

Small Steps Nurturing Center

Financial Statements
and Independent Auditors' Report
for the years ended December 31, 2013 and 2012

Small Steps Nurturing Center

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Independent Auditors' Report

To the Board of Directors of
Small Steps Nurturing Center:

We have audited the accompanying financial statements of Small Steps Nurturing Center, which comprise the statements of financial position as of December 31, 2013 and 2012 and the related statements of activities, of functional expenses, and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements – Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility – Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion – In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Small Steps Nurturing Center as of December 31, 2013 and 2012 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Blazek & Vetterling

May 15, 2014

Small Steps Nurturing Center

Statements of Financial Position as of December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash	\$ 258,172	\$ 152,577
Prepaid expenses and other assets	48,069	25,412
Pledges receivable (Note 2)	562,785	843,905
Cash designated or restricted for long-term purposes (Note 3)	1,221,848	864,335
Investments (Note 4)	593,051	520,898
Property, net (Note 5)	<u>3,333,063</u>	<u>3,292,972</u>
TOTAL ASSETS	<u>\$ 6,016,988</u>	<u>\$ 5,700,099</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 33,308	\$ 23,351
Funds held for others	32,093	
Construction payable		<u>116,700</u>
Total liabilities	<u>65,401</u>	<u>140,051</u>
Net assets:		
Unrestricted:		
Operating	3,563,471	2,199,462
Board-designated reserve funds	<u>444,167</u>	<u>406,184</u>
Total unrestricted net assets	4,007,638	2,605,646
Temporarily restricted (Notes 6 and 7)	<u>1,943,949</u>	<u>2,954,402</u>
Total net assets	<u>5,951,587</u>	<u>5,560,048</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 6,016,988</u>	<u>\$ 5,700,099</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Statement of Activities for the year ended December 31, 2013

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Contributions (<i>Note 9</i>)	\$ 812,480	\$ 645,500	\$ 1,457,980
Golf tournament	829,250		829,250
Sporting clay tournament	566,397	139,309	705,706
Wine Classic event	530,002		530,002
Luncheon event	183,754		183,754
Cost of direct donor benefits	(456,586)		(456,586)
Investment return (<i>Note 4</i>)	<u>38,937</u>	<u>47,220</u>	<u>86,157</u>
Total revenue	2,504,234	832,029	3,336,263
Net assets released from restrictions:			
Capital expenditures	1,496,791	(1,496,791)	
Program expenditures	290,691	(290,691)	
Expiration of time restrictions	<u>55,000</u>	<u>(55,000)</u>	
Total	<u>4,346,716</u>	<u>(1,010,453)</u>	<u>3,336,263</u>
EXPENSES:			
Program services	2,444,536		2,444,536
Management and general	176,003		176,003
Fundraising	<u>324,185</u>		<u>324,185</u>
Total expenses	<u>2,944,724</u>		<u>2,944,724</u>
CHANGES IN NET ASSETS	1,401,992	(1,010,453)	391,539
Net assets, beginning of year	<u>2,605,646</u>	<u>2,954,402</u>	<u>5,560,048</u>
Net assets, end of year	<u>\$ 4,007,638</u>	<u>\$ 1,943,949</u>	<u>\$ 5,951,587</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Statement of Activities for the year ended December 31, 2012

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Contributions (<i>Note 9</i>)	\$ 492,575	\$ 1,192,951	\$ 1,685,526
Golf tournament	779,750		779,750
Sporting clay tournament	471,053		471,053
Wine Classic event	458,374		458,374
Luncheon event	190,467		190,467
Cost of direct donor benefits	(394,219)		(394,219)
Investment return (<i>Note 4</i>)	<u>32,636</u>	<u>27,104</u>	<u>59,740</u>
Total revenue	2,030,636	1,220,055	3,250,691
Net assets released from restrictions:			
Program expenditures	206,541	(206,541)	
Expiration of time restrictions	<u>5,000</u>	<u>(5,000)</u>	
Total	<u>2,242,177</u>	<u>1,008,514</u>	<u>3,250,691</u>
EXPENSES:			
Program services	2,027,290		2,027,290
Management and general	153,645		153,645
Fundraising	<u>289,910</u>		<u>289,910</u>
Total expenses	<u>2,470,845</u>		<u>2,470,845</u>
CHANGES IN NET ASSETS	(228,668)	1,008,514	779,846
Net assets, beginning of year	<u>2,834,314</u>	<u>1,945,888</u>	<u>4,780,202</u>
Net assets, end of year	<u>\$ 2,605,646</u>	<u>\$ 2,954,402</u>	<u>\$ 5,560,048</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Statement of Functional Expenses for the year ended December 31, 2013

