

Combined Financial Statements Together with  
Report of Independent Certified Public Accountants

**SMILE TRAIN, INC. AND AFFILIATES**

June 30, 2013 and 2012

# SMILE TRAIN, INC. AND AFFILIATES

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**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

To the Board of Directors  
**Smile Train, Inc. and Affiliates:**

**Report on the financial statements**

We have audited the accompanying combined financial statements of Smile Train, Inc. and Affiliates (“Smile Train”), which comprise the combined statements of financial position as of June 30, 2013 and 2012, and the related combined statements of activities and change in net assets, functional expenses and cash flows for the years then ended, and the related notes to the combined financial statements.

**Management’s responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the organization’s preparation and fair presentation of the combined 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 organization’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 combined 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 combined financial statements referred to above present fairly, in all material respects, the combined financial position of Smile Train, Inc. and Affiliates as of June 30, 2013 and 2012, and the combined changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Supplementary information*

Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The supplemental combining schedules as of and for the year ended June 30, 2013 are presented for purposes of additional analysis and are not a required part of the combined financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audits of the combined financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the combined financial statements as a whole.



New York, New York  
February 28, 2014

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statements of Financial Position**  
**As of June 30, 2013 and 2012**

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<b>ASSETS</b>	<b>2013</b>	<b>2012</b>
Cash and cash equivalents	\$ 16,207,275	\$ 28,007,654
Investments	214,243,129	175,425,931
Contributions receivable, net	612,779	822,148
Prepaid expenses and other assets	1,745,314	2,095,973
Furniture and equipment, net	<u>298,111</u>	<u>152,588</u>
Total assets	<u>\$ 233,106,608</u>	<u>\$ 206,504,294</u>
 <b>LIABILITIES AND NET ASSETS</b>		
<b>LIABILITIES</b>		
Grants and contracts payable	\$ 5,240,947	\$ 6,707,101
Accounts payable and accrued expenses	2,477,751	2,795,782
Other liabilities	-	12,790
Deferred rent payable	<u>116,184</u>	<u>117,840</u>
Total liabilities	<u>7,834,882</u>	<u>9,633,513</u>
 <b>NET ASSETS</b>		
Unrestricted	224,439,568	194,966,711
Temporarily restricted	<u>832,158</u>	<u>1,904,070</u>
Total net assets	<u>225,271,726</u>	<u>196,870,781</u>
Total liabilities and net assets	<u>\$ 233,106,608</u>	<u>\$ 206,504,294</u>

*The accompanying notes are an integral part of these combined financial statements.*

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statement of Activities and Change in Net Assets**  
For the year ended June 30, 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
<b>SUPPORT AND REVENUE</b>			
Contributions	\$ 96,364,856	\$ 722,263	\$ 97,087,119
Contributions in-kind	52,525,367	-	52,525,367
Investment income, net	18,733,464	-	18,733,464
Other income	1,874,162	-	1,874,162
(Losses) in currency transactions	(295,444)	-	(295,444)
Net assets released from restriction:			
Satisfaction of purpose restrictions	<u>1,794,175</u>	<u>(1,794,175)</u>	<u>-</u>
Total support and revenue	<u>170,996,580</u>	<u>(1,071,912)</u>	<u>169,924,668</u>
<b>EXPENSES</b>			
Program services:			
Treatment	106,560,112	-	106,560,112
Training	1,767,308	-	1,767,308
Public education	<u>10,311,966</u>	<u>-</u>	<u>10,311,966</u>
Total program services	<u>118,639,386</u>	<u>-</u>	<u>118,639,386</u>
Support services:			
Management and general	2,353,327	-	2,353,327
Fundraising	<u>20,531,010</u>	<u>-</u>	<u>20,531,010</u>
Total supporting services	<u>22,884,337</u>	<u>-</u>	<u>22,884,337</u>
Total expenses	<u>141,523,723</u>	<u>-</u>	<u>141,523,723</u>
Change in net assets	<u>29,472,857</u>	<u>(1,071,912)</u>	<u>28,400,945</u>
Net assets, beginning of year	<u>194,966,711</u>	<u>1,904,070</u>	<u>196,870,781</u>
Net assets, end of year	<u>\$ 224,439,568</u>	<u>\$ 832,158</u>	<u>\$ 225,271,726</u>

*The accompanying notes are an integral part of this combined financial statement.*

