

South Carolina First Steps to School Readiness

Financial Statements

For the Year Ended June 30, 2018



September 21, 2018

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, 2018, was issued by Greene Finney, 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,

George L. Kennedy, III, CPA
State Auditor

GLKIII/cmw

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Greene Finney, LLP

CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

INDEPENDENT AUDITOR'S REPORT

Mr. George L. Kennedy, CPA
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 nonmajor discretely presented component unit of the State of South Carolina, as of and for the year ended June 30, 2018, 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 respective financial position of the governmental activities and the major fund of South Carolina First Steps to School Readiness as of June 30, 2018, 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.

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Change in Accounting Principle

As discussed in Note I.B to the financial statements, for the year ended June 30, 2018 First Steps adopted the provisions of Governmental Accounting Standards Board Statement No. 75 “*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*”. 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, budgetary comparison schedules, schedule of proportionate share of the net pension liability – South Carolina Retirement System, schedule of contributions – South Carolina Retirement System, schedule of proportionate share of the net OPEB liability – South Carolina Health Insurance Trust Fund, and schedule of contributions – South Carolina Health Insurance Trust Fund, 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 21, 2018 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, LLP

Greene Finney, LLP
Mauldin, South Carolina
September 21, 2018

**South Carolina First Steps to School Readiness
Management’s Discussion and Analysis
For the Year Ended June 30, 2018**

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 year ended June 30, 2018.

FINANCIAL HIGHLIGHTS

The South Carolina First Steps to School Readiness (“First Steps”) prepared its financial statements in accordance with Generally Accepted Accounting Principles (“GAAP”) and follows pronouncements from the Governmental Accounting Standards Board (“GASB”).

As of and for the year ended June 30, 2018:

- First Steps’ total net position increased by \$941,023 and its liabilities and deferred inflows of resources exceeded its assets and deferred outflows of resources (net position) by \$1,855,984, which includes \$10,926,758 in net position restricted for the 4K pre-school program and early childhood services.
- First Steps received \$35,904,451 in appropriations from the State of South Carolina, the significant majority of which was disbursed for funding the county partnerships and the 4K programs throughout the state.
- First Steps received federal, local, and private grants as well as Medicaid reimbursements totaling \$7,642,833.

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
For the Year Ended June 30, 2018**

Fund Statements:

The fund financial statements include the governmental fund's Balance Sheet and Statement of Revenue, Expenditures, and Change 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.

Statements of Net Position –The Statements of Net Position provides a summary of First Steps' financial condition at the end of the 2018 and 2017 fiscal years; the statement reports all assets, deferred outflows of resources, liabilities, and deferred inflows of resources using the accrual basis of accounting.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
STATEMENTS OF NET POSITION

	2018	2017*
Current assets	\$ 14,480,921	\$ 11,874,997
Capital assets, net	350,375	663,972
Total assets	14,831,296	12,538,969
Deferred outflows of resources	4,014,817	2,595,398
Current liabilities	899,046	1,311,467
Net pension liability	11,321,231	8,224,476
Net OPEB liability	7,636,576	8,157,559
Other noncurrent liabilities	117,076	228,940
Total liabilities	19,973,929	17,922,442
Deferred inflows of resources	728,168	8,932
Net investment in capital assets	350,375	663,972
Restricted	10,926,758	9,079,585
Unrestricted	(13,133,117)	(12,540,564)
Total net position, as restated	\$ (1,855,984)	\$ (2,797,007)

*June 30, 2017 amounts have been restated due to the implementation of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, which required the retroactive recognition of the net OPEB liability and related deferred outflows of resources.

Current assets have increased from \$11,874,997 at June 30, 2017 to \$14,480,921 at June 30, 2018 which is an increase of \$2,605,924. This is primarily due to an increase in cash which resulted from First Steps not expending all State appropriations it received during the year. During fiscal year 2018, the funding received was greater than cost of the services that the market could accept, based on the requirements and restrictions in the 4K Program. First Steps' net pension liability and related deferred outflows of resources increased substantially, which is based on First Steps' proportionate share of pension related amounts associated with the State's retirement plan. First Steps' also recognized its proportionate share of the OPEB related amounts associated with the State's retiree health plan.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2018**

First Steps reported negative unrestricted net position of \$(13,133,117) which is due primarily to its proportionate share of the net pension and OPEB liabilities of \$18,957,807. First Steps does not anticipate funding these liabilities and will continue to contribute to the respective plans at State required contribution rates.

Statements of Activities – The Statements of Activities reports the revenues and expenses during the 2018 and 2017 fiscal years.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
STATEMENTS OF ACTIVITIES

	2018	2017
Program Revenues		
Federal and state grants	\$ 7,396,996	\$ 13,904,691
Medicaid reimbursements	178,280	273,540
Local and private grants	67,557	395,227
Total program revenues	7,642,833	14,573,458
General Revenues		
State appropriations	35,904,451	41,804,568
Interest income	194,818	1,257,762
Total general revenues	36,099,269	43,062,330
Total revenues	43,742,102	57,635,788
Expenses		
Allocations to other entities	27,765,507	32,043,605
Contractual services	4,898,214	8,976,041
Salaries	2,949,305	5,015,808
Employer fringe benefits	3,068,059	2,279,358
Rent and leases	424,710	606,537
Materials	2,767,428	2,919,085
Travel	572,821	623,557
Loss on disposal of capital assets	267,035	—
Depreciation	88,000	166,948
Total expenses	42,801,079	52,630,939
Increase in net position	941,023	5,004,849
Net position beginning balance, as restated*	(2,797,007)	123,388
Net position ending balance	\$ (1,855,984)	\$ 5,128,237

*First Steps implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, during the year ended June 30, 2018. Net position as of July 1, 2017 has been restated in accordance with these provisions. See Note 1.B. for further details regards the restatement. The restatement was recorded as of July 1, 2017, and as such, the ending net position for June 30, 2017 does not agree to net position as of July 1, 2017.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2018**

Operating revenues of First Steps are largely dependent upon appropriations from the State of South Carolina as well as grants from the Federal government. The significant increase in net position is primarily attributed to State budget funds in the 4K Program and associated provisos with amounts that were greater than could be expended due to restrictions and requirements for the program. First Steps' total expenses decreased from \$52,630,939 for the year ended June 30, 2017 to \$42,801,079 for the year ended June 30, 2018 which was a decrease of \$9,829,860. First Steps transferred its BabyNet program to the Department of Health and Human Services ("DHHS") during the year ended June 30, 2018 and reduced its allocations to other entities which caused various classifications of expenses to increase during the year ended June 30, 2018 as compared to the year ended June 30, 2017. These decreases were offset by increases in both pension expense and OPEB expense. The collectively pension and OPEB expense was \$2.5 million, which has caused fringe benefits expense to exceed salaries expense.

Total program revenues decreased by \$6,930,625 primarily due to First Steps receiving additional Federal grant revenue during the year ended June 30, 2017 for its BabyNet program as compared to the year ended June 30, 2018. Total general revenues decreased by \$6,963,061. This decrease was also due primarily to the transfer of the BabyNet program to DHHS. Expenses decreased by \$9,829,860 primarily due to these same causes. First Steps realized an increase in net position from the prior year in the amount of \$941,023.

