

South Carolina First Steps to School Readiness

Financial Statements

For the Year Ended June 30, 2016



**South Carolina
Office of the State Auditor**

**George L. Kennedy, III, CPA
State Auditor**

October 5, 2016

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

This report on the audit of the financial statements of the South Carolina First Steps to School Readiness for the year ended June 30, 2016, was issued by Greene, Finney & Horton, LLP, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

A handwritten signature in blue ink that reads "George L. Kennedy, III". The signature is written in a cursive style.

George L. Kennedy, III, CPA
State Auditor

GLKIII/trb

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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, 2016, 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, 2016, 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.


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, and schedule of contributions – South Carolina Retirement System, 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 October 5, 2016 on our consideration of First Steps' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering First Steps' internal control over financial reporting and compliance.



Greene, Finney & Horton, LLP
Mauldin, South Carolina
October 5, 2016

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2016**

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, 2016.

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, 2016:

- First Steps' total net position decreased by \$6,438,214 and its assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources (net position) by \$123,388, which includes \$6,332,045 in net position restricted for the 4K pre-school program and early childhood services.
- First Steps received \$35,689,044 in appropriations from the State of South Carolina, the significant majority of which was disbursed for funding the county partnerships, 4K, and Baby Net programs throughout the state.
- First Steps received federal, local, and private grants as well as Medicaid reimbursements totaling \$8,188,845.

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, 2016**

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 2016 and 2015 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**

| | 2016 | 2015 |
|----------------------------------|--------------------|---------------------|
| Current assets | \$ 7,595,724 | \$ 12,428,843 |
| Capital assets, net | 427,255 | 587,475 |
| Total assets | <u>8,022,979</u> | <u>13,016,318</u> |
| Deferred outflows of resources | <u>564,085</u> | <u>474,392</u> |
| Current liabilities | 2,277,166 | 854,612 |
| Net pension liability | 5,961,706 | 5,404,384 |
| Other noncurrent liabilities | 214,143 | 214,483 |
| Total liabilities | <u>8,453,015</u> | <u>6,473,479</u> |
| Deferred inflows of resources | <u>10,661</u> | <u>455,629</u> |
| Net investment in capital assets | 427,255 | 587,475 |
| Restricted | 6,332,045 | 11,116,573 |
| Unrestricted | <u>(6,635,912)</u> | <u>(5,142,446)</u> |
| Total net position | <u>\$ 123,388</u> | <u>\$ 6,561,602</u> |

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2016**

Statements of Activities – The Statements of Activities reports the revenues and expenses during the 2016 and 2015 fiscal years.

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

| | 2016 | 2015 |
|-------------------------------------|--------------|--------------|
| Program Revenues | | |
| Federal grants | \$ 7,899,091 | \$ 6,249,741 |
| Medicaid reimbursements | 251,700 | 422,690 |
| Local and private grants | 38,054 | 327,061 |
| Total program revenues | 8,188,845 | 6,999,492 |
| General Revenues | | |
| State appropriations | 35,689,044 | 33,942,265 |
| Interest income | 378,682 | 129,302 |
| Total general revenues | 36,067,726 | 34,071,567 |
| Total revenues | 44,256,571 | 41,071,059 |
| Expenses | | |
| Allocations to other entities | 38,045,455 | 25,290,481 |
| Contractual services | 5,516,603 | 3,636,099 |
| Salaries | 3,732,304 | 3,331,550 |
| Employer fringe benefits | 1,346,667 | 1,155,531 |
| Rent and leases | 340,734 | 328,393 |
| Materials | 1,180,361 | 415,011 |
| Travel | 372,441 | 207,028 |
| Depreciation | 160,220 | 160,220 |
| Total expenses | 50,694,785 | 34,524,313 |
| (Decrease) increase in net position | (6,438,214) | 6,546,746 |
| Net position beginning balance | 6,561,602 | 14,856 |
| Net position ending balance | \$ 123,388 | \$ 6,561,602 |

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 decrease in net position is primarily attributed to State budget provisos that required First Steps to allocate approximately \$9.3 million to other State departments. First Steps also reported negative unrestricted net position of \$6,635,912 which is due primarily to its proportionate share of the net pension liability of \$5,961,706. First Steps does not anticipate funding this liability and will continue to contribute to the pension plan at State required contribution rates.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2016**

Total program revenues increased by \$1,189,353 primarily due to First Steps receiving additional Federal grant revenue in the amount of \$1,649,350. Total general revenues increased by \$1,996,159. This increase was due primarily to a substantial increase in State Education Improvement Act appropriations to expand program operations. Expenses increased by \$16,170,472 primarily due to a \$12,754,974 increase in allocations to other entities primarily due to State Provisos and an \$1,880,504 increase in contractual services due to expanded services First Steps was providing. First Steps realized a decrease in net position from the prior year in the amount of \$6,438,214.

