FINANCIAL STATEMENTS

SisterCities INTERNATIONAL

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

SISTER CITIES INTERNATIONAL

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of Sister Cities International (Sister Cities), which comprise the statements of financial position as of December 31, 2012 and 2011, and the related statements of activities and changes in net assets and 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.

Auditor's 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 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 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 opinion.

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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, 2012 and 2011, 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.

Gelman Rosenberg & Freedman

Bethesda, Maryland
July 11, 2013

SISTER CITIES INTERNATIONAL

STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2012 AND 2011

ASSETS

	2012	2011
CURRENT ASSETS		
Cash and cash equivalents	$ 1,918,184	$ 2,365,697
Investments (Notes 2 and 10)	35,937	2,031,756
Grants receivable	6,953	-
Other receivables and advances	38,881	85,068
Prepaid expenses	76,826	77,631
Total current assets	2,076,781	4,560,152
FURNITURE AND EQUIPMENT		
Furniture and equipment, net of accumulated depreciation of $216,335 and $170,528 for 2012 and 2011, respectively	43,304	89,111
NONCURRENT ASSETS		
Investments (Notes 2 and 10)	100,181	87,052
Security deposits	41,747	41,747
Total noncurrent assets	141,928	128,799
TOTAL ASSETS	**$ 2,262,013**	**$ 4,778,062**

LIABILITIES AND NET ASSETS (DEFICIT)

	2012	2011
CURRENT LIABILITIES		
Lines of credit (Note 4)	$ 59,956	$ 88,062
Capital lease obligation (Note 3)	-	30,943
Accounts payable and accrued expenses	234,639	73,732
Refundable advances	2,428	4,542,776
Deferred membership dues	42,380	48,510
Deferred event revenue	79,041	15,190
Total current liabilities	418,444	4,799,213
NONCURRENT LIABILITIES		
Deferred rent (Note 8)	55,178	44,725
Total liabilities	473,622	4,843,938
NET ASSETS (DEFICIT)		
Unrestricted:		
Undesignated	1,625,554	(216,647)
Board-designated (Note 5)	162,837	150,771
Total unrestricted net assets (deficit)	1,788,391	(65,876)
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	**$ 2,262,013**	**$ 4,778,062**

See accompanying notes to financial statements.

SISTER CITIES INTERNATIONAL

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
SUPPORT AND REVENUE		
U.S. Government awards (Note 9)	$ 594,382	$ 709,819
Contributions and grants	5,276,323	2,374,913
In-kind contributions	213,694	42,218
Conferences and events	244,784	211,599
Membership dues	291,340	359,541
Awards and visa fees	2,000	50
Interest and investment income (Note 2)	24,174	92,845
Other	16,247	20,283
Total support and revenue	6,662,944	3,811,268
EXPENSES (Note 6)		
Salaries, taxes and related benefits (Note 7)	858,379	869,860
Professional fees	47,160	72,720
Office supplies and expense	18,154	18,445
Telecommunications	12,639	23,697
Postage and shipping	10,142	11,675
Occupancy (Note 8)	169,493	170,237
Equipment expense	6,201	11,336
Printing and publications	38,738	54,865
Travel	337,074	504,260
Conferences, conventions and meetings	121,845	266,728
Depreciation	45,807	46,428
Grants and contracts	2,573,022	1,003,050
Other program services	52,180	27,878
Insurance	8,371	3,668
Consultants	374,546	263,436
Bad debt	-	20,036
Interns	8,286	7,630
Computer and website	103,544	74,340
Bank fees	21,115	15,741
Interest expense	6,303	9,412
Other	(4,322)	18,866
Total expenses	4,808,677	3,494,308
Changes in net assets	1,854,267	316,960
Net assets (deficit) at beginning of year	(65,876)	(382,836)
NET ASSETS (DEFICIT) AT END OF YEAR	**$ 1,788,391**	**$ (65,876)**

See accompanying notes to financial statements.

