 2018, the Foundation provided Starlight Fun Center units to its Canadian affiliate and received related revenue totaling \$68,385. There were no receivables from or payables to International Affiliates at December 31, 2018.

10. COMMITMENTS

The Foundation leases certain facilities and equipment under long-term operating lease agreements that expire through November 2022. Future minimum lease payments for leases that have a remaining noncancelable term in excess of one year as follows:

2019	\$	202,096
2020		207,792
2021		213,658
2022		<u>200,489</u>
Total noncancelable lease commitments	\$	<u><u>824,035</u></u>

Facilities rent expenses were \$171,950 and equipment rent expenses were \$933 during the year ended December 31, 2018.

11. LIQUIDITY AND AVAILABILITY

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, comprise the following:

Cash and cash equivalents	\$	1,111,695
Investments		8,213,971
Contributions and pledges receivable		<u>475,000</u>
		<u>9,800,666</u>
Board-designated reserve		(2,000,000)
Contributions and pledges receivable due past one year (see Note 2)		(50,000)
Net assets subject to expenditure for specified purpose (see Note 7)		<u>(3,602,077)</u>
		<u><u>(5,652,077)</u></u>
	\$	<u><u>4,148,589</u></u>

As part of Starlight's liquidity management plan, cash in excess of daily requirements is invested in treasury securities.

Starlight Children's Foundation
Notes to Financial Statements
December 31, 2018

11. LIQUIDITY AND AVAILABILITY (continued)

The Board-designated reserve of \$2,000,000 was created to ensure ongoing operations in the event of unforeseen shortfalls and represents approximately five and one-half months of operating expenses. It is subject to expenditure only upon the approval of the Board of Directors. These funds are held in short-term investment accounts.

12. SUBSEQUENT EVENTS

The Foundation has evaluated events and transactions occurring subsequent to the statement of financial position date of December 31, 2018 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through May 29, 2019, the date these financial statements were available to be issued.