

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Consolidated Financial Report
December 31, 2016

Contents

Independent auditor's report	1-2
<hr/>	
Financial statements	
Consolidated statement of financial position	3
Consolidated statement of activities	4
Consolidated statement of cash flows	5
Notes to consolidated financial statements	6-19



RSM US LLP

Independent Auditor's Report

To the Board of Directors
Horatio Alger Association of Distinguished Americans, Inc.
Alexandria, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Horatio Alger Association of Distinguished Americans, Inc. and Affiliate (the Association), which comprise the consolidated statement of financial position as of December 31, 2016, the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements (collectively, financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 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 Horatio Alger Association of Distinguished Americans, Inc. and Affiliate as of December 31, 2016, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the Association's 2015 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated August 10, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015, is consistent in all material respects, with the audited financial statements from which it has been derived.

RSM US LLP

McLean, Virginia
August 9, 2017

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Consolidated Statement of Financial Position
December 31, 2016
(With Comparative Totals for 2015)

	2016	2015
Assets		
Cash and cash equivalents	\$ 48,293,171	\$ 20,326,441
Prepaid expenses and other assets	1,186,649	1,454,757
Contributions receivable, net	27,236,967	28,806,008
Investments	147,213,259	147,859,978
Investments in deferred compensation assets	2,089,029	1,589,131
Furniture, equipment and leasehold improvements, net	28,194	43,981
Beneficial interest in perpetual trust	1,674,387	1,634,132
	<u>\$ 227,721,656</u>	<u>\$ 201,714,428</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 462,163	\$ 289,579
Scholarships payable, net	22,857,647	18,086,821
Deferred compensation plan obligations	2,089,029	1,589,131
Deferred rent	82,739	75,020
Total liabilities	<u>25,491,578</u>	<u>20,040,551</u>
Commitments (Notes 9 and 11)		
Net assets:		
Unrestricted:		
Operating assets	18,341,291	19,855,954
Board designated endowment assets	148,812,482	129,256,314
	<u>167,153,773</u>	<u>149,112,268</u>
Temporarily restricted	30,294,095	27,819,654
Permanently restricted	4,782,210	4,741,955
	<u>202,230,078</u>	<u>181,673,877</u>
	<u>\$ 227,721,656</u>	<u>\$ 201,714,428</u>

See notes to consolidated financial statements.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Consolidated Statement of Activities Year Ended December 31, 2016 (With Comparative Totals for 2015)

	2016				2015 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
Support and revenue:					
Contributions:					
Horatio Alger Membership Programs and Induction Ceremonies	\$ 8,514,871	\$ 3,330,382	\$ -	\$ 11,845,253	\$ 10,786,561
Scholarships and other	800,306	9,997,291	-	10,797,597	5,152,553
Capital campaign	-	7,391,227	-	7,391,227	30,617,583
Giving clubs	-	1,769,252	-	1,769,252	1,346,119
Video and book sales	31,540	-	-	31,540	10,233
Net assets released from restrictions:					
Satisfaction of program restrictions:					
Scholarships and other	6,212,934	(6,212,934)	-	-	-
Induction ceremony	1,267,457	(1,267,457)	-	-	-
Capital campaign	5,794,331	(5,794,331)	-	-	-
Satisfaction of time restrictions:					
Capital campaign	5,766,356	(5,766,356)	-	-	-
Giving clubs	972,633	(972,633)	-	-	-
Total support and revenue	29,360,428	2,474,441	-	31,834,869	47,913,049
Expenses:					
Program services:					
Other scholarship programs	7,491,377	-	-	7,491,377	2,054,914
State Scholarship Program	6,833,336	-	-	6,833,336	7,685,439
Horatio Alger Membership programs and induction ceremonies	5,157,599	-	-	5,157,599	4,821,784
National Scholars' Program	2,479,707	-	-	2,479,707	2,366,064
Membership meeting	1,306,199	-	-	1,306,199	3,332,507
National Scholars' Conference	509,555	-	-	509,555	472,968
Educational materials	469,606	-	-	469,606	299,432
State of Our Nation's Youth	363,743	-	-	363,743	-
Field directors meeting	323,926	-	-	323,926	29,019
Scholars' alumni programs	113,225	-	-	113,225	103,084
Collegiate Partners Program	85,462	-	-	85,462	83,485
Research	-	-	-	-	42,650
Total program services	25,133,735	-	-	25,133,735	21,291,346
Supporting services:					
Administration and general	1,047,788	-	-	1,047,788	1,205,606
Fundraising	695,509	-	-	695,509	629,022
Total supporting services	1,743,297	-	-	1,743,297	1,834,628
Total expenses	26,877,032	-	-	26,877,032	23,125,974
Change in net assets before other changes	2,483,396	2,474,441	-	4,957,837	24,787,075
Investment income (loss), net	15,558,109	-	-	15,558,109	(4,261,971)
Change in value of beneficial interest in perpetual trust	-	-	40,255	40,255	(136,971)
Change in net assets	18,041,505	2,474,441	40,255	20,556,201	20,388,133
Net assets:					
Beginning	149,112,268	27,819,654	4,741,955	181,673,877	161,285,744
Ending	\$ 167,153,773	\$ 30,294,095	\$ 4,782,210	\$ 202,230,078	\$ 181,673,877