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statement of Activities and Change in Net Assets**  
**For the year ended June 30, 2012**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
<b>SUPPORT AND REVENUE</b>			
Contributions	\$ 113,155,982	\$ 669,555	\$ 113,825,537
Contributions in-kind	49,272,637	-	49,272,637
Investment income, net	9,229,573	-	9,229,573
Other income	2,740,708	-	2,740,708
(Losses) in currency transactions	(83,240)		(83,240)
Net assets released from restriction:			
Satisfaction of purpose restrictions	<u>1,331,458</u>	<u>(1,331,458)</u>	<u>-</u>
Total support and revenue	<u>175,647,118</u>	<u>(661,903)</u>	<u>174,985,215</u>
<b>EXPENSES</b>			
Program Services:			
Treatment	98,815,190	-	98,815,190
Training	1,668,466	-	1,668,466
Public education	<u>32,091,773</u>	<u>-</u>	<u>32,091,773</u>
Total program services	<u>132,575,429</u>	<u>-</u>	<u>132,575,429</u>
Support Services:			
Management and general	1,911,078	-	1,911,078
Fundraising	<u>27,637,799</u>	<u>-</u>	<u>27,637,799</u>
Total supporting services	<u>29,548,877</u>	<u>-</u>	<u>29,548,877</u>
Total expenses	<u>162,124,306</u>	<u>-</u>	<u>162,124,306</u>
Change in net assets	<u>13,522,812</u>	<u>(661,903)</u>	<u>12,860,909</u>
Net assets, beginning of year	<u>181,443,899</u>	<u>2,565,973</u>	<u>184,009,872</u>
Net assets, end of year	<u>\$ 194,966,711</u>	<u>\$ 1,904,070</u>	<u>\$ 196,870,781</u>

*The accompanying notes are an integral part of this combined financial statement.*

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statement of Functional Expenses**  
For the year ended June 30, 2013

	Program Services				Supporting Services			
	Treatment	Training	Public Education	Total	Management and General	Fundraising	Total	Total
Grants	\$ 1,595,628	\$ 1,147,682	\$ 438,748	\$ 3,182,058	\$ -	\$ -	\$ -	\$ 3,182,058
Contracts with treatment partners	98,758,076	-	-	98,758,076	-	-	-	98,758,076
Medical advisory services	206,863	206,863	-	413,726	-	-	-	413,726
Salaries and employee benefits	1,666,915	204,428	277,111	2,148,454	1,342,814	2,390,108	3,732,922	5,881,376
Professional fees	2,404,339	87,364	120,071	2,611,774	460,056	408,766	868,822	3,480,596
Rents	499,401	58,137	79,901	637,439	161,895	272,014	433,909	1,071,348
Office expenses	526,393	48,349	66,452	641,194	330,335	226,312	556,647	1,197,841
Repairs and maintenance	91,748	3,625	4,982	100,355	8,021	16,960	24,981	125,336
Travel, food, and other	755,533	3,853	5,295	764,681	34,701	18,035	52,736	817,417
Printed program material and services	-	-	8,470,011	8,470,011	-	10,999,827	10,999,827	19,469,838
Advertising	-	-	839,764	839,764	-	6,166,200	6,166,200	7,005,964
Depreciation and amortization	55,216	7,007	9,631	71,854	15,505	32,788	48,293	120,147
Total	<u>\$ 106,560,112</u>	<u>\$ 1,767,308</u>	<u>\$ 10,311,966</u>	<u>\$ 118,639,386</u>	<u>\$ 2,353,327</u>	<u>\$ 20,531,010</u>	<u>\$ 22,884,337</u>	<u>\$ 141,523,723</u>

*The accompanying notes are an integral part of this combined financial statement.*



**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statement of Functional Expenses**  
For the year ended June 30, 2012

	Program Services				Supporting Services			
	Treatment	Training	Public Education	Total	Management and General	Fundraising	Total	Total
Grants	\$ 2,008,649	\$ 986,550	\$ 779,065	\$ 3,774,264	\$ -	\$ -	\$ -	\$ 3,774,264
Contracts with treatment partners	90,764,584	-	-	90,764,584	-	-	-	90,764,584
Medical advisory services	337,969	337,969	-	675,938	-	-	-	675,938
Salaries and employee benefits	1,578,907	155,235	203,830	1,937,972	1,098,962	1,847,614	2,946,576	4,884,548
Professional fees	2,048,602	55,146	71,609	2,175,357	319,298	205,021	524,319	2,699,676
Rents	516,158	60,991	79,568	656,717	154,549	226,752	381,301	1,038,018
Office expenses	574,773	51,983	67,501	694,257	258,693	193,261	451,954	1,146,211
Repairs and maintenance	76,150	4,839	6,284	87,273	11,407	17,991	29,398	116,671
Travel, food, and other	835,202	6,408	8,512	850,122	46,140	23,623	69,763	919,885
Printed program material and services	-	-	29,001,137	29,001,137	-	17,108,776	17,108,776	46,109,913
Advertising	-	-	1,862,132	1,862,132	-	7,980,019	7,980,019	9,842,151
Depreciation and amortization	74,196	9,345	12,135	95,676	22,029	34,742	56,771	152,447
Total	<u>\$ 98,815,190</u>	<u>\$ 1,668,466</u>	<u>\$ 32,091,773</u>	<u>\$ 132,575,429</u>	<u>\$ 1,911,078</u>	<u>\$ 27,637,799</u>	<u>\$ 29,548,877</u>	<u>\$ 162,124,306</u>

*The accompanying notes are an integral part of this combined financial statement.*

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combined Statements of Cash Flows**  
**For the years ended June 30, 2013 and 2012**

