

South Carolina First Steps to School Readiness

Financial Statements

For the Year Ended June 30, 2014

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State of South Carolina



Office of the State Auditor

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DEPUTY STATE AUDITOR

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September 29, 2014

The Honorable Nikki R. Haley, Governor
and
Members of the Board of Trustees
South Carolina First Steps to School Readiness
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina First Steps to School Readiness for the year ended June 30, 2014, was issued by Greene, Finney & Horton, LLP, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard H. Gilbert Jr.", written in a cursive style.

Richard H. Gilbert, Jr., CPA
Deputy State Auditor

RHGjr/cwc



INDEPENDENT AUDITOR'S REPORT

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
Office of the State Auditor
Columbia, South Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the major fund of South Carolina First Steps to School Readiness ("First Steps"), a component unit of the State of South Carolina, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise First Steps' basic financial statements as listed in the table of contents.

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 opinions 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and the major fund of South Carolina First Steps to School Readiness as of June 30, 2014, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Pending Implementation of GASB Statement on Pensions

As discussed in Note 12, the Governmental Accounting Standards Board recently issued Statement No. 68, *Accounting and Financial Reporting for Pensions* ("GASB #68"). GASB #68, which will be adopted by First Steps for the fiscal year ended June 30, 2015, will require First Steps to report a net pension liability on its applicable financial statements for its participation in the South Carolina Retirement System ("Plan"). Based on recent information provided by the South Carolina Public Employee Benefit Authority, it is anticipated that First Steps' share of the net pension liability associated with the Plan will decrease First Steps' net position by approximately \$5,513,000. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison schedules, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2014 on our consideration of First Steps' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering First Steps' internal control over financial reporting and compliance.



Greene, Finney & Horton, LLP
Mauldin, South Carolina
September 23, 2014

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
June 30, 2014**

The Management's Discussion and Analysis ("MD&A") of the South Carolina First Steps to School Readiness Board of Trustees provides an overview of the financial activities for the fiscal year ended June 30, 2014.

FINANCIAL HIGHLIGHTS

The South Carolina First Steps to School Readiness ("First Steps") prepared its financial statements on the Generally Accepted Accounting Principles ("GAAP") basis and follows pronouncements from the Governmental Accounting Standards Board ("GASB").

As of and for the year ended June 30, 2014:

- First Steps' total net position increased by \$3,111,745 and the assets of First Steps exceeded its liabilities (net position) by \$5,343,088, which includes \$4,004,031 in net position restricted for the 4K pre-school program.
- First Steps received \$27,225,789 in appropriations from the State of South Carolina, the significant majority of which was disbursed for funding the county partnerships, 4K, and Baby Net programs throughout the state.
- First Steps received federal, local, and private grants as well as Medicaid reimbursements and a reimbursement from the South Carolina Department of Education totaling \$7,999,912.

USING THESE AUDITED FINANCIAL STATEMENTS

The audited financial statements presented in this document include both government-wide and fund financial statements.

Government-wide Statements:

Government-wide statements include a Statement of Net Position and a Statement of Activities. These statements display information about First Steps as a whole. The government-wide financial statements of First Steps are presented on the accrual basis of accounting and provide short-term and long-term information about First Steps.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
June 30, 2014**

Fund Statements:

The fund financial statements include the governmental fund's Balance Sheet and Statement of Revenue, Expenditures, and Changes in Fund Balance. The governmental fund financial statements are presented on the modified accrual basis of accounting which focus on the near term inflows and outflows of resources available for expenditure for the fiscal year.

First Steps was created specifically to carry out the objectives of The South Carolina First Steps to School Readiness Act and to lessen the burdens on government by overseeing the initiative for improving early childhood development of the Act.

Statement of Net Position –The Statement of Net Position provides a summary of First Steps' financial condition at the end of the 2014 and 2013 fiscal years; the statement reports all assets and liabilities using the accrual basis of accounting. The Statement of Activities reports the revenues and expenses during the time periods indicated.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NET POSITION**

	2014	2013
Current assets	\$ 5,576,859	\$ 3,131,782
Capital assets, net	747,695	169,000
Total assets	6,324,554	3,300,782
Current liabilities	784,355	957,771
Noncurrent liabilities	197,111	111,668
Total liabilities	981,466	1,069,439
Net investment in capital assets	747,695	169,000
Restricted	4,004,031	-
Unrestricted	591,362	2,062,343
Total net position	\$ 5,343,088	\$ 2,231,343

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
June 30, 2014**

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
STATEMENT OF ACTIVITIES**

	<u>2014</u>	<u>2013</u>
Program Revenues		
Federal grants	\$ 5,978,733	\$ 6,541,640
Medicaid reimbursements	863,404	754,669
Local and private grants	230,239	501,179
Reimbursement from South Carolina Department of Education	927,536	-
Contributions	-	1,655
Total program revenues	<u>7,999,912</u>	<u>7,799,143</u>
General Revenues		
State appropriations	27,225,789	18,125,283
Interest income	176,927	92,779
Total general revenues	<u>27,402,716</u>	<u>18,218,062</u>
Total revenues	<u>35,402,628</u>	<u>26,017,205</u>
Expenses		
Allocations to other entities	20,152,537	13,208,227
Contractual services	7,487,576	8,096,889
Salaries	3,061,135	3,058,365
Employer fringe benefits	1,018,488	1,027,541
Rent and leases	240,520	225,240
Materials	123,505	157,290
Travel	153,716	122,149
Equipment	53,406	2,114
Total expenses	<u>32,290,883</u>	<u>25,897,815</u>
Increase in net position	3,111,745	119,390
Net position beginning balance	2,231,343	2,111,953
Net position ending balance	<u>\$ 5,343,088</u>	<u>\$ 2,231,343</u>

Operating revenues of First Steps are largely dependent upon appropriations from the State of South Carolina as well as grants from the Federal government.

First Steps received \$27,225,789 in appropriations from the State of South Carolina. These appropriations were spent for two primary purposes. The amount of \$21,408,506 was spent on the operations of First Steps' county partnerships throughout the State for programs within its mission and \$1,176,558 was spent on First Steps' operations and employees.