See notes to consolidated financial statements.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Consolidated Statement of Cash Flows
Year Ended December 31, 2016
(With Comparative Totals for 2015)

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ 20,556,201	\$ 20,388,133
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Unrealized and realized (gain) loss on investments, net	(12,160,737)	6,904,947
Bad debt expense for contributions receivable	-	400,160
(Decrease) Increase in discount on contributions receivable	(301,069)	777,359
Depreciation and amortization	26,225	66,032
Forfeitures on scholarships payable	(874,660)	(1,200,028)
(Increase) decrease in allowance for scholarship forfeitures	(261,220)	193,409
Increase in discount on scholarships payable	(142,683)	(33,727)
Change in beneficial interest in perpetual trust	(40,255)	136,971
Change in deferred rent	7,719	(5,258)
Contributions restricted for long-term investment	(500,000)	(500,000)
Changes in assets and liabilities:		
(Increase) decrease in:		
Prepaid expenses and other assets	268,108	2,071,850
Contributions receivable	1,870,110	(12,058,039)
Increase (decrease) in:		
Accounts payable and accrued expenses	172,584	(5,378)
Scholarships payable	6,049,389	2,554,516
Deferred revenue	-	(1,361,402)
Deferred compensation plan obligations	499,898	218,747
Net cash provided by operating activities	15,169,610	18,548,292
Cash flows from investing activities:		
Purchases of investments	(116,020,720)	(111,508,929)
Purchases of deferred compensation assets	(499,898)	(218,747)
Proceeds from sales and maturities of investments	128,828,176	99,763,538
Purchases of furniture, equipment and leasehold improvements	(10,438)	(15,815)
Net cash provided by (used in) investing activities	12,297,120	(11,979,953)
Cash flows from financing activities:		
Contributions restricted for long-term investment	500,000	500,000
Net cash provided by financing activities	500,000	500,000
Net increase in cash and cash equivalents	27,966,730	7,068,339
Cash and cash equivalents:		
Beginning	20,326,441	13,258,102
Ending	\$ 48,293,171	\$ 20,326,441

See notes to consolidated financial statements.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: Horatio Alger Association of Distinguished Americans, Inc. and Affiliate (the Association) consists of two entities: Horatio Alger Association of Distinguished Americans, Inc. (Horatio) and Horatio Alger Endowment Fund (the Fund).

Horatio is a nonprofit organization established to promote and advance the American tradition of success through scholarships for young Americans, educational programs, research, publications and events.

The Fund holds and manages the endowment funds previously held by Horatio and takes actions, as appropriate, to grow the funds of the endowment to support the educational and scholarship programs of Horatio.

The Association operates the following programs:

State Scholarship Program: Scholarships are awarded to provide financial assistance to students in particular states who have exhibited integrity and perseverance in overcoming personal adversity and who aspire to pursue higher education. The programs annually award scholarships ranging from \$2,500 to \$10,500 to deserving students, as well as provide educational and financial counseling towards obtaining a college degree.

Other Scholarship Programs: These programs include the internship and placement program, the cost of financial advising, the Alumni Advisory Council, the Scholarship Selection Committee and the members' forum meetings. The Association also offers grants to scholars pursuing graduate studies through the Dennis R. Washington Achievement Scholarships program.

Horatio Alger Membership Programs and Induction Ceremonies: The Horatio Alger Award is recognized as one of the nation's most prestigious honors. The Award is presented during the annual Membership Program and Induction Ceremonies held in Washington, D.C. each year during a multi-day program for Members, Life Partners and Friends of Distinction, held in conjunction with the National Scholars Conference. The programs focus on Member achievements, interviews with new Members, opportunities for Member networking and mentoring of the National Scholars and educational programs regarding the future of the American Dream.