	<u>PROGRAM SERVICES</u>	<u>MANAGEMENT AND GENERAL</u>	<u>FUNDRAISING</u>	<u>TOTAL</u>
Salaries	\$ 1,667,452	\$ 99,429	\$ 189,294	\$ 1,956,175
Employer payroll taxes	125,404	7,478	14,237	147,119
Employee benefits	<u>119,883</u>	<u>5,157</u>	<u>15,246</u>	<u>140,286</u>
Total salaries and related expenses	1,912,739	112,064	218,777	2,243,580
Depreciation	156,414	2,723	4,393	163,530
Professional services	35,551	40,607	12,355	88,513
Insurance	59,938	3,039	1,202	64,179
Utilities	57,729	2,565	3,073	63,367
Supplies	43,075	2,151	6,382	51,608
Food	49,358			49,358
Repairs and maintenance	41,209	2,161	3,105	46,475
Printing, publications and postage	999	1,329	41,006	43,334
Continuing education	23,511		20	23,531
Transportation	21,606	24	968	22,598
Extended day program provider	20,000			20,000
Bank and credit card fees		1,179	17,609	18,788
Equipment rental	9,097	26	674	9,797
Software and website	2,466		6,092	8,558
Other	<u>10,844</u>	<u>8,135</u>	<u>8,529</u>	<u>27,508</u>
Total expenses	<u>\$ 2,444,536</u>	<u>\$ 176,003</u>	<u>\$ 324,185</u>	2,944,724
Cost of direct donor benefits				<u>456,586</u>
Total				<u>\$ 3,401,310</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Statement of Functional Expenses for the year ended December 31, 2012

	<u>PROGRAM SERVICES</u>	<u>MANAGEMENT AND GENERAL</u>	<u>FUNDRAISING</u>	<u>TOTAL</u>
Salaries	\$ 1,341,978	\$ 77,539	\$ 156,770	\$ 1,576,287
Employer payroll taxes	100,387	5,577	11,536	117,500
Employee benefits	<u>116,449</u>	<u>5,404</u>	<u>10,399</u>	<u>132,252</u>
Total salaries and related expenses	1,558,814	88,520	178,705	1,826,039
Depreciation	120,566	1,841	2,761	125,168
Professional services	30,653	45,688	1,290	77,631
Insurance	44,484	2,970	3,953	51,407
Utilities	48,820	3,186	4,167	56,173
Supplies	38,178	1,324	8,811	48,313
Food	47,518			47,518
Repairs and maintenance	63,061	1,356	2,149	66,566
Printing, publications and postage	7,998	614	32,348	40,960
Continuing education	14,694		245	14,939
Transportation	17,696	1,090	301	19,087
Extended day program provider	20,000			20,000
Bank and credit card fees		618	16,794	17,412
Equipment rental	254		29,798	30,052
Software and website	1,686		5,553	7,239
Other	<u>12,868</u>	<u>6,438</u>	<u>3,035</u>	<u>22,341</u>
Total expenses	<u>\$ 2,027,290</u>	<u>\$ 153,645</u>	<u>\$ 289,910</u>	2,470,845
Cost of direct donor benefits				<u>394,219</u>
Total				<u>\$ 2,865,064</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Statements of Cash Flows for the years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 391,539	\$ 779,846
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Contributions restricted for long-term purposes	(301,016)	(932,004)
Depreciation	163,701	125,168
Net realized and unrealized gain on investments	(73,829)	(38,496)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(22,657)	(4,113)
Pledges receivable (operating)	(132,140)	(65,169)
Accounts payable	9,957	(10,241)
Funds held for others	<u>32,093</u>	<u> </u>
Net cash provided (used) by operating activities	<u>67,648</u>	<u>(145,009)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(11,559)	(15,406)
Proceeds from sale of investments	13,235	
Purchases of property	(320,492)	(1,122,639)
Net change in cash designated or restricted for long-term purposes	<u>(357,513)</u>	<u>310,198</u>
Net cash used by investing activities	<u>(676,329)</u>	<u>(827,847)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for long-term purposes	<u>714,276</u>	<u>705,052</u>
NET CHANGE IN CASH	105,595	(267,804)
Cash, beginning of year	<u>152,577</u>	<u>420,381</u>
Cash, end of year	<u>\$ 258,172</u>	<u>\$ 152,577</u>

See accompanying notes to financial statements.