Total program revenues increased by \$200,769 and total general revenues increased by \$9,184,654. These increases were due primarily from the reimbursement from the South Carolina Department of Education and a substantial increase in State appropriations to expand program operations. As a result, expenses increased by \$6,393,068 resulting in a corresponding increase in net position from the prior year in the amount of \$3,111,745.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
June 30, 2014**

Fund Highlights:

Governmental Fund

The focus of First Steps' governmental funds is to provide information regarding actual inflows and outflows of spendable resources. The General Fund is the chief operating fund of First Steps. The General Fund's operating revenues are primarily appropriations from the State of South Carolina and federal grants. For state appropriations, revenues are not budgeted by First Steps, therefore, expenditures are typically matched with appropriations so long as expenditures do not exceed budget. Additionally, the South Carolina Department of Education reimbursed First Steps \$927,536 for federal grant funds that had not been reimbursed in prior years. This, along with federal grant revenues that are received on a reimbursement basis, and other reimbursements and grants, resulted in revenues exceeding expenditures by \$2,714,843 for the year ended June 30, 2014. This resulted in an increase in fund balance from the beginning fund balance amount of \$2,299,935 to \$5,014,778, which includes \$4,004,031 in fund balance restricted for the 4K pre-school program and \$1,010,747 in unassigned fund balance.

Capital Assets:

First Steps' began the implementation of Early Intervention Management System that is compliant with both State and Federal requirements in fiscal year 2013 and continued that process in fiscal year 2014. This has resulted in \$632,101 being spent in the current fiscal year and \$169,000 being spent during the prior fiscal year for the system's implementation. The system was put into service in March 2014.

Noncurrent Liabilities:

First Steps' noncurrent liabilities consist of compensated absences. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. Compensated absences used during the fiscal year were \$189,527 while another \$371,320 were accrued.

Budget Highlights:

First Steps budgets State appropriations and other funds (earmark, restricted and federal) as they are received during the year. First Steps' budget for the general fund was originally \$27,205,209 for the year ended June 30, 2014. This compares to a final budgeted appropriation of \$27,225,789. Actual appropriations for the general fund were \$27,225,789 and the actual expenditures, on the budgetary basis, totaled \$22,585,064. The total other funds budget was \$10,427,890 with actual expenditures of \$10,189,530. The actual appropriations and other funds compared to expenditures were in line with the final budgeted amounts. The amount of expenditures budgeted exceeded actual expenditures as First Steps was not able to expand its programs rapidly enough during the year to consume all budgeted amounts. Those funds will be used in future fiscal years.

Current Conditions that are expected to have a Significant Effect on First Steps' Financial Position:

Due to the continually increasing costs of services central to the First Steps' mission and operations, First Steps does intend to request additional budgetary funding from the State of South Carolina General Assembly in future fiscal years to help ensure that these programs continue for the benefit of the State.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
June 30, 2014**

This discussion and analysis is designed to provide a general overview of the South Carolina First Steps to School Readiness' finances for all of South Carolina's citizens, taxpayers, customers, and investors and creditors. This financial report seeks to demonstrate First Steps' accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

South Carolina First Steps to School Readiness
1300 Sumter Street, Suite 100
Columbia, South Carolina 29201

**South Carolina First Steps to School Readiness
Statement of Net Position
June 30, 2014**

ASSETS

Current assets:

Cash and cash equivalents	\$ 5,236,728
Due from Federal government and other grantors	340,131
Total current assets	5,576,859

Noncurrent assets:

Capital assets, net	747,695
Total noncurrent assets	747,695
Total assets	6,324,554

LIABILITIES

Current liabilities:

Accounts payable	222,314
Accrued salaries and benefits	339,767
Compensated absences	222,274
Total current liabilities	784,355

Noncurrent liabilities:

Compensated absences	197,111
Total noncurrent liabilities	197,111
Total liabilities	981,466

NET POSITION

Net investment in capital assets	747,695
Restricted for the 4K pre-school program	4,004,031
Unrestricted	591,362
Total Net Position	\$ 5,343,088

The notes to the financial statements are an integral part of these financial statements. See accompanying independent auditor's report.

**South Carolina First Steps to School Readiness
Statement of Activities
For the year ended June 30, 2014**

Expenses

Governmental Activities – General Government

Allocations to other entities	\$ 20,152,537
Contractual services	7,487,576
Salaries	3,061,135
Employer fringe benefits	1,018,488
Rent and leases	240,520
Materials	123,505
Travel	153,716
Depreciation	53,406
Total expenses	<u>32,290,883</u>

Program Revenues – Operating Grants and Contributions

Federal grants	5,978,733
Medicaid reimbursements	863,404
Local and private grants	230,239
Reimbursement from South Carolina Department of Education	927,536
Total program revenues	<u>7,999,912</u>
Net (expenses)	<u>(24,290,971)</u>

General Revenues

State appropriations	27,225,789
Interest income	176,927
Total general revenues	<u>27,402,716</u>

Increase in net position	3,111,745
Net position, July 1, 2013	<u>2,231,343</u>
Net position, June 30, 2014	<u>\$ 5,343,088</u>

The notes to the financial statements are an integral part of these financial statements. See accompanying independent auditor's report.

**South Carolina First Steps to School Readiness
Balance Sheet -
Governmental Fund
June 30, 2014**

	General Fund
ASSETS	
Cash and cash equivalents	\$5,236,728
Due from Federal government and other grantors	340,131
Total Assets	\$5,576,859
LIABILITIES	
Accounts payable	\$ 222,314
Accrued salaries and benefits	339,767
Total liabilities	562,081
FUND BALANCE	
Restricted for the 4K pre-school program	4,004,031
Unassigned	1,010,747
Total fund balance	5,014,778
Total liabilities and fund balance	\$5,576,859

The notes to the financial statements are an integral part of these financial statements. See accompanying independent auditor's report.