Fund Highlights:

Governmental Fund:

The focus of First Steps' governmental fund is to provide information regarding actual inflows and outflows of spendable resources. The General Fund is the only 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, State appropriations that exceeded First Steps' program expenses resulted in revenues exceeding expenditures by \$2,892,195 for the year ended June 30, 2018. This resulted in an increase in fund balance from the beginning fund balance amount of \$10,821,701 to \$13,713,896, which includes \$10,962,758 in fund balance restricted for the 4K pre-school program and early childhood services and \$2,787,138 in unassigned fund balance.

Capital Assets:

First Steps purchased 2 vehicles for \$41,438 during the fiscal year ended June 30, 2018. These vehicles were purchased to help First Steps implement the Early Head Start Child Care Partnership Grant. First Steps also disposed of equipment and computer software with a net book value of \$267,035 as part of its transfer of the BabyNet program to DHHS during the fiscal year ended June 30, 2018. See note 4 to the financial statements for additional information regarding First Steps' capital assets.

Noncurrent Liabilities:

First Steps' noncurrent liabilities consist of compensated absences and its proportionate share of the State of South Carolina's net pension and net OPEB liabilities related to the South Carolina Retirement System ("SCRS"). 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 or transferred to another agency during the fiscal year were \$460,003 while another \$221,989 were accrued. See note 5 to the financial statements for additional information regarding First Steps' noncurrent liabilities.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2018**

First Steps' net pension liability has been recorded in accordance with GASB Statement No. 68 and represents First Steps' share of the State's net pension liability related to the SCRS. The net pension liability as of June 30, 2017 was \$8,224,476 and at June 30, 2018, it had increased to \$11,321,231. The increase is due to an overall increase in the net pension liability in the pension plan of the SCRS. GASB Statement No. 68 does not affect First Steps' required contributions to the net pension liability. See note 6 to the financial statements for additional information regarding First Steps' pension plan.

First Steps' was required to record its proportionate share of the net OPEB liability in accordance with GASB Statement No. 75 and represents First Steps' share of the State's net OPEB liability related to the State's Retiree Health Insurance Trust Fund. The net OPEB liability as of June 30, 2018 was \$7,636,576. The implementation of GASB Statement No. 75 also required the restatement of beginning net position for First Steps' proportionate share of the net OPEB liability as of June 30, 2017. This resulted in a reduction in beginning net position of \$7,925,244. See note 7 to the financial statements for additional information regarding First Steps' OPEB plan.

Budget Highlights:

First Steps budgets State appropriations and other funds (earmark, restricted and federal) as they are received during the year. First Steps' original and final budget for the General Fund was \$6,521,510 and \$6,582,010, respectively, for the year ended June 30, 2018. Actual expenditures, on the budgetary basis, totaled \$6,484,700. These amounts were spent primarily on the CDEPP programs. The total other funds budget was originally \$35,519,369 and was revised to \$42,274,554 with actual expenditures of \$33,496,392. 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. The South Carolina General Assembly and the Governor reauthorized First Steps with its Legislative Bill H3591 effective July 1, 2018. Bill H3591 extended SC First Steps authorization from July 1, 2018 (FY 19) thru June 30, 2025 (FY 25).

First Steps has discontinued its Early Head Start program and is in the process of closing out related grants during fiscal year 2019. The discontinuation of this program will reduce related revenues and expenditures. Revenues and expenditures for fiscal year 2018 were approximately \$5.7 million.

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, 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, 2018**

ASSETS

Current assets:

Cash and cash equivalents	\$ 13,147,010
Due from Federal government and other grantors	1,333,911
Total current assets	14,480,921

Noncurrent assets:

Capital assets, net	350,375
Total noncurrent assets	350,375
Total assets	14,831,296

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows of resources related to pensions	3,840,630
Deferred outflows of resources related to OPEB	174,187
Total deferred outflows of resources	4,014,817

LIABILITIES

Current liabilities:

Accounts payable	415,421
Accrued salaries and benefits	351,604
Compensated absences	132,021
Total current liabilities	899,046

Noncurrent liabilities:

Compensated absences	117,076
Net OPEB liability	7,636,576
Net pension liability	11,321,231
Total noncurrent liabilities	19,074,883
Total liabilities	19,973,929

DEFERRED INFLOWS OF RESOURCES

Deferred inflows of resources related to OPEB	721,893
Deferred inflows of resources related to pensions	6,275
Total deferred inflows of resources	728,168

NET POSITION

Net investment in capital assets	350,375
Restricted for the 4K pre-school program and early childhood services	10,926,758
Unrestricted	(13,133,117)
Total Net Position	\$ (1,855,984)

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, 2018**

Expenses

Governmental Activities – General Government

Allocations to other entities	\$ 27,765,507
Contractual services	4,898,214
Salaries	2,949,305
Employer fringe benefits	3,068,059
Rent and leases	424,710
Materials	2,767,428
Travel	572,821
Loss on disposal of capital assets	267,035
Depreciation	88,000
Total expenses	<u>42,801,079</u>

Program Revenues – Operating Grants and Contributions

Federal and state grants	7,396,996
Medicaid reimbursements	178,280
Local and private grants	67,557
Total program revenues	<u>7,642,833</u>
Net expenses	<u>(35,158,246)</u>

General Revenues

State appropriations	35,904,451
Interest income	194,818
Total general revenues	<u>36,099,269</u>

Increase in net position	941,023
Net position, July 1, 2017, as restated	<u>(2,797,007)</u>
Net position, June 30, 2018	<u><u>\$ (1,855,984)</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
Balance Sheet -
Governmental Fund
June 30, 2018**

	General Fund
ASSETS	
Cash and cash equivalents	\$ 13,147,010
Due from Federal government and other grantors	1,333,911
Total Assets	\$ 14,480,921
 LIABILITIES	
Accounts payable	\$ 415,421
Accrued salaries and benefits	351,604
Total liabilities	767,025
 FUND BALANCE	
Restricted for the 4K pre-school program and early childhood services	10,926,758
Unassigned	2,787,138
Total fund balance	13,713,896
Total liabilities and fund balance	\$ 14,480,921

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, 2018**

Total fund balance, governmental fund	\$ 13,713,896
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 governmental activities in the Statement of Net Position. This amount reflects gross capital assets of \$445,103 net of accumulated depreciation of \$94,728.	
	350,375
The net pension and net OPEB liabilities and related deferred inflows and outflows of resources are not due and payable in the current year and are not included in the fund financial statements, but are included in governmental activities in the Statement of Net Position.	
Net pension liability	(11,321,231)
Net OPEB liability	(7,636,576)
Deferred outflows of resources related to pensions	3,840,630
Deferred inflows of resources related to pensions	(6,275)
Deferred outflows of resources related to OPEB	174,187
Deferred inflows of resources related to OPEB	(721,893)
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 in the Statement of Net Position	
	(249,097)
Net position of governmental activities in the Statement of Net Position	<u>\$ (1,855,984)</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
Statement of Revenues, Expenditures, and Change in Fund Balance -
Governmental Fund
For the Year Ended June 30, 2018**