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	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 28,400,945	\$ 12,860,909
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	120,147	152,447
Net appreciation on investments	(15,686,529)	(9,509,191)
Donated securities	(405,205)	(733,197)
Decrease in contributions receivable	209,369	1,338,915
Decrease (increase) in prepaid expenses and other assets	350,659	(737,442)
(Decrease) increase in grants and contracts payable	(1,466,154)	1,074,570
Decrease in accounts payable and accrued expenses	(318,031)	(2,168,256)
Decrease in other liabilities	(12,790)	(104,182)
(Decrease) increase in deferred rent payable	<u>(1,656)</u>	<u>25,320</u>
Net cash provided by operating activities	<u>11,190,755</u>	<u>2,199,893</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of securities	(483,976,980)	(9,417,325)
Proceeds from sale of securities	461,251,516	8,577,509
Purchases of furniture and equipment	<u>(265,670)</u>	<u>(47,859)</u>
Net cash used in investing activities	<u>(22,991,134)</u>	<u>(887,675)</u>
Net (decrease) increase in cash and cash equivalents	(11,800,379)	1,312,218
Cash and cash equivalents, beginning of year	<u>28,007,654</u>	<u>26,695,436</u>
Cash and cash equivalents, end of year	<u>\$ 16,207,275</u>	<u>\$ 28,007,654</u>

*The accompanying notes are an integral part of these combined financial statements.*

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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**1. ORGANIZATION**

**Corporate Purposes**

Smile Train, Inc. and Affiliates (“Smile Train”) is a non-profit organization dedicated to helping children worldwide who are born with cleft lips and palates. Smile Train’s mission is to provide free cleft surgery for millions of poor children in developing countries and to provide free cleft-related training for doctors and medical professionals until there are no more children who need help and the problem of clefts is completely eradicated.

The Smile Train UK (“UK”), a non-profit organization, was incorporated on March 10, 2006, under the laws of the United Kingdom as an affiliate of Smile Train, Inc.

The Smile Train Canada (“Canada”) was incorporated on July 3, 2008 as a corporation without share capital under the Canada Corporations Act.

The Smile Train India (“India”) was incorporated on August 13, 2009 as a not-for-profit company under Section 25 of the Indian Companies Act 1956 as an affiliate of Smile Train, Inc.

The Smile Train Stiftung (“Germany”) was incorporated on October 27, 2008 under civil law with its seat in Munich.

UK, Canada, India and Germany’s objectives are congruent with Smile Train’s mission. These objectives are achieved through an ongoing marketing campaign used to raise awareness and receive donations within the United Kingdom, Canada, India, and Germany. Donations, net of related costs, are then made to Smile Train, which has the infrastructure in place to carry out each charity’s objectives.

Smile Train France is also an affiliate of Smile Train, Inc., and was incorporated on October 25, 2008 as a charity organization under the laws of the country. This affiliate did not have any operating activities during the years ended June 30, 2013 and 2012.

**Tax Status**

The IRS has classified Smile Train, Inc. as a public charity; therefore, Smile Train, Inc. is exempt from federal income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code (the “Code”), as well as state and local taxes.

The Smile Train UK is a registered charity and as such is potentially exempt from taxation of its income and gains, to the extent that they fall within the charity exemptions in the Corporation Tax Act 2010 or Section 256 Taxation of Chargeable Gains Act 1992. During the years ended June 30, 2013 and 2012, a tax charge of \$108,122 and \$26,140, respectively, arose from the charity’s commercial trading activities. The Smile Train UK is registered with HMRC in the UK for VAT purposes and, in common with many other charities, is unable to recover the majority of VAT that is incurred on purchases of goods and services in the UK.

The Smile Train Canada is classified as a registered charity as defined in paragraph 149(1)(f) of the Canada Corporations Act (the “Act”) and, therefore, is exempt from income taxes provided that it complies with donation and certain other requirements as specified by the Act.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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Smile Train India is registered with the IRS in India but has no taxable income. Donations to this subsidiary are eligible for tax deductibility to the extent of 50% under Section 80G of the Indian Income Tax Act.

According to the preliminary certificate from the tax office in Munich, Germany, Smile Train Stiftung is recognized as a charitable foundation. Smile Train Stiftung exclusively and immediately serves non-profitable purposes according to Art. 51 et seqq. of the German fiscal code. A new certificate has been requested at the tax office in Munich, Germany, but is still outstanding.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Presentation**

The Classification of Smile Train's net assets are based on the existence or absence of donor imposed restrictions. Amounts for each of the three classes of net assets (unrestricted, temporarily restricted and permanently restricted) are displayed in the accompanying combined statements of financial position and changes in each of those classes of net assets are displayed in the accompanying combining statements of activities and change in net assets. The combined financial statements of Smile Train have been prepared in accordance with U.S. generally accepted accounting principles ("US GAAP"), which require Smile Train to report information regarding its combined financial position and activities according to the following net asset classifications:

#### Unrestricted net assets

Net assets that are not subject to donor imposed restrictions and may be expended for any purpose in performing the primary objectives of the organization. The unrestricted net assets may be used at the discretion of Smile Train's management and the Board of Directors.

#### Temporarily restricted net assets

Net assets subject to donor and grantor imposed stipulations that will be met by actions of Smile Train and/or the passage of time.

