



SCHOLARSHIP AMERICA, INC.

Financial Statements and Supplemental Schedules

December 31, 2013 and June 30, 2013

(With Independent Auditors' Report Thereon)

SCHOLARSHIP AMERICA, INC.

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Board of Trustees
Scholarship America, Inc.:

We have audited the accompanying financial statements of Scholarship America, Inc., which comprise the statements of financial position as of December 31, 2013 and June 30, 2013, and the related statements of activities, and cash flows for the six months ended December 31, 2013 and the year ended June 30, 2013, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Scholarship America, Inc. as of December 31, 2013 and June 30, 2013, and the results of its operations and its cash flows for the six months ended December 31, 2013 and the year ended June 30, 2013, in accordance with U.S. generally accepted accounting principles.



Other Matter

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the basic 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 financial statements. The information has been subjected the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

Minneapolis, Minnesota
July 31, 2014

SCHOLARSHIP AMERICA, INC.

Statements of Financial Position

Assets	December 31, 2013	June 30, 2013
Current assets:		
Cash and cash equivalents	\$ 35,567,397	27,509,871
Accounts, interest, and other receivables	2,828,370	2,761,546
Contributions receivable, net (note 3)	1,439,772	1,941,584
Prepaid expenses and other assets	244,893	199,259
Total current assets	<u>40,080,432</u>	<u>32,412,260</u>
Contributions receivable, less current portion, net (note 3)	323,438	313,478
Investments (note 4)	127,016,465	153,338,644
Cash surrender value of life insurance	245,753	238,300
Property and equipment:		
Land	329,436	329,436
Building and improvements	4,848,663	4,792,478
Furniture and equipment	3,795,237	3,630,648
	<u>8,973,336</u>	<u>8,752,562</u>
Less accumulated depreciation	<u>(6,292,882)</u>	<u>(6,146,626)</u>
Property and equipment, net	<u>2,680,454</u>	<u>2,605,936</u>
Intangible assets (note 1)	2,069,062	—
Less accumulated amortization	<u>(92,732)</u>	<u>—</u>
Intangible assets, net	<u>1,976,330</u>	<u>—</u>
Total assets	<u>\$ 172,322,872</u>	<u>188,908,618</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 956,254	617,847
Accrued expenses	294,720	219,293
Current portion of long-term debt and promissory note (notes 6 and 11)	1,204,931	139,835
Scholarships payable	8,198,034	22,725,740
Refundable deposits	31,507,028	25,813,624
Total current liabilities	<u>42,160,967</u>	<u>49,516,339</u>
Long-term debt and promissory note (notes 6 and 11)	<u>1,185,226</u>	<u>1,190,163</u>
Total liabilities	<u>43,346,193</u>	<u>50,706,502</u>
Commitments (note 9)		
Net assets:		
Unrestricted:		
Designated for endowment	1,871,585	1,662,851
Undesignated	5,052,618	6,507,882
Total unrestricted	<u>6,924,203</u>	<u>8,170,733</u>
Temporarily restricted (note 8)	104,798,882	113,400,570
Permanently restricted (note 8)	17,253,594	16,630,813
Total net assets	<u>128,976,679</u>	<u>138,202,116</u>
Total liabilities and net assets	<u>\$ 172,322,872</u>	<u>188,908,618</u>

See accompanying notes to financial statements.

SCHOLARSHIP AMERICA, INC.