**South Carolina First Steps to School Readiness
Reconciliation of the Balance Sheet of the Governmental Fund
to the Statement of Net Position
June 30, 2014**

Total fund balance, governmental fund \$ 5,014,778

Amounts reported for governmental activities in the
Statement of Net Position are different because:

Capital assets used in governmental activities are not
current financial resources and therefore are not reported
in the fund financial statements, but are reported in the
governmental activities of the Statement of Net Position.
This amount reflects gross capital assets of \$807,111 net
of accumulated depreciation of \$59,416. 747,695

Compensated absences are not due and payable in the
current period and are not included in the fund financial
statements, but are included in the governmental
activities of the Statement of Net Position (419,385)

Net position of governmental activities in the Statement of
Net Position \$5,343,088

*The notes to the financial statements are an integral part of these financial statements. See accompanying
independent auditor's report.*

**South Carolina First Steps to School Readiness
Statement of Revenues, Expenditures, and Change in Fund Balance -
Governmental Fund
For the year ended June 30, 2014**

	General Fund
Revenues	
State appropriations	\$27,225,789
Federal grants	5,978,733
Medicaid reimbursements	863,404
Local and private grants	230,239
Interest income	176,927
Reimbursement from South Carolina Department of Education	927,536
Total revenues	35,402,628
Expenditures	
Allocations to other entities	20,152,537
Contractual services	8,119,676
Salaries	2,932,187
Employer fringe benefits	965,644
Rent and leases	240,520
Materials	123,505
Travel	153,716
Total expenditures	32,687,785
Excess of revenues over expenditures	2,714,843
Net change in fund balance	2,714,843
Fund balance, July 1, 2013	2,299,935
Fund balance, June 30, 2014	\$ 5,014,778

The notes to the financial statements are an integral part of these financial statements. See accompanying independent auditor's report.

**South Carolina First Steps to School Readiness
Reconciliation of the Statement of Revenues, Expenditures,
and Change in Fund Balance of the Governmental Fund to the
Statement of Activities
June 30, 2014**

Total change in fund balance, governmental fund	\$2,714,843
Amounts reported for governmental activities in the Statement of Activities are different because:	
Governmental funds report capital outlays as expenditures while governmental activities report those expenditures as capital assets	
Capital asset additions	632,101
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	
Depreciation	(53,406)
Compensated absences	<u>(181,793)</u>
Increase in net position, governmental activities	<u><u>\$3,111,745</u></u>

The notes to the financial statements are an integral part of these financial statements. See accompanying independent auditor's report.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies

A. Reporting Entity

The South Carolina First Steps to School Readiness (“First Steps”) is a non-profit, tax-exempt public charity created specifically to carry out the objectives of The South Carolina First Steps to School Readiness Act and to lessen the burdens on government by overseeing the initiative for improving early childhood development of the Act. First Steps was created through enabling legislation recorded in June of 1999 in Section 59-152-10 of the South Carolina Code of Laws. First Steps is financially accountable to and dependent on the State and is subject to various State procurement, budget, personnel, and other regulations. First Steps is reported as a discretely presented component unit of the State of South Carolina and included in the State's Comprehensive Annual Financial Report.

Operationally, the SC First Steps Executive Director reports to a State Board of Trustees, consisting of 22 voting members and the heads of all South Carolina child-serving agencies. The board is chaired by the Governor of the State of South Carolina (the “Governor”). The corporation's governing board is composed of two classes of members, voting and nonvoting. The Board's voting members include the Governor, State Superintendent of Education, ten Governor appointees, four members appointed by the President Pro Tempore of the Senate, four members appointed by the Speaker of the House of Representatives, the Chairman of the Senate Education Committee, and the Chairman of the House Education and Public Works Committee. First Steps accomplishes its directives through the use of 46 county partnerships which cover all counties within the state of South Carolina. Each local partnership has its own governing board based on the enabling law, and employs staff as determined by the local board.

First Steps was enacted to help improve school readiness outcomes for the state's youngest learners and to create public-private partnerships to strengthen the system of early education and care statewide. First Steps implements specific and targeted programs through five broad categories in communities across the state: 1) Family Strengthening, 2) Childcare, 3) Early Education, 4) School Transition, and 5) Health. Each South Carolina county has a First Steps Partnership (with Internal Revenue Service not-for-profit 501(c)3 status), comprised of business and community leaders, early education professionals, parents, faith-based and agency partners. Local First Steps partnerships examine unmet needs in their communities to help local young children and their families. Through its Internal Revenue Service not-for-profit 501(c)3 status, First Steps mobilizes resources beyond state appropriated dollars, leveraging local private and public funds, federal grants, planned gifts, in-kind contributions, and volunteer hours.

In addition, First Steps serves as the state's lead agency for the federal Individuals with Disabilities Education Act Part C program, known in South Carolina as “BabyNet”. BabyNet is a system of supports to help the families of infants and toddlers who are experiencing developmental delays. First Steps also co-administers the state's 4-K pre-school program known as the Child Development Education Pilot Program which provides full-day pre-kindergarten to eligible children in both public and private settings. South Carolina First Steps serves as the state coordinator for Nurse-Family Partnership and Parents as Teachers. Finally, by Executive Order, First Steps serves as South Carolina's Early Childhood Advisory Council under the federal Head Start reauthorization of 2007.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements are presented using Generally Accepted Accounting Principles (“GAAP”) using the accrual basis of accounting and following pronouncements issued by the Governmental Accounting Standards Board (“GASB”).

All of the functions available to finance First Steps are presented together as general government activities. Financial information for funds that are not available to finance these activities are not included; consequently, the government-wide financial statements exclude fiduciary assets and liabilities, when applicable.

The fund financial statements are used to report First Step’s financial position and results of operations as well as to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. The governmental fund statements are presented on the modified accrual basis. These methods of accounting are described below.

Fund Financial Statements

Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned or for non-exchange transactions, when all eligibility requirements have been met, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measureable and available. “Measureable” means that the amount of the transaction can be determined and “available” means collectible within the current period or soon enough thereafter to pay obligations of the current period. For this purpose, First Steps considers major sources of revenues to be available if they are collected within sixty days of the end of the current fiscal year.

Governmental Fund Types

General Fund – The General Fund is the primary operating fund of First Steps. This fund is used to account for all financial transactions and resources except those required to be accounted for in another fund. The General Fund is First Steps’ only reported fund and therefore is its only major fund.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting (continued)

Cash and Cash Equivalents

The amounts shown in the accompanying financial statements as *cash and cash equivalents* represent petty cash, cash on deposit in banks, cash equivalents on deposit with external parties, and cash invested in various instruments as a part of the State's cash management pool, an internal investment pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of domestic corporations, certificates of deposit, and collateralized repurchase agreements.