#### Permanently restricted net assets

Net assets which include donor-imposed restrictions that stipulate that the resources are to be maintained permanently. Income earned on permanently restricted net assets is available to be used in the unrestricted or temporarily restricted net asset class, based on stipulations by the donors. As of June 30, 2013 and 2012, Smile Train did not have any permanently restricted net assets.

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. When a donor's restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished) temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statement of activities as net assets released from restrictions. Donated securities are recorded at their quoted market value on the date received.

### **Basis of Combination**

The combined financial statements include the accounts of Smile Train and its affiliates, UK, Canada, India and Germany. All intercompany balances and transactions have been eliminated in combination.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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**Contributions Receivable**

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-adjusted interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in contribution revenue. Conditional promises to give are not included as support until the conditions are met. As of June 30, 2013 and 2012, Smile Train's contributions receivable consisted of unconditional promises to give that are expected to be collected within one year and Smile Train was not aware of any conditional promises.

**Contributions In-Kind**

Contributions in-kind include donated services, materials, use of facilities and equipment and are recorded at their fair value on the date of donation. Other volunteers have also donated time to Smile Train's program services and fundraising campaigns. These services were not reflected in the accompanying combined statement of activities and change in net assets because they do not meet the necessary criteria for recognition under US GAAP.

**Cash and Cash Equivalents**

Smile Train considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents, except for those amounts that are held in the investment portfolio which are considered to be invested for long-term purposes.

**Investments**

Investments in equity, debt securities and mutual funds are carried at their fair values, which are based on quoted market prices or published unit values. Investments in money market funds are carried at cost, which approximates fair value.

Changes in fair value are reported as investment income in the accompanying combined statements of activities and change in net assets. Interest and dividend income earned on all investments is recognized as unrestricted revenue unless specifically restricted for use by the donor. Purchases and sales of securities are reflected on a trade-date basis.

**Fair Value Measurements**

Smile Train accounts for fair value measurements under the accounting standard that establishes a hierarchy for the inputs used to measure fair value based on the nature of the data input which generally range from quoted prices for identical instruments in a principal trading market (Level 1) to estimates determined using related market data (Level 3). Multiple inputs may be used to measure fair value.

- Level 1: Measurements that are most observable are based on quoted prices of identical instruments obtained from principal markets in which they are traded. Closing prices are both readily available and representative of fair value. Market transactions occur with sufficient frequency and volume to ensure liquidity.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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Level 2: Measurements derived indirectly from observable inputs or from quoted prices from markets that are less liquid. Measurements may consider inputs that other market participants would use in valuing a portfolio, quoted market prices for similar securities, interest rates, credit risks, and others. Also included in Level 2 are investments measured using a net asset value (“NAV”) per share, or its equivalent, that may be redeemed at that NAV at the date of the combined statement of financial position or in the near term, which Smile Train has generally considered to be within ninety days.

Level 3: Measurements that are least observable are estimated from related market data, determined from sources with little or no market activity for comparable contracts, or are positions with longer durations. Also included in Level 3 are investments measured using a NAV per share, or its equivalent, that can never be redeemed at NAV or for which redemption at NAV is uncertain due to lockup periods or other investment restrictions.

Inputs are used in applying the various valuation techniques and broadly refer to the assumption that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes “observable” requires significant judgment by Smile Train’s management. Smile Train considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to Smile Train’s perceived risk of that instrument.

**Surgery Advances**

Smile Train advances money to Smile Train partners to either establish or help sustain cleft treatment programs. Surgery advances are included in prepaid and other assets in the accompanying combined statements of financial position.

**Furniture and Equipment, net**

Smile Train capitalizes expenditures for furniture and equipment and leasehold improvements in excess of \$1,000 which are stated at cost less accumulated depreciation and amortization.

Depreciation of furniture and equipment is provided using the straight-line method over the following estimated useful lives:

Furniture	5 years
Equipment	3 years

Leasehold improvements are amortized over the term of the related lease or the estimated useful life of the improvement, whichever is shorter.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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**Grants and Contracts Payable**

Grants payable include all unconditional awards that have been authorized prior to Smile Train's fiscal year end, but remain unpaid as of June 30, 2013 and 2012. Conditional grants are expensed and considered an obligation in the period the conditions are substantially satisfied.

**Advertising**

Smile Train expenses the cost of advertising as incurred. Advertising expense was \$7,005,964 and \$9,842,151 for the years ended June 30, 2013 and 2012.

**Functional Allocation**

The costs of providing program services and other activities of Smile Train have been classified on a functional basis in the combined statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Such allocations are determined by management on an equitable basis.

**Use of Estimates**

The preparation of the combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Concentrations of Credit**

Financial instruments which potentially subject Smile Train to concentrations of credit risk consist primarily of cash and cash equivalents and investments. Smile Train maintains cash and cash equivalents and investments in depository accounts with creditworthy, high-quality financial institutions which, at times, may exceed federally insured limits. Smile Train has not experienced, nor does it anticipate, any losses with respect to such accounts and believes it is not exposed to any significant credit risk related to its cash, cash equivalents or investments.

