FINANCIAL STATEMENTS

SisterCities INTERNATIONAL

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

SISTER CITIES INTERNATIONAL

CONTENTS

GELMAN, ROSENBERG & FREEDMAN
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Sister Cities International
Washington, D.C.

We have audited the accompanying statements of financial position of Sister Cities International (Sister Cities), as of December 31, 2011 and 2010, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of Sister Cities. 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 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Sister Cities' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sister Cities as of December 31, 2011 and 2010, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 5, 2012 on our consideration of Sister Cities' 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 Sister Cities' internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the Sister Cities' internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Gelman Rosenberg & Freedman

July 5, 2012

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SISTER CITIES INTERNATIONAL

STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2011 AND 2010

ASSETS

	2011	2010
CURRENT ASSETS		
Cash and cash equivalents	$ 2,365,697	$ 306,280
Investments, current portion (Notes 2 and 9)	2,031,756	3,814,065
Grants receivable	-	8,950
Other receivables and advances	85,068	89,402
Prepaid expenses	77,631	52,033
Total current assets	4,560,152	4,270,730
FURNITURE AND EQUIPMENT		
Furniture and equipment, net of accumulated depreciation of $170,528 and $124,100 for 2011 and 2010, respectively	89,111	88,264
NONCURRENT ASSETS		
Investments, noncurrent portion (Notes 2 and 9)	87,052	85,200
Security deposits	41,747	50,497
Total noncurrent assets	128,799	135,697
TOTAL ASSETS	**$ 4,778,062**	**$ 4,494,691**

LIABILITIES AND NET ASSETS (DEFICIT)

	2011	2010
CURRENT LIABILITIES		
Lines of credit (Note 4)	$ 88,062	$ 111,843
Capital lease obligation, current portion (Note 3)	30,943	26,700
Accounts payable and accrued expenses	73,732	162,405
Refundable advances, current portion	4,542,776	2,219,523
Deferred membership dues	48,510	48,235
Deferred conference registrations	15,190	28,005
Total current liabilities	4,799,213	2,596,711
NONCURRENT LIABILITIES		
Capital lease obligation, net of current portion (Note 3)	-	28,658
Refundable advances, net of current portion	-	2,252,158
Deferred rent (Note 7)	44,725	-
Total noncurrent liabilities	44,725	2,280,816
Total liabilities	4,843,938	4,877,527
NET ASSETS (DEFICIT)		
Unrestricted:		
Undesignated	(216,647)	(529,763)
Board-designated (Note 5)	150,771	146,927
Total unrestricted net assets (deficit)	(65,876)	(382,836)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	**$ 4,778,062**	**$ 4,494,691**

See accompanying notes to financial statements.

SISTER CITIES INTERNATIONAL

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	Unrestricted	
	2011	2010
SUPPORT AND REVENUE		
U.S. Government awards (Note 8)	$ 711,400	$ 479,594
Contributions and grants	2,374,913	1,803,514
Annual fund contributions	-	254
In-kind contributions	42,218	82,122
Conferences and events	211,599	304,878
Membership dues	359,541	331,050
Awards and visa fees	50	4,180
Interest and investment income (loss) (Note 2)	92,845	(2,825)
Other	18,702	28,567
Total support and revenue	3,811,268	3,031,334
EXPENSES		
Salaries, taxes and related benefits (Note 6)	869,860	873,355
Professional fees	72,720	114,982
Office supplies and expense	18,445	56,282
Telecommunications	23,697	31,473
Postage and shipping	11,675	13,876
Occupancy (Note 7)	170,237	206,948
Equipment expense	11,336	14,530
Printing and publications	54,865	72,095
Travel	504,260	480,441
Conferences, conventions and meetings	266,728	265,053
Depreciation	46,428	40,340
Grants and contracts	1,003,050	304,470
Other program services	27,878	201,455
Insurance	3,668	7,634
Consultants	263,436	242,581
Bad debt	20,036	23,923
Interns	7,630	12,372
Computer and website	74,340	61,657
Bank fees	15,741	18,318
Interest expense	9,412	13,593
Other	18,866	39,492
Total expenses	3,494,308	3,094,870
Changes in net assets (deficit)	316,960	(63,536)
Net assets (deficit) at beginning of year	(382,836)	(319,300)
NET ASSETS (DEFICIT) AT END OF YEAR	**$ (65,876)**	**$ (382,836)**

See accompanying notes to financial statements.