SISTER CITIES INTERNATIONAL

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	$ 1,854,267	$ 316,960
Adjustments to reconcile changes in net assets to net cash (used) provided by operating activities:		
Depreciation	45,807	46,428
Donated investments	(272)	-
Unrealized gain on investments	(42,524)	(18,868)
Realized loss on sales of investments	48,797	23,640
Bad debt	-	20,036
Deferred rent abatement	10,453	44,725
(Increase) decrease in:		
Grants receivable	(6,953)	8,950
Other receivables and advances	46,187	(15,702)
Prepaid expenses	805	(25,598)
Security deposits	-	8,750
Increase (decrease) in:		
Accounts payable and accrued expenses	160,907	(88,673)
Refundable advances	(4,540,348)	71,095
Deferred membership dues	(6,130)	275
Deferred event revenue	63,851	(12,815)
Net cash (used) provided by operating activities	(2,365,153)	379,203
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment	-	(47,275)
Purchase of investments	(24,604)	(57,976)
Proceeds from sales of investments	2,001,293	1,833,661
Net cash provided by investing activities	1,976,689	1,728,410
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings from lines of credit	-	2,885
Repayments on lines of credit	(28,106)	(26,666)
Principal payments on capital lease obligation	(30,943)	(24,415)
Net cash used by financing activities	(59,049)	(48,196)
Net (decrease) increase in cash and cash equivalents	(447,513)	2,059,417
Cash and cash equivalents at beginning of year	2,365,697	306,280
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 1,918,184**	**$ 2,365,697**
SUPPLEMENTAL INFORMATION:		
Interest Paid	**$ 6,303**	**$ 9,412**

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, 2012 and 2011, 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 -

As of December 31, 2011, included in refundable advances were 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 donor's 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, the total refundable advances, including this award, aggregated $4,542,776. During the year ended December 31, 2012, the donor removed the previously established conditions and indicated the remaining funds under the award could be used for unrestricted purposes. Accordingly, the refundable advance was recognized as unrestricted revenue. At December 31, 2012, refundable advances for other award agreements totaled $2,428.

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 and cash equivalents as of December 31, 2012 and 2011 are $27,298 and $2,472, respectively, which have been designated for the Lou Wozar endowment (see Note 5).

Through December 31, 2012, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provided temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts at all Federal Deposit Insurance Corporation (FDIC) insured depository institutions (the "Dodd-Frank Deposit Insurance Provision"). Sister Cities maintained a portion of its cash balance at a financial institution in a non-interest bearing account; thereby, all of this cash balance was protected by the FDIC under this Act. Beginning January 1, 2013, funds deposited in non-interest bearing accounts will no longer receive unlimited deposit insurance coverage. Bank deposit accounts at one institution will be insured by the FDIC up to a limit of $250,000. Management believes the risk in these situations to be minimal.

Investments -

Investments are recorded at their readily determinable fair value. Realized and unrealized gains and losses are included in interest and 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 five years. 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.

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

Uncertain tax positions -

For the years ended December 31, 2012 and 2011, Sister Cities has documented its consideration of FASB ASC 740-10, *Income Taxes*, that provides guidance for reporting uncertainty in income taxes and has determined that no material uncertain tax positions qualify for either recognition or disclosure in the financial statements.

The Federal 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.

In-kind contributions -

In-kind contributions consist primarily of time donated by consultants and attorneys. These services are reported at their fair value, based on estimates of the number of donated hours and market rates for the services provided. In-kind contributions of $213,694 and $42,218, representing the fair value of these services, have been recorded as revenue and expenses in the accompanying financial statements for the years ended December 31, 2012 and 2011, respectively.

Sister Cities also receives additional donated time from various volunteers. These donated services are not reflected in the accompanying financial statements since these services do not meet the criteria for recognition as contributed services.

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 to 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.

Investment 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.

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

Fair value measurement -

Sister Cities adopted the provisions of FASB ASC 820, *Fair Value Measurement*. 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, 2012 and 2011 are comprised of the following:

	2012		2011	
	Fair Value	Cost Basis	Fair Value	Cost Basis
Current:				
Common stock	$ 580	$ 526	$ 245	$ 254
Preferred stock	-	-	21,377	16,726
Mutual funds	35,357	22,839	1,999,985	2,028,778
Certificates of deposit	-	-	10,149	10,000
Subtotal - current investments	35,937	23,365	2,031,756	2,055,758
Noncurrent:				
Corporate bonds	79,141	68,417	65,705	61,238
Certificates of deposit	21,040	20,000	21,347	20,000
Subtotal - noncurrent investments	100,181	88,417	87,052	81,238
TOTAL INVESTMENTS	**$ 136,118**	**$ 111,782**	**$ 2,118,808**	**$ 2,136,996**

The following are included in interest and investment income, for the years ended December 31, 2012 and 2011:

	2012	2011
Interest and dividends	$ 30,447	$ 97,617
Unrealized gain on investments	42,524	18,868
Realized loss on sales of investments	(48,797)	(23,640)
TOTAL INTEREST AND INVESTMENT INCOME	**$ 24,174**	**$ 92,845**

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) was recorded as an asset (equipment) and as a liability (capital lease obligation) in the accompanying Statements of Financial Position. As of December 31, 2011, the capital lease liability aggregated $30,943. During the year ended December 31, 2012, the capital lease liability was paid off.

