

**The Association of Graduates of
the United States Military
Academy
d/b/a West Point Association of Graduates**

Financial Statements

December 31, 2012 and 2011



The Association of Graduates of the United States Military Academy

Table of Contents

December 31, 2012 and 2011

	<u>Page</u>
Independent Auditors' Report	1
Financial Statements	
Statement of Financial Position	3
Statement of Activities	4
Statement of Net Assets	5
Statement of Cash Flows	6
Notes to Financial Statements	7

Independent Auditors' Report

Board of Directors
The Association of Graduates of the United States Military Academy

We have audited the accompanying financial statements of The Association of Graduates of the United States Military Academy, d/b/a West Point Association of Graduates (the "Association"), which comprise the statement of financial position as of December 31, 2012 and 2011, and the related statements of activities, net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

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 of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Association of Graduates of the United States Military Academy as of December 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

ParenteBeard LLC

New York, New York
May 3, 2013

The Association of Graduates of the United States Military Academy

Statement of Financial Position

December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Cash	\$ 5,509,599	\$ 3,964,736
Pledges receivable, net	29,824,938	23,400,683
Inventories and other assets	680,626	435,702
Investments	214,551,595	183,496,989
Split interest and other trusts	27,628,561	23,759,771
Investments restricted by agreements	5,403,929	5,068,459
Building and equipment, net	5,327,006	5,567,917
	<u>288,926,254</u>	<u>245,694,257</u>
Total assets	<u>\$ 288,926,254</u>	<u>\$ 245,694,257</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 1,361,396	\$ 988,393
Proffer payable	5,653,745	1,578,398
Deferred obligations and revenue	3,212,953	3,153,028
Liabilities - remainder trusts	2,894,504	3,017,545
Due to classes	2,624,580	2,545,656
Deferred compensation	387,985	393,737
	<u>16,135,163</u>	<u>11,676,757</u>
Total liabilities	<u>16,135,163</u>	<u>11,676,757</u>
Net Assets		
Unrestricted	21,683,928	19,514,947
Temporarily restricted	138,776,107	114,883,900
Permanently restricted	112,331,056	99,618,653
	<u>272,791,091</u>	<u>234,017,500</u>
Total net assets	<u>272,791,091</u>	<u>234,017,500</u>
Total liabilities and net assets	<u>\$ 288,926,254</u>	<u>\$ 245,694,257</u>

See notes to financial statements

The Association of Graduates of the United States Military Academy

Statement of Activities

Years Ended December 31, 2012 and 2011

	2012				2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, Gains and Other Support								
Contributions	\$ 609,963	\$ 40,351,141	\$ 4,981,012	\$ 45,942,116	\$ 446,704	\$ 28,026,196	\$ 6,638,649	\$ 35,111,549
Bequests	8,758	772,421	995,963	1,777,142	286,334	478,732	308,987	1,074,053
Royalties	684,605	132,765	7,720	825,090	684,824	144,868	15,069	844,761
Return on investments	1,813,242	2,640,364	-	4,453,606	2,310,208	1,891,216	-	4,201,424
Sales - gift shop	1,528,659	-	-	1,528,659	1,510,943	-	-	1,510,943
Subscriptions and advertising	205,900	-	-	205,900	264,442	-	-	264,442
Alumni activities	1,098,524	74,058	-	1,172,582	1,264,204	61,997	-	1,326,201
Other	248,439	(17,980)	18,001	248,460	241,225	(5,682)	15,000	250,543
Net Assets Released from Restriction								
Satisfaction of program restriction	18,445,772	(18,437,189)	(8,583)	-	13,299,444	(13,296,944)	(2,500)	-
Reimbursement for administrative and development expenses	3,862,026	(3,197,370)	(664,656)	-	2,933,183	(2,437,745)	(495,438)	-
Transfers, net	236,405	(6,860,375)	6,623,970	-	282,489	(5,426,729)	5,144,240	-
	<u>28,742,293</u>	<u>15,457,835</u>	<u>11,953,427</u>	<u>56,153,555</u>	<u>23,524,000</u>	<u>9,435,909</u>	<u>11,624,007</u>	<u>44,583,916</u>
Total revenue and support								
Expenses								
Program services								
Alumni services	3,562,826	-	-	3,562,826	3,599,455	-	-	3,599,455
Educational and historical	18,489,047	-	-	18,489,047	13,360,062	-	-	13,360,062
Communications and marketing	1,142,389	-	-	1,142,389	944,066	-	-	944,066
Provision for (recovery of) uncollectible pledges, net	-	3,101,557	(758,976)	2,342,581	-	1,926,778	608,014	2,534,792
Supporting services								
Management and administration	991,390	-	-	991,390	916,486	-	-	916,486
Fund raising	5,443,596	-	-	5,443,596	5,538,278	-	-	5,538,278
	<u>29,629,248</u>	<u>3,101,557</u>	<u>(758,976)</u>	<u>31,971,829</u>	<u>24,358,347</u>	<u>1,926,778</u>	<u>608,014</u>	<u>26,893,139</u>
Change in Net Assets before Investment Transactions	(886,955)	12,356,278	12,712,403	24,181,726	(834,347)	7,509,131	11,015,993	17,690,777
Realized and Unrealized Gain (Loss) on Investments	3,055,936	11,535,929	-	14,591,865	(1,055,214)	(2,548,329)	-	(3,603,543)
Change in Net Assets	<u>\$ 2,168,981</u>	<u>\$ 23,892,207</u>	<u>\$ 12,712,403</u>	<u>\$ 38,773,591</u>	<u>\$ (1,889,561)</u>	<u>\$ 4,960,802</u>	<u>\$ 11,015,993</u>	<u>\$ 14,087,234</u>