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, however, carryover of prior year funding not spent is allowed. This, along with federal grant revenues that are received on a reimbursement basis, and other reimbursements and grants, resulted in expenditures exceeding revenues by \$6,256,058 for the year ended June 30, 2016. This resulted in a decrease in fund balance from the beginning fund balance amount of \$11,816,101 to \$5,560,043, which includes \$6,332,045 in fund balance restricted for the 4K pre-school program and early childhood services and \$772,002 in deficit unassigned fund balance. First Steps management anticipates that fiscal year 2017 funding will be sufficient to fund both fiscal year 2017 operations as well as replenish the deficit fund balance as of June 30, 2016.

Capital Assets:

First Steps' began the implementation of an Early Intervention Management System that is compliant with both State and Federal requirements in fiscal year 2013 that was completed during fiscal year 2014. No additional capital assets have been purchased by First Steps during fiscal year 2016. 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 liability. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. Compensated absences used during the fiscal year were \$302,915 while another \$302,190 were accrued. See note 5 to the financial statements for additional information regarding First Steps' noncurrent liabilities.

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. The net pension liability as of June 30, 2015 was \$5,404,384 and at June 30, 2016, it had increased to \$5,961,706. The increase is due to an overall increase in the net pension liability in the pension plan. 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.

**South Carolina First Steps to School Readiness
Management's Discussion and Analysis
For the Year Ended June 30, 2016**

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 \$6,518,480 and \$6,553,720, respectively, for the year ended June 30, 2016. Actual appropriations for the general fund were \$6,553,720 and the actual expenditures, on the budgetary basis, totaled \$6,553,720. These amounts were spent on First Steps Private 4K program and the one-time bonus paid to State employees. The total other funds budget was originally \$42,899,750 and was revised to \$40,899,750 with actual expenditures of \$33,338,971. 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.

In September 2016, the Governor of South Carolina issued Executive Order No. 20, which designated the South Carolina Department of Health and Human Services as the lead agency for South Carolina's IDEA Part C program, known locally as "BabyNet". This Executive Order took effect immediately with the Department of Health and Human Services formally assuming the IDEA Part C lead agency responsibility beginning July 1, 2017. Funding related to the BabyNet program is expected to be appropriated to the South Carolina Department of Health and Human Service beginning in fiscal year 2018.

The South Carolina General Assembly and the Governor reauthorized First Steps with its Legislative Bill H3428 effective July 1, 2014. Bill H3428 extended SC First Steps authorization from July 1, 2014 (FY 15) thru June 30, 2016 (FY 16). For the period July 1, 2016 thru June 30, 2017 (FY 17), the SC General Assembly and the Governor did not use legislation to extend SC First Steps' authorization. However, it did include First Steps in the budget appropriation which funded it for one fiscal year, July 1, 2016 thru June 30, 2017 (FY 17).

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, 2016**

ASSETS

Current assets:

| | |
|--|------------------|
| Cash and cash equivalents | \$ 6,498,991 |
| Due from Federal government and other grantors | 1,096,733 |
| Total current assets | <u>7,595,724</u> |

Noncurrent assets:

| | |
|-------------------------|------------------|
| Capital assets, net | 427,255 |
| Total noncurrent assets | <u>427,255</u> |
| Total assets | <u>8,022,979</u> |

DEFERRED OUTFLOWS OF RESOURCES

| | |
|--|----------------|
| Deferred outflows of resources related to pensions | 564,085 |
| Total deferred outflows of resources | <u>564,085</u> |

LIABILITIES

Current liabilities:

| | |
|-------------------------------|------------------|
| Accounts payable | 1,495,968 |
| Accrued salaries and benefits | 539,713 |
| Compensated absences | 241,485 |
| Total current liabilities | <u>2,277,166</u> |

Noncurrent liabilities:

| | |
|------------------------------|------------------|
| Compensated absences | 214,143 |
| Net pension liability | 5,961,706 |
| Total noncurrent liabilities | <u>6,175,849</u> |
| Total liabilities | <u>8,453,015</u> |

DEFERRED INFLOWS OF RESOURCES

| | |
|---|---------------|
| Deferred inflows of resources related to pensions | 10,661 |
| Total deferred inflows of resources | <u>10,661</u> |