Small Steps Nurturing Center

Notes to Financial Statements for the years ended December 31, 2013 and 2012

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization – Small Steps Nurturing Center (Small Steps) is a Texas nonprofit corporation located in Houston, Texas, providing a comprehensive early childhood development program aimed at giving at-risk, pre-school-age children and their parents the opportunity to grow socially, emotionally, physically, intellectually, and spiritually. Small Steps serves approximately 164 students at its Jensen and DePelchin campuses. Small Steps relies on charitable contributions for support of its program and does not solicit or accept governmental funding.

Federal income tax status – Small Steps is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(1). Small Steps files annual federal information returns that are subject to routine examination; however, there are no examinations for any tax periods currently in progress. Small Steps believes it is no longer subject to examinations of returns for tax years ended before December 31, 2010.

Cash concentration – Bank deposits exceed the federally insured limit per depositor per institution.

Pledges receivable that are expected to be collected within one year are reported at net realizable value. Pledges receivable that are expected to be collected in future years are discounted, if material, to estimate the present value of future cash flows.

Investments are reported at fair value. Investment return is reported in the statement of activities as an increase in unrestricted net assets unless the use of the income is limited by donor-imposed restrictions. Investment return whose use is restricted by the donor is reported as an increase in temporarily restricted net assets until expended in accordance with donor-imposed restrictions.

Property with an original value of at least \$1,000 is reported at cost if purchased and at fair value at the date of gift if donated. Property is depreciated using the straight-line method over estimated useful lives of 3 to 7 years for furniture, equipment and supplies, and 10 to 30 years for buildings and improvements.

Net asset classification – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Contributions are recognized as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are classified as restricted support. Conditional contributions are recognized in the same manner when the conditions are substantially met. Small Steps recognizes gifts of long-lived assets as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit

restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are classified as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, Small Steps reports releases of donor restrictions when the assets are placed in service.

In-kind contributions – Donated materials, use of facilities and services are recognized at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recognized as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts of reported revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 2 – PLEDGES RECEIVABLE

Pledges receivable consist of the following:

	<u>2013</u>	<u>2012</u>
Capital campaign	\$ 345,476	\$ 758,736
Operating	<u>217,309</u>	<u>85,169</u>
Pledges receivable, net	<u>\$ 562,785</u>	<u>\$ 843,905</u>

Pledges receivable at December 31, 2013 are expected to be collected as follows:

Due within one year	\$ 537,508
Due in one to five years	<u>25,277</u>
Total pledges receivable	<u>\$ 562,785</u>

NOTE 3 – CASH DESIGNATED OR RESTRICTED FOR LONG-TERM PURPOSES

Cash whose use has been limited or restricted for long-term purposes consist of the following:

	<u>2013</u>	<u>2012</u>
Donor-restricted for capital campaign	\$ 925,000	\$ 564,452
Board-designated for future operations	151,732	151,601
Donor-restricted for higher education	<u>145,116</u>	<u>148,282</u>
Total	<u>\$ 1,221,848</u>	<u>\$ 864,335</u>

NOTE 4 – INVESTMENTS AND FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity’s assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at December 31, 2013 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Mutual funds:				
Balanced index	\$ 300,166			\$ 300,166
Moderate growth	<u>292,885</u>			<u>292,885</u>
Total assets measured at fair value	<u>\$ 593,051</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 593,051</u>

Assets measured at fair value at December 31, 2012 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Mutual funds:				
Balanced index	\$ 266,315			\$ 266,315
Moderate growth	<u>254,583</u>			<u>254,583</u>
Total assets measured at fair value	<u>\$ 520,898</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 520,898</u>

Mutual funds are valued at the closing price reported on the active market in which the individual securities are traded. This valuation method may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Small Steps believes its valuation method is appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

Investments are exposed to various risks such as interest rate, market, and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

Investment return includes earnings on cash and consists of the following:

	<u>2013</u>	<u>2012</u>
Interest and dividends	\$ 12,328	\$ 21,244
Net realized and unrealized gain	<u>73,829</u>	<u>38,496</u>
Total investment return	<u>\$ 86,157</u>	<u>\$ 59,740</u>

NOTE 5 – PROPERTY

Property consists of the following:

	<u>2013</u>	<u>2012</u>
Land	\$ 367,748	\$ 367,748
Buildings and improvements	3,708,201	2,404,664
Office furniture and equipment	113,591	81,663
Classroom equipment and supplies	185,327	171,057
Vans	193,552	168,748
Construction in progress	<u> </u>	<u>1,174,121</u>
Property, at cost	4,568,419	4,368,001
Accumulated depreciation	<u>(1,235,356)</u>	<u>(1,075,029)</u>
Property, net	<u>\$ 3,333,063</u>	<u>\$ 3,292,972</u>

NOTE 6 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2013</u>	<u>2012</u>
Capital improvements, future operations and continuity fund	\$ 1,270,476	\$ 2,466,251
Term endowment to support school operations	300,166	266,315
For use in future years	149,309	65,000
Higher education	145,116	148,282
Telephone system	40,000	
Outcomes measurement	25,000	
Other	<u>13,882</u>	<u>8,554</u>
Total temporarily restricted net assets	<u>\$ 1,943,949</u>	<u>\$ 2,954,402</u>

NOTE 7 – ENDOWMENT FUND

Small Steps maintains a term endowment fund that is restricted by the donor until 2020 to provide consistent, long-term funding for educational operations by annually distributing 4% to 5% of the fund's average quarterly value. This fund has no permanently restricted component, but was established to function similar to an endowment. At the end of the term of the endowment, any remaining unspent funds may be used at the discretion of the Small Steps' Board of Directors.

Changes in net assets of the term endowment fund are as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Net assets, December 31, 2011	\$ 0	\$ 239,211	\$ 0	\$ 239,211
Investment return:				
Interest and dividends		5,279		5,279
Net realized and unrealized gain		<u>21,825</u>		<u>21,825</u>
Net investment return		<u>27,104</u>		<u>27,104</u>
Net assets, December 31, 2012	<u>0</u>	<u>266,315</u>	<u>0</u>	<u>266,315</u>
Investment return:				
Interest and dividends		5,204		5,204
Net realized and unrealized gain		<u>41,882</u>		<u>41,882</u>
Net investment return		<u>47,086</u>		<u>47,086</u>
Distributions		<u>(13,235)</u>		<u>(13,235)</u>
Net assets, December 31, 2013	<u>\$ 0</u>	<u>\$ 300,166</u>	<u>\$ 0</u>	<u>\$ 300,166</u>

The Board of Directors of Small Steps has interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) as requiring the classification of the entire market value of the term endowment fund, as of the date of the financial statements, as temporarily restricted net assets. Annually, in accordance with the donor's wish as expressed in the gift instrument, Small Steps appropriates for expenditure an amount of money determined by a formula based on average net assets over a period of twelve quarters. In determining the specific amount of money to be appropriated for expenditure, the Small Steps' Board of Directors considers the following factors:

- The duration and preservation of the funds
- The purposes of Small Steps and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of Small Steps
- The investment policies of Small Steps

Investment Policy

Small Steps has adopted an investment policy for term endowment investments and other invested funds of Small Steps. The general purpose of the policy is to preserve and enhance the real value of the principal and to provide Small Steps with a dependable source of revenue to support its facilities and programs. More specifically, with respect to the donor-restricted term endowment fund, the purpose of the policy is to provide a relatively stable annual income whose real value will remain consistent over the next ten years.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, Small Steps relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Small Steps targets a diversified asset allocation that varies based on the

objectives of the specific fund. Asset allocation targets are determined by the Board of Directors based on the recommendations of the Finance Committee of the Board of Directors.

NOTE 8 – CONCENTRATION OF CONTRIBUTIONS

During the year ended December 31, 2013, contributions from five donors, three of which were foundations, comprised approximately \$550,000 or 17% of total contributions. During the year ended December 31, 2012, contributions from two foundations comprised approximately \$600,000 or 19% of total contributions.

NOTE 9 – IN-KIND CONTRIBUTIONS

The following in-kind contributions are included in revenue as unrestricted contributions and capitalized as fixed assets or expensed and reported in their respective functional categories:

	<u>2013</u>	<u>2012</u>
Program supplies and food	\$ 11,135	\$ 13,300
Building fire system and design services	6,500	44,647
Promotional video	4,800	
Printing and publications	4,000	4,000
Other	<u>2,695</u>	<u>4,000</u>
Total in-kind contributions	<u>\$ 29,130</u>	<u>\$ 65,947</u>

NOTE 10 – RELATED PARTY TRANSACTIONS

During 2012, Small Steps purchased vans from a related party for approximately \$54,000.

NOTE 11 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through May 15, 2014, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.