

**CHILDREN'S DEFENSE FUND
AND CHILDREN'S DEFENSE FUND
ACTION COUNCIL**

**AUDITED CONSOLIDATED
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION**

DECEMBER 31, 2012 AND 2011

Children's Defense Fund and Children's Defense Fund Action Council

Table of Contents

	Page
Independent Auditor's Report	1 - 2
Audited Consolidated Financial Statements	
Consolidated Statements of Financial Position	3
Consolidated Statements of Activities and Changes in Net Assets	4 - 5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7 - 24
Independent Auditor's Report on Supplementary Information	25
Consolidated Schedules of Functional Expenses	26 - 27



Independent Auditor's Report

Board of Directors

Children's Defense Fund and Children's Defense Fund Action Council
Washington, D.C.

We have audited the accompanying consolidated financial statements of **Children's Defense Fund and Children's Defense Fund Action Council** (a nonprofit organization), which comprise the Consolidated Statements of Financial Position as of December 31, 2012 and 2011, and the related Consolidated 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 consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of **Children's Defense Fund and Children's Defense Fund Action Council** as of December 31, 2012 and 2011, and the 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.

Other Matter

As more fully described in Note 2 to the financial statements, the financial statements include investments valued at approximately \$4,880,000 and \$6,026,000 (22.5% and 23.5% of net assets) at December 31, 2012 and 2011, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the investment fund managers.

Aronson LLC

Rockville, Maryland
August 28, 2013

Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Statements of Financial Position

<i>December 31,</i>	2012	2011
Assets		
Cash and cash equivalents	\$ 2,136,555	\$ 1,850,591
Investments	20,253,604	20,961,119
Pledges receivable, net	3,366,759	2,887,332
Government contracts and grants receivable	176,008	29,120
Property and equipment, net	9,891,020	10,428,369
Other assets	333,987	317,518
Total assets	\$ 36,157,933	\$ 36,474,049
 Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 1,944,903	\$ 1,362,772
Lines of credit	7,500,000	4,000,000
Bonds payable	5,040,000	5,415,000
Total liabilities	14,484,903	10,777,772
 Net assets		
Unrestricted	8,304,507	9,783,266
Temporarily restricted	6,261,923	8,806,411
Permanently restricted	7,106,600	7,106,600
Total net assets	21,673,030	25,696,277
Total liabilities and net assets	\$ 36,157,933	\$ 36,474,049

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Statement of Activities and Changes in Net Assets

<i>Year Ended December 31, 2012</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	2012 Total
Revenue, gains and other support				
Contributions and donations				
Foundations and corporations	\$ 1,066,296	\$ 7,816,082	\$ -	\$ 8,882,378
Individuals	1,598,350	-	-	1,598,350
Organizations and groups	488,709	-	-	488,709
In kind donations	62,669	-	-	62,669
Other				
Special events	2,316,723	-	-	2,316,723
Training and Haley Farm fees	2,909,859	-	-	2,909,859
Government contracts and grants	168,890	-	-	168,890
Service contracts	487,016	-	-	487,016
Rental income	312,625	-	-	312,625
Miscellaneous	263,377	-	-	263,377
Investment income				
Endowment				
Interest and dividends	174,380	97,625	-	272,005
Realized and unrealized gains, net of management fees	435,222	235,258	-	670,480
Operating interest and dividends	6,248	-	-	6,248
Net assets released from restrictions	10,693,453	(10,693,453)	-	-
Total revenue, gains and other support	20,983,817	(2,544,488)	-	18,439,329
Expenses				
Program services				
Leadership development and state and community capacity building	16,520,141	-	-	16,520,141
Policy and program development and implementation	1,094,995	-	-	1,094,995
Public education, media campaigns, internet outreach and publications	1,543,908	-	-	1,543,908
Total program services	19,159,044	-	-	19,159,044
Supporting services				
General and administrative	2,434,425	-	-	2,434,425
Fundraising	869,107	-	-	869,107
Total supporting services	3,303,532	-	-	3,303,532
Total expenses	22,462,576	-	-	22,462,576
Change in net assets	(1,478,759)	(2,544,488)	-	(4,023,247)
Beginning net assets	9,783,266	8,806,411	7,106,600	25,696,277
Ending net assets	\$ 8,304,507	\$ 6,261,923	\$ 7,106,600	\$ 21,673,030

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Statement of Activities and Changes in Net Assets

<i>Year Ended December 31, 2011</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	2011 Total
Revenue, gains and other support				
Contributions and donations				
Foundations and corporations	\$ 1,363,000	\$ 5,843,098	\$ -	\$ 7,206,098
Individuals	1,235,906	-	-	1,235,906
Organizations and groups	429,324	-	-	429,324
Other				
Special events	2,220,875	-	-	2,220,875
Training and Haley Farm fees	2,040,284	-	-	2,040,284
Government contracts and grants	433,238	-	-	433,238
Service contracts	484,700	-	-	484,700
Rental income	247,073	-	-	247,073
Miscellaneous	250,759	-	-	250,759
Investment income				
Endowment				
Interest and dividends	242,527	124,382	-	366,909
Realized and unrealized gains, net of management fees	490,577	251,597	-	742,174
Operating interest and dividends	211	-	-	211
Net assets released from restrictions	12,110,820	(12,110,820)	-	-
Total revenue, gains and other support	21,549,294	(5,891,743)	-	15,657,551
Expenses				
Program services				
Leadership development and state and community capacity building	15,246,319	-	-	15,246,319
Policy and program development and implementation	1,454,345	-	-	1,454,345
Public education, media campaigns, internet outreach and publications	1,210,040	-	-	1,210,040
Total program services	17,910,704	-	-	17,910,704
Supporting services				
General and administrative	2,520,607	-	-	2,520,607
Fundraising	960,029	-	-	960,029
Total supporting services	3,480,636	-	-	3,480,636
Total expenses	21,391,340	-	-	21,391,340
Change in net assets	157,954	(5,891,743)	-	(5,733,789)
Beginning net assets	9,625,312	14,698,154	7,106,600	31,430,066
Ending net assets	\$ 9,783,266	\$ 8,806,411	\$ 7,106,600	\$ 25,696,277