**Foreign Currency Translation**

The functional currencies for the UK, Canada, India and Germany are the pound sterling, Canadian dollars, Indian rupees, and Euros, respectively. All elements of the combined financial statements are translated by using the appropriate exchange rate. For assets and liabilities, the exchange rate at the date of the combined statement of financial position is used. For support and revenues, expenses and gains and losses, an appropriately weighted average exchange rate for the period is used to translate those elements.

**Income Taxes**

Smile Train follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can only be recognized in the combined financial statements if the position is "more-likely-than-not" to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged. Smile Train is exempt from income tax under IRC section 501(c)(3), though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. Smile Train has processes

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it has nexus; and to identify and evaluate other matters that may be considered tax positions. The tax years ending 2010, 2011 and 2012 are still open to audit for both federal and state purposes. Smile Train has determined that there are no material uncertain tax positions that require recognition or disclosure in the combined financial statements.

**Subsequent Events**

Subsequent events have been evaluated through February 28, 2014, which is the date the combined financial statements were available to be issued. In October of 2013, Smile Train entered into an agreement with STOP Cleft- International Alliance (“SCIA”) wherein SCIA would operate as a subsidiary of Smile Train in an effort to develop their complementary strategies and enhance the mission of the organization.

**3. INVESTMENTS**

Investments held by Smile Train are reported at fair value and consisted of the following at June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents	\$ 13,996,736	\$ 639,201
Equities – stocks and mutual funds	133,552,184	139,164,734
Fixed income – mutual funds	42,313,355	35,157,791
Real estate – mutual funds	9,198,705	-
Commodities – mutual funds	3,767,635	-
Arbitrage – mutual funds	2,005,381	-
Fixed income – government bonds	2,882,272	-
Fixed income – corporate bonds	2,225,319	-
Alternative assets – hedge funds	<u>3,919,247</u>	<u>269,831</u>
	213,860,834	175,231,557
Accrued income	<u>382,295</u>	<u>194,374</u>
Total investments	<u>\$ 214,243,129</u>	<u>\$ 175,425,931</u>

Investment income, net, for the years ended June 30, 2013 and 2012 consisted of the following:

	<u>2013</u>	<u>2012</u>
Interest and dividends	\$ 3,839,694	\$ 3,625,705
Net unrealized and realized gains on investments	15,686,527	5,972,014
Investment fees	<u>(792,757)</u>	<u>(368,146)</u>
	<u>\$ 18,733,464</u>	<u>\$ 9,229,573</u>



**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

The following tables provide the fair value hierarchy of Smile Train's investments as of June 30, 2013 and 2012:

	<b>2013</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Cash and cash equivalents				\$ 13,996,736
Equities – stocks:				
Basic materials	\$ 2,040,125	\$ -	\$ -	2,040,125
Biotechnology	65,410	-	-	65,410
Consumer - discretionary	10,219,631	-	-	10,219,631
Consumer- staples	8,281,021	-	-	8,281,021
Energy	4,994,357	-	-	4,994,357
Financials	11,019,626	-	-	11,019,626
Healthcare	11,707,390	-	-	11,707,390
Industrials	9,824,999	-	-	9,824,999
Information technology	12,988,491	-	-	12,988,491
Materials	2,696,909	-	-	2,696,909
Services	2,127,585	-	-	2,127,585
Technology	2,720,298	-	-	2,720,298
Telecom services	1,173,974	-	-	1,173,974
Utilities	1,813,209	-	-	1,813,209
Equities – mutual funds:				
Domestic	19,611,834			19,611,834
International	32,267,325			32,267,325
Fixed income – mutual funds	42,313,355	-	-	42,313,355
Real estate – mutual funds	9,198,705	-	-	9,198,705
Commodities – mutual funds	3,767,635	-	-	3,767,635
Arbitrage – mutual funds	2,005,381	-	-	2,005,381
Fixed income – government bonds	-	2,882,272	-	2,882,272
Fixed income – corporate bonds	-	2,225,319	-	2,225,319
Alternative assets – hedge funds	-	3,790,181	129,066	3,919,247
Total	<u>\$ 190,837,260</u>	<u>\$ 8,897,772</u>	<u>\$ 129,066</u>	<u>\$ 213,860,834</u>

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

	<b>2012</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Cash and cash equivalents				\$ 639,201
Equities – stocks:				
Consumer – discretionary	\$ 13,429,536	\$ -	\$ -	13,429,536
Consumer – staples	21,846,429	-	-	21,846,429
Energy	7,945,193	-	-	7,945,193
Financials	23,571,955	-	-	23,571,955
Healthcare	16,661,313	-	-	16,661,313
Industrials	4,380,858	-	-	4,380,858
Information technology	15,047,162	-	-	15,047,162
Materials	1,122,638	-	-	1,122,638
Equities – mutual funds:				
Domestic	23,378,252	-	-	23,378,252
International	11,781,398	-	-	11,781,398
Fixed income – mutual funds	35,157,791	-	-	35,157,791
Alternative assets – hedge funds	-	-	269,831	269,831
Total	<u>\$ 174,322,525</u>	<u>\$ -</u>	<u>\$ 269,831</u>	<u>\$ 175,231,557</u>

Smile Train has two alternative investments, one with Citibank (“Citi”) as the investment manager, and the other with Brown Brothers Harriman (“BBH”) as the investment manager. The following summarizes the strategy of the alternative investments:

The Citibank alternative investment is a concentrated, multi-strategy fund of hedge funds portfolio that seeks to provide investors attractive long-term capital appreciation, with moderate volatility and correlation to the broad equity and fixed income markets. In order to manage the overall volatility of its investments, this series primarily invests with portfolio managers employing different investment strategies. Due to this investment objective, the investment is intended for investors who are willing to subject their principal to increased risk in order to potentially generate a greater rate of return. The investment has provisions for quarterly redemptions provided that notice is made in writing 90 days prior to the applicable withdrawal date.