Statements of Activities

	Six months ended December 31, 2013	Year ended June 30, 2013
Changes in unrestricted net assets:		
Total scholarships raised	\$ 132,472,464	133,195,133
Less scholarships designated by donors for specific beneficiaries	<u>(48,312,548)</u>	<u>(51,904,549)</u>
Scholarship revenue	84,159,916	81,290,584
Program management fees	5,850,568	8,867,837
Investment income (note 4)	266,833	295,621
Contributions	397,346	1,029,744
Other income	108,326	239,777
Dollars for Scholars®	<u>75,287</u>	<u>413,245</u>
Revenues and support	90,858,276	92,136,808
Net assets released from restrictions:		
Satisfaction of program restrictions	<u>13,902,324</u>	<u>19,251,213</u>
Total unrestricted revenues and support	<u>104,760,600</u>	<u>111,388,021</u>
Expenses:		
Program services:		
Total scholarship distributions	145,797,079	151,319,599
Less scholarships designated by donors for specific beneficiaries	<u>(48,312,548)</u>	<u>(51,904,549)</u>
Scholarship awards	97,484,531	99,415,050
Scholarship Management Services™	4,578,122	5,106,839
Dollars for Scholars®	647,367	1,384,618
Other programs	387,300	626,080
Supporting services:		
General and administrative	2,014,166	3,658,952
Fundraising	<u>895,644</u>	<u>1,524,174</u>
Total expenses	<u>106,007,130</u>	<u>111,715,713</u>
Change in unrestricted net assets	<u>(1,246,530)</u>	<u>(327,692)</u>
Changes in temporarily restricted net assets:		
Contributions and project grants	1,469,987	17,453,956
Change in donor restrictions	(996,788)	235,879
Investment income (note 4)	4,827,437	5,347,087
Net assets released from restrictions:		
Satisfaction of program restrictions	<u>(13,902,324)</u>	<u>(19,251,213)</u>
Change in temporarily restricted net assets	<u>(8,601,688)</u>	<u>3,785,709</u>
Changes in permanently restricted net assets:		
Endowment contributions	622,781	62,340
Change in donor restrictions	<u>—</u>	<u>(615,245)</u>
Change in permanently restricted net assets	<u>622,781</u>	<u>(552,905)</u>
Change in net assets	(9,225,437)	2,905,112
Net assets:		
Balance at beginning of period	<u>138,202,116</u>	<u>135,297,004</u>
Balance at end of period	<u>\$ 128,976,679</u>	<u>138,202,116</u>

See accompanying notes to financial statements.

SCHOLARSHIP AMERICA, INC.

Statements of Cash Flows

	Six months ended December 31, 2013	Year ended June 30, 2013
	<u> </u>	<u> </u>
Cash flows from operating activities:		
Change in net assets	\$ (9,225,437)	2,905,112
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	146,256	168,619
Amortization of intangibles	92,732	—
Unrealized (gains) losses on investments	6,170,867	(465,776)
Realized gains on sale of investments	(10,464,326)	(2,286,686)
Scholarships distributed and designated by donors for specific beneficiaries	(48,312,548)	(51,904,549)
Scholarships raised and designated by donors for specific beneficiaries	48,312,548	51,904,549
Permanently restricted contributions	(622,781)	(62,340)
Changes in assets and liabilities:		
Accounts, interest, and other receivables	(66,824)	(154,338)
Contributions receivable, net	491,852	395,386
Prepaid expenses and other assets	(45,634)	38,468
Cash surrender value of life insurance	(7,453)	3,738
Accounts payable	338,407	(50,421)
Scholarships payable	(14,527,706)	(157,438)
Accrued expenses	75,427	12,375
Refundable deposits	5,693,404	(1,650,939)
Net cash used in operating activities	<u>(21,951,216)</u>	<u>(1,304,240)</u>
Cash flows from investing activities:		
Purchase of investments	(50,040,544)	(39,249,141)
Proceeds from sale of investments	80,656,181	31,482,900
Purchase of customer accounts (note 1)	(2,069,062)	—
Purchase of property and equipment	(220,774)	(58,730)
Net cash provided by (used in) investing activities	<u>28,325,801</u>	<u>(7,824,971)</u>
Cash flows from financing activities:		
Contributions received	622,781	62,340
Repayments of long-term debt	(69,115)	(135,576)
Issuance of promissory note	1,556,562	—
Repayments of promissory note	(427,287)	—
Net cash provided by (used in) financing activities	<u>1,682,941</u>	<u>(73,236)</u>
Increase (decrease) in cash and cash equivalents	8,057,526	(9,202,447)
Cash and cash equivalents at beginning of period	<u>27,509,871</u>	<u>36,712,318</u>
Cash and cash equivalents at end of period	<u>\$ 35,567,397</u>	<u>27,509,871</u>
Supplemental cash flow information:		
Cash paid during the period for interest	\$ 27,126	44,424

See accompanying notes to financial statements.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(1) Organization

Scholarship America, Inc. (Scholarship America) is a nonprofit corporation organized under the laws of the Commonwealth of Massachusetts to mobilize America through scholarships and educational support to make postsecondary education possible for all students. Until January 2003, the corporation was known as Citizens' Scholarship Foundation of America.