Cash Management Pool – Allocation of Interest

The State of South Carolina cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account. All earnings on that account are recorded in the General Fund of the State of South Carolina. In contrast, each special deposit account retains its own earnings.

Investment Holdings and Basis

The South Carolina State Treasurer's Office (the "Office") is authorized by statute to invest all State funds. The Office's investment objectives are preservation of capital, maintenance of adequate liquidity, and obtaining the best yield possible within prescribed parameters. To meet those objectives, the Office uses various resources including an investment advisory service, electronic financial quotation and information services, various economic reports, and daily communication with brokers and financial institution investment officers.

To ensure safety of principal, the Office's policy is to limit liquid investments (i.e., those with maturities not exceeding one year) to cash, repurchase agreements (when collateralized by United States Treasury, federal agency or other federally guaranteed obligations with a market value in excess of 100.0% of funds advanced), United States Treasury bills, federal agency discount notes, and commercial paper.

The Office further preserves principal by investing in only the highest investment grade securities. In order to diversify investment holdings, asset allocation policies are utilized for investments having more than one year to maturity. Overall credit exposure is managed by asset allocation policies and by additional constraints controlling risk exposure to individual corporate issuers. Substantially all of the State's investments are presented at fair value; securities are valued at the last reported sales price as provided by an independent pricing service.

More information pertaining to the carrying amounts, fair value, credit and other risks of the cash management pool that First Steps participates in as required under GASB Statement No. 40, *Deposits and Investments – Risk Disclosures* are disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting (continued)

Due from Federal Government and Other Grantors

Amounts reported as due from Federal government and other grantors represent amounts that have been expended by First Steps and are reimbursable by the grantor agency, but not received by First Steps, as of June 30, 2014. During the year ended June 30, 2013, \$927,536 was estimated as an allowance for doubtful accounts related to the federal revenue due from another State agency of which collectability was uncertain. During the year ended June 30, 2014, the State agency remitted the \$927,536 and the amounts were recorded as Reimbursement from South Carolina Department of Education.

Capital Assets

First Steps reports its capital assets in the governmental activities in the government-wide financial statements. During the years ended June 30, 2013 and 2014, First Steps implemented a software system that was put into service in March 2014. The software is reported as capital assets and is currently being depreciated.

First Steps' capital assets are valued at historical cost or at estimated historical cost if actual historical cost data is not available. Donated capital assets are recorded at estimated fair market value on the donation date. The costs of normal maintenance and repairs that do not significantly add to the value of an asset or materially extend an asset's useful life are not capitalized.

An individual asset is capitalized and reported if it has an estimated useful life of at least two years and a historical cost of more than \$5,000 for buildings, machinery, vehicles, and equipment. All land and non-depreciable land improvements are capitalized and reported, regardless of cost. Once First Steps places a depreciable capital asset in service, depreciation is recorded using the straight-line method over the following useful lives:

<u>Asset Category</u>	<u>Years</u>
Equipment and computer software	5

Compensated Absences

Generally, all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the First Step's work week are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The entire unpaid liability for which First Steps expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded as a liability.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting (continued)

Fund Balance and Net Position

Fund Balance

The GASB has issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010. First Steps implemented the provisions of this statement during the year ended June 30, 2013, the first year in which it prepared financial statements. The following categories of fund balance are being used in the fund level financial statement of the governmental fund:

Nonspendable fund balance

The nonspendable fund balance classification includes amounts that cannot be spent because they are either not in spendable form or legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash, for example, inventories and prepaid amounts. It also includes the long-term amount of loans and notes receivable, as well as other assets. As of June 30, 2014, First Steps did not have any nonspendable fund balance.

Restricted fund balance

The restricted fund balance classification includes amounts that are either restricted externally by creditors, grantors, contributors, or laws or regulations of other governments or restricted by law through constitutional provisions or enabling legislation. As of June 30, 2014, First Steps’ restricted fund balance consisted of state appropriations restricted for the 4K pre-school program.

Committed fund balance

The committed fund balance classification includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of First Steps’ highest level of decision-making authority. Those committed amounts cannot be used for any other purpose unless First Steps removes or changes the specified use by taking the same type of action it employed to previously commit those amounts. Committed fund balances also incorporate contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements. As of June 30, 2014, First Steps did not have any committed fund balance.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting (continued)

Fund Balance and Net Position (continued)

Fund Balance (continued)

Assigned fund balance

The assigned fund balance classification includes amounts that are constrained by First Steps' intent to be used for specific purposes but are not restricted or committed. The authority for making an assignment is not required to be First Steps' highest level of decision-making authority and as such, the nature of the actions necessary to remove or modify an assignment does not require First Steps' highest level of authority. As of June 30, 2014, First Steps did not have any assigned fund balance.

Unassigned fund balance

The unassigned fund balance classification includes amounts that have not been assigned to other funds and has not been restricted, committed, or assigned for specific purposes within the General Fund.

Based on First Steps' policies regarding fund balance classifications as noted above, First Steps considers amounts that are restricted, committed, or assigned to be spent when the corresponding expenditure that has been designated by the State or donors has been made. After these fund balances have been depleted, unassigned fund balance will be considered to have been spent.

Net Position

The GASB has issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this statement is to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statements by providing guidance where none previously existed. The statement incorporated deferred inflows and outflows as required components of the residual measure of the government and renaming that measure as net position, rather than net assets.

The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. First Steps implemented the provisions of this statement during the year ended June 30, 2013, the first year in which it prepared financial statements. The following categories of net position are now being used in the Statement of Net Position:

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

1. Summary of Significant Accounting Policies (continued)

B. Basis of Presentation, Measurement Focus and Basis of Accounting (continued)

Fund Balance and Net Position (continued)

Net Position (continued)

Restricted net position

Restricted net position consist of assets with constraints placed on the use either by external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or law through constitutional provisions or enabling legislation. In all cases, if individual restricted net position categories are negative, the negative balance is eliminated and reclassified against unrestricted net position. As of June 30, 2014, First Steps' restricted net position consisted of state appropriations restricted for the 4K program.