SISTER CITIES INTERNATIONAL

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets (deficit)	$ 316,960	$ (63,536)
Adjustments to reconcile changes in net assets (deficit) to net cash provided by operating activities:		
Depreciation	46,428	40,340
Donated investments	-	(254)
Unrealized (gain) loss on investments	(18,868)	51,715
Realized loss on sales of investments	23,640	1,033
Bad debt	20,036	23,923
Deferred rent abatement	44,725	-
(Increase) decrease in:		
Grants receivable	8,950	(4,793)
Other receivables and advances	(15,702)	(96,778)
Prepaid expenses	(25,598)	(162)
Security deposits	8,750	(33,535)
Increase (decrease) in:		
Refundable advances	71,095	2,935,355
Accounts payable and accrued expenses	(88,673)	(60,364)
Deferred membership dues	275	(4,555)
Deferred conference registrations	(12,815)	(8,795)
Net cash provided by operating activities	379,203	2,779,594
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment	(47,275)	(3,679)
Purchase of investments	(57,976)	(3,950,544)
Proceeds from sales of investments	1,833,661	130,000
Net cash provided (used) by investing activities	1,728,410	(3,824,223)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings from lines of credit	2,885	2,885
Repayments on lines of credit	(26,666)	(21,200)
Principal payments on capital lease obligation	(24,415)	(24,875)
Net cash used by financing activities	(48,196)	(43,190)
Net increase (decrease) in cash and cash equivalents	2,059,417	(1,087,819)
Cash and cash equivalents at beginning of year	306,280	1,394,099
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 2,365,697**	**$ 306,280**
SUPPLEMENTAL INFORMATION:		
Interest Paid	**$ 9,412**	**$ 13,593**

See accompanying notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION

Organization -

Sister Cities International (Sister Cities) is a non-profit organization incorporated under the laws of the District of Columbia on June 12, 1967. Sister Cities was formed to promote local community development and volunteer action to provide opportunities for citizens of different countries to share culture, develop trade relationships and provide an atmosphere for learning and problem solving between nations.

Basis of presentation -

The accompanying financial statements are presented on the accrual basis of accounting, and in accordance with FASB ASC 958, *Not-for-Profit Entities*.

Classification of net assets -

The net assets of Sister Cities are reported in the two self-balancing groups as follows:

- **Unrestricted net assets** include unrestricted revenue and contributions received without donor-imposed restrictions. These net assets are available for the operation of Sister Cities and include both internally designated and undesignated resources.

- **Temporarily restricted net assets** include revenue and contributions subject to donor-imposed stipulations that will be met by the actions of Sister Cities and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statements of Activities and Changes in Net Assets as net assets released from restrictions. At December 31, 2011 and 2010, Sister Cities had no temporarily restricted net assets.

Contributions and grants -

Unrestricted and temporarily restricted contributions and grants are recorded as revenue in the year notification is received from the donor. Temporarily restricted contributions and grants are recognized as unrestricted support only to the extent of actual expenses incurred in compliance with the donor-imposed restrictions and satisfaction of time restrictions. Temporarily restricted contributions and grants received in excess of expenses incurred are shown as temporarily restricted net assets in the accompanying financial statements.