The financial statements do not include assets, liabilities, revenues, or expenses of the individual Dollars for Scholars® affiliates, because these affiliates are treated as independent organizations.

In fiscal year 2002, the Families of Freedom Scholarship Fund (the Fund) was created to provide education assistance for postsecondary study to financially needy dependents of those killed or permanently disabled as a result of the terrorist attacks on September 11, 2001, and during the rescue activities related to those attacks. The Fund is intended for children and spouses of the victims, including airplane crew and passengers, World Trade Center and Pentagon workers and visitors, and rescue workers, including firefighters, emergency medical personnel, and law enforcement personnel. Assistance from the Fund must be used to defray costs of education at accredited colleges, universities, or vocational-technical schools based in the United States. Scholarship America may from time to time assess a charge to income of the Fund in an amount reasonably calculated to reimburse Scholarship America's direct and indirect costs incurred in the administration of the Fund.

In July 2013, Scholarship America completed the acquisition of certain assets of the ACT SRS Division for a purchase price of approximately \$2.07 million. These assets consisted of certain client relationships to be integrated into the Scholarship Management Services (SMS) business line. The acquisition further enhances the organization's ability to provide scholarships and educational support to a greater number of students.

On January 6, 2014, the Board of Trustees of Scholarship America approved a change in the organization's fiscal year end to December 31st from June 30th. As such, these financial statements reflect the financial position as of December 31, 2013 and June 30, 2013 and the statements of activities for the six months ended December 31, 2013 and the year ended June 30, 2013.

(2) Summary of Significant Accounting Policies

The accounting policies of Scholarship America conform to U.S. generally accepted accounting principles (GAAP). The significant accounting policies followed by Scholarship America are set forth below:

(a) Basis of Presentation

The financial statements of Scholarship America have been prepared on the accrual basis of accounting.

Net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Scholarship America and changes therein, are classified and reported as follows:

Unrestricted Net Assets

This classification contains net assets that are not subject to donor-imposed stipulations.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

Temporarily Restricted Net Assets

This classification includes net assets that have been restricted by donors for specific purposes or are not available for use until a specific time. These consist primarily of contributions, project grants, and investment income of temporarily restricted net assets and return on donor-restricted endowments not yet appropriated for expenditure under Scholarship America's endowment spending policy.

Permanently Restricted Net Assets

This classification includes net assets that have been restricted by donors who stipulate the resources be maintained permanently by Scholarship America.

(b) Accounting for Scholarships

Scholarship programs where the beneficiary has been specified by the donor or the determination of the beneficiary is under the control of another third party are treated as agency transactions and are not reported as scholarship revenues or scholarship distribution expenses in the statements of activities unless Scholarship America has variance power with respect to the determination of the beneficiary. Variance power is the unilateral ability to redirect the use of the transferred assets to another beneficiary. Recognizing that designated scholarships (agency transactions) are a significant element of activities, they are included in scholarships raised and deducted from that amount to calculate scholarship revenue.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash held in bank accounts and temporary investments with original maturities of less than three months when purchased.

(d) Investments

Investments, excluding certificate of deposits, are reported at fair value as set forth in note 5. Certificate of deposits are reported at cost, which approximates fair value. Investments in alternative investments are recorded at net asset value as a practical expedient to fair value.

(e) Property and Equipment

Expenditures for the acquisition of property and equipment are capitalized at cost. Donated property and equipment is capitalized at fair value on the date of receipt. Depreciation is provided using the straight-line method over estimated useful lives as follows:

	<u>Years</u>
Building and improvements	35
Furniture and equipment	3 – 12

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(f) *Intangible Assets*

Acquired intangible assets are the result of purchased customer contracts. These assets are valued at actual purchase price. The intangible assets are amortized over 10.1 years, which is the average historical duration for client relationships in the SMS business line.

(g) *Contributed Services*

A number of volunteers have made significant donations of their time to program and support functions. The value of this contributed time does not meet the criteria for recognition of contributed services and, accordingly, is not reflected in the accompanying financial statements.

(h) *Contributions*

Contributions, which include unconditional promises to give, are recognized as revenues in the period received. All contributions are available for unrestricted use unless specifically restricted by the donor.