Net Investment in Capital Assets

The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Unrestricted Net Position

The unrestricted component of net position is the net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

First Steps' policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

First Steps implemented GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65") in the year ended June 30, 2014. GASB No. 65 establishes accounting and financial reporting standards that require reclassification, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. GASB No. 65 supplements and extends the reach of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which was adopted by First Steps in the year ended June 30, 2013. There were no significant changes in classifications to the financial statements as a result of the implementation.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

2. Budget Policy

First Steps is granted an annual appropriation for operating purposes by the South Carolina General Assembly. The appropriation as enacted becomes the legal operating budget for First Steps. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The “Total Funds” column in the Appropriation Act for each individual budgetary unit authorizes expenditures from all budgeted resources. A revenue budget is not adopted for individual budgetary funds. Budgetary control is maintained at the line-item level of the budgetary entity. Agencies may process disbursement vouchers in the State’s budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its authority or by the agency as set forth in Appropriation Act Proviso 117.9 as follows: Agencies and institutions shall be authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and Comptroller General. No such transfer may exceed twenty percent of the program budget. Upon request, details of such transfers may be provided to members of the General Assembly on an agency by agency basis. Transfers of appropriations from personal service accounts to other operating accounts or from other operating accounts to personal service accounts may be restricted to any established standard levels set by the Budget and Control Board upon formal approval by a majority of the members of the Budget and Control Board.

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and interfund payments for the fiscal year to that fiscal year’s appropriations. Any unexpended State General Fund monies as of June 30 automatically lapse to the General Fund of the State on July 1 unless authorization is received from the General Assembly to carry over the funds to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

3. Deposits and Investments

By law, all deposits and investments are under the control of the South Carolina State Treasurer’s Office (the “Office”) except for those that, by specific authority, are under the control of other agencies or component units. The deposit and investment policies of those entities may differ from those of the Office. Typically, these agencies follow the deposit and investment policies of the Office in an effort to minimize deposit and investment risks.

The balances held by First Steps presented in these financial statements act as a demand deposit account with the Office and are therefore treated as cash and cash equivalents. The disclosures under GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, are not required for cash and cash equivalents. However, as the First Steps deposits are invested in the State of South Carolina investment pool, information can be obtained from the State of South Carolina Comprehensive Annual Financial Report which can be found at www.cg.sc.gov.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

4. Capital Assets

Capital asset activity for the fiscal year ended June 30, 2014, for the primary government was as follows:

	Beginning Balance July 1, 2013	<u>Additions</u>	<u>Disposals</u>	<u>Transfers</u>	Ending Balance June 30, 2014
Governmental activities					
Capital assets not being depreciated:					
Capital assets in progress	\$ 169,000	\$ 632,101	\$ —	\$ (801,101)	\$ —
Capital assets being depreciated:					
Equipment and computer software	6,010	—	—	801,101	807,111
Less accumulated depreciation for:					
Equipment and computer software	(6,010)	(53,406)	—	—	(59,416)
Capital assets for governmental activities, net	<u>\$ 169,000</u>	<u>\$ 578,695</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 747,695</u>

5. Long-term Liabilities

Long-term liabilities consist of compensated absences. Compensated absence activity for the fiscal year ended June 30, 2014, for the primary government was as follows:

	Beginning Balance July 1, 2013	<u>Increases</u>	<u>Decreases</u>	Ending Balance June 30, 2014	Current Portion
Compensated absences	\$ 237,592	\$ 371,320	\$(189,527)	\$ 419,385	\$ 222,274

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

6. Pension Plan

The majority of employees of First Steps are covered by a retirement plan through the South Carolina Retirement System (“SCRS”), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Benefits Division of the Public Employee Benefits Authority (“PEBA”). Generally all full-time or part-time equivalent State employees in a permanent position are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws, as amended, or are eligible and elect to participate in the State Optional Retirement Program (“ORP”). The SCRS plan provides a lifetime monthly retirement annuity benefits to eligible members as well as disability, survivor options, annual benefit adjustments, and incidental death benefits to eligible employees and retired members.

The Retirement Division (the “Division”) maintains five independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (“CAFR”) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the South Carolina Public Employee Benefit Authority, P.O. Box 11960, Columbia, South Carolina 29211-1960. Furthermore, the Division and the five pension plans are included in the State of South Carolina’s CAFR.

Under the SCRS, Class II members are eligible for a full service retirement annuity upon reaching age 65 or completion of 28 years credited service regardless of age. Employees who first became members of the System after June 30, 2012 are considered Class III members and are eligible for a full service retirement annuity upon reaching age 65 or upon meeting the rule of 90 requirement (i.e., the members age plus the years of service add up to a total of at least 90). The benefit formula for full service retirement annuity effective since July 1, 1989 for the SCRS is 1.82 percent of an employee’s average final compensation (“AFC”) multiplied by the number of years of credited service. For Class II members, AFC is the average annual earnable compensation during 12 consecutive quarters and includes an amount for up to 45 days termination pay at retirement for unused annual leave. For Class III members, AFC is the average annual earnable compensation during 20 consecutive quarters and termination pay for unused annual leave at retirement is not included. Early retirement options with reduced benefits are available as early as age 55 for Class II members and age 60 for Class III members. Class II members are vested for a deferred annuity after five years of earned service. Class III members are vested for a deferred annuity after eight years of earned service. Members qualify for survivor’s benefit upon completion of 15 years of credited service (five years effective January 1, 2002).

Disability annuity benefits are available to Class II members if they have permanent incapacity to perform regular duties of the member’s job and they have at least 5 years of earned service (this requirement does not apply if the disability is a result of a job related injury). Class III members can apply for disability annuity benefits provided they have a permanent incapacity to perform the regular duties of the member’s job and they have a minimum of eight years of credited service. For disability applications received after December 31, 2013, a member of SCRS will have to be approved for disability benefits from the Social Security Administration in order to be eligible for SCRS disability retirement benefits.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

6. Pension Plan (continued)

An incidental death benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service or to a working retired contributing member. There is no service requirement for death resulting from actual performance of duties for an active member. For eligible retired members, a lump-sum payment is made to the retiree's beneficiary of up to \$6,000 based on years of service at retirement. TERI participants and retired contributing members are eligible for the increased death benefit equal to their annual salary in lieu of the standard retired member benefit.