	<u>General Fund</u>
Revenues	
State appropriations	\$ 35,904,451
Federal grants	7,352,282
Medicaid reimbursements	178,280
Local and private grants	67,557
Interest income	194,818
Total revenues	<u>43,697,388</u>
Expenditures	
Allocations to other entities	27,765,507
Contractual services	4,898,214
Salaries	3,187,319
Employer fringe benefits	1,147,756
Materials	2,767,428
Travel	572,821
Capital outlay	41,438
Rent and leases	424,710
Total expenditures	<u>40,805,193</u>
Increase in fund balance	2,892,195
Fund balance, July 1, 2017	10,821,701
Fund balance, June 30, 2018	<u>\$ 13,713,896</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
Reconciliation of the Statement of Revenues, Expenditures,
and Change in Fund Balance of the Governmental Fund to the
Statement of Activities
For the Year Ended June 30, 2018**

Net change in fund balance, governmental fund	\$ 2,892,195
Amounts reported for governmental activities in the Statement of Activities are different because:	
Current year retirement plan contributions are considered a deferred outflow of resources rather than a current year expense in the Statement of Activities	412,089
Current year OPEB contributions are considered a deferred outflow of resources rather than a current year expense in the Statement of Activities	161,065
Nonemployer contributions to the OPEB plan are recognized in the Statement of Activities as revenues	44,714
Expenditures for capital assets are considered an asset in the Statement of Net Position	41,438
The loss on disposal of capital assets is only recognized in the Statement of Activities as it does not use current financial resources	(267,035)
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 the governmental fund:	
Depreciation	(88,000)
Increase in pension expense due to changes in First Steps' portion of collective pension expense	(2,028,640)
Increase in OPEB expense due to changes in First Steps' portion of collective OPEB expense	(464,817)
Compensated absences	<u>238,014</u>
Increase in net position, governmental activities	<u>\$ 941,023</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, 2018

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 25 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 Board’s voting members include the Governor or the Governor’s designee, State Superintendent of Education or the State Superintendent of Education’s designee, seven 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, the Chairman of the House Education and Public Works Committee, and the Chief Executive Officers of the Department of Social Services, Department of Health and Environmental Control, Department of Health and Human Services, Department of Disabilities and Special Needs, State Head Start Collaboration Officer, and Children’s Trust of South Carolina. 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 served 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. Due to Executive Order No. 60, issued by the Governor of South Carolina in September 2016, the South Carolina Department of Health and Human Services was designated as the lead agency for BabyNet. The Department of Health and Human Services formally assumed the IDEA Part C lead agency responsibility beginning July 1, 2017. Funding related to the BabyNet program was appropriated to the South Carolina Department of Health and Human Service beginning in fiscal year 2018. First Steps transferred software and computer equipment to the Department of Health and Human Services when this transition occurred.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

1. Summary of Significant Accounting Policies (continued)

A. Reporting Entity (continued)

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.

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

Government-wide Financial Statements

The government-wide financial statements are presented in accordance with 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.

Fund Financial Statements

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.

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, a major fund, is the only operating fund of First Steps and is used to account for all financial transactions and resources.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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. The internal investment pool is not registered with the Securities and Exchange Commission and does not have other regulatory oversight. 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* and GASB Statement No. 72, *Fair Value Measurement and Application*, 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, 2018

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, 2018.

Capital Assets

First Steps reports its capital assets in the governmental activities in the government-wide financial statements.

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 acquisition 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
Vehicles	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 month 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, 2018

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

First Steps reports fund balance in accordance with GASB 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 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, 2018, 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, 2018, First Steps’ restricted fund balance consisted of state appropriations restricted for the 4K pre-school program and early childhood services.

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, 2018, 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, 2018

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, 2018, 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

First Steps reports net position in accordance with GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

The following categories of net position are used in the Statement of Net Position:

Restricted net position

Restricted net position consists 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, 2018, First Steps' restricted net position consisted of state appropriations restricted for the 4K program and early childhood services.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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)

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 any 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.

Deficit Net Position

First Steps reported negative unrestricted net position of \$13,133,117 which is due primarily to its proportionate share of the net pension liability and OPEB liability of \$11,321,231 and \$7,636,576, respectively (see notes 6 and 7 for more details). First Steps will not be required to fully fund these liabilities in any given year, however, they will continue to contribute to the pension plan at State required contribution rates.

Implementation of New Accounting Standard and Restatement of Net Position

First Steps implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions* ("GASB No. 75"), during the year ended June 30, 2018.

The primary objective of GASB No. 75 is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions ("OPEB"). It also improves information provided by state and local government employers about financial support for OPEB that are provided by other entities. In addition, state and local governments who participate in a cost-sharing multiple employer plan are now required to recognize a liability for their proportionate share of the net OPEB liability of the plan.

In particular, GASB No. 75 requires First Steps to recognize a net OPEB liability (and related deferred outflows and inflows of resources) for its participation in the State's Retiree Health Plan 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 which can be found in Note 7.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

1. Summary of Significant Accounting Policies (continued)

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

Implementation of New Accounting Standard and Restatement of Net Position (continued)

The implementation of GASB No. 75 resulted in the restatement of net position reported as of June 30, 2017 as presented below:

Net position at June 30, 2017 as originally reported	\$ 5,128,237
First Steps' share of net OPEB liability	(8,157,559)
Deferred outflows of resources for contributions made after the measurement date	<u>232,315</u>
Net position at June 30, 2017 as restated	<u>\$ (2,797,007)</u>

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 Fiscal Accountability Authority, previously known as 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 Executive Budget Office. 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 State Fiscal Accountability Authority upon formal approval by a majority of the members of the State Fiscal Accountability Authority.

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.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

3. Deposits and Investments (continued)

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* and GASB Statement No. 72, *Fair Value Measurement and Application*, are not required for cash and cash equivalents. However, as the First Steps deposits are generally 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.

4. Capital Assets

Capital asset activity for the fiscal year ended June 30, 2018, for the primary government was as follows:

	Beginning Balance <u>July 1, 2017</u>	<u>Additions</u>	<u>Disposals</u>	Ending Balance <u>June 30, 2018</u>
Governmental activities				
Capital assets being depreciated:				
Equipment and computer software	\$ 807,111	\$ —	\$ (801,161)	\$ 6,010
Vehicles	<u>403,665</u>	<u>41,438</u>	<u>—</u>	<u>445,103</u>
	<u>1,210,776</u>	<u>41,438</u>	<u>(801,161)</u>	<u>451,113</u>
Less accumulated depreciation for:				
Equipment and computer software	(540,076)	—	534,066	(6,010)
Vehicles	<u>(6,728)</u>	<u>(88,000)</u>	<u>—</u>	<u>(94,728)</u>
	<u>(546,804)</u>	<u>(88,000)</u>	<u>534,066</u>	<u>(100,738)</u>
Capital assets for governmental activities, net	<u>\$ 663,972</u>	<u>\$ (46,562)</u>	<u>\$ (267,035)</u>	<u>\$ 350,375</u>

Depreciation expense for the year ended June 30, 2018 was \$88,000. The equipment and computer software were transferred to DHHS on July 1, 2017 as part of the transfer of the BabyNet program as discussed in Note 1 and a loss on disposal of the assets of \$267,035 was recorded as a result of the transfer.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