NET POSITION

| | |
|---|--------------------|
| Net investment in capital assets | 427,255 |
| Restricted for the 4K pre-school program and early childhood services | 6,332,045 |
| Unrestricted | <u>(6,635,912)</u> |
| Total Net Position | <u>\$ 123,388</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 Activities
For the Year Ended June 30, 2016**

Expenses

Governmental Activities – General Government

| | |
|-------------------------------|-------------------|
| Allocations to other entities | \$ 38,045,455 |
| Contractual services | 5,516,603 |
| Salaries | 3,732,304 |
| Employer fringe benefits | 1,346,667 |
| Rent and leases | 340,734 |
| Materials | 1,180,361 |
| Travel | 372,441 |
| Depreciation | 160,220 |
| Total expenses | <u>50,694,785</u> |

Program Revenues – Operating Grants and Contributions

| | |
|--------------------------|---------------------|
| Federal grants | 7,899,091 |
| Medicaid reimbursements | 251,700 |
| Local and private grants | 38,054 |
| Total program revenues | <u>8,188,845</u> |
| Net expenses | <u>(42,505,940)</u> |

General Revenues

| | |
|------------------------|-------------------|
| State appropriations | 35,689,044 |
| Interest income | 378,682 |
| Total general revenues | <u>36,067,726</u> |

| | |
|--------------------------|-------------|
| Decrease in net position | (6,438,214) |
|--------------------------|-------------|

| | |
|----------------------------|------------------|
| Net position, July 1, 2015 | <u>6,561,602</u> |
|----------------------------|------------------|

| | |
|-----------------------------|--------------------------|
| Net position, June 30, 2016 | <u><u>\$ 123,388</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, 2016**

| | <u>General Fund</u> |
|--|----------------------------|
| ASSETS | |
| Cash and cash equivalents | \$ 6,498,991 |
| Due from Federal government and other grantors | 1,096,733 |
| Total Assets | <u>\$ 7,595,724</u> |
| LIABILITIES | |
| Accounts payable | \$ 1,495,968 |
| Accrued salaries and benefits | 539,713 |
| Total liabilities | <u>2,035,681</u> |
| FUND BALANCE | |
| Restricted for the 4K pre-school program and early childhood services | 6,332,045 |
| Unassigned | <u>(772,002)</u> |
| Total fund balance | 5,560,043 |
| Total liabilities and fund balance | <u>\$ 7,595,724</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 Balance Sheet of the Governmental Fund
to the Statement of Net Position
June 30, 2016**

| | |
|---|-------------------|
| Total fund balance, governmental fund | \$ 5,560,043 |
| 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 \$807,111 net of accumulated depreciation of \$379,856. | 427,255 |
| The net pension liability 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 | (5,961,706) |
| Deferred outflows of resources related to pensions | 564,085 |
| Deferred inflows of resources related to pensions | (10,661) |
| 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 | <u>(455,628)</u> |
| Net position of governmental activities in the Statement of Net Position | <u>\$ 123,388</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, 2016**

| | <u>General Fund</u> |
|-------------------------------|----------------------------|
| Revenues | |
| State appropriations | \$ 35,689,044 |
| Federal grants | 7,899,091 |
| Medicaid reimbursements | 251,700 |
| Local and private grants | 38,054 |
| Interest income | 378,682 |
| Total revenues | <u>44,256,571</u> |
| Expenditures | |
| Allocations to other entities | 38,045,455 |
| Contractual services | 5,516,603 |
| Salaries | 3,733,029 |
| Employer fringe benefits | 1,324,006 |
| Materials | 1,180,361 |
| Travel | 372,441 |
| Rent and leases | 340,734 |
| Total expenditures | <u>50,512,629</u> |
| Decrease in fund balance | (6,256,058) |
| Fund balance, July 1, 2015 | 11,816,101 |
| Fund balance, June 30, 2016 | <u><u>\$ 5,560,043</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
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, 2016**

| | |
|---|----------------|
| Net change in fund balance, governmental fund | \$ (6,256,058) |
|---|----------------|

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 | 412,387 |
|---|---------|

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 | (160,220) |
| Pension expense due to changes in First Step's portion of collective pension expense | (435,048) |
| Compensated absences, net effect | 725 |

| | |
|---|----------------|
| Decrease in net position, governmental activities | \$ (6,438,214) |
|---|----------------|

*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, 2016**

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

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

1. Summary of Significant Accounting Policies (continued)

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

Government-wide Financial Statements

The government-wide financial statements are presented 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, 2016**

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, 2016**

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, 2016.