Effective January 1, 2001, Section 9-1-2210 of the South Carolina Code of Laws allows employees eligible for service retirement to participate in the Teacher and Employee Retention Incentive ("TERI") Program. TERI participants may retire and begin accumulating retirement benefits on a deferred basis without terminating employment for up to five years. Upon termination of employment or at the end of the TERI period, whichever is earlier, participants will begin receiving monthly service retirement benefits which will include any benefit adjustments granted during the TERI period. Because participants are considered retired during the TERI period, they do not earn service credit, and are ineligible for disability retirement benefits. The TERI program will end effective June 30, 2018 and a member's participation may not continue after this date.

Effective July 1, 2013, employees participating in the SCRS are required to contribute 7.50 percent of all earnable compensation. The employer contribution rate was 15.52 percent. Included in the total SCRS employer contribution rate is a base retirement contribution of 10.45 percent, 0.15 percent for the incidental death program and a 4.92 percent surcharge that will fund retiree health and dental insurance coverage. First Steps' actual contributions to the SCRS for the year ended June 30, 2014, 2013, and 2012 were \$297,873, \$301,881, and \$324,902, respectively, and equaled the base required retirement contribution rate, excluding retiree insurance surcharge and incidental death benefit program contributions, of 10.45 percent for 2014, 10.45 percent for 2013 and 9.385 percent for 2012. Also, First Steps paid employer incidental death program contributions of \$4,210, \$4,434, and \$3,780 at the rate of 0.15 percent of compensation for the current fiscal years ended June 30, 2014, 2013, and 2012, respectively.

As an alternative to membership in the SCRS, newly hired State and school district employees may elect to participate in the State Optional Retirement Program ("ORP"), a defined contribution retirement plan. The ORP was established in 1987 under Title 9, Chapter 20, of the South Carolina Code of Laws. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. The State assumes no liability for the State ORP plan other than for the employer's payment of contributions to designated companies. To elect participation in the ORP, eligible employees must elect membership within their first 30 days of employment. Under State law, contributions to the ORP are required at the same rates as for the SCRS, 10.60 percent plus retiree insurance surcharge of 4.92 percent from the employer in fiscal year 2014. Of the 10.60 percent employer retirement contribution rate, the employer remits 5.00 percent directly to the participant's ORP account and the remaining 5.45 percent retirement contribution and 0.15 percent incidental death benefit program contribution amounts are remitted to SCRS.

For fiscal year 2014, total contributions requirements to the ORP were \$6,614 (excluding the surcharge) from First Steps as employer and \$2,554 from its employees as plan members.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

6. Pension Plan (continued)

The amounts paid by First Steps for pension, incidental death program, and accidental death program contributions are reported as employer contribution expenditures within the applicable functional expenditure categories to which the related salaries are charged.

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit, and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS are actuarially determined.

While the surcharge to fund retiree health and dental insurance benefits is collected by the Retirement Benefits Division of PEBA, it is remitted to the Insurance Benefits Division of PEBA, which is responsible for administration of retiree health and dental insurance benefits and establishment of the applicable retiree insurance surcharge rate.

For the current fiscal year, the SCRS does not make separate measurements of assets and pension benefit obligations for individual employers within the cost-sharing plan. Under Title 9 of the South Carolina Code of Laws, First Steps' liability under the plan is limited to the amount of required employer contributions (stated as a percentage of covered payroll) as established by the PEBA and as appropriated in the South Carolina Appropriation Act and from other applicable revenue sources. Accordingly, First Steps recognizes no contingent liability for unfunded costs associated with participation in the plan.

7. Post-Employment Benefits Other than Pensions

Plan Description

In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental and long-term disability benefits to retired State and school district employees and their covered dependents. First Steps contributes to the South Carolina Retiree Health Insurance Trust Fund ("SCRHITF") and the South Carolina Long-Term Disability Insurance Trust Fund ("SCLTDITF"), cost-sharing multiple employer defined benefit post-employment healthcare and long-term disability plans administered by the Insurance Benefits Division ("IB") of the South Carolina Public Employee Benefit Authority.

Generally, retirees are eligible for the health and dental benefits if they have established at least ten years of retirement service credit. For new hires beginning employment May 2, 2008 and after, retirees are eligible for benefits if they have established 25 years of service for 100 percent employer funding and 15 through 24 years of service for 50 percent employer funding.

Benefits become effective when the former employee retires under a State retirement system. Basic long-term disability ("BLTD") benefits are provided to active state, public school district, and participating local government employees approved for disability.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

7. Post-Employment Benefits Other than Pensions (continued)

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these post-employment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the IB and participating retirees to the PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the IB, for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 4.92 percent of annual covered payroll for 2014 and 4.55 percent of annual covered payroll for 2013. The IB sets the employer contribution rate based on a pay-as-you-go basis. First Steps paid \$138,360 and \$142,449 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2014 and 2013, respectively. BLTD benefits are funded through a person's premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to IB was \$3.22 for fiscal years ended June 30, 2014 and 2013. First Steps recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of \$2,554 and \$2,202 for the years ended June 30, 2014 and 2013, respectively.

Effective May 1, 2008 the State established two trust funds through Act 195 for the purpose of funding and accounting for the employer costs of retiree health and dental insurance benefits and long-term disability insurance benefits. The SCRHITF is primarily funded through the payroll surcharge. Other sources of funding include additional State appropriated dollars, accumulated IB reserves, and income generated from investments. The SCLTDITF is primarily funded through investment income and employer contributions.

A copy of the complete financial statements for the benefit plans and the trust funds may be obtained by writing to the South Carolina Public Benefit Authority - Insurance Benefits Division, P.O. Box 11960, Columbia, SC 29211-1960.

8. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401(k), and 403(b), are administered by third parties and are not included in First Steps' financial statements. Compensation deferred under the plans is placed in trust for the contributing employee. First Steps has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan. First Steps made no contributions for the fiscal year ending June 30, 2014.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

9. Risk Management

First Steps is exposed to various risks of loss including theft of, damage to, or destruction of assets, general torts and maintains state insurance coverage for non-owned motor vehicles and general torts. First Steps did not incur any losses during the year.

First Steps has not transferred the risk of loss for employee theft or misappropriation of assets and the portion of the risks of loss related to insurance policy deductibles for non-owned motor vehicles and torts to a state or commercial insurer.