See notes to financial statements

The Association of Graduates of the United States Military Academy

Statement of Net Assets

Years Ended December 31, 2012 and 2011

	<u>Total Unrestricted</u>	<u>Total Temporarily Restricted</u>	<u>Total Permanently Restricted</u>	<u>Total</u>
Net Assets, January 1, 2011	\$ 21,404,508	\$ 109,923,098	\$ 88,602,660	\$ 219,930,266
Net (decrease) increase in net assets for 2011	<u>(1,889,561)</u>	<u>4,960,802</u>	<u>11,015,993</u>	<u>14,087,234</u>
Net Assets, December 31, 2011	19,514,947	114,883,900	99,618,653	234,017,500
Net increase in net assets for 2012	<u>2,168,981</u>	<u>23,892,207</u>	<u>12,712,403</u>	<u>38,773,591</u>
Net Assets, December 31, 2012	<u>\$ 21,683,928</u>	<u>\$ 138,776,107</u>	<u>\$ 112,331,056</u>	<u>\$ 272,791,091</u>

See notes to financial statements

The Association of Graduates of the United States Military Academy

Statement of Cash Flows

Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities		
Change in net assets	\$ 38,773,591	\$ 14,087,234
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Contributions of securities, gifts in kind and other	(3,605,735)	(2,312,153)
Contributions restricted for long-term investment	(6,002,696)	(6,977,705)
Net realized and unrealized (gain) loss on investments	(14,591,865)	3,603,543
Depreciation on building and equipment	299,276	330,857
Increase in value of trusts	(3,012,940)	(433,592)
Changes in:		
Unrestricted and temporarily restricted pledges receivable	(7,450,284)	(4,019,848)
Inventories and other assets	(244,924)	114,160
Accounts payable, accrued expenses and deferred compensation	367,252	(163,047)
Proffer payable	4,075,347	842,678
Deferred obligations and revenue	59,925	159,160
Liabilities associated with remainder trusts	(123,041)	491,708
Due to classes	78,924	81,974
Net cash provided by operating activities	<u>8,622,830</u>	<u>5,804,969</u>
Cash Flows from Investing Activities		
Purchase of investments	(135,829,009)	(49,973,745)
Proceeds from sale and maturity of investments	119,989,234	38,506,451
Purchase of building improvements and equipment	(58,366)	(35,486)
Proceeds from settlement of split interest agreements	293,653	-
Purchase of investments restricted by agreements	1,497,796	1,341,669
Net cash used in investing activities	<u>(14,106,692)</u>	<u>(10,161,111)</u>
Cash Flows from Financing Activities		
Proceeds from contributions	6,002,696	6,977,704
Changes in permanently restricted pledge receivable	1,026,029	(1,407,731)
Net cash provided by financing activities	<u>7,028,725</u>	<u>5,569,973</u>
Net Increase in Cash	1,544,863	1,213,831
Cash and Cash Equivalents, Beginning	<u>3,964,736</u>	<u>2,750,905</u>
Cash and Cash Equivalents, Ending	<u>\$ 5,509,599</u>	<u>\$ 3,964,736</u>

See notes to financial statements

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

1. Organization and Summary of Significant Accounting Policies

The Association of Graduates of the United States Military Academy, d/b/a West Point Association of Graduates, (the "Association") is an organization dedicated to furthering the ideals and promoting the welfare of the United States Military Academy (the "Academy"). The Association is exempt from federal income tax under the Internal Revenue Code. However, income from certain activities not directly related to the Association's tax-exempt purpose is subject to taxation as unrelated business income. In addition, the Association qualifies for the charitable contribution deduction under Internal Revenue rules and has been classified as an organization that is not a private foundation.