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Statements of Cash Flows

<i>Years Ended December 31,</i>	2012	2011
Cash flows from operating activities		
Change in net assets	\$ (4,023,247)	\$ (5,733,789)
Adjustment to reconcile change in net assets to net cash (used) provided by operating activities		
Depreciation and amortization	743,029	833,780
Realized and unrealized gains on investments	(914,283)	(1,086,180)
Donated securities	(152,589)	(6,848)
Provision for doubtful accounts	-	68,924
Discount on pledges receivable	10,408	(130,468)
Change in assets and liabilities		
Pledges receivable	(479,835)	6,044,098
Government contracts and grants receivable	(146,888)	(29,120)
Other assets	(26,469)	580,949
Accounts payable and accrued expenses	582,131	(347,288)
Net cash (used) provided by operating activities	(4,407,743)	194,058
Cash flows from investing activities		
Proceeds from sales of investments	5,142,608	7,894,807
Purchases of investments	(3,368,221)	(7,667,708)
Proceeds from sales of property and equipment	4,081	-
Purchases of property and equipment	(209,761)	(49,169)
Net cash provided by investing activities	1,568,707	177,930
Cash flows from financing activities		
Proceeds from lines of credit	7,500,000	6,500,000
Payments on lines of credit	(4,000,000)	(5,000,000)
Principal payments on bonds payable	(375,000)	(355,000)
Net cash provided by financing activities	3,125,000	1,145,000
Increase in cash and cash equivalents	285,964	1,516,988
Cash and cash equivalents, beginning of year	1,850,591	333,603
Cash and cash equivalents, end of year	\$ 2,136,555	\$ 1,850,591
Supplemental cash flows information		
Actual cash payments of interest	\$ 132,981	\$ 93,845

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

1. Organization and significant accounting policies

Organization: The Children's Defense Fund is a private, nonprofit corporation that began in 1973. The Children's Defense Fund Leave No Child Behind mission is to ensure every child a *Healthy Start*, a *Head Start*, a *Fair Start*, a *Safe Start* and a *Moral Start* in life and successful passage to adulthood with the help of caring families and communities. The Children's Defense Fund provides a strong, effective and independent voice for *all* the children of America who cannot vote, lobby or speak for themselves. It pays particular attention to the needs of poor and minority children and those with disabilities. The Children's Defense Fund educates the nation about the needs of children and encourages preventive investments before they get sick, drop out of school, get into trouble or suffer family breakdown. The Children's Defense Fund is supported primarily by foundation and corporate grants and individual donations.

The Children's Defense Fund Action Council shares the Children's Defense Fund's mission. It was organized to conduct lobbying activities and grassroots mobilization in advocating for legislation that meets the needs of children. The organizations are under common management, with the Children's Defense Fund staff performing duties of the Children's Defense Fund Action Council.

The Washington Research Project was granted 501(c)(3) status in 2011 and also shares the Children's Defense Fund's mission. It was organized to provide education and technical assistance to governmental units, private nonprofit organizations, and others that receive funding to support programs intended to advance the health, education and welfare of children. In 2012, the Children's Defense Fund assumed responsibility for providing these services. The Washington Research Project is currently in the process of being dissolved and had minimal activity in 2012.

Basis of consolidation: The consolidated financial statements include the accounts of the Children's Defense Fund, the Children's Defense Fund Action Council and the Washington Research Project (collectively referred to as "CDF"). Because the organizations are under common control and an economic interest exists between them, they have been consolidated as required under accounting principles generally accepted in the United States of America. All intercompany accounts and transactions have been eliminated in consolidation.

Basis of accounting: The consolidated financial statements have been prepared on the accrual basis of accounting, which is in accordance with accounting principles generally accepted in the United States of America.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Cash and cash equivalents: CDF considers demand deposits, money market funds and commercial paper with original maturities of three months or less as cash and cash equivalents. Uninvested cash held in certain endowment investment accounts are considered investments as such amounts are not to be used for general operating purposes. CDF maintains a legal right of offset with certain financial institutions, allowing any potential overdrafts to be offset with funds from other accounts held at the same institution. CDF maintains accounts which may exceed federally insured limits. Management does not consider this to be a significant credit risk.

Investments: Investments in marketable securities and bond funds are presented at fair value based on quoted market prices in principal active markets for identical assets. Fair values of alternative investments were developed using the net asset value (NAV) as reported by the underlying fund managers and reviewed by CDF. Money market funds are recorded at cost, which approximates fair value.