5. Long-term Liabilities

Long-term liabilities consist of compensated absences. Compensated absence activity for the fiscal year ended June 30, 2018, for the primary government was as follows:

	Beginning Balance <u>July 1, 2017</u>	<u>Increases</u>	<u>Decreases</u>	Ending Balance <u>June 30, 2018</u>	Current Portion
Compensated absences	\$ 487,111	\$ 221,989	\$ (460,003)	\$ 249,097	\$ 132,021
Total	<u>\$ 487,111</u>	<u>\$ 221,989</u>	<u>\$ (460,003)</u>	<u>\$ 249,097</u>	<u>\$ 132,021</u>

6. Pension Plan

The South Carolina Public Employee Benefit Authority (PEBA), which was created July 1, 2012, administers the various retirement systems and retirement programs managed by its Retirement Division. PEBA has an 11-member Board of Directors, appointed by the Governor and General Assembly leadership, which serves as co-trustee and co-fiduciary of the systems and the trust funds. By law, the State Fiscal Accountability Authority (SFAA), which consists of five elected officials, also reviews certain PEBA Board decisions regarding the funding of the South Carolina Retirement Systems (Systems) and serves as a co-trustee of the Systems in conducting that review. Effective July 1, 2017, the Retirement System Funding and Administration Act of 2017 assigned the PEBA Board of Directors as the Custodian of the Retirement Trust Funds and assigned SC PEBA and the Retirement Systems Investment Commission (RSIC) as co-trustees of the Retirement Trust Funds.

For purposes of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Systems and additions to/deductions from the Systems fiduciary net position have been determined on the accrual basis of accounting as they are reported by the Systems in accordance with generally accepted accounting principles (GAAP). For this purpose, revenues are recognized when earned and expenses are recognized when incurred. Benefit and refund expenses are recognized when due and payable in accordance with the terms of the plan. Investments are reported at fair value.

PEBA issues a Comprehensive Annual Financial Report (CAFR) containing financial statements and required supplementary information for the Systems' Pension Trust Funds. The CAFR is publicly available through the Retirement Benefits' link on PEBA's website at www.peba.sc.gov, or a copy may be obtained by submitting a request to PEBA, 202 Arbor Lake Drive, Columbia, SC 29223. PEBA is considered a division of the primary government of the state of South Carolina and therefore, retirement trust fund financial information is also included in the comprehensive annual financial report of the state.

Plan Descriptions

- The South Carolina Retirement System ("SCRS"), a cost-sharing multiple-employer defined benefit pension plan, was established effective July 1, 1945, pursuant to the provisions of Section 9-1-20 of the South Carolina Code of Laws for the purpose of providing retirement allowances and other benefits for employees of the state, its public school districts, and political subdivisions.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Plan Descriptions (continued)

- The State Optional Retirement Program (“State ORP”) is a defined contribution plan that is offered as an alternative to certain newly hired state, public school, and higher education employees. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers.

Membership

Membership requirements are prescribed in Title 9 of the South Carolina Code of Laws. A brief summary of the requirements under each system is presented below.

- SCRS - Generally, all employees of covered employers are required to participate in and contribute to the system as a condition of employment. This plan covers general employees and teachers and individuals newly elected to the South Carolina General Assembly beginning with the November 2012 general election. An employee member of the system with an effective date of membership prior to July 1, 2012, is a Class Two member. An employee member of the system with an effective date of membership on or after July 1, 2012, is a Class Three member.

- State ORP - As an alternative to membership in SCRS, newly hired state, public school, and higher education employees and individuals newly elected to the S.C. General Assembly beginning with the November 2012 general election have the option to participate in the State Optional Retirement Program (State ORP), which is a defined contribution plan. State ORP participants direct the investment of their funds into a plan administered by one of four investment providers. PEBA assumes no liability for State ORP benefits. Rather, the benefits are the liability of the investment providers. For this reason, State ORP programs are not part of the retirement systems’ trust funds for financial statement purposes. Employee and Employer contributions to the State ORP are at the same rates as SCRS. A direct remittance is required from the employers to the member’s account with investment providers for the employee contribution and a portion of the employer contribution (5 percent). A direct remittance is also required to SCRS for the remaining portion of the employer contribution and an incidental death benefit contribution, if applicable, which is retained by SCRS.

Benefits

Benefit terms are prescribed in Title 9 of the South Carolina Code of Laws. PEBA does not have the authority to establish or amend benefit terms without a legislative change in the code of laws. Key elements of the benefit calculation include the benefit multiplier, years of service, and average final compensation. A brief summary of the benefit terms for each system is presented below.

- SCRS - A Class Two member who has separated from service with at least five or more years of earned service is eligible for a monthly pension at age 65 or with 28 years credited service regardless of age. A member may elect early retirement with reduced pension benefits payable at age 55 with 25 years of service credit. A Class Three member who has separated from service with at least eight or more years of earned service is eligible for a monthly pension upon satisfying the Rule of 90 requirement that the total of the member’s age and the member’s creditable service equals at least 90 years. Both Class Two and Class Three members are eligible to receive a reduced deferred annuity at age 60 if they satisfy the five- or eight-year earned service requirement, respectively. An incidental death benefit is also available to beneficiaries of active and retired members of employers who participate in the death benefit program.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Plan Descriptions (continued)

Benefits (continued)

The annual retirement allowance of eligible retirees or their surviving annuitants is increased by the lesser of one percent or five hundred dollars every July 1. Only those annuitants in receipt of a benefit on July 1 of the preceding year are eligible to receive the increase. Members who retire under the early retirement provisions at age 55 with 25 years of service are not eligible for the benefit adjustment until the second July 1 after reaching age 60 or the second July 1 after the date they would have had 28 years of service credit had they not retired.

Contributions

Contributions are prescribed in Title 9 of the South Carolina Code of Laws. Upon recommendation by the actuary in the annual actuarial valuation, the PEBA Board may adopt and present to the SFAA for approval an increase in the SCRS employer and employee contribution rates, but any such increase may not result in a differential between the employee and total employer contribution rate that exceeds 2.9 percent of earnable compensation for SCRS. An increase in the contribution rates adopted by the Board may not provide for an increase of more than one-half of one percent in any one year. If the scheduled employee and employer contributions provided in statute or the rates last adopted by the Board are insufficient to maintain a thirty-year amortization schedule of the unfunded liabilities of the plans, the Board shall increase the contribution rates in equal percentage amounts for the employer and employee as necessary to maintain the thirty-year amortization period; and, this increase is not limited to one-half of one percent per year.

If the most recent annual actuarial valuation of the Systems for funding purposes shows a ratio of the actuarial value of system assets to the actuarial accrued liability of the system (the funded ratio) that is equal to or greater than ninety percent, then the board, effective on the following July first, may decrease the then current contribution rates upon making a finding that the decrease will not result in a funded ratio of less than ninety percent. Any decrease in contribution rates must maintain the 2.9 and 5 percent differentials between the SCRS employer and employee contribution rates respectively. If contribution rates are decreased pursuant to this provision, and the most recent annual actuarial valuation of the system shows a funded ratio of less than ninety percent, then effective on the following July first, and annually thereafter as necessary, the board shall increase the then current contribution rates until a subsequent annual actuarial valuation of the system shows a funded ratio that is equal to or greater than 90 percent.