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 |

Compensated Absences

Generally, all permanent full-time State employees and certain part-time employees scheduled to work at least half of the working days in a 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, 2016**

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, 2016, 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, 2016, 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, 2016, 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, 2016**

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, 2016, 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 consist of assets with constraints placed on the use either by external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or law through constitutional provisions or enabling legislation. In all cases, if individual restricted net position categories are negative, the negative balance is eliminated and reclassified against unrestricted net position. As of June 30, 2016, 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, 2016**

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 Fund Balance and Net Position

First Steps reported a negative unassigned fund balance of \$772,002 as of June 30, 2016. First Steps management anticipates that fiscal year 2017 funding will be sufficient to fund both fiscal year 2017 operations as well as replenish the deficit fund balance as of June 30, 2016.

First Steps also reported negative unrestricted net position of \$6,635,912 which is due primarily to its proportionate share of the net pension liability of \$5,961,706. First Steps does not anticipate funding this liability and will continue to contribute to the pension plan at State required contribution rates.

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.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

2. Budget Policy (continued)

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 Budget and Control Board 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.

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 invested in the State of South Carolina investment pool, information can be obtained from the State of South Carolina Comprehensive Annual Financial Report which can be found at www.cg.sc.gov.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

4. Capital Assets

Capital asset activity for the fiscal year ended June 30, 2016, for the primary government was as follows:

| | Beginning Balance July 1, 2015 | Additions | Disposals | Ending Balance June 30, 2016 |
|---|---|---------------------|-------------|---------------------------------------|
| Governmental activities | | | | |
| Capital assets being depreciated: | | | | |
| Equipment and computer software | \$ 807,111 | \$ — | \$ — | \$ 807,111 |
| Less accumulated depreciation for: | | | | |
| Equipment and computer software | (219,636) | (160,220) | — | (379,856) |
| Capital assets for governmental activities, net | <u>\$ 587,475</u> | <u>\$ (160,220)</u> | <u>\$ —</u> | <u>\$ 427,255</u> |

5. Long-term Liabilities

Long-term liabilities consist of compensated absences. Compensated absence activity for the fiscal year ended June 30, 2016, for the primary government was as follows:

| | Beginning Balance July 1, 2015 | Increases | Decreases | Ending Balance June 30, 2016 | Current Portion |
|----------------------|--------------------------------------|-------------------|---------------------|------------------------------------|--------------------|
| Compensated absences | \$ 456,353 | \$ 302,190 | \$ (302,915) | \$ 455,628 | \$ 241,485 |
| Total | <u>\$ 456,353</u> | <u>\$ 302,190</u> | <u>\$ (302,915)</u> | <u>\$ 455,628</u> | <u>\$ 241,485</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 Budget and Control Board (State Fiscal Accountability Authority effective July 1, 2015), 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.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

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. 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, PO Box 11960, Columbia, SC 29211-1960. 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.
- 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.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

Plan Descriptions (continued)

Membership (continued)

- 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.

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.

The 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.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

Plan Descriptions (continued)

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 State Fiscal Accountability Authority 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.

Required employee contribution rates¹ are as follows:

| | <u>Fiscal Year 2016</u> | <u>Fiscal Year 2015</u> |
|----------------------|-------------------------|-------------------------|
| SCRS | | |
| Employee Class Two | 8.16% | 8.00% |
| Employee Class Three | 8.16% | 8.00% |
| State ORP | | |
| Employee | 8.16% | 8.00% |

Required employer contribution rates¹ are as follows:

| | <u>Fiscal Year 2016</u> | <u>Fiscal Year 2015</u> |
|------------------------------------|-------------------------|-------------------------|
| SCRS | | |
| Employer Class Two | 10.91% | 10.75% |
| Employer Class Three | 10.91% | 10.75% |
| Employer Incidental Death Benefit | 0.15% | 0.15% |
| State ORP | | |
| Employer Contribution ² | 10.91% | 10.75% |
| Employer Incidental Death Benefit | 0.15% | 0.15% |

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

Plan Descriptions (continued)

Contributions (continued)

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.

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. The last experience study was performed on data through June 30, 2010, and the next experience study, performed on data through June 30, 2015, is currently underway.

The June 30, 2015, total pension liability, net pension liability, and sensitivity information were determined by our consulting actuary, Gabriel, Roeder, Smith and Company (GRS) and are based on the July 1, 2014, actuarial valuations, as adopted by the PEBA Board and Budget and Control Board which utilized membership data as of July 1, 2014. The total pension liability was rolled-forward from the valuation date to the plan's fiscal year ended June 30, 2015, using generally accepted actuarial principles. Information included in the following schedules is based on the certification provided by GRS.