Fair value of financial instruments: As of December 31, 2012 and 2011, the estimated fair values of financial instruments subject to fair value disclosures were determined based on available market information and valuation methodologies believed to be appropriate for these purposes. Considerable judgment is involved in developing these estimates and, therefore, are not necessarily indicative of the actual amounts that could be realized in a current market exchange.

Gains and losses on investments, including changes in fair value, are reported in the Consolidated Statements of Activities and Changes in Net Assets as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by donor stipulation, applicable laws, or under the accounting rules for endowments pursuant to the DC Uniform Prudent Management of Institutional Funds Act (UPMIFA).

Fair value: CDF values certain investments at fair value in accordance with a three-tier fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

In the case of multiple inputs being used in the fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported.

Pledges receivable: Pledges receivable represent unconditional promises to give and are recorded in the financial statements at the time the promises are made. The allowance for doubtful accounts reflects the best estimate of probable losses determined principally on the basis of historical experience. All amounts are considered collectible at December 31, 2012. Amounts due in excess of one year are recorded at the present value of their estimated future cash flows, using discount rates equal to the prevailing local borrowing rate which ranged from 1.60% to 1.75% and 1.53% to 1.75% for the years ended December 31, 2012 and 2011, respectively. Amortization of the discount is included in contribution revenue.

Government contracts and grants receivable: Government contracts and grants receivable include all current billed and unbilled costs chargeable to those awards within the respective cost limits. All unbilled receivables will be billed at the next billing date and are expected to be collected within a twelve-month period. The face amount of receivables is reduced by an allowance for doubtful accounts, if needed. The allowance for doubtful accounts reflects the best estimate of probable losses determined principally on the basis of historical experience. As of December 31, 2012 and 2011, management fully expects to collect all balances.

Property and equipment: Property and equipment over \$1,000 are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	30 years
Building improvements	5 to 30 years
Furniture, equipment and software	2 to 10 years

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

CDF evaluates all long-lived assets held for use for impairment based upon comparison of the undiscounted future net cash flows for the asset to the net book value. These evaluations for impairment are significantly impacted by estimates of revenue, costs and expenses, sales rates and other factors. If the net book value is greater than the future undiscounted cash flow, CDF records an impairment adjustment to reduce its assets cost basis to its fair value when indications of impairment exist.

During the years ended December 31, 2012 and 2011, CDF recorded no impairment adjustments on assets held for use.

Net assets: Unrestricted net assets represent resources that are not restricted, either temporarily or permanently, by donor-imposed stipulations. They are available for support of all organizational operations and services.

Temporarily restricted net assets represent assets contributed whose use is limited by donor-imposed stipulations. These restrictions are temporary in that they either expire by the passage of time or by the fulfillment of certain actions of CDF pursuant to those stipulations.

Permanently restricted net assets represent assets contributed that are received with donor stipulations requiring that the original gift amount be held in perpetuity and only the earnings, if any, be used for the purposes designated by the donor.

Endowment fund: CDF has established an endowment fund to account for gifts which are required by donors to be held in perpetuity or designated by donors for a specific purpose and to account for board designated funds. The gifts, grants, contributions, and investment income of the endowment fund are recorded as either unrestricted, temporarily restricted, or permanently restricted revenue and support, depending on the restrictions, if any, imposed by the donors. The endowment fund is managed according to the guidelines and policies established by CDF's finance committee and approved by the Board of Directors.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Revenue recognition: Contributions, including unconditional promises to give, are recognized when received. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Contributions that are restricted by the donor for a specific time or purpose are reported as temporarily or permanently restricted contributions based on the nature of the restriction. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the Consolidated Statement of Activities and Changes in Net Assets as net assets released from restrictions. Applying this policy at times creates year-to-year fluctuations of changes in net assets, with grants immediately recognized as revenue in an earlier period than grant related expenses. Conditional promises to give are not included as support until the conditions are substantially met.

Special events are activities not regularly carried on. Special events, Training and Haley Farm fees, and Miscellaneous revenue is recognized when the services are performed.

Allocation of functional expenses: The costs of providing the various programs and other activities have been summarized in the accompanying Consolidated Statements of Activities and Changes in Net Assets. Costs which cannot be specifically identified with a particular function and which benefit more than one functional category are allocated based on either the portion of time expended by the staff on the various functions, or the average number of people in the division.

Program services definitions: Leadership Development and State and Community Capacity Building expenses relate to child advocacy services across many different programs. The major programs are:

Freedom Schools: This program provides summer and after-school enrichment through a research-based and multicultural curriculum that supports children and families.

Beat the Odds Scholarship and Leadership Development: For more than 20 years, the Children's Defense Fund has honored outstanding high school students with our *Beat the Odds* college scholarship and leadership training program.

Young Advocate Leadership Training (YALT): CDF believes that the next great movement for children will have to be led by the next generation of servant leaders. YALT is an action-oriented training series for young leaders to empower them at the national, state, and local level to take action for justice and social progress on behalf of children.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

CDF Haley Farm: This farm, located in Tennessee, is the CDF home for spiritual renewal, interdisciplinary, intergenerational, interfaith, and interracial discourse for building the children's movement. Training programs at the farm have touched nearly 20,000 leaders.

Policy and Program Development and Implementation expenses represent costs associated with the collection and analysis of data and problems of children, private and governmental health, family income, teen pregnancy prevention, childcare, child protection, and violence prevention. Over the years, CDF has become known for careful research on policies that effect children in all racial and income groups, and for independent analyses of how federal and state policies affect children, their families, and their communities.