The Retirement System Funding and Administration Act increased employer contribution rates to 13.56 percent for SCRS, effective July 1, 2017. It also removes the 2.9 percent and 5 percent differential and increases and establishes a ceiling on employee contribution rates at 9 percent for SCRS. The employer contribution rates will continue to increase annually by 1 percent through July 1, 2022. The legislation's ultimate scheduled employer rate is 18.56 percent for SCRS. The amortization period is scheduled to be reduced one year for each of the next 10 years to a twenty-year amortization schedule. The recent pension reform legislation also changes the long term funded ratio requirement from ninety to eighty-five.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Plan Descriptions (continued)

Contributions (continued)

Required employee contribution rates¹ are as follows:

	<u>Fiscal Year 2018</u>	<u>Fiscal Year 2017</u>
SCRS		
Employee Class Two	9.00%	8.66%
Employee Class Three	9.00%	8.66%
State ORP		
Employee	9.00%	8.66%

Required employer contribution rates¹ are as follows:

	<u>Fiscal Year 2018</u>	<u>Fiscal Year 2017</u>
SCRS		
Employer Class Two	13.41%	11.41%
Employer Class Three	13.41%	11.41%
Employer Incidental Death Benefit	0.15%	0.15%
State ORP		
Employer Contribution ²	13.41%	11.41%
Employer Incidental Death Benefit	0.15%	0.15%

¹ Calculated on earnable compensation as defined in Title 9 of the South Carolina Code of laws.

² Of this employer contribution, 5% of earnable compensation must be remitted by the employer directly to the ORP vendor to be allocated to the member's account with the remainder of the employer contribution remitted to the SCRS.

First Steps has contributed \$412,089, \$586,573, and \$412,387 to the SCRS and ORP for the years ended June 30, 2018, 2017, and 2016, respectively.

Actuarial Assumptions and Methods

Actuarial valuations involve estimates of the reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and future salary increases. Actuarial assumptions and methods used during the annual valuation process are subject to periodic revision, typically with an experience study, as actual results over an extended period of time are compared with past expectations and new estimates are made about the future. South Carolina state statute requires that an actuarial experience study be completed at least once in each five-year period. An experience report was most recently issued as of July 1, 2015.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Actuarial Assumptions and Methods (continued)

The June 30, 2017, total pension liability (TPL), the net pension liability (NPL), and sensitivity information shown in this report were determined by the consulting actuary, Gabriel, Roeder, Smith and Company (GRS) and are based on an actuarial valuation performed as of July 1, 2016. The total pension liability was rolled-forward from the valuation date to the plans' fiscal year end, June 30, 2017, using generally accepted actuarial principles. The Retirement System Funding and Administration Act of 2017 was signed into law April 25, 2017, and included a provision to reduce the assumed rate of return from 7.50% to 7.25% effective July 1, 2017. As a result of this legislation, GRS made an adjustment to the calculation of the roll-forward total pension liability for this assumption change as of the measurement date of June 30, 2017.

The following table provides a summary of the actuarial assumptions and methods used to calculate the TPL as of June 30, 2017.

	SCRS
Actuarial cost method	Entry age normal
Investment rate of return ¹	7.25%
Projected salary increases ¹	3.0% to 12.5% (varies by service)
Benefit adjustments	lesser of 1% or \$500 annually
¹ Includes inflation at 2.25%	

The post-retiree mortality assumption is dependent upon the member's job category and gender. The base mortality assumptions, the 2016 Public Retirees of South Carolina Mortality table (2016 PRSC), was developed using the Systems' mortality experience. These base rates are adjusted for future improvement in mortality using published Scale AA projected from the year 2016.

Assumptions used in the determination of the June 30, 2017, TPL are as follows.

Former Job Class	Males	Females
Educators	2016 PRSC Males multiplied by 92%	2016 PRSC Females multiplied by 98%
General Employees and Members of the General Assembly	2016 PRSC Males multiplied by 100%	2016 PRSC Females multiplied by 111%
Public Safety and Firefighters	2016 PRSC Males multiplied by 125%	2016 PRSC Females multiplied by 111%

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Net Pension Liability

The net pension liability (“NPL”) is calculated separately for each system and represents that particular system's total pension liability determined in accordance with GASB No. 67 less that System's fiduciary net position. As of June 30, 2017, First Step’s proportional share of the NPL amounts for SCRS is presented below:

System	Total Pension Liability	Plan Fiduciary Net Position	Employers’ Net Pension Liability	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
SCRS	\$ 48,244,437,494	\$ 25,732,829,268	\$ 22,511,608,226	53.3384%

The TPL is calculated by the Systems’ actuary, and each plan’s fiduciary net position is reported in the Systems’ financial statements. The NPL is disclosed in accordance with the requirements of GASB 67 in the Systems’ notes to the financial statements and required supplementary information. Liability calculations performed by the Systems’ actuary for the purpose of satisfying the requirements of GASB Nos. 67 and 68 are not applicable for other purposes, such as determining the plans’ funding requirements.

First Step’s proportionate share of the net pension liability was calculated on the basis of historical employer contributions. Although GASB 68 encourages the use of the employer's projected long-term contribution effort to the retirement plan, allocating on the basis of historical employer contributions is considered acceptable. For the year ending June 30, 2017, First Step’s percentage of the SCRS net pension liability was 0.038504%. For the year ending June 30, 2018, the First Step’s percentage of the SCRS net pension liability was 0.050291% which is an increase of 0.011787%. First Step’s proportionate share is determined by its percentage of total contributions to SCRS during the respective fiscal year. The change in percentage resulted in First Step’s recognizing a change in its proportionate share of the SCRS net pension liability at related deferred outflows and inflows of resources.

Discount Rate

The discount rate used to measure the TPL was 7.25 percent. The projection of cash flows used to determine the discount rate assumed that contributions from participating employers in SCRS and PORS will be made based on the actuarially determined rates based on provisions in the South Carolina Code of Laws. Based on those assumptions, the System’s fiduciary net position was projected to be available to make all the projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the TPL.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Net Pension Liability (continued)

Long-term Expected Rate of Return

The long-term expected rate of return on pension plan investments is based upon 30-year capital market assumptions. The long-term expected rate of returns represents assumptions developed using an arithmetic building block approach primarily based on consensus expectations and market-based inputs. Expected returns are net of investment fees.

The expected returns, along with the expected inflation rate, form the basis for the target asset allocation adopted at the beginning of the 2017 fiscal year. The long-term expected rate of return is produced by weighting the expected future real rates of return by the target allocation percentage and adding expected inflation and is summarized in the table on the following page. For actuarial purposes, the 7.25 percent assumed annual investment rate of return used in the calculation of the TPL includes a 5.00 percent real rate of return and a 2.25 percent inflation component.