Basis of Accounting

The financial statements of the Association have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Basis of Presentation

The Association follows accounting and reporting guidelines established by the Financial Accounting Standards Board ("FASB"). The Association records written unconditional promises to give (pledges) as receivables and revenue, and in addition, distinguishes between contributions received for each net asset category in accordance with donor imposed restrictions. The Association has established standards for financial reporting, including the classification of resources into three classes of net assets: unrestricted, temporarily restricted and permanently restricted, based upon the absence or existence and nature of donor-imposed restrictions as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that can be fulfilled by actions of the Association pursuant to those stipulations or that expire by passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Association. Generally, the donors of such assets permit the Association to use all or part of the income earned on the assets for specific purposes.

Cash

The Association considers highly liquid debt instruments with original maturities of three months or less to be cash equivalents, excluding amounts held in Investments.

The Association places its cash and cash equivalents with high quality financial institutions where, balances generally exceed the Federal Deposit Insurance Corporation (the "FDIC") insurance limits. Accounts at each institution are insured by the FDIC up to \$250,000 for interest and non-interest bearing accounts.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Promises to Give

Unconditional written promises to give (pledges) are recognized as contribution revenue in the period received and as assets. Promises to give are recorded at net realizable value and are discounted at an appropriate rate commensurate with the risks involved. Amortization of discounts is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for uncollectible promises to give is provided based upon management's judgment, including such factors as due date (aging), prior collection history, type of contribution, and nature of fundraising activity. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Proffer Payable

Proffer Payable represents unconditional promises to grant funds to the United States Military Academy that have been offered prior to year end, but remain unpaid as of the statement of financial position date.

The Association, in accordance with Army Regulations, proffers gifts it intends to make to the United States Military Academy, similar to making a promise to give. Proffers are recorded as liabilities at the time they are offered and are generally paid within a one year period.

Split-Interest and Other Trust Agreements

The Association is a party to various types of split-interest and other trust agreements whereby the donor makes an initial gift in which the Association has a beneficial interest but is not the sole beneficiary. These agreements include charitable remainder trusts, pooled life income funds, gift annuities, other types of trusts and irrevocable bequests and are reported at fair value.

Inventories

Inventories consist of gift shop items and are stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment

Property and equipment are carried at cost or, if donated, at the estimated fair value at the date of donation. Depreciation is computed using primarily the straight-line method and is based on the assets' estimated useful lives between three and five years for equipment and forty years for the building.

Donated Property and Securities

Donated materials and equipment are reflected as contributions in the accompanying statements at their estimated fair value at date of donation. Donated marketable securities are recorded at their fair value at date of donation. Absent donor restrictions to the contrary, donated securities are sold immediately. Contributions for the year ended December 31, 2012, include \$3,123,164 of donated securities (\$1,592,144 in 2011).

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Due to Classes

The Association maintains commingled brokerage accounts consisting of cash and investments, on behalf of various graduated classes. These assets are recorded in the statement of financial position as investments, along with an offsetting liability. This liability is presented in the statement of financial position as "Due to classes" in the amounts of \$2,624,580 and \$2,545,656 at December 31, 2012 and 2011, respectively.

Restricted and Unrestricted Revenue

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted revenue, depending on the existence and/or nature of any donor restrictions, and are reported as an increase in unrestricted, temporarily, or permanently restricted net assets. When a restriction expires (that is, when the purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Deferred Obligations and Revenue

Deferred obligations and revenue consists of advance payments for subscriptions and advertising relating to the Association's publication, and obligations for payments relating to pooled life income funds and charitable gift annuities.

Tax Status and Expense

The Association is classified for tax purposes as an organization under Section 501 (c)(3) of the Internal Revenue Code and, except for unrelated business income, is exempt from income taxes under Section 501(a) of the Code. Therefore, no provision for income taxes is made in the accompanying financial statements.

Effective January 1, 2009, the Association adopted guidance issued by the FASB regarding accounting for uncertainty in income taxes. The income tax positions taken by the Association for any years open under the various statutes of limitations are that the Association continues to be exempt from income taxes and that the Association earns revenues from certain activities which are considered unrelated business taxable income under the Internal Revenue Code. In both 2012 and 2011, however, unrelated business income (net of applicable expenses) resulted in no material tax expense. The adoption of this guidance did not impact the Association's financial position or results of operations. The Association believes that there are no other tax positions taken or expected to be taken that would significantly increase or decrease unrecognized tax expenses or benefits within 12 months of the reporting date. None of the Association's federal or state income tax returns is currently under examination by the Internal Revenue Service ("IRS") or state authorities. However fiscal years 2009 and later remain subject to examination by the IRS and New York State.

Use of Estimates

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

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

New Accounting Pronouncements

In 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-04, Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). ASU No. 2011-04 includes new and clarified guidance on fair value measurements (highest and best use, equity instruments, managed net portfolio positions, and application of premiums and discounts) and disclosure (quantitative information, valuation processes and sensitivity of unobservable inputs, assets not in highest and best use, and assets not measured at fair value). ASU 2011-04 is effective for periods beginning after December 15, 2011. ASU 2011-04 does not have a material impact on the Association’s financial statements.