Sister Cities receives funding under grants and contracts from the U.S. Government, private organizations and other grantors for direct and indirect program costs. This funding is subject to contractual restrictions, which must be met through incurring qualifying expenses for particular programs. Accordingly, such grants are considered exchange transactions and are recorded as unrestricted income to the extent that related expenses are incurred in compliance with the criteria stipulated in the grant agreements.

Grants receivable represents amounts due from funding organizations for reimbursable expenses incurred in accordance with the grant agreements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

Refundable advances -

Included in refundable advances are funds received from a donor under a conditional award whereby the program restrictions have not been met (unrestricted revenue has not been earned). Upon satisfaction of the donors restrictions Sister Cities will recognize unrestricted income (by reducing the refundable advances balance), as the criteria of an exchange transaction have been met. At December 31, 2011 and 2010, total refundable advances under this award aggregated $4,542,776 and $4,471,681, respectively.

Cash and cash equivalents -

For financial statement presentation, cash and money market accounts with maturities of three months or less are considered to be cash equivalents. Included in cash as of December 31, 2011 and 2010 is unspent funds in the amount of $2,236,989 and $279,770, respectively, received from the Bill and Melinda Gates Foundation. Also included in cash as of December 31, 2011 and 2010 are $2,472 and $2,432, respectively, which have been designated for the Lou Wozar endowment (Note 5).

Investments -

Investments are recorded at readily determinable fair value. Realized and unrealized gains and losses are included in investment income in the accompanying Statements of Activities and Changes in Net Assets.

Furniture and equipment -

Furniture and equipment with an acquisition value in excess of $1,000 are recorded at cost and are depreciated over an estimated useful life of 60 months. Expenditures for major repairs and improvements are capitalized; conversely, expenditures for minor repairs and maintenance costs are expensed when incurred.

Income taxes -

Sister Cities is exempt from Federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision has been made for Federal income taxes in the accompanying financial statements. Sister Cities is not a private foundation.

Uncertain tax positions -

In June 2006, the Financial Accounting Standards Board (FASB) released FASB ASC 740-10, *Income Taxes*, that provides guidance for reporting uncertainty in income taxes. For the years ended December 31, 2011 and 2010, Sister Cities has documented its consideration of FASB ASC 740-10 and determined that no material uncertain tax positions qualify for either recognition or disclosure in the financial statements. IRS Form 990, *Return of Organization Exempt from Income Tax*, is subject to examination by the Internal Revenue Service, generally for three years after it is filed.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

In-kind contributions -

In-kind contributions consist primarily of time donated by consultants and attorneys. These services are reported at fair value based on estimates of the number of donated hours and market rates of services. In-kind contributions of $42,218 and $82,122, representing the fair value of the use of these services, have been recorded as revenue and expenses in the accompanying financial statements for the years ended December 31, 2011 and 2010, respectively.

Sister Cities also receives additional contributed services for which an estimate of the fair value is not determinable.

Membership dues -

Annual membership dues are billed to members in either January or July for the current fiscal year. Membership dues payments, which are received in the current fiscal year but are attributable for a future membership period, are presented as a deferred current liability in the accompanying Statements of Financial Position.

Use of estimates -

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification -

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

Risks and uncertainties -

Sister Cities invests in various investment securities. Investment securities are exposed to various risks such as interest rates, market and credit risks. Due to the level of risk associated with certain investment securities, 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 accompanying financial statements.

Fair value measurements -

Sister Cities adopted the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*. FASB ASC 820 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs (assumptions that market participants would use in pricing assets and liabilities, including assumptions about risk) used to measure fair value, and enhances disclosure requirements for fair value measurements. Sister Cities accounts for a significant portion of its financial instruments at fair value or considers fair value in their measurement.