<u>Asset Class</u>	<u>Target Asset Allocation</u>	<u>Expected Arithmetic Real Rate of Return</u>	<u>Long Term Expected Portfolio Real Rate of Return</u>
Global Equity	45.0%		
Global Public Equity	31.0%	6.72%	2.08%
Private Equity	9.0%	9.60%	0.86%
Equity Options Strategies	5.0%	5.91%	0.30%
Real Assets	8.0%		
Real Estate (Private)	5.0%	4.32%	0.22%
Real Estate (REITs)	2.0%	6.33%	0.13%
Infrastructure	1.0%	6.26%	0.06%
Opportunistic	17.0%		
GTAA/Risk Parity	10.0%	4.16%	0.42%
Hedge Funds (non-PA)	4.0%	3.82%	0.15%
Other Opportunistic Strategies	3.0%	4.16%	0.12%
Diversified Credit	18.0%		
Mixed Credit	6.0%	3.92%	0.24%
Emerging Markets Debt	5.0%	5.01%	0.25%
Private Debt	7.0%	4.37%	0.31%
Conservative Fixed Income	12.0%		
Core Fixed Income	10.0%	1.60%	0.16%
Cash and Short Duration (Net)	2.0%	0.92%	0.02%
Total Expected Real Return	<u>100.0%</u>		<u>5.31%</u>
Inflation for Actuarial Purposes			<u>2.25%</u>
Total Expected Nominal Return			<u>7.56%</u>

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Sensitivity Analysis

The following table presents the collective net pension liability of the participating employers calculated using the discount rate of 7.25 percent, as well as what the employers' net pension liability would be if it were calculated using a discount rate that is 1.00 percent lower (6.25 percent) or 1.00 percent higher (8.25 percent) than the current rate.

Sensitivity of the Proportional Share of Net Pension Liability to Changes in the Discount Rate			
System	1.00% Decrease (6.25%)	Current Discount Rate (7.25%)	1.00% Increase (8.25%)
SCRS	\$ 14,591,513	\$ 11,321,231	\$ 9,336,940

Deferred Outflows (Inflows) of Resources

For the year ended June 30, 2018, First Steps recognized pension expense of \$2,028,641 which is included in employer fringe benefits in the accompanying financial statements. At June 30, 2018, the First Steps reported deferred outflows (inflows) of resources related to pensions from the following sources and will be amortized to pension expense as noted in following schedules. Average remaining service lives of all employees provided with pensions through the pension plans at June 30, 2017 was 4.073 years for SCRS:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Pension contributions subsequent to measurement date	\$ 412,089	\$ —
Differences in actual and expected plan experience	50,470	6,275
Change in proportionate share and differences between First Steps' contributions and proportionate share of contributions	2,399,298	—
Changes in assumptions	662,737	—
Net differences between projected and actual earnings on plan investments	316,036	—
	<u>\$ 3,840,630</u>	<u>\$ 6,275</u>

Measurement Period Ending June 30,	Fiscal Year Ending June 30,	<u>SCRS</u>
2018	2019	\$ (1,189,733)
2019	2020	(1,357,992)
2020	2021	(916,240)
2021	2022	41,699

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

6. Pension Plan (continued)

Deferred Outflows (Inflows) of Resources (continued)

First Steps reported \$412,089 as deferred outflows of resources related to contributions subsequent to the measurement date which will be recognized as a reduction of the net pension liability in the year ended June 30, 2019.

7. Post-Employment Benefits Other than Pensions

PEBA is a state agency responsible for the administration and management of the state's employee insurance programs, other post-employment benefits trusts. By law, the SFFA, which consists of five elected officials, also reviews certain PEBA Board decisions in administering the State Health Plan and other post-employment benefits (OPEB). See Note 6 for more details on PEBA and the SFAA.

PEBA, Insurance Benefits issues audited financial statements and required supplementary information for the OPEB Trust Fund. This information is publicly available through the Insurance Benefits' link on PEBA's website at www.peba.sc.gov or a copy may be obtained by submitting a request to PEBA – Insurance Benefits, 202 Arbor Lake Drive, Columbia, SC 29223. PEBA is considered a division of the primary government of the state of South Carolina and therefore, OPEB Trust fund financial information is also included in the comprehensive annual financial report of the state.

Plan Descriptions

The Other Post-Employment Benefits Trust Fund (OPEB Trust), refers to the South Carolina Retiree Health Insurance Trust Fund (SCRHITF) established by the State of South Carolina as Act 195, which became effective on May 2008. The SCRHITF was created to fund and account for the employer costs of the State's retiree health and dental plans.

In accordance with Act 195, the OPEB Trust is administered by the PEBA, Insurance Benefits and the State Treasurer is the custodian of the funds held in trust. The Board of Directors of PEBA has been designated as the Trustee.

The OPEB Trust is a cost-sharing multiple-employer defined benefit plan. Article 5 of the State Code of Laws defines the plan and authorizes the Trustee to at any time adjust the plan, including its benefits and contributions, as necessary to insure the fiscal stability of the plan. In accordance with the South Carolina Code of Laws and the annual Appropriations Act, the State provides post-employment health and dental benefits to retired State and school district employees and their covered dependents.

Benefits

The SCRHITF is a healthcare plan that covers retired employees of the State of South Carolina, including all agencies, and public-school districts. The SCRHITF provides health and dental insurance benefits to eligible retirees. 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% employer funding and 15-24 years of service for 50% employer funding.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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

Contributions and Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these postemployment and long-term disability benefits to be funded through annual appropriations by the General Assembly for active employees to the PEBA, Insurance Benefits and participating retirees to PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the PEBA, Insurance Benefits. For active employees who are not funded by State General Fund appropriations, participating employers are mandated by State statute to contribute at a rate assessed each year by the Department of Administration Executive Budget Office. The covered payroll surcharge for the year ended June 30, 2017 was 5.33 percent and for the year ended June 30, 2018 was 5.50 percent. The South Carolina Retirement System collects the monthly surcharge for all participating employers and remits it directly to the SCRHITF. Other sources of funding for the SCRHITF include mandatory transfers of accumulated PEBA, Insurance Benefits' reserves and income generated from investments. Employer contributions also include the implicit subsidy, or age-related subsidy inherent in the healthcare premiums structure. The implicit subsidy represents a portion of the health care expenditures paid on behalf of the employer's active employees. For purposes of GASB Statement No. 75, this expenditure on behalf of the active employee is reclassified as a retiree health care expenditure so that the employer's contributions towards the plan reflect the underlying age-adjusted, retiree benefit costs.

Actuarial Assumptions and Methods

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plans (as understood by the employer and plan participants) and include the types of benefits provided at the time the valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

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

Actuarial Assumptions and Methods (continued)

Additional information as of the latest actuarial valuation for SCRHITF:

Valuation Date:	June 30, 2016
Actuarial Cost Method:	Entry Age Normal
Inflation:	2.25%
Investment Rate of Return:	4.00%, net of OPEB Plan investment expense; including inflation
Single Discount Rate:	3.56% as of June 30, 2017
Demographic Assumptions:	Based on the experience study performed for the South Carolina Retirement Systems for the 5-year period ending June 30, 2015
Mortality:	For healthy retirees, the 2016 Public Retirees of South Carolina Mortality Table for Males and the 2016 Public Retirees of South Carolina Mortality Table for Females are used with fully generational mortality projections based on Scale AA from the year 2016. Multipliers are applied to the base tables based on gender and employment type.
Health Care Trend Rate:	Initial trend starting at 7.00% and gradually decreasing to an ultimate trend rate of 4.15% over a period of 15 years
Aging Factors:	Based on plan specific experience
Retiree Participation:	79% for retirees who are eligible for funded premiums
Notes:	There were no benefit changes during the year; the discount rate changed from 2.92% as of June 30, 2016 to 3.56% as of June 30, 2017

Net OPEB Liability

The Net OPEB Liability (NOL) is calculated separately for each OPEB Trust Fund and represents that particular Trust's Total OPEB Liability (TOL) determined in accordance with GASB No. 74 less that Trust's fiduciary net position. The allocation of each employer's proportionate share of the collective Net OPEB Liability and collective OPEB Expense was determined using the employer's payroll-related contributions over the measurement period. This method is expected to be reflective of the employer's long-term contribution effort.