The BBH alternative assets are invested in a unit trust that invests in funds focused on investing its assets in funds or accounts managed by independent investment managers specializing in equity investments in specific Asian countries. While the funds are primarily invested in publicly-traded common stocks and equity-linked instruments, they also may have investments in fixed-income securities, currencies or other financial instruments, and may also hold short positions in any security or instrument. The underlying assets are invested in a fund (the “Fund”) whose objective is to achieve consistent, absolute returns independent of the broader market movements and generate over the long term returns within a certain range based on the London interbank offered rate. The Fund attempts to achieve this objective primarily by investing in investment companies implementing a variety of strategies in the U.S. and international securities markets. The terms and conditions of those strategies, including provisions for additional contributions and redemptions, are subject to the terms of the respective shareholder agreements. The investments generally have provisions for monthly, quarterly, semi-annual, or annual redemptions, subject to, in some cases, lock-up periods. The Fund is in the process of liquidating and distributing its assets to shareholders.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

Smile Train uses the NAV per share for purposes of reporting the fair value of all its underlying investments which: (a) may not have a readily determinable fair value, and (b) the investment managers prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments valued at NAV by major category:

2013							
Strategy	Level of Investment	Significant Investment Strategy	NAV in Funds	\$ Amount of Unfunded Commitments	Timing of Draw Down Commitments	Redemption Frequency	Redemption Notice Period
BBH Hedge Fund	3	Market neutral or arbitrage strategies in the US and international securities markets	\$ 129,066	-	Fund is in liquidation	Fund is in liquidation	Fund is in liquidation
Citi Hedge Fund	2	Multi-strategy fund of hedge funds portfolio	\$ 3,790,181	-	None	Quarterly	90 calendar days
Fixed Income Government Bonds	2	Maximum total return consistent with the preservation of capital	\$ 2,882,272	-	None	Daily	None
Fixed Income Corporate Bonds	2	Maximum total return consistent with the preservation of capital	\$ 2,225,319	-	None	Daily	None
2012							
Strategy	Level of Investment	Significant Investment Strategy	NAV in Funds	\$ Amount of Unfunded Commitments	Timing of Draw Down Commitments	Redemption Frequency	Redemption Notice Period
BBH Hedge Fund	3	Market neutral or arbitrage strategies in the US and international securities markets	\$ 269,831	-	Fund is in liquidation	Fund is in liquidation	Fund is in liquidation

The following is a reconciliation of Smile Train's level 3 hedge fund investments for the years ended June 30, 2013 and 2012:

	2013	2012
<b>Balance at beginning of year</b>	\$ 269,831	\$ 337,411
Additions	-	-
Liquidation proceeds (sales)	(31,009)	(65,280)
Net loss	(109,756)	(2,300)
<b>Balance at end of year</b>	<u>\$ 129,066</u>	<u>\$ 269,831</u>

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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**4. FURNITURE AND EQUIPMENT, NET**

Furniture and equipment, net, consisted of the following as of June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Furniture and equipment	\$ 1,398,087	\$ 1,275,479
Leasehold improvements	127,180	127,180
Construction-in-progress	<u>143,061</u>	<u>-</u>
Total	1,668,328	1,402,659
Less: accumulated depreciation	<u>(1,370,217)</u>	<u>(1,250,071)</u>
Furniture and equipment, net	<u>\$ 298,111</u>	<u>\$ 152,588</u>

The construction-in-progress relates to the build out of additional space in the New York headquarters. As of June 30, 2013, Smile Train had not placed this space into service.

Depreciation expense was \$120,147 and \$152,447 for the years ended June 30, 2013 and 2012.

**5. CONTRIBUTIONS IN-KIND**

Contributions in-kind consisted of the following for the years ended June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Grants and contracts with treatment partners	\$ 52,167,752	\$ 48,805,097
Medical advisory services	289,365	467,540
Medical supplies	<u>68,250</u>	<u>-</u>
Total contributions in-kind	<u>\$ 52,525,367</u>	<u>\$ 49,272,637</u>

Treatment partners consist of hospitals, doctors, and other providers performing surgeries and related services that are compensated at contract rates that are below the rates they charge based on their respective fee schedules. Smile Train adopted the policy of determining contributions of their services based on the excess of the fair value rates established on their fee schedules over the contract rates negotiated between them and Smile Train.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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**6. TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets as of June 30, 2013 and 2012 were available as follows:

	<u>2013</u>	<u>2012</u>
Treatment program services	\$ 788,722	\$ 1,691,574
Other	<u>43,436</u>	<u>212,496</u>
	<u>\$ 832,158</u>	<u>\$ 1,904,070</u>