Subsequent Events

Subsequent events have been evaluated for recognition or disclosure through May 3, 2013 the date when the financial statements were available to be issued.

2. Pledges Receivable

Pledges receivable are written unconditional promises to give. The Association recognizes potentially uncollectible pledges and provides an allowance for the estimated uncollectible amount. Pledges receivable, net of the discount to present value (at risk adjusted rates) and the allowance for uncollectible pledges, are as follows:

	December 31,	
	2012	2011
Receivable in less than one year	\$ 12,734,311	\$ 9,018,238
Receivable in one year to five years	27,101,964	24,981,247
Receivable in more than five years	5,519,452	2,200,566
Total unconditional promises to give	45,355,727	36,200,051
Less allowance for uncollectible pledges	(12,188,542)	(9,845,961)
Less discounts to net present value	(3,342,247)	(2,953,407)
Total	<u>\$ 29,824,938</u>	<u>\$ 23,400,683</u>

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

3. Investments

Investments, including pooled life income funds and gift annuities, are presented in the financial statements at fair value and are categorized as follows:

	December 31,	
	2012	2011
Investments	\$ 214,551,595	\$ 183,496,989
Investments – pooled life income funds	2,274,493	2,251,476
Investments – gift annuities	2,919,078	2,606,046
Investments – gift annuity reserve	210,358	210,937
Investments restricted by agreements	5,403,929	5,068,459
Total	<u>\$ 219,955,524</u>	<u>\$ 188,565,448</u>

Investments are comprised of the following:

	December 31,	
	2012	2011
Short-term investments (money markets)	\$ 543,139	\$ 619,063
Fixed income securities	69,153,850	70,037,693
Equity securities	109,763,513	85,409,507
Alternative investments	39,619,948	32,241,139
Other	875,074	258,046
Total	<u>\$ 219,955,524</u>	<u>\$ 188,565,448</u>

Return on Investments, gains and losses on investment transactions are comprised of the following:

	December 31,	
	2012	2011
Unrestricted:		
Return on investments (interest and dividends)	<u>\$ 1,813,242</u>	<u>\$ 2,310,208</u>
Net realized gains on sale of investments	1,313,922	420,597
Net unrealized gains (losses) on investments	1,742,014	(1,475,811)
	<u>\$ 3,055,936</u>	<u>\$ (1,055,214)</u>
Temporarily restricted:		
Return on investments (interest and dividends)	<u>\$ 2,640,364</u>	<u>1,891,216</u>
Net realized gains on sale of investments	5,534,934	1,640,678
Net unrealized gains (losses) on investments	6,000,995	(4,189,007)
	<u>\$ 11,535,929</u>	<u>\$ (2,548,329)</u>

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Investment gains (losses) on permanently restricted net assets are reported as increases (decreases) in unrestricted or temporarily restricted net assets depending upon donor restrictions placed on the use of the investment income.

The Association has entered into several agreements with Commonfund, a non-profit investment manager, to invest in various partnerships. These agreements contain provisions for capital calls by the general partner up to specified amounts. Total capital committed under the agreements amounts to \$13,750,000 and the total amount of capital contributed to the partnerships by the Association as of December 31, 2012 was approximately \$11,505,000. This investment is included in alternative investments as level 3 in the fair value table below. As capital calls are received, other investments are sold and the proceeds and available cash are used to fulfill the capital call. In addition, the Association has entered into an agreement with AEW Capital Management, LP, to invest in a real estate investment trust. This agreement contains provisions for capital calls by the general partner up to specified amounts. Total capital committed under the agreement amounts to \$3,000,000. Capital calls funded by the Association as of December 31, 2012 are approximately \$2,271,226. In accordance with these agreements, the redemption period for these funds range from 7 to 10 years and they are classified as mutual and real estate fund level 3 investments in the fair value table below.

The Association follows FASB guidance for Fair Value Measurement for investments, which establishes a framework for measuring fair value under generally accepted accounting principles, and also provides guidance regarding a fair value hierarchy. This hierarchy prioritizes information used to measure fair value and the effects of fair value measurements on earnings and provides for enhanced disclosures determined by the level within the hierarchy of information used in the valuation.

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell an asset occurs in the principal market for the asset, or in the absence of a principal market, the most advantageous market for the asset. The principal market is the market in which the reporting entity would sell or transfer the asset with the greatest volume or level of activity for the asset. In determining the principal market for an asset, it is assumed that the reporting entity has access to the market as of the measurement date. If no market for the asset exists or if the reporting entity does not have access to the principal market, the reporting entity use a hypothetical market.