The following table represents the components of the net OPEB liability as of June 30, 2017:

OPEB Trust	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability	Plan Fiduciary Net Position as a % of Total OPEB Liability
SCRHITF	\$ 14,659,610,970	\$ 1,114,774,760	\$ 13,544,836,210	7.60%

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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

Net OPEB Liability (continued)

The TOL is calculated by the Trusts' actuary, and each Trust's fiduciary net position is reported in the Trust's financial statements. The NOL is disclosed in accordance with the requirements of GASB No. 74 in the Trusts' notes to the financial statements and required supplementary information. Liability calculations performed by the Trusts' actuary for the purpose of satisfying the requirements of GASB Nos. 74 and 75 and are not applicable for other purposes, such as determining the Trusts' funding requirements.

At June 30, 2018, First Steps reported a liability of \$7,636,576 for its proportionate share of the net OPEB liability. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of June 30, 2016 and rolled forward to June 30, 2017. First Steps' proportion of the net OPEB liability was based on a projection of the First Steps' long-term share of contributions to the OPEB plan relative to the projected contributions of all participating entities, actuarially determined. At June 30, 2017, First Steps' proportion was 0.056381%.

Single Discount Rate

The Single Discount Rate of 3.56% was used to measure the total OPEB liability for the SCRHITF. The accounting policy for this plan is to set the Single Discount Rate equal to the prevailing municipal bond rate. Due to the plan's investment and funding policies, the difference between a blended discount rate and the municipal bond rate would be less than several basis points (several hundredths of one percent).

Long-term Expected Rate of Return

The long-term expected rate of returns represents assumptions developed using an arithmetic building block approach primarily based on consensus expectations and market-based inputs. The expected returns, along with the expected inflation rate, form the basis for the target asset allocation adopted at the beginning of the 2017 fiscal year. The long-term expected rate of return is produced by weighting the expected future real rates of return by the target allocation percentage and adding expected inflation. For actuarial purposes, the 4.00 percent assumed annual investment rate of return includes a 1.75 percent real rate of return and a 2.25 percent inflation component. This information is summarized in the following table:

<u>Asset Class</u>	<u>Target Asset Allocation</u>	<u>Expected Arithmetic Real Rate of Return</u>	<u>Allocation Weighted Long Term Expected Portfolio Real Rate of Return</u>
US Domestic Fixed Income	80.00%	2.09%	1.67%
Cash	20.00%	0.84%	0.17%
Total Expected Real Return	<u>100.0%</u>		<u>1.84%</u>
Expected Inflation			<u>2.25%</u>
Total Return			<u>4.09%</u>
Investment Return Assumption			<u>4.00%</u>

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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

Net OPEB Liability (continued)

Sensitivity Analysis

The following table represents First Steps' proportionate share of the SCRHITF's net OPEB liability calculated using a Single Discount Rate of 3.56%, as well as what the First Steps' proportionate share of the net OPEB liability would be if it were calculated using a Single Discount Rate that is one percent lower or one percent higher:

Sensitivity of the Proportional Share of Net OPEB Liability to Changes in the Single Discount Rate			
OPEB Trust	1.00% Decrease (2.56%)	Current Discount Rate (3.56%)	1.00% Increase (4.56%)
SCRHITF	\$ 8,993,891	\$ 7,636,576	\$ 6,542,498

Regarding the sensitivity of First Steps' proportionate share of SCRHITF's net OPEB liability to changes in the healthcare cost trend rates, the following table presents First Steps' proportionate share of the net OPEB liability, calculated using the assumed trend rates as well as what First Steps' proportionate share of the net OPEB liability would be if were calculated using a trend rate that is one percent lower or one percent higher:

Sensitivity of the Proportional Share of Net OPEB Liability to Changes in the Healthcare Cost Trend Rate			
OPEB Trust	1.00% Decrease	Current Healthcare Cost Trend Rate	1.00% Increase
SCRHITF	\$ 6,262,422	\$ 7,636,576	\$ 9,416,092

OPEB Expense and Deferred Outflows and Inflows of Resources

For the year ended June 30, 2018, First Steps recognized OPEB expense of \$465,480. At June 30, 2018, First Steps reported deferred outflows and inflows of resources related to OPEB from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
OPEB contributions subsequent to measurement date	\$ 161,065	\$ —
Differences in actual and expected plan experience	—	3,314
Changes in assumptions	—	718,579
Net differences between projected and actual earnings on plan investments	13,122	—
	<u>\$ 174,187</u>	<u>\$ 721,893</u>

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

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

OPEB Expense and Deferred Outflows and Inflows of Resources (continued)

Contributions subsequent to the measurement date of \$161,065 were reported as deferred outflows of resources related to OPEB and will be recognized as a reduction of the net OPEB liability in the year ended June 30, 2019. Other amounts reported as deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense as follows. Average remaining services lives of all employees provided with OPEB through the June 30, 2017 was 7.246 years for SCRHITF:

Measurement Period Ending June 30,	Fiscal Year Ending June 30,	SCRHITF
2018	2019	\$ 112,296
2019	2020	112,296
2020	2021	112,296
2021	2022	112,296
2022	2023	115,577
Thereafter		144,010

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, 2018.

9. Risk Management

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

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 \$1,054,000 for the year ended June 30, 2018, including approximately \$35,000 in insurance premiums described below.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
 NOTES TO THE FINANCIAL STATEMENTS
 FOR THE YEAR ENDED JUNE 30, 2018

10. Transactions with State Entities / Related Parties (continued)

First Steps provided no material services free of charge to other State agencies during the fiscal year. First Steps participates in the statewide dual employment program. Workers' compensation and other insurance premiums for the fiscal year ended June 30, 2018 of \$35,064 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, 2018 was \$799,336. 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 a non-cancellable lease, considered an operating lease, for a facility used to house operations critical to First Steps' mission. Rent expense related to this lease was approximately \$121,000. Total lease and rental expense was approximately \$451,776, for the year ended June 30, 2018. Future base rental payments under non-cancellable leases are as follows:

Fiscal year ending June 30:

2019	\$	137,185
2020		129,953
2021		49,463
Total	\$	316,601

As discussed in Note 1, the BabyNet program was moved to DHHS effective July 1, 2017. With this change, a number of operating leases to which First Steps is a party, were also transferred to DHHS. As such, those future commitments are not included the above table.

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, 2018.