Promises to give are recorded as contributions receivable using a discount rate of 5%. Additionally, an allowance for uncollectible contributions is provided based on management's judgment, including factors such as prior collection history and nature of fundraising activity.

Contributions with donor-imposed restrictions, such as time or purpose restrictions, are recorded as temporarily restricted net assets. When a donor-imposed time restriction expires, or a donor-imposed purpose restriction is fulfilled, the temporarily restricted net assets are reclassified to unrestricted net assets. This reclassification is reported as net assets released from restrictions on the statements of activities.

Contributions of land, buildings, and equipment are recorded as unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. Contributions of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, Scholarship America reports expiration of donor restrictions when the donated or acquired long-lived assets are placed in service.

(i) *Scholarships Payable and Refundable Deposits*

Scholarships payable represent awards that have been made that Scholarship America has not yet distributed to the beneficiaries. Refundable deposits represent amounts held by Scholarship America for scholarship programs that, under terms of the program agreement, are refundable or revocable at the discretion of the resource provider. Refundable deposits also include amounts held by Scholarship America in connection with agreements that have stipulations that the assets be passed on to specific beneficiaries.

(j) *Program Management Fees*

Program management fees are recognized as revenue as the fees are earned. Approximately two-thirds of the program management fees are recognized as the program is developed and

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

applications are processed, with the remaining one-third being recognized after final scholarship distributions have been made.

(k) Grants

Restricted grants are recognized as revenue and support only to the extent that expenses have been incurred during the period for the purpose specified.

(l) Functional Expenses

Scholarship America's financial statements segregate expenses by function, including general and administration, and fundraising. Expenses are charged directly to specific functions when practicable. Expenses not identified as relating to specific functions are allocated primarily based on direct salary costs or headcount.

(m) Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Income Tax Status

Scholarship America is a nonprofit organization exempt from federal income tax under Internal Revenue Code Section 501(c)(3), is a publicly supported organization under Internal Revenue Code Section 170(b)(1)(A)(vi), and is not a private foundation as defined in Section 509(a) of the Internal Revenue Code. Scholarship America is subject to income taxes only on net unrelated business income. Scholarship America did not have any unrelated business income for the six months ended December 31, 2013 and the year ended June 30, 2013.

Scholarship America's accounting policy provides that a tax expense or benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Scholarship America has no uncertain tax positions resulting in an accrual of tax expense or benefit.

(o) Retirement Plan

Effective October 2010, Scholarship America offered a 403(b) retirement plan to its employees. Employee participation is optional. In the year beginning January 1, 2012, Scholarship America offered a matching contribution of up to 1% of an employee's annual salary. Beginning January 1, 2013, the matching contribution increased to 2%, which resulted in Scholarship America's contributions to the plan totaling \$46,023 and \$65,497 for the six months ended December 31, 2013 and the year ended June 30, 2013, respectively.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(p) Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents; accounts, interest, and other receivables; accounts payable; accrued expenses; scholarships payable; and refundable deposits approximate fair value because of the short maturity of these financial instruments. The fair value of cash surrender values of insurance policies is based upon market information provided from the respective insurance companies. Contributions receivable are recorded at the present value of estimated future cash flows using discount rates consistent with the general principles of present value measurement, which approximates fair value. Investments are carried at fair value, as indicated in note 2(d). The carrying value of long-term debt approximates fair value given the total outstanding amount at fiscal year-end.

(3) Contributions Receivable

Contributions are to be collected during the following years at December 31, 2013 and June 30, 2013:

	December 31, 2013	June 30, 2013
Less than one year	\$ 1,515,550	2,043,773
One to five years	305,000	257,500
Greater than five years	100,000	150,000
	<u>1,920,550</u>	<u>2,451,273</u>
Less:		
Discounts for the time value of money	64,540	77,524
Allowance for uncollectible contributions	92,800	118,687
	<u>\$ 1,763,210</u>	<u>2,255,062</u>

(4) Investments and Investment Income

Investments consisted of the following at December 31, 2013 and June 30, 2013:

	December 31, 2013	June 30, 2013
Cash equivalents and certificates of deposit	\$ 72,271	73,264
U.S. Treasury bonds and notes	767,980	20,578,427
U.S. government securities	3,500,537	3,534,354
Equity mutual funds	29,082,707	43,598,258
Fixed income mutual funds	56,552,690	65,503,072
Corporate bonds and notes	20,271,872	20,051,269
Limited partnerships and other	7,602,300	—
Hedge funds	9,166,108	—
	<u>\$ 127,016,465</u>	<u>153,338,644</u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

Investment income (loss) is recorded in the statements of activities and comprises the following for the six months ended December 31, 2013 and the year ended June 30, 2013:

	<u>Interest and dividends</u>	<u>Unrealized gain (loss)</u>	<u>Realized gain (loss)</u>	<u>Total</u>
December 31, 2013:				
Unrestricted	\$ 78,158	188,770	(95)	266,833
Temporarily restricted	722,653	(6,359,637)	10,464,421	4,827,437
June 30, 2013:				
Unrestricted	\$ 109,618	177,564	8,439	295,621
Temporarily restricted	2,780,628	288,212	2,278,247	5,347,087

(5) Fair Value Measurements

Financial Accounting Standards Board Accounting Standards Codification 820 (ASC 820), *Fair Value Measurement*, established a three-level fair value hierarchy that 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 lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets, or liabilities.
- Level 2 Pricing inputs other than identical quoted prices in active markets that are observable for the financial instrument, such as similar instruments, interest rates, and yield curves that are observable at commonly quoted intervals. Level 2 includes alternative investments such as an energy limited partnership, commodity fund, and REIT fund. Alternative investments are valued at the net asset value of the underlying partnership or fund as a practical expedient.
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. Level 3 inputs include situations where there is little, if any, market activity for the financial instrument. Level 3 alternative investments include an investment in a hedge fund. Alternative investments are valued at the net asset value of the underlying partnership as a practical expedient. The difference between Level 2 and Level 3 alternative investments is due to the liquidity of the investment.

Following is a description of the valuation methodologies used for assets measured at fair value:

Equity mutual funds and fixed income mutual funds: Valued at their quoted net asset value of shares held at fiscal year-end.

U.S. Treasury bonds and notes, U.S. government securities, and corporate bonds and notes: Valued at their quoted market price based on similar instruments held at fiscal year-end.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

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Limited partnerships and other: Valued at their quoted net asset value of shares held in the underlying partnership or fund at fiscal year-end.

Hedge fund: Valued at their net asset value of the underlying fund at fiscal year-end.

Valuation levels are not necessarily an indication of the risk associated with investing in those securities.

Description	Fair value at December 31, 2013			
	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ 72,271	—	—	72,271
Domestic equities:				
Equity mutual funds	29,082,707	—	—	29,082,707
Debt securities:				
Fixed income mutual funds	56,552,690	—	—	56,552,690
U.S. Treasury bonds and notes	—	767,980	—	767,980
U.S. government securities	—	3,500,537	—	3,500,537
Corporate bonds and notes	—	20,271,872	—	20,271,872
Limited partnerships and other	—	7,602,300	—	7,602,300
Hedge funds	—	—	9,166,108	9,166,108
	<u>\$ 85,707,668</u>	<u>32,142,689</u>	<u>9,166,108</u>	<u>127,016,465</u>

Description	Fair value at June 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ 73,264	—	—	73,264
Domestic equities:				
Equity mutual funds	43,598,258	—	—	43,598,258
Debt securities:				
Fixed income mutual funds	65,503,072	—	—	65,503,072
U.S. Treasury bonds and notes	—	20,578,427	—	20,578,427
U.S. government securities	—	3,534,354	—	3,534,354
Corporate bonds and notes	—	20,051,269	—	20,051,269
	<u>\$ 109,174,594</u>	<u>44,164,050</u>	<u>—</u>	<u>153,338,644</u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

The following table summarizes the changes in fair value associated with Level 3 investments during the six-month period ended December 31, 2013:

		<u>Hedge fund at fair value</u>
Balance at June 30, 2013	\$	—
Purchases		9,000,000
Sales		—
Change in unrealized appreciation (depreciation)		<u>166,108</u>
Balance at December 31, 2013	\$	<u><u>9,166,108</u></u>

Given that the net asset value of the underlying funds as a practical expedient to fair value is used for all of Scholarship America's Level 3 investments, a table of valuation techniques, observable inputs, and ranges of inputs is not provided for those investments classified as Level 3.