2. INVESTMENTS

Investments at December 31, 2011 and 2010 include funds received from the Bill and Melinda Gates Foundation, and are comprised of the following:

	2011		2010	
	Fair Value	Cost Basis	Fair Value	Cost Basis
Current:				
Common stock	$ 245	$ 254	$ 281	$ 254
Preferred stock	21,377	16,726	19,558	15,580
Mutual funds	1,999,985	2,035,112	3,784,101	3,836,169
Certificates of deposit	10,149	10,000	10,125	10,000
Subtotal - current investments	2,031,756	2,062,092	3,814,065	3,862,003
Noncurrent:				
Corporate bonds	65,705	61,238	53,472	50,652
Certificates of deposit	21,347	20,000	31,728	30,000
Subtotal - noncurrent investments	87,052	81,238	85,200	80,652
TOTAL INVESTMENTS	**$2,118,808**	**$2,143,330**	**$3,899,265**	**$3,942,655**

Included in interest and investment income (loss), during the years ended December 31, 2011 and 2010, are the following:

	2011	2010
Interest and dividends	$ 97,617	$ 49,923
Unrealized gain (loss) on investments	18,868	(51,715)
Realized loss on sales of investments	(23,640)	(1,033)
TOTAL INTEREST AND INVESTMENT INCOME (LOSS)	**$ 92,845**	**$ (2,825)**

3. CAPITAL LEASE OBLIGATION

During 2008, Sister Cities acquired a membership database software system that qualified as a capital lease transaction. The total value of the software ($125,000) has been recorded as an asset (equipment) and as a liability (capital lease obligation) in the accompanying Statements of Financial Position. As of December 31, 2011 and 2010, the total liability aggregated $30,943 and $55,358, respectively.

3. CAPITAL LEASE OBLIGATION (Continued)

Future minimum lease payments at December 31, 2011 and 2010 are as follows:

Year Ended December 31,	2011
2012	$ 32,240
Less: Interest (7.10%)	(1,297)
	30,943
Less: Current portion	(30,943)
LONG-TERM PORTION	**$ -**

4. LINES OF CREDIT

Sister Cities maintains a line of credit with a local financial institution in the amount of $80,000. The line of credit is secured by Sister Cities' receivables. Borrowings on the line bear interest of 8.25% and 8.25% at December 31, 2011 and 2010, respectively. Outstanding borrowings aggregated $32,134 and $58,800 as of December 31, 2011 and 2010, respectively.

During 2009, Sister Cities established a second line of credit with a local financial institution in the amount of $60,000. The line of credit is secured by Sister Cities' receivables. Borrowings on the line bear interest of 5.25% and 5.25% at December 31, 2011 and 2010, respectively. Outstanding borrowings (including accrued interest) aggregated $55,928 and $53,043 as of December 31, 2011 and 2010, respectively.

5. UNRESTRICTED BOARD-DESIGNATED NET ASSETS

Sister Cities previously received a $550,000 endowment from The Jesse Phillips Foundation. Under the original terms of the award, the funds were to be invested in-perpetuity and the investment income to be used for general operating purposes.

On May 22, 2001, The Jesse Phillips Foundation agreed to retroactively release the permanent restriction as of December 31, 2000. As a result, the net asset balance previously reported as permanently restricted was transferred to unrestricted net assets and designated by the Board of Directors as an endowment in the name of Lou Wozar. As of December 31, 2011 and 2010, the amounts designated for the Lou Wozar Endowment totaled $150,771 and $146,927, respectively (Note 1).

6. RETIREMENT PLAN

Sister Cities offers its employees retirement benefits through a 403(b) plan. The plan covers all employees who have attained the age of 18 and have been employed for a minimum of six months. Sister Cities currently contributes 5% of each eligible employee's gross salary to the plan. Retirement expense for the years ended December 31, 2011 and 2010 totaled $11,863 and $22,275, respectively.

7. COMMITMENT

On July 17, 2006, Sister Cities entered into a lease agreement for office space. The lease agreement terminated on December 31, 2010. On January 1, 2011, Sister Cities entered into a lease agreement for office space that has a lease term of ten years, expiring on December 31, 2020. Base rent is $134,140 per year, plus a proportionate share of expenses, increasing by a factor of 2.5% per year.