Public Education, Media Campaigns, Internet Outreach and Publications expenses are related to external communications and publications. Some of the major campaigns in this area included:

Cradle to Prison Pipeline campaign seeks to replace the pipeline that sends children to prison with a pipeline to college, work, and successful adulthood.

Be Careful What You Cut campaign makes the economic case that cutting children from the budget now will cost all of us later.

All Healthy Children campaign ensures that 95 percent of all children will have access to health care under the Affordable Care Act.

Protect Children, Not Guns campaign seeks to educate the public and policy makers about children injured or killed by guns and to support common sense gun safety laws.

Use of estimates: The preparation of the consolidated 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 may differ from those estimates.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Tax status: Children's Defense Fund is a public charity exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is classified as an organization that is not a private foundation. Children's Defense Fund Action Council is a social welfare organization exempt from federal income tax under section 501(c)(4) of the Internal Revenue Code. Washington Research Project is a public charity exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is classified as an organization that is not a private foundation.

Uncertainty in income taxes: CDF evaluates uncertainty in income tax positions taken or expected to be taken on a tax return based on a more-likely-than not recognition standard. If that threshold is met, the tax position is then measured as the largest amount that is greater than 50% likely of being realized upon ultimate settlement. As of December 31, 2012 and 2011, there are no accruals for uncertain tax positions. If applicable, CDF records interest and penalties as a component of income tax expense. Tax years from 2009 through the current year remain open for examination by tax authorities.

Reclassifications: Certain 2011 balances have been reclassified to conform with the 2012 presentation.

Subsequent events: Management has evaluated subsequent events for disclosure in the consolidated financial statements through August 28, 2013, which is the date the consolidated financial statements were available to be issued.

2. Investments

Investments as of December 31 consist of the following:

	2012	2011
Endowment investments		
Hedge fund	\$ 3,849,082	\$ 4,870,841
Real estate investment trust fund	1,030,635	1,154,931
Conservative allocation mutual fund	1,753,096	1,548,413
Short-term bond mutual fund	4,129,273	3,545,593
Intermediate-term bond fund	1,022,484	-
Inflation-protected bond mutual fund	4,623,166	4,319,800
Money market funds	3,845,868	5,521,541
Total endowment investments	\$ 20,253,604	\$ 20,961,119

The hedge fund and real estate investment trust fund in which CDF invests consist of domestic and foreign securities, including stocks, bonds, currencies, futures contracts, forward contracts, options, swaps, real estate and other commodity interests, as well as securities and options contracts sold short, but not yet purchased. CDF has invested in these alternative investments for the purpose of diversifying investment risk.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

The underlying investments of the hedge fund consist of securities that are valued based on quoted market prices or other observable inputs. The hedge fund shares may be redeemed, as of the last calendar day of any month, following the second anniversary of their issuance or purchase, provided that notice is given at least 60 days prior to the requested redemption date.

The underlying assets of the real estate investment trust fund consist primarily of investments in other domestic real estate funds that invest in real estate assets or natural resources that do not have readily determinable fair values. The primary objective is to assist organizations in maintaining endowment purchasing power by generating returns in a manner that will cause CDF's total portfolio to be less volatile. The real estate investment trust fund is illiquid because the units are subject to restrictions on transferability and cannot be sold unless they are subsequently registered under the Securities Act of 1933, as amended, and all other applicable securities laws or an exemption from such laws is available. Partial distributions are received from the fund periodically. The real estate investment trust fund has a 15-year term expiring December 31, 2016, subject to extension at the managing member's discretion for up to five consecutive one-year periods.

For the years ended December 31, 2012 and 2011, in conjunction with a line of credit with Morgan Stanley Bank, the bank has a continuing security interest in an investment account, which had a balance of \$9,209,628 and \$7,235,530 at December 31, 2012 and 2011, respectively.

Net investment income consists of the following for the years ended:

December 31, 2012	Unrestricted	Temporarily Restricted	Total
Interest and dividends	\$ 174,380	\$ 97,625	\$ 272,005
Net realized and unrealized gains	593,479	320,803	914,282
Management fees	(158,257)	(85,545)	(243,802)
Operating	6,248	-	6,248
Total investment income	\$ 615,850	\$ 332,883	\$ 948,733
December 31, 2011			
Interest and dividends	\$ 242,527	\$ 124,382	\$ 366,909
Net realized and unrealized gains	717,965	368,215	1,086,180
Management fees	(227,388)	(116,618)	(344,006)
Operating	211	-	211
Total investment income	\$ 733,315	\$ 375,979	\$ 1,109,294

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

3. **Fair value of investments** The fair value of investments is presented as follows:

December 31, 2012	Total	Quoted prices in active markets for identical assets (Level 1)	Significant unobservable inputs (Level 3)
Money market funds	\$ 3,845,868	\$ 3,845,868	\$ -
Hedge fund	3,849,082	-	3,849,082
Real estate investment trust fund	1,030,635	-	1,030,635
Conservative allocation mutual fund	1,753,096	1,753,096	-
Short-term bond mutual fund	4,129,273	4,129,273	-
Intermediate-term bond fund	1,022,484	1,022,484	-
Inflation-protected bond mutual fund	4,623,166	4,623,166	-
Total	\$ 20,253,604	\$ 15,373,887	\$ 4,879,717
December 31, 2011			
Money market funds	\$ 5,521,541	\$ 5,521,541	\$ -
Hedge fund	4,870,841	-	4,870,841
Real estate investment trust fund	1,154,931	-	1,154,931
Conservative allocation mutual fund	1,548,413	1,548,413	-
Short-term bond mutual fund	3,545,593	3,545,593	-
Inflation-protected bond mutual fund	4,319,800	4,319,800	-
Total	\$ 20,961,119	\$ 14,935,347	\$ 6,025,772