During the years ended June 30, 2013 and 2012, net assets were released from donor restrictions (by incurring expenses satisfying the restrictions) as follows:

	<u>2013</u>	<u>2012</u>
Treatment program services	\$ 1,584,428	\$ 1,212,181
Other	<u>209,747</u>	<u>119,277</u>
	<u>\$ 1,794,175</u>	<u>\$ 1,331,458</u>

**7. ALLOCATION OF JOINT COSTS**

Smile Train conducts direct mail campaigns and print advertising that include a program/educational component, along with the request for contributions. The costs of conducting these joint activities were allocated as follows:

	<u>2013</u>	<u>2012</u>
Program (education)	\$ 9,086,717	\$ 30,291,056
Fundraising	<u>9,962,712</u>	<u>19,020,026</u>
Total Joint Costs	19,049,429	49,311,082
Direct fundraising	7,203,315	6,068,769
Direct program	<u>223,058</u>	<u>572,213</u>
	<u>\$ 26,475,802</u>	<u>\$ 55,952,064</u>

**8. COMMITMENTS AND CONTINGENCIES**

**Operating Leases**

On May 5, 2008, Smile Train entered into a non-cancelable operating lease for its existing office space, the terms of which included the sublet and relocation of its prior New York office space through the expiration of such prior lease. The office lease agreement commenced May 2008 and extends to June 2018.

**SMILE TRAIN, INC. AND AFFILIATES**  
**Notes to Combined Financial Statements**  
**June 30, 2013 and 2012**

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As of June 30, 2013, the minimum future annual rental payments are as follows:

2014	\$ 928,532
2015	955,508
2016	955,508
2017	955,508
2018	<u>955,508</u>
Total	<u>\$ 4,750,564</u>

Rent expense for Smile Train Inc. and its affiliates was \$1,071,348 and \$1,038,018 for the years ended June 30, 2013 and 2012, respectively.

**Severance Arrangements**

During the year ended June 30, 2013, Smile Train discontinued employment of a member of its management and made a severance arrangement. Accordingly, an accrual was included in accounts payable and accrued expenses in the accompanying combined financial statements as of June 30, 2013.

**Contingencies**

In the normal course of its operations, Smile Train is a party to various legal proceedings and complaints, some of which are covered by insurance. While it is not feasible to predict the ultimate outcomes of such matters, management of Smile Train is not aware of any claims or contingencies that would have a material adverse effect on Smile Train's combined financial position, change in net assets or cash flows.

**9. RETIREMENT PLAN**

Smile Train established a defined contribution retirement plan, which covers all eligible full-time employees. Smile Train matches 100% of employees' contributions up to 6% of an employee's salary. Smile Train's contributions for the year ended June 30, 2013 and 2012, were \$152,458 and \$138,439, respectively.

**10. RELATED-PARTY TRANSACTIONS**

Smile Train has a contractual agreement with NeuLion, Inc. ("NeuLion") to manage the Cleft Patients Database (Smile Train Express) and to maintain Smile Train's medical website, medpro.smiletrain.org. For the years ended June 30, 2013 and 2012, the amount paid to NeuLion was \$102,000 and \$108,000, respectively. The principal shareholder of NeuLion is related to the chairman of the board of directors of Smile Train who is also the chairman of the board of directors of NeuLion.

## **SUPPLEMENTARY INFORMATION**

**SMILE TRAIN, INC. AND AFFILIATES**  
**Combining Schedule of Financial Position**  
**As of June 30, 2013**

	<u>Smile Train, Inc.</u>	<u>Smile Train UK</u>	<u>Smile Train Canada</u>	<u>Smile Train India</u>	<u>Smile Train Germany</u>	<u>Eliminations</u>	<u>Total</u>
<b>ASSETS</b>							
Cash and cash equivalents	\$ 14,352,939	\$ 1,797,154	\$ 41,154	\$ 1,149	\$ 14,879	\$ -	\$ 16,207,275
Investments	214,243,129	-	-	-	-	-	214,243,129
Contributions receivable	306,535	306,093	151	-	-	-	612,779
Prepaid expenses and other assets	1,607,551	127,888	9,489	-	386	-	1,745,314
Due from Affiliates	26,548	17,714	-	-	-	(44,262)	-
Furniture and equipment, net	298,111	-	-	-	-	-	298,111
	<u>298,111</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>298,111</u>
Total assets	<u>\$230,834,813</u>	<u>\$ 2,248,849</u>	<u>\$ 50,794</u>	<u>\$ 1,149</u>	<u>\$ 15,265</u>	<u>\$ (44,262)</u>	<u>\$ 233,106,608</u>
<b>LIABILITIES AND NET ASSETS</b>							
<b>LIABILITIES</b>							
Grants and contracts payable	\$ 5,240,947	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,240,947
Accounts payable and accrued expenses	2,028,752	434,032	14,967	-	-	-	2,477,751
Other liabilities	-	-	-	-	-	-	-
Due to affiliates	17,714	25,461	-	-	1,087	(44,262)	-
Deferred rent liability	116,184	-	-	-	-	-	116,184
	<u>116,184</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>116,184</u>
Total liabilities	<u>7,403,597</u>	<u>459,493</u>	<u>14,967</u>	<u>-</u>	<u>1,087</u>	<u>(44,262)</u>	<u>7,834,882</u>
<b>NET ASSETS</b>							
Unrestricted	222,654,267	1,734,147	35,827	1,149	14,178	-	224,439,568
Temporarily restricted	776,949	55,209	-	-	-	-	832,158
	<u>776,949</u>	<u>55,209</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>832,158</u>
Total net assets	<u>223,431,216</u>	<u>1,789,356</u>	<u>35,827</u>	<u>1,149</u>	<u>14,178</u>	<u>-</u>	<u>225,271,726</u>
Total liabilities and net assets	<u>\$230,834,813</u>	<u>\$ 2,248,849</u>	<u>\$ 50,794</u>	<u>\$ 1,149</u>	<u>\$ 15,265</u>	<u>\$ (44,262)</u>	<u>\$ 233,106,608</u>