The level of fair value inputs used to measure investments is characterized in accordance with an established fair value hierarchy. Where inputs for an investment fall in more than one level in the fair value hierarchy, the investment is classified in its entirety based on the lowest level input that is significant to that investment's fair value measurement. Management uses judgment and considers factors specific to the investment in determining the significance of an input to a fair value measurement. The three levels of the fair value hierarchy and investments that fall into each of the levels are described as follows:

- Level 1: Level 1 inputs are unadjusted quoted market prices in active markets that are accessible at the measurement date for identical assets.
- Level 2: Level 2 are inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly.
- Level 3: Level 3 inputs are unobservable and cannot be corroborated by observable market data.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

The basis of fair value for underlying assets is as follows:

- Fixed income and equity funds classified as Level 1 are valued at the last sales price on the date of valuation or, if no sale occurred on such date, at the last bid price thereon.
- Equity, real estate and limited partnerships classified as Level 2 or 3 are valued based on the net asset value (NAV) of a share. Fair value is determined by reference to the fund's reported NAV per share as a practical expedient, unless it is probable that the investment will be disposed at some value other than NAV per share in which case reference would be made to the expected disposal price or other indicators of value. The investments valued using the NAV per share include a strategy that invests in publicly traded equity securities, fixed income securities and marketable alternative investments. These funds do not have redemption restrictions or commitments.
- Mutual and real estate funds classified as Level 3 include private capital securities that are generally valued according to the "mark-to-market method" which attempts to apply a fair value standard by referring to meaningful third-party transactions, comparable public market valuations or the income approach, in which market expectations of future cash flows or earnings are converted to a present value. However, in some instances, it may be most appropriate to value an investment at cost, if little has changed since the initial investment in the company. This valuation process is often used in the early years of investments in a private company, and in these instances cost is reflective of fair value.

The following fair value hierarchy table sets forth the investment portfolio by level as of December 31, 2012 and 2011 where carrying value equals fair value (refer to Note 4 for split-interests and other trusts):

	2012			Total
	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
Short-term investments	\$ 465,331	\$ 77,808	\$ -	\$ 543,139
Fixed income funds				
Mortgage backed	38,054,379	-	-	38,054,379
Corporate funds	10,773,013	-	-	10,773,013
Government funds	19,671,133	655,324	-	20,326,457
Equity funds				
Domestic equity	17,816,300	40,934,805	-	58,751,105
International equity	51,012,408	-	-	51,012,408
Alternative investments				
Limited Partnerships	-	-	22,482,880	22,482,880
Mutual funds	-	-	11,598,935	11,598,935
Real estate funds	-	3,266,983	2,271,151	5,538,134
Other	875,074	-	-	875,074
Total	\$ 138,667,638	\$ 44,934,920	\$ 36,352,966	\$ 219,955,524

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

	2011			Total
	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	
Short-term investments	\$ 619,063	\$ -	\$ -	\$ 619,063
Fixed income funds				
Mortgage backed	29,401,681	-	-	29,401,681
Corporate funds	23,646,330	-	-	23,646,330
Government funds	16,886,361	103,321	-	16,989,682
Equity funds				
Domestic equity	14,962,102	34,274,315	-	49,236,417
International equity	18,877,804	17,295,286	-	36,173,090
Alternative investments				
Limited Partnerships	-	-	18,518,945	18,518,945
Mutual funds	-	-	9,429,731	9,429,731
Real estate funds	-	2,879,296	1,413,167	4,292,463
Other	258,046	-	-	258,046
Total	\$ 104,651,387	\$ 54,552,218	\$ 29,361,843	\$ 188,565,448

The following table sets forth a summary of changes in fair value of investments measured using Level 3 inputs for the year ended December 31:

	2012	2011
Balance, beginning of year	\$ 29,361,843	\$ 20,384,374
Purchases	13,135,106	7,991,932
Earnings	1,538,520	1,663,450
Sales	(7,682,503)	(677,913)
Balance, end of year	\$ 36,352,966	\$ 29,361,843

Overall challenges to the economic environment have created significant financial market volatility and illiquidity. The Association is not immune to the impacts of these market conditions. It should be noted that it is at least possible that fair values could change rapidly.

Investments are primarily pooled in investment portfolios containing multiple unrestricted, temporarily restricted and permanently restricted funds. On a quarterly basis investment income is allocated to the individual funds within the pool based upon the proportional invested balance of each fund.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

4. Split Interest Trusts, Other Trusts and Investments Restricted by Agreements

The Association is the beneficiary of various split interest agreements, investments restricted by agreements and other trusts as follows:

Irrevocable Trusts and Others

Donors have established irrevocable trusts held by third party trustees. The trusts consist of various investment portfolios. Pursuant to the trust agreements, the donors designated beneficiary is entitled to the income earned on the trust during the beneficiary's lifetime and upon death the assets in the trust will be available to the Association. The present value of the estimated amount to be received was calculated using a risk adjusted discount rate (approximately 5%) and the applicable mortality table and is \$12,579,215 at December 31, 2012 (\$10,629,482 at 2011).