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Level 3 values for alternative investments were developed using the NAV as reported by the underlying fund managers and reviewed by CDF. The NAV is determined by the fund managers based on the fair market value of the underlying investments on the most recent practical date. The NAV per share of each series within a class is determined by first allocating any increase or decrease in the NAV among all shares of the series pro rata. Each share within a series has the same NAV. CDF's determination of fair value is based upon the best available information and may incorporate management assumptions and best estimates after considering a variety of internal and external factors. The values generally represent CDF's proportionate share of the funds' fair value as reported by their general partners. CDF has determined through its monitoring activities to rely on the fair market value as decided by the fund managers. The risk of any derivative exposure is limited to the amount invested with each manager.

A reconciliation of beginning and ending balances of investments measured with Level 3 inputs is as follows for the years ended:

December 31, 2012	Hedge Fund	Real Estate Investment Trust Fund	Total
Beginning balance	\$ 4,870,841	\$ 1,154,931	\$ 6,025,772
Total gains (realized and unrealized)	488,978	83,414	572,392
Purchases	-	24,655	24,655
Sales	(1,283,120)	(216,179)	(1,499,299)
Management fees	(227,617)	(16,186)	(243,803)
Ending balance	\$ 3,849,082	\$ 1,030,635	\$ 4,879,717
December 31, 2011			
Beginning balance	\$ 4,519,439	\$ 1,156,171	\$ 5,675,610
Total gains (realized and unrealized)	679,467	239,254	918,721
Sales	-	(224,553)	(224,553)
Management fees	(328,065)	(15,941)	(344,006)
Ending balance	\$ 4,870,841	\$ 1,154,931	\$ 6,025,772

Unrealized gains related to level 3 assets held at December 31, 2012 and 2011 and for the years then ended were \$572,392 and \$902,780, respectively.

CDF recognizes transfers of assets into and out of levels as of the date an event or change in circumstances causes the transfer. There were no transfers between levels during the years ended December 31, 2012 and 2011.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

4. **Pledges receivable and concentration** CDF has received the following multi-year commitments as of December 31:

	2012	2011
Due in less than one year	\$ 2,792,477	\$ 2,768,601
Due in two to five years	587,626	131,667
Total pledges receivable	3,380,103	2,900,268
Less: Discounts on pledges receivable	(13,344)	(2,936)
Less: Allowance for doubtful accounts	-	(10,000)
Total pledges receivable, net	\$ 3,366,759	\$ 2,887,332

Concentration of pledges receivable and foundation revenue: Three of the receivables at December 31, 2012 and two of the receivables as of December 31, 2011 included in CDF's pledges receivable in the accompanying Consolidated Statements of Financial Position comprise 37% and 66% of the amounts, respectively. Total foundations and corporation revenue for the years ended December 31, 2012 and 2011 in the accompanying Consolidated Statements of Activities and Changes in Net Assets includes three grantor's constituting 26% and 33% of the amounts, respectively.

5. **Property and equipment** Property and equipment consist of the following as of:

December 31, 2012	Headquarters and State and Local Offices	Haley Farm	Total
Land	\$ 1,995,718	\$ 592,874	\$ 2,588,592
Buildings and improvements	13,156,920	5,177,488	18,334,408
Furniture, equipment and software	4,503,316	732,350	5,235,666
Total property and equipment	19,655,954	6,502,712	26,158,666
Less: Accumulated depreciation	(13,347,142)	(2,919,704)	(16,266,846)
Net property and equipment	\$ 6,308,812	\$ 3,583,008	\$ 9,891,820

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

December 31, 2011	Headquarters and State and Local Offices	Haley Farm	Total
Land	\$ 1,995,718	\$ 592,874	\$ 2,588,592
Buildings and improvements	13,011,001	5,177,488	18,188,489
Furniture, equipment and software	4,448,416	726,689	5,175,105
Total property and equipment	19,455,135	6,497,051	25,952,186
Less: Accumulated depreciation	(12,800,835)	(2,722,982)	(15,523,817)
Net property and equipment	\$ 6,654,300	\$ 3,774,069	\$ 10,428,369

Depreciation and amortization expense for the years ended December 31, 2012 and 2011 was \$743,029 and \$833,780, respectively.

6. Lines of credit

In May 2012, CDF entered into a \$7.5 million line of credit agreement with BB&T, primarily for working capital needs. The line of credit is secured by a portion of CDF's investments, totaling \$9,209,628 as of December 31, 2012. During the term of the line of credit the outstanding balance is not to exceed 85% of the above mentioned investment balance. The change was made from the line of credit previously held with Morgan Stanley, due to superior interest rates, term of debt instrument, advance rates and covenants. Borrowings accrue interest at various rate tiers (1.60% at December 31, 2012). Monthly payments consist of accrued interest only. In July 2013, the line of credit agreement was amended and will mature in May 2015. At that time principal and interest are due in full. CDF is in compliance with all covenants related to the lines of credit.