10. Transactions with State Entities / Related Parties

First Steps had significant transactions with the State and various State agencies. First Steps purchases goods and services from various State agencies. Total purchases from State agencies were approximately \$2.0 million for the year ended June 30, 2014.

First Steps provided no material services free of charge to other State agencies during the fiscal year. The Office participates in the statewide dual employment program. Workers' compensations insurance premiums for the fiscal year ended June 30, 2014 of \$28,070 were paid to the State Accident Fund.

The executive director of Richland County First Steps Partnership serves as a voting member of the First Steps Board of Trustees. Richland County First Steps Partnership receives a significant amount of its funding from First Steps. The amount of funding authorized to each county First Steps partnership is determined by a mathematical formula which uses a variety of demographics of children 0-5 that serve as a proxy for the level of need in each county. Richland County First Steps Partnership's general fund budget authorization for the year ended June 30, 2014 was \$791,345. As a First Steps Board of Trustees member, the Richland County First Steps Partnership executive director abstains from voting on county partnership funding authorizations.

11. Commitments and Contingencies

Leases

First Steps has entered into several non-cancellable leases, considered operating leases, for facilities used to house operations critical to First Steps' mission. Rent expense related to these leases was approximately \$170,000, while total lease and rental expense was \$240,520, for the year ended June 30, 2014. First Steps also entered into a five year equipment lease, which is considered an operating lease, in May 2014. Future base rental payments under non-cancellable leases are as follows:

Year ending June 30,:

2015	\$214,830
2016	158,004
2017	101,592
2018	68,261
2019	11,232
2020	10,482
Total	<u>\$564,401</u>

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

11. Commitments and Contingencies (Continued)

Capital asset maintenance fee

First Steps implemented a new software system in March 2014. An annual maintenance fee of approximately \$289,000 is expected to be incurred each year under a maintenance contract; however, the maintenance fee is renewable on an annual basis.

County Partnership Regional Finance Managers

First Steps has an accounting contract with two public accounting firms to provide bookkeeping services for each county's Partnership office. The contract extends through November 30, 2016 with the following total annual payments.

Year ending June 30,:

2015	\$392,917
2016	397,625
2017	166,458
Total	<u>\$957,000</u>

County Partnerships

First Steps has agreements with each County within the State related to early childhood services. First Steps' total appropriations to the county partnerships during the year ended June 30, 2014 were \$13,081,192, of which \$12,508,593 was disbursed to the county partnerships. This leaves total commitments of \$572,599 yet to be disbursed to county partnerships during future fiscal years.

Grants

First Steps receives financial assistance from various federal, state, and local governmental agencies in the form of grants. Disbursements of funds received under these programs generally require compliance with the terms and conditions specified in the grant agreements. The disbursements are also subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability. However, in the opinion of management, any such disallowed claims will not have a material effect on any of the financial statements included herein or on the overall financial position of First Steps at June 30, 2014.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

12. Other Information

Pending Implementation of GASB Statement on Pensions

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (“GASB #68”), which was issued by the GASB in June 2012, is required to be implemented by First Steps for the fiscal year ended June 30, 2015. The primary objective of GASB #68 is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local government employers about financial support for pensions that are provided by other entities. In addition, state and local governments who participate in a cost-sharing multiple employer plan will now be required to recognize a liability for its proportionate share of the net pension liability of that plan. It is GASB’s intention that GASB #68 will provide citizens and other users of the financial statements with a clearer picture of the size and nature of First Steps’ financial obligations to current and former employees for past services rendered.

In particular, GASB #68 will require First Steps to recognize a net pension liability (and related deferred outflows and inflows of resources) for its participation in the SCRS on financial statements prepared on the economic resources measurement focus and accrual basis of accounting (i.e., the Statement of Net Position) and present more extensive note disclosures. It is anticipated that its implementation will not have a significant impact on First Steps’ governmental fund.

First Steps has been in communications with the PEBA on the effect of implementing GASB #68. Based on recent information provided by the PEBA, it is anticipated that First Steps’ proportionate share of the net pension liability associated with the SCRS will decrease First Step’ beginning unrestricted net position for the year ended June 30, 2015 by approximately \$5,513,000.

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Budgetary Comparison Schedule – Budgetary General Funds
(Non-GAAP Budgetary Basis – Unaudited)
For the year ended June 30, 2014**

	Budgeted Amounts			Variance Positive (Negative)
	Original	Final	Actual	
Expenditures:				
First Steps to School Readiness				
Personal Services				
Classified Positions	\$ 661,939	\$ 661,969	\$ 456,898	\$ 205,071
Unclassified Positions	121,540	121,540	121,540	—
Other Personal Services	50,000	87,045	87,045	—
Other Operating Expenses	443,257	443,257	306,963	136,294
Employer Contributions	—	248,949	204,112	44,837
Total First Steps to School Readiness	<u>1,276,736</u>	<u>1,562,760</u>	<u>1,176,558</u>	<u>386,202</u>
 BabyNet				
Personal Services				
Classified Positions	881,514	881,514	881,514	—
Other Personal Services	100,000	100,000	100,000	—
Other Operating Expenses	467,112	467,112	467,112	—
Employer Contributions	—	342,811	342,811	—
Total Baby Net	<u>1,448,626</u>	<u>1,791,437</u>	<u>1,791,437</u>	<u>—</u>
 Childhood Development				
Educational Pilot Program				
Personal Service				
Classified Positions	368,000	338,000	280,903	57,097
Other Personal Services	—	30,000	28,094	1,906
Other Operating Expenses	11,209,864	11,181,893	7,237,173	3,944,720
Employer Contributions	—	93,000	92,692	308
Total Childhood Development Educational Program	<u>11,577,864</u>	<u>11,642,893</u>	<u>7,638,862</u>	<u>4,004,031</u>
 Early Childhood Services				
Other Operating	983,000	950,785	705,945	244,840
Employer Contributions	—	15,700	10,048	5,652
Local Services	11,262,214	11,262,214	11,262,214	—
Total Early Childhood Services	<u>12,245,214</u>	<u>12,228,699</u>	<u>11,978,207</u>	<u>250,492</u>
 Employee Benefits				
Employer Contributions	656,769	—	—	—
Total Employee Benefits	<u>656,769</u>	<u>—</u>	<u>—</u>	<u>—</u>
 Total Expenditures	<u>\$ 27,205,209</u>	<u>\$ 27,225,789</u>	<u>\$ 22,585,064</u>	<u>\$4,640,725</u>