There were no transfers between Levels 1, 2, and 3 during the six months ended December 31, 2013 and the year ended June 30, 2013.

(6) Long-Term Debt

A summary of long-term debt as of December 31, 2013 and June 30, 2013 is as follows:

	<u>December 31, 2013</u>	<u>June 30, 2013</u>
Note payable to The First National Bank of St. Peter with variable interest at 1.62% (adjusted from 3.1% in September 2013), payable in semiannual installments through September 2025. Such payments are secured by a mortgage and security interest granted to the creditor by Scholarship America	\$ 1,260,881	1,329,998
Less current maturities	<u>(160,208)</u>	<u>(139,835)</u>
	<u>\$ 1,100,673</u>	<u><u>1,190,163</u></u>

Aggregate annual maturities of long-term debt at December 31, 2013 are as follows:

2014	\$	160,208
2015		162,834
2016		165,460
2017		168,191
2018		170,910
Thereafter		<u>433,278</u>
	\$	<u><u>1,260,881</u></u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(7) Endowment Funds

Scholarship America's endowment consists of approximately 40 individual funds established for a variety of purposes including both endowment funds restricted by the donor and funds designated by the board of trustees to function as endowment. Net assets associated with endowment funds, including funds designated by the board of trustees to function as an endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The board of trustees of Scholarship America 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 gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Scholarship America 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 that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with donor instructions and the standard of prudence prescribed by the UPMIFA. In accordance with UPMIFA, Scholarship America considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The stated instructions of the donor
2. The donor's objectives concerning the duration and preservation of the fund
3. The expected total return from income and the appreciation of investments

Fund-by-Fund Analysis

(a) *Endowment Net Asset Composition by Type of Fund*

Endowment net assets consist of the following at December 31, 2013:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ —	2,980,795	17,102,612	20,083,407
Board-designated endowment funds	<u>1,871,585</u>	<u>—</u>	<u>—</u>	<u>1,871,585</u>
Total endowment net assets	<u>\$ 1,871,585</u>	<u>2,980,795</u>	<u>17,102,612</u>	<u>21,954,992</u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

Endowment net assets consist of the following at June 30, 2013:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ —	2,230,619	16,487,373	18,717,992
Board-designated endowment funds	<u>1,662,851</u>	<u>—</u>	<u>—</u>	<u>1,662,851</u>
Total endowment net assets	<u>\$ 1,662,851</u>	<u>2,230,619</u>	<u>16,487,373</u>	<u>20,380,843</u>

(b) Changes in Endowment Net Assets

Changes in endowment net assets for the six months ended December 31, 2013 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, July 1, 2013	\$ 1,662,851	2,230,619	16,487,373	20,380,843
Investment return:				
Investment income	19,668	230,619	—	250,287
Net gain on investments	<u>189,066</u>	<u>707,665</u>	<u>—</u>	<u>896,731</u>
Total investment return	208,734	938,284	—	1,147,018
Contributions	—	—	615,239	615,239
Appropriation of endowment assets for expenditure	<u>—</u>	<u>(188,108)</u>	<u>—</u>	<u>(188,108)</u>
Endowment net assets, December 31, 2013	<u>\$ 1,871,585</u>	<u>2,980,795</u>	<u>17,102,612</u>	<u>21,954,992</u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

Changes in endowment net assets for the year ended June 30, 2013 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, July 1, 2012	\$ 1,440,720	2,193,662	17,058,663	20,693,045
Investment return:				
Investment income	33,789	478,315	—	512,104
Net gain on investments	188,342	301,314	—	489,656
Total investment return	222,131	779,629	—	1,001,760
Contributions	—	—	43,955	43,955
Appropriation of endowment assets for expenditure	—	(616,554)	—	(616,554)
Change in donor restrictions	—	(126,118)	(615,245)	(741,363)
Endowment net assets, June 30, 2013	<u>\$ 1,662,851</u>	<u>2,230,619</u>	<u>16,487,373</u>	<u>20,380,843</u>

(c) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the UPMIFA requires Scholarship America to retain as a fund of perpetual duration. There were no deficiencies reported in unrestricted net assets as of December 31, 2013 and June 30, 2013, respectively.