The following provides a summary of the actuarial assumptions and methods used in the July 1, 2014, valuations for SCRS.

| | SCRS |
|---|-----------------------------------|
| Actuarial cost method | Entry age normal |
| Investment rate of return ¹ | 7.50% |
| Projected salary increases ¹ | 3.5% to 12.5% (varies by service) |
| Benefit adjustments | lesser of 1% or \$500 annually |

¹ Includes inflation at 2.75%

The post-retiree mortality assumption is dependent upon the member's job category and gender. This assumption includes base rates which are automatically adjusted for future improvement in mortality using published Scale AA projected from the year 2000. Assumptions used in the July 1, 2014, valuations for the SCRS are as follows.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

Actuarial Assumptions and Methods (continued)

| Former Job Class | Males | Females |
|--|---|--|
| Educators and Judges | RP-2000 Males (with White Collar adjustment) multiplied by 110% | RP-2000 Females (with White Collar adjustment) multiplied by 95% |
| General Employees and Members of the General Assembly | RP-2000 Males multiplied by 100% | RP-2000 Females multiplied by 90% |
| Public Safety, Firefighters and members of the South Carolina National Guard | RP-2000 Males (with Blue Collar adjustment) multiplied by 115% | RP-2000 Females (with Blue Collar adjustment) multiplied by 115% |

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, 2016, First Step's proportional share of the NPL amounts for SCRS is presented below:

| System | Total Pension Liability | Plan Fiduciary Net Position | First Steps' Net Pension Liability | Plan Fiduciary Net Position as a Percentage of the Total Pension Liability |
|---------------|--------------------------------|------------------------------------|---|---|
| SCRS | \$ 44,097,310,230 | \$ 25,131,828,101 | \$ 5,961,706 | 57.0% |

The total pension liability is calculated by the Systems' actuary, and each plan's fiduciary net position is reported in the Systems' financial statements. 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, 2015, First Step's percentage of the SCRS net pension liability was 0.03139%. For the year ending June 30, 2016, the First Step's percentage of the SCRS net pension liability was 0.03143% which is an increase of 0.00004%. 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 total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate assumed that contributions from participating employers in SCRS will be made based on the actuarially determined rates based on provisions in the South Carolina State Code of Laws. Based on those assumptions, each System's fiduciary net position was projected to be available to make all 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 total pension liability.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

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, as used in the July 1, 2014, actuarial valuations, was based upon the 30-year capital market outlook at the end of the fourth quarter 2013, as developed by the Retirement Systems Investment Commission in collaboration with its investment consultant, Aon Hewitt. The long-term expected rate of return represents assumptions developed using an arithmetic building block approach, reflecting observable inflation and interest rate information available in the fixed income markets as well as Consensus Economics forecasts. Long-term assumptions for other asset classes are based on historical results, current market characteristics, and professional judgment.

The expected returns, along with the expected inflation rate, form the basis for the target asset allocation as adopted by the Investment Commission for fiscal year 2015. The long-term expected rate of return is produced by weighting the expected future real rates of return by the target allocation percentage and by adding expected inflation and is summarized in the table on the following page. For actuarial purposes, the 7.50 percent assumed annual investment rate of return set in statute and used in the calculation of the total pension liability includes a 4.75 percent real rate of return and a 2.75 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> |
|---|--|--|---|
| Short Term | 5.0% | | |
| Cash | 2.0% | 1.90% | 0.04% |
| Short Duration | 3.0% | 2.00% | 0.06% |
| Domestic Fixed Income | 13.0% | | |
| Core Fixed Income | 7.0% | 2.70% | 0.19% |
| Mixed Credit | 6.0% | 3.80% | 0.23% |
| Global Fixed Income | 9.0% | | |
| Global Fixed Income | 3.0% | 2.80% | 0.08% |
| Emerging Markets Debt | 6.0% | 5.10% | 0.31% |
| Global Public Equity | 31.0% | 7.10% | 2.20% |
| Global Tactical Asset Allocation | 10.0% | 4.90% | 0.49% |
| Alternatives | 32.0% | | |
| Hedge Funds (Low Beta) | 8.0% | 4.30% | 0.34% |
| Private Debt | 7.0% | 9.90% | 0.69% |
| Private Equity | 9.0% | 9.90% | 0.89% |
| Real Estate (Broad Market) | 5.0% | 6.00% | 0.30% |
| Commodities | 3.0% | 5.90% | 0.18% |
| Total Expected Real Return | 100.0% | | 6.00% |
| Inflation for Actuarial Purposes | | | 2.75% |
| Total Expected Nominal Return | | | 8.75% |