Remainder Trusts

Donors have established charitable remainder trusts naming the Association as the trustee. Charitable remainder trusts provide for the payment of distributions to designated beneficiaries over the trusts' terms (usually the designated beneficiary's lifetime). At the end of each trust's term, the remaining assets are available for the Association's use, subject to the donor-imposed restrictions. Assets held in charitable remainder trusts totaled \$5,480,824 at December 31, 2012 (\$5,519,431 in 2011) and are recorded at estimated realizable value. On an annual basis the Association revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions. The present value of the estimated future payments (\$2,894,504 and \$3,017,545 at December 31, 2012 and 2011, respectively) is calculated using a discount rate (approximately 3%) and applicable mortality tables.

Donors have established charitable remainder trusts for which the Association is not the trustee. The present value of the estimated beneficial interest to be received at the end of the trusts' terms (usually the designated beneficiary's lifetime) totaled \$8,561,945 at December 31, 2012 (\$6,650,881 at 2011).

Perpetual Trust

A donor has established a perpetual trust under which the Association receives 35% of the trust's 5% annual distribution. The net present value of future cash flows expected to be received from the trust approximated \$1,006,577 at December 31, 2012 (\$959,977 in 2011).

Pooled Life Income Funds

The Association has a pooled life income fund whereby donors contribute into an investment pool and are assigned a specific number of units. The donor or designated beneficiary receives an allocation of income on a quarterly basis. Upon the death of the beneficiary, the value of the assigned units reverts to the Association. The Association's remainder interest in the assets received is measured at the fair value of the assets to be received discounted for the estimated time period until the death of the designated beneficiary using the applicable mortality tables. Assets held in pooled life income funds totaled \$2,274,493 at December 31, 2012 (\$2,251,476 in 2011). The liability for future payments is recorded as deferred obligations and approximated \$924,911 at December 31, 2012 (\$949,385 in 2011).

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Gift Annuities

The Association receives certain gifts whereby it is contractually obligated to make periodic payments to the donor for the remainder of his or her life. The Association purchases annuity contracts from insurance companies to fund these obligations. Currently, gift annuity contributions are deposited into an investment portfolio at a financial institution. The assets received are recorded at fair value and an annuity payment liability is recorded as deferred obligations at the present value of the future cash flows expected to be paid to the designated beneficiary using the applicable mortality table. Assets held in gift annuities accounts totaled \$2,919,078 at December 31, 2012 (\$2,606,046 in 2011). At December 31, 2012, deferred obligations associated with gift annuities approximated \$1,893,391 (\$1,834,285 in 2011).

As required by insurance law, the Association maintains an annuity reserve greater than 115% of associated liabilities. The reserve requirement is met using the specific assets and liabilities of the pooled life income funds and gift annuities as well as an additional reserve. At December 31, 2012, the Association's gift annuity and pooled life income fund assets and liabilities amounted to \$5,193,571 and \$2,818,302 respectively (\$4,857,522 and \$2,783,670 in 2011). At December 31, 2012 and 2011, the Association maintained sufficient assets in excess of liabilities to fulfill the requirement under the law. The Association maintains an additional reserve, included in investments, in a portfolio at a financial institution. At December 31, 2012, the fair value of the amount reserved was approximately \$210,358 (\$210,937 in 2011). The Association was in full compliance with reserve requirements under the insurance law at December 31, 2012 and 2011.

The split-interest and other trusts are considered level 3 investments as defined in Note 3. The changes in split-interest and other trusts for 2012 and 2011 were as follows:

	Split-Interest and Other Trusts			
	Irrevocable & Other Trusts	Remainder Trusts	Perpetual Trust	Total Split Interest & Other Trusts
Balance at December 31, 2010	\$ 9,768,029	\$ 11,372,309	\$ 1,026,681	\$ 22,167,019
Contributions	421,557	999,466	-	1,421,023
Change in value	439,896	(201,463)	(66,704)	171,729
Balance at December 31, 2011	10,629,482	12,170,312	959,977	23,759,771
Contributions	1,770,069	1,187,161	-	2,957,230
Payments received	-	(293,653)	-	(293,653)
Change in value	179,664	978,949	46,600	1,205,213
Balance at December 31, 2012	<u>\$ 12,579,215</u>	<u>\$ 14,042,769</u>	<u>\$ 1,006,577</u>	<u>\$ 27,628,561</u>

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

The changes in investments restricted by agreements for 2012 and 2011 were as follows:

	Investments Restricted by Agreements			Total Investments Restricted by Agreements
	Pooled Life Income Funds	Gift Annuities	Reserve	
Balance at December 31, 2010	\$ 2,196,859	\$ 2,477,371	\$ 211,719	4,885,949
Contributions	-	446,571	-	446,571
Payments received	-	(104,369)	-	(104,369)
Change in value	54,617	(213,527)	(782)	(159,692)
Balance at December 31, 2011	2,251,476	2,606,046	210,937	5,068,459
Contributions	-	310,635	-	310,635
Payments received	(11,665)	-	-	(11,665)
Change in value	34,682	2,397	(579)	36,500
Balance at December 31, 2012	<u>\$ 2,274,493</u>	<u>\$ 2,919,078</u>	<u>\$ 210,358</u>	<u>\$ 5,403,929</u>

5. Building and Equipment

A summary of building and equipment is as follows:

	December 31,	
	2012	2011
Equipment	\$ 580,190	\$ 538,120
Building & Improvements	9,496,352	9,480,057
	10,076,542	10,018,177
Less accumulated depreciation	4,749,536	4,450,260
Total	<u>\$ 5,327,006</u>	<u>\$ 5,567,917</u>

Depreciation expense was \$299,276 and \$330,857 as of December 31, 2012 and 2011, respectively.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

6. Lines of Credit

The Association has entered into a \$4,000,000 line of credit and a \$ 1,000,000 automated clearing house facility with a bank. These lines were established under a working capital support agreement dated June 18, 2012, with interest rate options of LIBOR plus 1.4% or Prime Rate minus 1.25%. There were no outstanding balances on these lines at December 31, 2012 or 2011. Credit lines expire on June 18, 2013.

The Association incurred no interest expense for the years ended December 31, 2012 and 2011.

7. Deferred Compensation

The Association has arrangements with its executive officers whereby specified amounts of their compensation are deferred. These amounts are invested on behalf of the executives and are payable upon their retirement. At December 31, 2012, the Association's obligation pursuant to these arrangements was approximately \$387,985 (\$393,737 in 2011).

8. Pension Plan

The Association sponsors a defined contribution retirement plan under IRC 403(b) that allows for contributions by employees as well as the Association. Substantially all employees are eligible to participate in this plan. The Association's contributions to the plan are based on a percentage of the employee's elective contribution and totaled approximately \$281,525 for the year ended December 31, 2012 (\$246,301 for 2011).

9. Property Lease

In 1992, the Association entered into a fifty year lease with the Secretary of the Army for approximately 1.5 acres of land on which its alumni center was constructed. This lease has a renewal option for an additional fifty years and is revocable by the Secretary of the Army. The land is being leased at no charge to the Association.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

10. Restrictions on Net Assets

Temporarily restricted net assets are available for the support of various projects related to the United States Military Academy and its graduates.

Permanently restricted net assets consist of endowment funds and are restricted to the following:

	<u>December 31,</u>	
	<u>2012</u>	<u>2011</u>
Permanent endowment with no restrictions on the use of income	\$ 25,233,368	\$ 24,374,859
Permanent endowments with income restricted to the support of projects and programs related to the United States Military Academy and its graduates	<u>87,097,688</u>	<u>75,243,794</u>
Total	<u>\$ 112,331,056</u>	<u>\$ 99,618,653</u>

11. Transfers

Transfers are made among the net asset classes to reclassify previously recognized revenue that has been re-allocated based upon the occurrence of certain events or the determination that a transfer is needed to reflect the donors' intent for the contribution. The Association ensures donors' consent before making net asset transfers from temporarily restricted to permanently restricted.

12. Functional Allocation of Expenses

The cost of providing various programs and other activities has been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

13. Description of Program and Supporting Services

The following program and supporting services are included in the accompanying financial statements:

Communications and Marketing - Disseminates information on current events and the history, activities, objectives and purpose of the United States Military Academy through certain publications.

Management and Administration - Relates to the overall administration of the Association.

Fund Raising - Provides the structure necessary to encourage and secure private financial support from individuals, foundations and corporations.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Educational and Historical – Provides gift funds and assets to the United States Military Academy (“USMA”) with the purpose to include the encouragement of the study of leadership and to enhance the image of the United States Military Academy. The Association recorded \$18,489,047 of proffers to the United States Military Academy in 2012 (\$13,360,062 in 2011), related to educational and historical programs and support services.

Alumni Services - Encompasses activities, support and services provided to graduates including events, awards and the maintenance of detailed biographical and historical records on graduates of the United States Military Academy and includes expenses for the operation of a gift shop.