Accounting principles generally accepted in the United States of America require that the total rent commitment should be recognized on a straight-line basis over the term of the lease. Accordingly, the difference between the actual monthly payments and the rent expense being recognized for financial statement purposes is recorded as a deferred rent liability. As of December 31, 2011 and 2010, the liability totaled $44,725 and $0, respectively.

The following is a schedule of future minimum payments required under the lease agreement as of December 31, 2011:

Year Ended December 31,	
2012	$ 137,115
2013	128,918
2014	143,867
2015	147,464
2016	153,949
Thereafter	686,119
	$1,397,432

Occupancy expense for the office lease and an operation lease in Ghana (including operating costs and related utilities) totaled $170,237 and $206,948 for the years ended December 31, 2011 and 2010, respectively.

8. CONTINGENCY

Sister Cities receives awards from agencies of the U.S. government, and the funds spent under those awards are subject to audit under the provisions of OMB Circular A-133. The ultimate determination of amounts received under U.S. government awards is based upon the allowance of costs reported to and accepted by the U.S. government as a result of the audits. Audits in accordance with the provisions of OMB Circular A-133 have been completed for all required fiscal years through 2011; until such audits have been accepted by the U.S. government, there exists a contingency to refund any amount received in excess of allowable costs.

9. FAIR VALUE MEASUREMENTS

In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, Sister Cities has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Investments recorded in the Statements of Financial Position are categorized based on the inputs to valuation techniques as follows:

9. FAIR VALUE MEASUREMENTS (Continued)

Following is a description of the valuation methodology used for investments measured at fair value. There have been no changes in the methodologies used at December 31, 2011 and 2010.

Level 1. These are investments where values are based on unadjusted quoted prices for identical assets in an active market Sister Cities has the ability to access.

Level 2. These are investments where values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full-term of the investments.

Level 3. These are investments where values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect assumptions of management about assumptions market participants would use in pricing the investments. These investments include non-readily marketable securities that do not have an active market.

- *Money market funds* - Fair value is equal to the reported net asset value of the fund.
- *Common stocks and preferred stocks* - Valued at the closing price reported on the active market in which the individual securities are traded.
- *Mutual funds* - The fair value is equal to the reported net asset value of the fund, which is the price at which additional shares can be obtained.

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Current:				
Common stock	$ 245	$ -	$ -	$ 245
Preferred stock	21,377	-	-	21,377
Mutual funds	1,999,985	-	-	1,999,985
Certificates of deposit	-	10,149	-	10,149
Subtotal - current investments	2,021,607	10,149	-	2,031,756
Noncurrent:				
Corporate bonds	65,705	-	-	65,705
Certificates of deposit	-	21,347	-	21,347
Subtotal - noncurrent investment	65,705	21,347	-	87,052
TOTAL	**$ 2,087,312**	**$ 31,496**	**$ -**	**$ 2,118,808**

9. FAIR VALUE MEASUREMENTS (Continued)

	2010			
	Level 1	Level 2	Level 3	Total
Current:				
Common stock	$ 281	$ -	$ -	$ 281
Preferred stock	19,558	-	-	19,558
Mutual funds	3,784,101	-	-	3,784,101
Certificates of deposit	-	10,125	-	10,125
Subtotal - current investments	3,803,940	10,125	-	3,814,065
Noncurrent:				
Corporate bonds	53,472	-	-	53,472
Certificates of deposit	-	31,728	-	31,728
Subtotal - noncurrent investment	53,472	31,728	-	85,200
TOTAL	**$ 3,857,412**	**$ 41,853**	**$ -**	**$ 3,899,265**

10. SUBSEQUENT EVENTS

In preparing these financial statements, Sister Cities has evaluated events and transactions for potential recognition or disclosure through July 5, 2012, the date the financial statements were issued.