At December 31, 2011, CDF had a \$4.6 million line of credit with Morgan Stanley at a rate of interest that varies (2.75% at December 31, 2011).

The outstanding balances on the lines of credit at December 31, 2012 and 2011 were \$7,500,000 and \$4,000,000, respectively.

7. Bonds payable

In April 1997, CDF issued variable rate demand bonds (the Bonds) in the amount of \$9,000,000, as follows:

\$7,500,000 of Tax-exempt Variable Rate Demand Bonds issued through the District of Columbia which provide for scheduled principal payments every April 1 commencing in 1998 in the amount of \$150,000, increasing to a final scheduled payment of \$510,000 in 2022.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

\$1,500,000 Taxable Variable Rate Demand Bonds which provide for scheduled principal payments on April 1, commencing in 1998 in the scheduled amount of \$30,000, increasing to a final scheduled payment of \$120,000 in 2022.

Interest rates on these bonds are determined weekly by a remarketing agent based on prevailing financial market conditions for bonds with comparable maturity dates. The interest rates at December 31, 2012 for the tax-exempt and taxable bonds were 0.25% and 0.26%, respectively. The interest rates at December 31, 2011 for the tax-exempt and taxable bonds were 0.19% and 0.27%, respectively. Bond interest expense for the years ended December 31, 2012 and 2011 was \$9,112 and \$20,750 respectively.

Land, building, furniture, equipment and improvements at CDF's Washington, DC headquarters are pledged as collateral. In order to provide enhanced security and liquidity for the remarketing of the bonds, CDF has entered into letters of credit. Under the terms of the letters of credit, the bank is obligated to lend funds to CDF in amounts sufficient to pay the purchase price of any bonds tendered. These agreements contain financial covenants and are subject to periodic review by the bank. As of December 31, 2012, CDF was in compliance with all letter of credit financial covenant requirements except for the following: the late filing of audited and interim financial statements and related compliance certificate with the bank, notification of a claim that was settled during the year and a change to the line of credit. CDF received a waiver from the bank for the noncompliance of these covenants.

As of December 31, 2012, the aggregate scheduled principal maturities on the Bonds over the next five years and thereafter are as follows:

Year ending December 31	Amount
2013	\$ 395,000
2014	415,000
2015	435,000
2016	460,000
2017	490,000
Thereafter	2,845,000
Total	\$ 5,040,000

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

8. Restricted net assets The consolidated temporarily restricted net assets are available for the following programs or purposes as of December 31:

	2012	2011
Operating		
Leadership development and state and community capacity building	\$ 4,607,815	\$ 5,663,678
Policy and program development and implementation	1,443,305	1,655,874
Time restricted for use in future periods	130,813	89,752
Total operating	6,181,933	7,409,304
Endowment		
Policy and program development and implementation	28,755	502,248
Public education, media campaigns, internet outreach and publications	51,235	894,859
Total endowment	79,990	1,397,107
Total temporarily restricted net assets	\$ 6,261,923	\$ 8,806,411

In accordance with donor stipulations, permanently restricted net assets are held (and invested) in perpetuity, as of December 31:

	2012	2011
Endowment		
Leadership development and state and community capacity building	\$ 4,606,600	\$ 4,606,600
Public education, media campaigns, internet outreach and publications	2,500,000	2,500,000
Total permanently restricted net assets	\$ 7,106,600	\$ 7,106,600

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

9. Releases from restrictions	Releases from restrictions were as follows for the years ended December 31:		
		2012	2011
	Leadership development and state and community capacity building	\$ 7,709,610	\$ 9,851,953
	Policy and program development and implementation	1,244,091	1,450,877
	Time and other	89,752	557,990
	Endowment policy and program development and implementation	593,161	89,873
	Endowment public education, media campaigns, internet outreach and publications	1,056,839	160,127
	Total releases from restrictions	\$ 10,693,453	\$ 12,110,820

10. Endowment funds CDF's endowment consists of permanently restricted contributions established for a variety of purposes and board designated funds available at the discretion of the board. As required by Generally Accepted Accounting Principles (GAAP), net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of the Relevant Law: Management of CDF has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, CDF classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund will be classified as temporarily restricted net assets (to the extent the cumulative balance in the endowment fund exceeds the original corpus amount) until those amounts are appropriated for expenditure by CDF in a manner consistent with the standard prudence prescribed by UPMIFA. Losses from the endowment fund will be allocated against unrestricted net assets with subsequent earnings and appreciation restoring the unrestricted net assets.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

In accordance with UPMIFA, CDF considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the organization and donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and appreciation of investments
6. Other resources of the organization
7. The investment policies of the organization

The change in endowment net assets is as follows for the years ended:

December 31, 2012	Board Designated Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 12,457,412	\$ 1,397,107	\$ 7,106,600	\$ 20,961,119
Investment income	609,602	332,883	-	942,485
Appropriation of endowment assets for expenditure	-	(1,650,000)	-	(1,650,000)
Endowment net assets, end of year	\$ 13,067,014	\$ 79,990	\$ 7,106,600	\$ 20,253,604
December 31, 2011				
Endowment net assets, beginning of year	\$ 11,717,462	\$ 1,271,128	\$ 7,106,600	\$ 20,095,190
Additions	6,846	-	-	6,846
Investment income	733,104	375,979	-	1,109,083
Appropriation of endowment assets for expenditure	-	(250,000)	-	(250,000)
Endowment net assets, end of year	\$ 12,457,412	\$ 1,397,107	\$ 7,106,600	\$ 20,961,119

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA as of December 31, 2012 and 2011 is \$7,106,600.