(d) Return Objectives and Risk Parameters and Strategies Employed for Achieving Objectives

Each endowment fund is supported by an underlying agreement with the donor in which the spending level and the underlying investment mix is outlined (if no mix is specified, the selection defaults to 70% bonds and 30% equities). Most funds include an investment placed in one of two equity funds plus one of two bond funds; an index fund is one of the options. Fund performance is expected to at least equal the S&P 500 Index or the Barclays U.S. Aggregate Bond Index. Typically, dividends and interest are available for expenditure because the funds focus on current need rather than maintaining a perpetual fund of constant purchasing power.

(e) Spending Policy and How Investment Objectives Relate to Spending Policy

The board-designated endowment is invested at the default ratio in index funds. To date, all earnings have been returned to the endowment.

A separately managed board-designated endowment, previously established for the Northeast region is invested in a mix of equity and bond mutual fund investments. The board of trustees allows 5% of a 12-quarter moving average to be used for operations, as needed. During the six months ended December 31, 2013, \$0 was released for operations and during the year ended June 30, 2013, \$186,000 was released.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(8) Temporarily and Permanently Restricted Net Assets

Donor-restricted temporarily restricted net assets are available at December 31, 2013 and June 30, 2013 for the following purposes:

	<u>December 31, 2013</u>	<u>June 30, 2013</u>
The portion of unexpended investment return generated from donor-restricted endowment funds subject to UPMIFA available for scholarships	\$ 2,980,795	2,230,619
Gifts and other unexpended revenues and support available for:		
Scholarships	99,274,281	108,100,910
Regions	794,543	679,103
Other projects	1,749,263	2,389,938
	<u>\$ 104,798,882</u>	<u>113,400,570</u>

Donor-restricted permanently restricted net asset balances at December 31, 2013 and June 30, 2013 and the purposes for which the income can be used are as follows:

	<u>December 31, 2013</u>	<u>June 30, 2013</u>
Endowment fund for:		
Scholarships	\$ 14,745,693	14,122,912
Regions	1,517,901	1,517,901
Other projects	990,000	990,000
	<u>17,253,594</u>	<u>16,630,813</u>
Nonendowment funds for scholarships	<u>—</u>	<u>—</u>
	<u>\$ 17,253,594</u>	<u>16,630,813</u>

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(9) Leases

Rental expense for office space was \$123,924 and \$205,257 for the six months ended December 31, 2013 and the year ended June 30, 2013, respectively. Lease agreements having an original term of more than one year expire on various dates through calendar year 2014. Minimum annual payments under terms of these operating leases are as follows:

Year ending December 31:		
2014	\$	72,882
2015		102,303
2016		137,917
2017		140,417
2018		142,916
2019 and beyond		<u>949,718</u>
	\$	<u><u>1,546,153</u></u>

Note, in December 2013, the organization entered into a new 10-year lease agreement for office space.

(10) Supporting Services Expense Ratios

Scholarship America's supporting services expense ratios as a percentage of unrestricted revenues and support, excluding scholarships designated by donors for specific beneficiaries, for the six months ended December 31, 2013 and the year ended June 30, 2013 are as follows:

	December 31, 2013		June 30, 2013	
General and administration	\$ 2,014,166	1.92%	\$ 3,658,952	3.28%
Fundraising	<u>895,644</u>	<u>0.85</u>	<u>1,524,174</u>	<u>1.37</u>
Total	<u><u>\$ 2,909,810</u></u>	<u><u>2.77%</u></u>	<u><u>\$ 5,183,126</u></u>	<u><u>4.65%</u></u>
Unrestricted revenues and support, excluding scholarships designated by donors for specific beneficiaries				
	\$ 104,760,600		111,388,021	

Fundraising costs also include costs related to the generation of scholarships raised and designated by donors for specific beneficiaries.

SCHOLARSHIP AMERICA, INC.