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

11. Commitments and Contingencies (continued)

County Partnership Regional Finance Managers

During 2018, First Steps entered into a contract with a single Regional Finance Manager for its County Partnerships. The contract has a five-year term with estimated remaining payments as follows:

Fiscal year ending June 30:

2019	\$	392,500
2020		392,500
2021		392,500
2022		392,500
		<u>\$ 1,570,000</u>

Reauthorization

The South Carolina General Assembly and the Governor reauthorized First Steps with its Legislative Bill H3591 effective July 1, 2018. Bill H3591 extended SC First Steps authorization from July 1, 2018 (FY 19) thru June 30, 2025 (FY 25).

**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, 2018**

	<u>Budgeted Amounts</u>			Variance Positive (Negative)
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	
Expenditures:				
First Steps to School Readiness				
Personal Services				
Classified Positions	\$ 67,621	\$ 67,621	\$ —	\$ 67,621
Special Items				
Teacher Supplies	—	60,500	60,500	—
CDEPP	6,424,200	6,424,200	6,424,200	—
Employer Contributions	29,689	29,689	—	29,689
Total First Steps to School Readiness	<u>\$ 6,521,510</u>	<u>\$ 6,582,010</u>	<u>\$ 6,484,700</u>	<u>\$ 96,950</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, 2018**

	Budgeted Amounts			Variance Positive (Negative)
	Original	Final	Actual	
Expenditures:				
First Steps to School Readiness				
Personal Services				
Classified Positions	\$ 2,873,885	\$ 1,383,000	\$ 926,870	\$ 456,130
Unclassified Positions	121,540	65,000	61,440	3,560
Other Personal Services	425,000	1,655,197	1,208,797	446,400
Other Operating Expenses	1,906,225	3,009,945	1,754,534	1,255,411
Special Items				
County Partnerships	14,435,228	14,435,228	14,435,228	—
Babynet	—	421,000	185,245	235,755
Early Head Start	3,182,392	9,223,158	5,739,058	3,484,100
CDEPP	9,767,864	9,662,864	8,210,507	1,452,357
Office of First Steps	1,821,000	1,400,000	193,304	1,206,696
Employer Contributions	986,235	1,019,162	781,409	237,753
Total First Steps to School Readiness	\$ 35,519,369	\$ 42,274,554	\$ 33,496,392	\$ 8,778,162

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2018**

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 State Fiscal Accountability Authority approval. Also, a revision of budgeted amounts over and above the total revenues appropriated requires approval of the State Fiscal Accountability Authority.

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 115 (*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 required supplementary information.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2018**

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. First Steps has such authorization to carry forward its funds. 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. A reconciliation of the budgetary basis expenditures to the GAAP basis expenditures is below:

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2018**

5. Budget to GAAP Reporting Differences (continued)

Reconciliation of Budget Basis to GAAP Basis Expenditures
For the Year Ended June 30, 2018

	General Fund	Other Budgeted Funds	Total
Total expenditures, budgetary basis	\$ 6,484,700	\$ 33,496,392	\$ 39,981,092
Perspective differences:			
All expenditures are reported in the General Fund for GAAP	33,496,392	(33,496,392)	—
Basis of accounting differences:			
Change in accrued salaries	48,981	—	48,981
Change in accounts payable	(335,250)	—	(335,250)
Amounts grossed up for GAAP basis that represent a transfer of appropriations on the budgetary basis	1,105,000		1,105,000
Other basis differences	5,370	—	5,370
Total expenditures, GAAP basis	<u>\$ 40,805,193</u>	<u>\$ —</u>	<u>\$ 40,805,193</u>

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Schedule of the South Carolina First Steps
to School Readiness' Proportionate Share of the Net
Pension Liability – South Carolina Retirement System
As of June 30, 2018
Last Five Fiscal Years**

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
First Steps' proportion of the net pension liability	0.050291%	0.038504%	0.031435%	0.031390%	0.031390%
First Steps' proportionate share of the net pension liability	\$ 11,321,231	\$ 8,224,476	\$ 5,961,706	\$ 5,404,384	\$ 5,630,315
First Steps' covered payroll	\$ 5,074,161	\$ 3,728,634	\$ 2,947,293	\$ 2,849,840	\$ 2,889,764
First Steps' proportionate share of the net pension liability as percentage of covered payroll	223.12%	220.58%	202.28%	189.64%	194.84%
Plan fiduciary net position as a percentage of the total pension liability	53.3%	52.9%	57.0%	59.9%	56.4%

Note: The amounts presented above were determined as of June 30th of the preceding year.

Note: Only five years of data were available; thus, only five years were presented.

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Schedule of the South Carolina First Steps
to School Readiness' Contributions –
South Carolina Retirement System
As of June 30, 2018
Last Eight Fiscal Years**

	2018	2017	2016	2015	2014
Contractually required contribution	\$ 412,089	\$ 586,573	\$ 412,387	\$ 321,255	\$ 302,083
Contributions in relation to the contractually required contribution	412,089	586,573	412,387	321,255	302,083
Contribution deficiency (excess)	<u>\$ -</u>				
First Steps covered payroll	\$ 3,039,003	\$ 5,074,161	\$ 3,728,634	\$ 2,947,293	\$ 2,849,840
Contributions as a percentage of covered payroll	13.56%	11.56%	11.06%	10.90%	10.60%
	2013	2012	2011		
Contractually required contribution	\$ 306,315	\$ 219,508	\$ 189,512		
Contributions in relation to the contractually required contribution	306,315	219,508	189,512		
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>		
First Steps covered payroll	\$ 2,889,764	\$ 2,302,129	\$ 2,018,232		
Contributions as a percentage of covered payroll	10.60%	9.54%	9.39%		

Note: Only eight years of data were available; thus, only eight years were presented.

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Schedule of the South Carolina First Steps
to School Readiness' Proportionate Share of the Net
OPEB Liability – South Carolina Health Insurance Trust Fund
As of June 30, 2018
Last Two Fiscal Years**

	<u>2018</u>	<u>2017</u>
First Steps' proportion of the net OPEB liability	0.056381%	0.056381%
First Steps' proportionate share of the net OPEB liability	\$ 7,645,667	\$ 8,157,559
First Steps' covered payroll	\$ 4,760,094	\$ 3,728,634
First Steps' proportionate share of the net OPEB liability as percentage of covered payroll	160.62%	218.78%
Plan fiduciary net position as a percentage of the total OPEB liability	7.60%	6.62%

Note: The amounts presented above were determined as of June 30th of the preceding year.

Note: Only two years of data was available; thus, only two years are presented.

**South Carolina First Steps to School Readiness
Required Supplementary Information -
Schedule of the South Carolina First Steps
to School Readiness' Contributions –
South Carolina Health Insurance Trust Fund
As of June 30, 2018
Last Two Fiscal Years**

	2018	2017
Contractually required contribution	\$ 161,065	\$ 232,315
Contributions in relation to the contractually required contribution	161,065	232,315
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>
 First Steps covered payroll	 \$ 2,928,455	 \$ 4,358,630
Contributions as a percentage of Covered payroll	5.50%	5.33%

Note: Only two years of data were available; thus, only two years are presented.



Greene Finney, LLP

CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

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. George L. Kennedy, CPA
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, 2018, and the related notes to the financial statements, which collectively comprise First Steps' basic financial statements, and have issued our report thereon dated September 21, 2018.

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 opinions 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*.

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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, LLP

Greene Finney, LLP
Mauldin, South Carolina
September 21, 2018