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Budgetary Comparison Schedule – Other Budgeted Funds
(Non-GAAP Budgetary Basis – Unaudited)
For the year ended June 30, 2014**

	Budgeted Amounts			Variance Positive (Negative)
	Original	Final	Actual	
Expenditures:				
Policy and Accountability				
Other Operating Expenses	\$ 104,309	\$ 104,309	\$ 4,800	\$ 99,509
Total Policy and Accountability	104,309	104,309	4,800	99,509
BabyNet				
Personal Services				
Classified Positions	534,714	534,714	534,714	—
Other Personal Services	364,527	364,527	364,527	—
Other Operating Expenses	6,987,822	6,987,822	6,849,025	138,797
Employer Contributions	307,363	307,363	307,363	—
Total Early Childhood Initiative	8,194,426	8,194,426	8,055,629	138,797
Early Childhood Services				
Personal Services				
Classified Positions	13,105	13,105	13,105	—
Other Personal Services	40,948	40,948	40,948	—
Other Operating Expenses	92,655	92,655	92,654	1
Employer Contributions	15,624	15,624	15,571	53
County Partnerships	1,966,823	1,966,823	1,966,823	—
Total Early Childhood Services	2,129,155	2,129,155	2,129,101	54
Total Expenditures	\$ 10,427,890	\$ 10,427,890	\$ 10,189,530	\$ 238,360

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2014**

1. Budgetary Funds

South Carolina's Annual Appropriation Act, the State's legally adopted budget, does not present budgets by GAAP fund. Instead, it presents program-level budgets for the following two funds:

General Funds – These funds are general operating funds. The resources in the funds are primarily taxes. The State expends General Funds to provide traditional State government services.

Total Funds – The Total Funds column in the Appropriations Act includes all budgeted resources. Amounts in this column include General Funds as well as most, but not all, federal and department-generated resources. Total funds include portions of certain proprietary and capital project fund activities as well as most special revenue activities but exclude the pension trust funds and some other fiduciary fund activities.

Amounts presented as *Other Budgeted Funds* are obtained by subtracting the General Funds column in the Appropriations Act from the Total Funds columns. Revenue is not presented in the budgetary schedule because it is budgeted at the Statewide level.

As operating conditions change, First Steps may transfer appropriations between programs and classifications within programs. However, limits are placed on increasing/decreasing authorizations for personal services without Budget and Control Board approval. Also, a revision of budgeted amounts over and above the total revenues appropriated requires approval of the Budget and Control Board.

Both the funds appropriated by the State and other budgeted funds are included within the General Fund for financial statement presentation under GAAP.

2. Original and Final Budgeted Amounts; Basis of Presentation

The original appropriations presented in the accompanying schedule for the General Funds include amounts in the Appropriations Act as well as any appropriation reductions specifically authorized by law to prevent duplicate appropriations. The terminology, classification, and format of the appropriations section of the accompanying schedules are substantively the same as for the legally adopted budget. The State allows First Steps to transfer its appropriated funds to restricted accounts to allow for the opportunity for interest to be earned on these appropriated amounts. However, expenditures have been presented in accordance with the classifications provided for in the legally adopted budget.

The State's General Assembly does not approve estimated revenue or fund balance amounts for Other Budgeted Funds which include the First Steps' General Fund. However, Section 88 (*Recapitulations*) of the Appropriation Act includes net source of funds amounts (i.e. estimated cash brought forward from the previous fiscal year plus estimated revenue for the current fiscal year minus estimated cash to be carried forward to the following fiscal year) for three categories of Other Budgeted Funds: Federal, Earmarked, and Restricted. A budget versus actual comparison for the First Steps' General Funds and Other Budgeted Funds are presented as supplementary information.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2014**

3. Legal Level of Budgetary Control

First Steps maintains budgetary control at the level of summary objective category of expenditure within each program of each department or agency which is the level of detail presented in the accompanying schedules.

4. Basis of Budgeting

Current legislation states that the General Assembly intends to appropriate all monies to operate State government for the current fiscal year. Unexpended appropriations lapse on July 31 unless the department or agency is given specific authorization to carry them forward to the next fiscal year. Cash-basis accounting for payroll expenditures is used, while the accrual basis is used for other expenditures.

State law does not precisely define the State's budgetary basis of budgeting. In practice, however, it is the cash basis with the following exceptions:

- Departments and agencies shall charge certain vendor and interfund payments against the preceding fiscal year's appropriations through July 14.
- All revenues are recorded only when the State receives the related cash with the exception of certain tax amounts, such as motor fuel taxes and gas taxes, which are not received by First Steps' General Funds.

5. Budget to GAAP Reporting Differences

Budgetary accounting principles differ significantly from GAAP accounting principles. Basis differences arise because the basis of budgeting differs from the GAAP basis used to prepare the statement of revenues, expenditures, and changes in fund balance. In the current year, there are funds that are received by First Steps that are not legally budgeted and therefore, the amounts reported as actual expenditures on the budgetary basis do not agree to the actual expenditures reported in the governmental fund Statement of Revenue, Expenditure, and Changes in Fund Balance and the Statement of Activities. The differences between the budgetary comparison schedules for the General Funds and Other Budgeted Funds as compared to the Statement of Revenues, Expenditures, and Changes in Fund Balance are related strictly to the modified accrual basis of accounting which include accounts receivable and accounts payable as revenues and expenditures in the current year while the budgetary basis would include those amounts in the year that payments were actually received or paid.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

INDEPENDENT AUDITOR'S REPORT

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
Office of the State Auditor
Columbia, South Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities and the major fund of South Carolina First Steps to School Readiness ("First Steps"), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise First Steps' basic financial statements, and have issued our report thereon dated September 23, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered First Steps' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of First Steps' internal control. Accordingly, we do not express an opinion on the effectiveness of First Steps' internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether First Steps' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Greene, Finney & Horton, LLP
Mauldin, South Carolina
September 23, 2014