Notes to Financial Statements

December 31, 2013 and June 30, 2013

(11) Promissory Note

As part of the acquisition of certain assets of the ACT SRS Division (see note 1), Scholarship America executed a promissory note to finance a portion of the purchase price. A summary of the promissory note as of December 31, 2013 and June 30, 2013 is as follows:

	<u>December 31, 2013</u>	<u>June 30, 2013</u>
Promissory note payable to ACT, Inc. with monthly installments of interest (4.0% fixed rate) and principal through January 2015.	\$ 1,129,275	—
Less current maturities	<u>(1,044,723)</u>	<u>—</u>
	<u>\$ 84,552</u>	<u>—</u>

Aggregate annual maturities of the promissory note are as follows:

2014	\$ 1,044,723
2015	<u>84,552</u>
	<u>\$ 1,129,275</u>

(12) Subsequent Events

In connection with the preparation of the financial statements, Scholarship America evaluated subsequent events after the statement of financial position date of December 31, 2013 through July 31, 2014, which was the date the financial statements were available to be issued. This evaluation did not result in any subsequent events that necessitated financial statement disclosures and/or adjustments.

SCHOLARSHIP AMERICA, INC.
 Families of Freedom Scholarship Fund
 Schedule of Financial Position
 December 31, 2013

Assets

Current assets:		
Cash and cash equivalents	\$	722,190
Contributions receivable, net		522,500
Total current assets		<u>1,244,690</u>
Contributions receivable, less current portion, net		274,861
Investments		<u>84,842,040</u>
Total assets	\$	<u><u>86,361,591</u></u>

Liabilities and Net Assets

Refundable deposits	\$	7,709,338
Net assets:		
Temporarily restricted		<u>78,652,253</u>
Total liabilities and net assets	\$	<u><u>86,361,591</u></u>

See accompanying independent auditors' report.

Schedule 2**SCHOLARSHIP AMERICA, INC.**

Families of Freedom Scholarship Fund

Schedule of Activities

Six months ended December 31, 2013

Changes in unrestricted net assets:	
Net assets released from restrictions:	
Satisfaction of program restrictions	\$ 10,355,603
Total unrestricted revenues and support	<u>10,355,603</u>
Expenses:	
Program services:	
Scholarship awards	10,118,027
Scholarship Management Services™	28,275
Supporting services:	
General and administration	209,254
Fundraising	47
Total expenses	<u>10,355,603</u>
Change in unrestricted net assets	<u>—</u>
Changes in temporarily restricted net assets:	
Contributions for scholarships	382,521
Investment income	3,050,008
Net assets released from restrictions:	
Satisfaction of program restrictions	<u>(10,355,603)</u>
Change in temporarily restricted net assets	<u>(6,923,074)</u>
Change in net assets	<u>(6,923,074)</u>
Net assets:	
Balance at beginning of period	<u>85,575,327</u>
Balance at end of period	<u>\$ 78,652,253</u>

See accompanying independent auditors' report.

SCHOLARSHIP AMERICA, INC.

Schedule of Functional Expenses

Six months ended December 31, 2013

	Program services					Supporting services		Total	
	Scholarship awards	Scholarship Management Services™	Dollars for Scholars®	Dreamkeepers®	Families of Freedom NYC	Other	General and administrative		Fundraising
Scholarship awards	\$ 97,484,531	—	—	—	—	—	—	—	97,484,531
Personnel	—	2,167,055	426,652	129,527	103,371	26,717	1,242,147	686,725	4,782,194
Meetings and travel	—	73,876	95,286	5,822	7,348	11,080	92,417	53,159	338,988
Printing	—	122,475	11,170	418	3,125	42	21,716	4,288	163,234
Professional services	—	1,526,844	43,758	67,699	3,575	15,358	464,676	31,417	2,153,327
Publicity and promotion	—	43,319	18,338	—	6,100	—	20,536	73,693	161,986
Postage	—	103,381	2,979	7	653	658	10,425	2,631	120,734
Occupancy	—	114,792	19,360	1,143	—	—	77,100	13,609	226,004
Interest	—	34,871	455	—	—	—	1,455	—	36,781
Insurance	—	42,872	5,612	4	709	—	11,799	4,526	65,522
Office expenses	—	121,180	15,418	974	2,456	331	36,415	12,373	189,147
Depreciation and amortization	—	205,436	5,483	11	—	172	25,430	2,456	238,988
Miscellaneous	—	22,021	2,856	—	—	—	10,050	10,767	45,694
Total expenses	\$ 97,484,531	4,578,122	647,367	205,605	127,337	54,358	2,014,166	895,644	106,007,130

See accompanying independent auditors' report.