*This schedule should be read in conjunction with the accompanying report of independent certified public accounts and the combined financial statements and notes thereto.*



**SMILE TRAIN, INC. AND AFFILIATES**  
**Combining Schedule of Activities and Change in Net Assets**  
**For the year ended June 30, 2013**

	Smile Train, Inc.			Smile Train UK			Smile Train Canada	Smile Train India	Smile Train Germany	Eliminations	Combined Total		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total	Unrestricted	Unrestricted	Unrestricted	Eliminations	Unrestricted	Temporarily Restricted	Total
Support and revenue :													
Contributions	\$ 89,450,398	\$ 605,365	\$ 90,055,763	\$ 12,752,873	\$ 116,898	\$ 12,869,771	\$ 2,334,688	\$ 252,315	\$ 6,787	\$ (8,432,205)	\$ 96,364,856	\$ 722,263	\$ 97,087,119
Contributions in-kind	52,525,367	-	52,525,367	274,074	-	274,074	-	-	-	(274,074)	52,525,367	-	52,525,367
Investment income	18,733,464	-	18,733,464	-	-	-	-	-	-	-	18,733,464	-	18,733,464
Other income	1,380,045	-	1,380,045	490,068	-	490,068	135	3,914	-	-	1,874,162	-	1,874,162
(Losses) gains in currency translations	(68,300)	-	(68,300)	(59,221)	-	(59,221)	10,201	68	1,218	(179,410)	(295,444)	-	(295,444)
Net assets released from restriction	1,732,486	(1,732,486)	-	61,689	(61,689)	-	-	-	-	-	1,794,175	(1,794,175)	-
<b>Total support and revenue</b>	<b>163,753,460</b>	<b>(1,127,121)</b>	<b>162,626,339</b>	<b>13,519,483</b>	<b>55,209</b>	<b>13,574,692</b>	<b>2,345,024</b>	<b>256,297</b>	<b>8,005</b>	<b>(8,885,689)</b>	<b>170,996,580</b>	<b>(1,071,912)</b>	<b>169,924,668</b>
Expenses :													
Treatment	106,303,868	-	106,303,868	7,640,760	-	7,640,760	966,147	260,952	-	(8,611,615)	106,560,112	-	106,560,112
Training	1,767,308	-	1,767,308	-	-	-	-	-	-	-	1,767,308	-	1,767,308
Public education	7,958,696	-	7,958,696	1,630,319	-	1,630,319	722,951	-	-	-	10,311,966	-	10,311,966
Management and general	1,632,153	-	1,632,153	656,184	-	656,184	39,687	1,233	24,070	-	2,353,327	-	2,353,327
Fundraising	17,380,312	-	17,380,312	2,836,605	-	2,836,605	587,549	-	618	(274,074)	20,531,010	-	20,531,010
<b>Total expenses</b>	<b>135,042,337</b>	<b>-</b>	<b>135,042,337</b>	<b>12,763,868</b>	<b>-</b>	<b>12,763,868</b>	<b>2,316,334</b>	<b>262,185</b>	<b>24,688</b>	<b>(8,885,689)</b>	<b>141,523,723</b>	<b>-</b>	<b>141,523,723</b>
Change in net assets	28,711,123	(1,127,121)	27,584,002	755,615	55,209	810,824	28,690	(5,888)	(16,683)	-	29,472,857	(1,071,912)	28,400,945
Net assets, beginning of year	193,943,144	1,904,070	195,847,214	978,532	-	978,532	7,137	7,037	30,861	-	194,966,711	1,904,070	196,870,781
Net assets, end of year	<u>\$ 222,654,267</u>	<u>\$ 776,949</u>	<u>\$ 223,431,216</u>	<u>\$ 1,734,147</u>	<u>\$ 55,209</u>	<u>\$ 1,789,356</u>	<u>\$ 35,827</u>	<u>\$ 1,149</u>	<u>\$ 14,178</u>	<u>\$ -</u>	<u>\$ 224,439,568</u>	<u>\$ 832,158</u>	<u>\$ 225,271,726</u>

*This schedule should be read in conjunction with the accompanying report of independent certified public accounts and the combined financial statements and notes thereto.*