Spending Policy and How the Investment Objectives Relate to Spending Policy: CDF's investment policies will be based on the assumption that annual spending over the long term will approximate 5% of the trailing twelve-quarter average market value of the endowment.

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

Return Objectives and Risk Parameters: CDF has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to preserve the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period and board designated funds. Under the investment policy, the Endowment Investment Program is to outperform, over time, the Lipper Analytical Services, Inc.'s Index of Balanced Funds and achieve total return equal to a real rate of return of more than 5%.

Strategies Employed for Achieving Objectives: The Finance Committee evaluates, selects and monitors one or more investment managers to directly manage CDF's investment portfolio of assets within general guidelines provided. To satisfy its long-term rate of return objectives, CDF relies on a return strategy in which investment returns are achieved through current yield (interest and dividends) and capital appreciation.

11. Retirement plan

Employees of CDF participate in a defined contribution plan under Section 403(b) of the Internal Revenue Code, which covers all employees who have completed six months of service and have attained the age of 21. Contributions to the plan are based on percentages of the annual salary of each participating employee ranging from 5% to 7% based upon the employee's length of service. Employees are fully vested after two years of employment. Pension expense totaled \$435,497 and \$431,242 for the years ended December 31, 2012 and 2011, respectively.

12. Leases

CDF is obligated under various noncancelable operating lease agreements for office facilities expiring at various dates through 2018. CDF rents space in multiple locations across the United States, some of which are subject to month-to-month agreements. CDF also subleases some of its space. The minimum payments required under the leases are recorded on a pro rata basis over the term of the leases. The difference between the amounts expensed and the required lease payments is recorded as deferred rent and included in accounts payable and accrued expenses on the accompanying Consolidated Statements of Financial Position. Rent expense for all office space for the years ended December 31, 2012 and 2011 was \$530,436 and \$671,500, respectively. Future minimum lease payments, less rental income, are as follows:

Year Ending December 31,	Payments	Income	Total
2013	\$ 560,501	\$ (342,786)	\$ 217,715
2014	538,648	(60,438)	478,210
2015	456,240	-	456,240
2016	395,273	-	395,273
2017	358,084	-	358,084
Thereafter	61,188	-	61,188
Total minimum lease payments	\$ 2,369,934	\$ (403,224)	\$ 1,966,710

Children's Defense Fund and Children's Defense Fund Action Council

Notes to Consolidated Financial Statements

13. Related parties

The CDF Marlboro County Office in South Carolina leases office space, for the nominal rate of \$1 per year, in a home that is owned by CDF's Founder. Additional office space for the expansion of the Freedom Schools program in Marlboro Country was acquired in 2012. The land and building being used for this purpose were acquired from a family member of CDF's Founder at a cost of \$150,000. Funding for this purchase was provided by gifts made to CDF in 2012 by CDF's founder and a family member.

The Children's Defense Fund has a contractual agreement with the Southern Coalition for Education Equity, which is run by a member of CDF's Board of Directors. This organization provides services to support CDF's work in Alabama, Georgia and Mississippi. In 2012 and 2011, the total paid to this organization for consulting services was \$84,671 and \$246,000, respectively.

14. Commitments and contingencies

CDF entered into an investment agreement on December 14, 2001 with a real estate investment trust fund (See Note 2) committing up to \$3 million over the life of the fund through December 31, 2016. As of December 31, 2012, CDF has contributed \$2,574,655. If CDF were to fail to make a payment in accordance with the terms of the agreement, CDF would forfeit, at a minimum, 25% of its investment. As of December 31, 2012, CDF has made all payments in accordance with the terms of the agreement. CDF anticipates having the ability to continue capital contributions as required by the commitment.

15. Financial condition

These financial statements are prepared on a going concern basis as shown in the accompanying consolidated financial statements. CDF experienced a loss of \$4,023,247 and \$5,733,789 in 2012 and 2011, respectively. This loss is primarily driven by a significant amount of multi-year grant revenue recognized in 2010 (temporarily restricted net asset additions) and the expense of implementing those grants occurring in 2011 and 2012 (releases of temporarily restricted net assets). CDF is reducing approximately \$1.8 million in expenses on an annual, sustainable basis (a process which started in 2012) without affecting programs. This represents approximately 18% of CDF's recurring expense base, excluding salaries, employee benefits and re-grants. In addition to expense containment, CDF management aims to increase revenue by: pursuing new federal government funding sources; expanded fundraising activities launched on the organization's 40th Anniversary which will continue for three years; and evaluating real estate holdings to maximize their full value. Management believes these actions will permit CDF to fund its future operations.



Independent Auditor's Report on Supplementary Information

Board of Directors
Children's Defense Fund and Children's Defense Fund Action Council
Washington, D.C.