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

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 7.50 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 (6.50 percent) or 1.00 percent higher (8.50 percent) than the current rate.

| Sensitivity of the Proportional Share of Net Pension Liability to Changes in the Discount Rate | | | |
|---|-----------------------------------|--|-----------------------------------|
| System | 1.00% Decrease (6.50%) | Current Discount Rate (7.50%) | 1.00% Increase (8.50%) |
| SCRS | \$ 7,514,930 | \$ 5,961,706 | \$ 4,658,335 |

Deferred Outflows (Inflows) of Resources

For the year ended June 30, 2016, First Steps recognized pension expense of \$435,048 which is included in employer fringe benefits in the accompanying financial statements. At June 30, 2016, 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 services lives of all employees provided with pensions through the pension plans at June 30, 2015 was 4.164 years for SCRS:

| | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> |
|---|---|--|
| Pension contributions subsequent to measurement date | \$ 412,387 | \$ — |
| Differences in actual and expected plan experience | 105,917 | 10,661 |
| Change in proportionate share and differences between First Steps' contributions and proportionate share of contributions | 5,877 | — |
| Net differences between projected and actual earnings on plan investments | 39,904 | — |
| | <u>\$ 564,085</u> | <u>\$ 10,661</u> |

| Measurement Period Ending June 30, | Fiscal Year Ending June 30, | SCRS |
|---|--|-------------|
| 2016 | 2017 | \$ (27,379) |
| 2017 | 2018 | (27,379) |
| 2018 | 2019 | 9,001 |
| 2019 | 2020 | \$ (95,280) |

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

6. Pension Plan (continued)

Deferred Outflows (Inflows) of Resources (continued)

First Steps reported \$412,387 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, 2017.

7. Post-Employment Benefits Other than Pensions

Plan Description

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

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

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

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

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

Funding Policies

Section 1-11-710 of the South Carolina Code of Laws of 1976, as amended, requires these post-employment and long-term disability benefits be funded through annual appropriations by the General Assembly for active employees to the IB and participating retirees to the PEBA, except for the portion funded through the pension surcharge and provided from the other applicable sources of the IB, for its active employees who are not funded by State General Fund appropriations. Employers participating in the RMP are mandated by State statute to contribute at a rate assessed each year by the Office of the State Budget, 5.33 percent of annual covered payroll for 2016 and 5.00 percent of annual covered payroll for 2015. The IB sets the employer contribution rate based on a pay-as-you-go basis. First Steps paid \$198,736 and \$147,365 applicable to the surcharge included with the employer contribution for retirement benefits for the fiscal years ended June 30, 2016 and 2015, respectively. BLTD benefits are funded through a person's premium charged to State agencies, public school districts, and other participating local governments. The monthly premium per active employee paid to IB was \$3.22 for fiscal years ended June 30, 2016 and 2015. First Steps recorded employer contributions expenses applicable to these insurance benefits for active employees in the amount of approximately \$2,700 for the years ended June 30, 2016 and 2015.

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

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

8. Deferred Compensation Plans

Several optional deferred compensation plans are available to State employees. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401(k), and 403(b), are administered by third parties and are not included in First Steps' financial statements. Compensation deferred under the plans is placed in trust for the contributing employee. First Steps has no liability for losses under the plans. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan. First Steps made no contributions for the fiscal year ending June 30, 2016.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

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 \$1.2 million for the year ended June 30, 2016.

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, 2016 of \$19,988 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, 2016 was \$791,346 and they were paid \$813,197 resulting in an amount owed to First Steps of \$21,851 as of June 30, 2016. This amount will be repaid through a reduction in fiscal year 2017 payments. 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

Capital asset maintenance fee

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

County Partnership Regional Finance Managers

First Steps has an accounting contract with two public accounting firms to provide bookkeeping services for each county's Partnership office. The contract extends through November 30, 2016. The remaining commitment is \$166,458 for fiscal year 2017.

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

11. Commitments and Contingencies (continued)

Leases

First Steps has entered into several non-cancellable leases, considered operating leases, for facilities used to house operations critical to First Steps' mission. Rent expense related to these leases was approximately \$256,000, while total lease and rental expense was approximately \$341,000, for the year ended June 30, 2016. First Steps entered into a five-year equipment lease, in May 2014, and various computer equipment leases during 2016, which are considered operating leases. Future base rental payments under non-cancellable leases are as follows:

Year ending June 30:

| | |
|-------|-------------------|
| 2017 | \$ 267,820 |
| 2018 | 235,973 |
| 2019 | 175,476 |
| 2020 | 147,668 |
| 2021 | 2,500 |
| Total | <u>\$ 829,437</u> |

County Partnerships

First Steps has agreements with each County within the State related to early childhood services. First Steps' total appropriations to the county partnerships during the year ended June 30, 2016 were \$12,693,265, of which all was disbursed to the county partnerships. However, amounts for fiscal year 2015 were not entirely paid out during fiscal years 2015 or 2016 and this leaves total commitments of \$328,920 yet to be disbursed to county partnerships during future fiscal years.