Total programming and supporting services are comprised of the following expense categories:

	<u>2012</u>	<u>2011</u>
Grants to USMA	\$ 18,489,047	\$ 13,360,062
Salaries	5,636,643	5,487,663
Benefits	1,002,993	938,747
Professional services	942,270	476,357
Printing	202,494	292,485
Postage and shipping	305,336	357,033
Cost of goods sold	784,617	790,828
Employee travel	163,966	167,106
Awards and alumni events	642,025	571,936
Donor recognition expense	128,028	226,919
Donor acquisition	264,897	526,451
Office expenses	87,872	96,435
Building expenses	273,337	283,468
Depreciation	278,362	282,751
All other	427,361	500,106
	<u>\$ 29,629,248</u>	<u>\$ 24,358,347</u>

14. Endowment

In September 2010, the State of New York enacted the New York Prudent Management of Institutional Funds Act (NYPMIFA, the “Act”). The Act provides specific guidance regarding investment management and spending policies related to funds donated as “endowment” to the organization. Among its many provisions, the Act promotes a total return approach to spending, with the goals of investing at a rate that will preserve the purchasing power of the principal over the long term as well as a spend rate that, over the long term, will reflect the donor’s intentions. The Act requires each organization to establish written investment and spending policies to ensure compliance with the Act. The Act also outlines the following eight standards for prudent spending, including a requirement that organizations have a written policy describing how such standards were adopted:

1. The duration and preservation of the endowment fund
2. The purpose of the institution and the endowment fund

The Association of Graduates of the United States Military Academy

Notes to Financial Statements

December 31, 2012 and 2011

3. General economic conditions
4. The possible effect of inflation or deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the institution
7. Where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the institution
8. The investment policy of the institution

In addition, the Act establishes that a yearly spend of more than 7% of an endowment's market value creates a rebuttal presumption of imprudence. Spending is to be based on quarterly market values of the endowment calculated over a period of not less than 5 years. The Act also requires written notification to all existing endowment donors allowing them to indicate whether or not they will allow the endowment to be spent below the original gift amount.

The primary investment objective is to maximize total return within prudent risk guidelines. The secondary objective is preserve capital – less risk will be assumed for funds intended for near-term use, while greater risk may be assumed for longer-term funds, including endowments.

For endowments whose income is unrestricted or restricted for specific purposes, the Association uses a total return policy whereby a fixed percentage (4% for restricted and 5% for unrestricted in 2012 and 2011) of the prior twelve quarters' market value of permanently restricted investments and their related temporarily restricted income accounts is available for distribution in the ensuing year for the intended endowment purposes. The unrestricted endowed assets represents income available for unrestricted purposes. For endowments whose income accounts reflected negative balances at year end, the availability of distributions is limited to interest and dividend income earned by the endowment fund during the calendar year.

In addition, it is the Association's current policy to recognize the historic dollar value of all endowment funds and not spend any portion of the corpus. The Association classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment and (b) the original value of subsequent gifts to the permanent endowment. 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 by the Association in a manner consistent with the Act.

The Association of Graduates of the United States Military Academy

Notes to Financial Statements
December 31, 2012 and 2011

Changes in endowed net assets for the year ended December 31, 2012, are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, end of year, December 31, 2011	\$ 5,438,763	\$ 17,240,928	\$ 99,618,653	\$ 122,298,344
Contributions	-	271,671	5,976,975	6,248,646
Return on investment	(84,400)	1,678,006	-	1,593,606
Realized and unrealized gain on investment	2,586,740	8,714,560	-	11,301,300
Transfers and other, net	(1,233,569)	(2,037,908)	6,735,428	3,463,951
Amount appropriated for expenditure	<u>(30,145)</u>	<u>(1,180,133)</u>	<u>-</u>	<u>(1,210,278)</u>
Endowment net assets, end of year, December 31, 2012	<u>\$ 6,677,389</u>	<u>\$ 24,687,124</u>	<u>\$ 112,331,056</u>	<u>\$ 143,695,569</u>

Changes in endowed net assets for the year ended December 31, 2011, are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, end of year, December 31, 2010	\$ 5,680,086	\$ 19,879,722	\$ 88,602,660	\$ 114,162,468
Contributions	-	(128,361)	6,449,699	6,321,338
Return on investment	385,475	1,189,768	-	1,575,243
Realized and unrealized gain on investment	(626,798)	(1,854,882)	-	(2,481,680)
Transfers and other, net	-	(1,079,140)	4,566,294	3,487,154
Amount appropriated for expenditure	<u>-</u>	<u>(766,179)</u>	<u>-</u>	<u>(766,179)</u>
Endowment net assets, end of year, December 31, 2011	<u>\$ 5,438,763</u>	<u>\$ 17,240,928</u>	<u>\$ 99,618,653</u>	<u>\$ 122,298,344</u>

15. Contingency

The Association has recorded an interest in an irrevocable trust which was established pursuant to a court order. During 2012, the Association received notice which challenged the entitlement to such trust. While a recent court decision resulted in a ruling in favor of the Association, the ruling is subject to appeal. Accordingly, the ultimate outcome of this matter cannot be determined at this time. However, management believes that any adjustment arising as a result of this dispute will not have a material adverse effect on the financial position or results of operations of the Association.