We have audited the consolidated financial statements of **Children's Defense Fund and Children's Defense Fund Action Council** as of and for the years ended December 31, 2012 and 2011, and our report thereon dated August 28, 2013, which expressed an unmodified opinion on those financial statements, appears on pages 1 - 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Consolidated Schedules of Functional Expenses on pages 26 and 27 are presented for purposes of additional analysis of the consolidated financial statements and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Rockville, Maryland
August 28, 2013

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Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Schedule of Functional Expenses

Year Ended December 31, 2012

	Leadership Development and State and Community Capacity Building	Policy and Program Development and Implementation	Public Education, Media Campaigns, Internet Outreach and Publications	Total Program Services	General and Administrative	Fundraising	Total Supporting Services	Total
Grants to organizations in U.S.	\$ 950,652	\$ -	\$ -	\$ 950,652	\$ -	\$ -	\$ -	\$ 950,652
Grants to individuals in U.S.	273,976	200	-	274,176	-	-	-	274,176
Compensation and wages	6,102,043	666,396	741,786	7,510,225	890,053	406,676	1,296,729	8,806,954
Pension plan contributions	239,035	26,107	29,061	294,203	34,893	15,932	50,825	345,028
Other employee benefits	738,294	80,628	89,750	908,672	107,689	49,204	156,893	1,065,565
Payroll taxes	522,757	57,090	63,548	643,395	76,250	34,839	111,089	754,484
Consulting fees	1,560,347	10,988	34,964	1,606,299	93,204	71,323	164,527	1,770,826
Legal fees	-	-	-	-	61,609	-	61,609	61,609
Accounting fees	-	-	-	-	237,737	-	237,737	237,737
Advertising and promotion	14,092	-	66,549	80,641	-	21,757	21,757	102,398
Office expenses	387,236	42,290	47,074	476,600	56,483	25,808	82,291	558,891
Information technology	80,154	19	9,812	89,985	58,597	3,726	62,323	152,308
Occupancy	985,326	107,606	119,780	1,212,712	143,721	65,668	209,389	1,422,101
Travel	1,875,437	15,249	11,959	1,902,645	152,082	21,883	173,965	2,076,610
Conferences and conventions	1,207,340	32	1,167	1,208,539	22,642	32,231	54,873	1,263,412
Interest	-	-	-	-	149,077	-	149,077	149,077
Depreciation and amortization	514,820	56,223	62,583	633,626	75,092	34,311	109,403	743,029
Insurance	69,209	-	6,007	75,216	81,667	-	81,667	156,883
Printing and publication	808,665	6,851	121,332	936,848	78,076	36,416	114,492	1,051,340
Training	1,000	-	132,744	133,744	-	-	-	133,744
Miscellaneous expenses	189,758	25,316	5,792	220,866	115,553	49,333	164,886	385,752
Total expenses	\$ 16,520,141	\$ 1,094,995	\$ 1,543,908	\$ 19,159,044	\$ 2,434,425	\$ 869,107	\$ 3,303,532	\$ 22,462,576

Refer to accompanying Independent Auditor's Report on Supplementary Information.

Children's Defense Fund and Children's Defense Fund Action Council

Consolidated Schedule of Functional Expenses

Year Ended December 31, 2011

	Leadership Development and State and Community Capacity Building	Policy and Program Development and Implementation	Public Education, Media Campaigns, Internet Outreach and Publications	Total Program Services	General and Administrative	Fundraising	Total Supporting Services	Total
Grants to organizations in U.S.	\$ 1,444,159	\$ -	\$ -	\$ 1,444,159	\$ -	\$ -	\$ -	\$ 1,444,159
Grants to individuals in U.S.	275,516	-	-	275,516	-	-	-	275,516
Compensation and wages	5,369,955	813,495	622,230	6,805,680	1,059,572	477,290	1,536,862	8,342,542
Pension plan contributions	277,583	42,051	32,164	351,798	54,772	24,672	79,444	431,242
Other employee benefits	651,310	98,667	75,469	825,446	128,513	57,889	186,402	1,011,848
Payroll taxes	384,860	58,303	44,595	487,758	75,939	34,207	110,146	597,904
Consulting fees	1,753,513	58,669	27,320	1,839,502	224,896	582	225,478	2,064,980
Legal fees	-	-	-	-	36,058	-	36,058	36,058
Accounting fees	-	-	-	-	149,118	-	149,118	149,118
Professional fundraising fees	-	-	-	-	-	76,828	76,828	76,828
Advertising and promotion	14,225	-	7,735	21,960	673	14,982	15,655	37,615
Office expenses	348,532	52,799	40,385	441,716	68,770	30,978	99,748	541,464
Information technology	94,806	14,362	10,985	120,153	18,706	8,426	27,132	147,285
Occupancy	931,301	141,083	107,912	1,180,296	183,760	82,776	266,536	1,446,832
Travel	992,974	24,984	7,391	1,025,349	67,574	10,390	77,964	1,103,313
Conferences and conventions	862,841	4,915	5,486	873,242	42,808	32,344	75,152	948,394
Interest	-	-	-	-	113,644	-	113,644	113,644
Depreciation and amortization	536,570	81,336	62,213	680,119	105,940	47,721	153,661	833,780
Insurance	101,721	15,410	11,787	128,918	20,071	9,041	29,112	158,030
Printing and publication	917,493	1,290	34,544	953,327	56,166	24,338	80,504	1,033,831
Training	250	-	83,889	84,139	52,434	-	52,434	136,573
Miscellaneous expenses	288,710	46,981	35,935	371,626	61,193	27,565	88,758	460,384
Total expenses	\$ 15,246,319	\$ 1,454,345	\$ 1,210,040	\$ 17,910,704	\$ 2,520,607	\$ 960,029	\$ 3,480,636	\$ 21,391,340

Refer to accompanying Independent Auditor's Report on Supplementary Information.