Grants

First Steps receives financial assistance from various federal, state, and local governmental agencies in the form of grants. Disbursements of funds received under these programs generally require compliance with the terms and conditions specified in the grant agreements. The disbursements are also subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability. However, in the opinion of management, any such disallowed claims will not have a material effect on any of the financial statements included herein or on the overall financial position of First Steps at June 30, 2016.

Reauthorization

The South Carolina General Assembly and the Governor reauthorized First Steps with its Legislative Bill H3428 effective July 1, 2014. Bill H3428 extended SC First Steps authorization from July 1, 2014 (FY 15) thru June 30, 2016 (FY 16). For the period July 1, 2016 thru June 30, 2017 (FY 17), the SC General Assembly and the Governor did not use legislation to extend SC First Steps' authorization. However, it did include First Steps in the budget appropriation which funded it for one fiscal year, July 1, 2016 thru June 30, 2017 (FY 17).

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016**

12. Subsequent Event

In September 2016, the Governor of South Carolina issued Executive Order No. 20, which designated the South Carolina Department of Health and Human Services as the lead agency for South Carolina's IDEA Part C program, known locally as "BabyNet". This Executive Order took effect immediately with the Department of Health and Human Services formally assuming the IDEA Part C lead agency responsibility beginning July 1, 2017. Funding related to the BabyNet program is expected to be appropriated to the South Carolina Department of Health and Human Service beginning in fiscal year 2018.

**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, 2016**

| | Budgeted Amounts | | | Variance Positive (Negative) |
|---------------------------------------|---------------------|---------------------|---------------------|------------------------------------|
| | Original | Final | Actual | |
| Expenditures: | | | | |
| First Steps to School Readiness | | | | |
| Personal Services | | | | |
| Classified Positions | \$ 65,000 | \$ 65,000 | \$ 65,000 | \$ — |
| Other Personal Services | — | 35,240 | 35,240 | — |
| Special Items | | | | |
| CDEPP | 6,424,200 | 6,424,200 | 6,424,200 | — |
| Employer Contributions | 29,280 | 29,280 | 29,280 | — |
| Total First Steps to School Readiness | <u>\$ 6,518,480</u> | <u>\$ 6,553,720</u> | <u>\$ 6,553,720</u> | <u>\$ —</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, 2016**

| | Budgeted Amounts | | | Variance Positive (Negative) |
|---------------------------------------|----------------------|----------------------|----------------------|------------------------------------|
| | Original | Final | Actual | |
| Expenditures: | | | | |
| First Steps to School Readiness | | | | |
| Personal Services | | | | |
| Classified Positions | \$ 2,605,453 | \$ 2,545,058 | \$ 2,193,751 | \$ 351,307 |
| Unclassified Positions | 121,540 | 66,681 | 66,681 | — |
| Other Personal Services | 425,000 | 961,887 | 821,689 | 140,198 |
| Other Operating Expenses | 6,876,181 | 6,420,978 | 3,565,647 | 2,855,331 |
| Special Items | | | | |
| County Partnerships | 12,693,265 | 12,693,265 | 12,693,265 | — |
| Babynet | 7,581,000 | 7,581,000 | 5,751,804 | 1,829,196 |
| CDEPP | 9,767,864 | 7,767,864 | 5,424,549 | 2,343,315 |
| Babynet Autism Therapy | 1,699,848 | 1,699,848 | 1,699,848 | — |
| Employer Contributions | 1,129,599 | 1,163,169 | 1,121,737 | 41,432 |
| Total First Steps to School Readiness | <u>\$ 42,899,750</u> | <u>\$ 40,899,750</u> | <u>\$ 33,338,971</u> | <u>\$7,560,779</u> |

**SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULES
FOR THE YEAR ENDED JUNE 30, 2016**

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 the General Funds or the Other Budgeted Funds. 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, 2016**