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% at December 31, 2012 and 2011. Outstanding borrowings aggregated $5,467 and $32,134 as of December 31, 2012 and 2011, 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% at December 31, 2012 and 2011. Outstanding borrowings (including accrued interest) aggregated $54,489 and $55,928 as of December 31, 2012 and 2011, respectively.

In November 2012, Sister Cities established a third line of credit with a local financial institution in the amount of $50,000. The line of credit is secured by Sister Cities' receivables, equipment and inventories. The line of credit bears interest at the bank's prime rate, plus six percentage points. There was no balance on this line of credit as of December 31, 2012.

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. However, on May 22, 2001, The Jesse Phillips Foundation agreed to release the permanent restriction as of December 31, 2000.

In an effort to fulfill the original intent of The Jesse Phillips Foundation, the Board of Directors designated a portion of Sister Cities' unrestricted net assets in the name of Lou Wozar. As of December 31, 2012 and 2011, the remaining amounts designated by the Board of Directors totaled $162,837 and $150,771, respectively (Note 1).

6. FUNCTIONAL EXPENSES

The costs of providing the various programs and other activities have been summarized on a functional basis. Accordingly, certain costs have been allocated among the programs and supporting services benefited. The expenses of Sister Cities, on a functional basis, are estimated as follows at at December 31, 2012 and 2011:

	2012	2011
Program Services	$ 3,939,328	$ 2,551,988
Development	36,092	18,730
Management and General	833,257	923,590
TOTAL EXPENSES	**$ 4,808,677**	**$ 3,494,308**

7. 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, 2012 and 2011 totaled $8,998 and $11,863, respectively.

8. COMMITMENT

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, 2012 and 2011, the liability totaled $55,178 and $44,725, respectively.

The following is a schedule of future minimum payments required under the lease agreement as of December 31, 2012:

Year Ending December 31,	
2013	$ 128,918
2014	143,867
2015	147,464
2016	153,949
2017	158,357
Thereafter	527,762
	$ 1,260,317

Occupancy expense for the office lease and an additional short-term lease in Ghana (including operating costs and related utilities) totaled $169,493 and $170,237 for the years ended December 31, 2012 and 2011, respectively. The Ghana lease expired during 2012 and was not renewed.

9. 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 2012; 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.

10. FAIR VALUE MEASUREMENT

In accordance with FASB ASC 820, *Fair Value Measurement*, 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.

10. FAIR VALUE MEASUREMENT (Continued)

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:

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 for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, or model-based valuation techniques that utilize inputs that are observable either directly or indirectly for substantially the full-term of the investments.

Level 3. Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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, 2012 and 2011.

- *Common 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.
- *Corporate bonds* - Fair value is based upon current yields available on comparable securities of issuers with similar ratings, the security's terms and conditions, and interest rate and credit risk.
- *Certificates of deposit* - Generally valued at original cost plus accrued interest, which approximates fair value.

The table below summarizes, by level within the fair value hierarchy, Sister Cities' investments as of December 31, 2012:

	Level 1	Level 2	Level 3	Total
Current:				
Common stock	$ 580	$ -	$ -	$ 580
Mutual funds	35,357	-	-	35,357
Subtotal - current investments	35,937	-	-	35,937
Noncurrent:				
Corporate bonds	-	79,141	-	79,141
Certificates of deposit	-	21,040	-	21,040
Subtotal - noncurrent investments	-	100,181	-	100,181
TOTAL	**$ 35,937**	**$ 100,181**	**$ -**	**$ 136,118**

10. FAIR VALUE MEASUREMENT (Continued)

The table below summarizes, by level within the fair value hierarchy, Sister Cities' investments as of December 31, 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 investments	-	87,052	-	87,052
TOTAL	**$ 2,021,607**	**$ 97,201**	**$ -**	**$ 2,118,808**

11. SUBSEQUENT EVENTS

In preparing these financial statements, Sister Cities has evaluated events and transactions for potential recognition or disclosure through July 11, 2013, the date the financial statements were issued.