3. Legal Level of Budgetary Control

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

4. Basis of Budgeting

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

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

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

5. Budget to GAAP Reporting Differences

Budgetary accounting principles differ significantly from GAAP accounting principles. Basis differences arise because the basis of budgeting differs from the GAAP basis used to prepare the statement of revenues, expenditures, and changes in fund balance. In the current year, there are funds that are received by First Steps that are not legally budgeted and therefore, the amounts reported as actual expenditures on the budgetary basis do not agree to the actual expenditures reported in the governmental fund Statement of Revenue, Expenditure, and Changes in Fund Balance and the Statement of Activities. The differences between the budgetary comparison schedules for the General Funds and Other Budgeted Funds as compared to the Statement of Revenues, Expenditures, and Changes in Fund Balance are related strictly to the modified accrual basis of accounting which include accounts receivable and accounts payable as revenues and expenditures in the current year while the budgetary basis would include those amounts in the year that payments were actually received or paid. 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, 2016**

5. Budget to GAAP Reporting Differences (continued)

Reconciliation of Budget Basis to GAAP Basis Expenditures
For the Year Ended June 30, 2016

| | General Fund | Other Budgeted Funds | Total |
|--|--------------|----------------------|---------------|
| Total expenditures, budgetary basis | \$ 6,553,720 | \$ 33,338,971 | \$ 39,892,691 |
| Basis of accounting differences: | | | |
| Change in accrued salaries | — | 159,866 | 159,866 |
| Change in accounts payable | — | 1,261,072 | 1,261,072 |
| Transfers to other entities not expenditures under budgetary basis | — | 9,286,502 | 9,286,502 |
| Other basis differences | — | (87,502) | (87,502) |
| Total expenditures, GAAP basis | \$ 6,553,720 | \$ 43,958,909 | \$ 50,512,629 |

**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, 2016
Last Three Fiscal Years**

| | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|---|--------------|--------------|--------------|
| First Steps' proportion of the net pension liability | 0.03143% | 0.031390% | 0.031390% |
| First Steps' proportionate share of the net pension liability | \$ 5,961,706 | \$ 5,404,384 | \$ 5,630,315 |
| First Steps' covered – employee payroll | \$ 2,947,293 | \$ 2,849,840 | \$ 2,889,764 |
| First Steps' proportionate share of the net pension liability as percentage of covered-employee payroll | 202.28% | 189.64% | 194.84% |
| Plan fiduciary net position as a percentage of the total pension liability | 57.0% | 59.9% | 56.4% |

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

Note: Only three years of data were available; thus, only three 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, 2016
Last Six Fiscal Years**

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

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

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**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, 2016, and the related notes to the financial statements, which collectively comprise First Steps' basic financial statements, and have issued our report thereon dated October 5, 2016.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2016-001 that we consider to be a material weakness.

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*.

First Steps' Response to Finding

First Steps' response to the finding identified in our audit is described in the accompanying schedule of findings and responses. First Steps' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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.

A handwritten signature in cursive script that reads "Greene, Finney & Horton LLP".

Greene, Finney & Horton, LLP
Mauldin, South Carolina
October 5, 2016

SOUTH CAROLINA FIRST STEPS TO SCHOOL READINESS

SCHEDULE OF FINDINGS AND RESPONSES

FOR THE YEAR ENDED JUNE 30, 2016

2016-001: CLOSING PROCESS FOR THE ANNUAL FINANCIAL STATEMENTS

| | |
|------------------------|---|
| Condition: | First Steps operates on a modified cash basis throughout the year and converts to the modified accrual basis (as required by generally accepted accounting principles) when preparing the annual financial statements. In order to accomplish this, First Steps compiles a list of receivables, payables, and other adjustments that need to be recorded in adjusting its modified cash basis financial statements to the modified accrual basis required in the annual financial statements. Due to a number of unique situations, complexities, and funding challenges for the year ended June 30, 2016 ("2016"), First Steps inadvertently accrued some receivables and payables that later had to be removed. |
| Criteria: | Revenues and expenditures should be recorded in accordance with generally accepted accounting principles. |
| Context/Effect: | Due to the complexities surrounding the funding of First Steps for 2016, some additional adjustments had to be made that reduced First Steps' fund balance at June 30, 2016. |
| Cause: | Complexity of First Steps funding situation for 2016. |
| Recommendation: | We recommend that First Steps carefully compile and review receivables, payables, and other adjustments during the closing process to ensure that all amounts have been properly recorded. |
| Response: | First Steps agrees with the finding and has put into place additional reviews to ensure that any prior year payables are properly documented in the correct year, based on federal and state requirements and generally accepted accounting principles. Any corrections have already been processed to ensure that correct accounting of all transactions has taken place. |