National Scholars' Program: This program allows more than 100 students each year from high schools across the United States and Puerto Rico to receive Horatio Alger National Scholarships. These students, known as National Scholars, receive a \$21,000 scholarship to apply to a college of their choice. The Association's Horatio Alger National Scholarship award of \$21,000 is available to scholars for a four-year period, during which the scholars may request a maximum of \$5,250 per year. Awards may be used only for tuition, fees, room, board, books and supplies. Horatio Alger National Scholarships are awarded on the basis of a student's overcoming adversity, critical financial need, personal potential and academic achievement, school and community, work history, character and promise of future contributions to society.

Membership Meeting: The Association convenes the Lifetime Members and Life Partners to advance the mission, programs and services of the Association on a regular basis including, but not limited to, the Annual Board of Directors Meeting, Annual Awards Week in Washington and at specialized forums, such as the International Forum, Alumni summits and regional convenings, such as the Association's concert series. These activities include ongoing communications with members, such as Forum; the biennial report, *Only in America*; and other on-line and printed materials that keep the members connected to the Association's mission and work.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

National Scholars' Conference: This program allows recipients of the Horatio Alger National Scholarship to attend the annual four-day conference in Washington, D.C. The conference provides National Scholars the opportunity to meet with Association members to gain a better understanding of the American free enterprise system. They also meet with congressional leaders to gain deeper insight into the operation of the federal government. The goal of the conference is to awaken the scholars to the possibilities that are available to them as American citizens and to encourage their participation and interest in building a strong future for our nation.

Educational Materials: This program provides information about the Association's mission and programs through a variety of sources. Publications are printed for members, National Scholars, education partners, friends and the general public. The educational documents reinforce the message of Horatio Alger's original characters that success as an adult is within the reach of every young person with a dream and a commitment to hard work and integrity.

State of Our Nation's Youth: Conducted every four years in collaboration with Peter Hart and Associates and New York University, this longstanding program and publication surveys the attitudes of 14 through 23 year old American youth regarding education, politics and the issues shaping their lives. The report is released at a national press conference and distributed to media, education leaders and Association Members.

Field Directors Meeting: The Association has volunteer field directors throughout the United States who serve as ambassadors to private, parochial and public schools in promoting the scholarships, programs and services of the Association. Most field directors are secondary or higher education professionals and some are alumni of the Association's scholarship programs. Field directors convene for training on occasion and communicate regularly with the headquarters staff.

Scholars' Alumni Programs: As the scholarship programs have grown, the number of students considered alumni of the program, both those in undergraduate school and those who have graduated, has grown rapidly. The alumni programs include the Association's ongoing work with scholars as they pursue their undergraduate degrees; the alumnus of the year program that recognizes outstanding alumni each year; the semiannual newsletter, *Strive and Succeed*; an online message board for scholars to communicate; and the Scholars Alumni Summit meeting.

Collegiate Partners Program: This program is a unique program under which private and public colleges and universities unite with the Association to form a consortium for the purpose of providing special financial assistance to National and State Scholars to reduce their educational costs. Collegiate Partner institutions usually match the amount the scholar brings to the school and then offer aid through campus scholarships, grants and work-study programs. This program has grown rapidly to include over 280 institutions of higher learning.

Career/Technical Scholarships: This program was piloted in 2015 for students in Nebraska and California to receive scholarships to attend community colleges for training and certification in a range of career and technical fields leading to associate degrees or certification for students to enter careers. Students in these programs will also be given an opportunity to further advance their education in the future through scholarship assistance. Expenses for this program are included in other scholarships in the statement of activities. These are included within other scholarship programs.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

A summary of the Association's significant accounting policies follows:

Basis of accounting: The accompanying consolidated financial statements are presented in accordance with the accrual basis of accounting, whereby unconditional support is recognized when received, revenue is recognized when earned and expenses are recognized when incurred.

Basis of presentation: The consolidated financial statement presentation follows the recommendations of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (the Codification). As required by the Not-for-Profit topics of the Codification, Balance Sheet and Income Statement, the Association is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

Net assets, support and revenue, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Association are classified and reported as follows:

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

Temporarily restricted: Net assets subject to donor-imposed stipulations that will be met either by actions of the Association and/or the passage of time.

Permanently restricted: Net assets subject to donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by the actions of the Association. Generally, the donors of these assets permit the Association to use all or part of the income earned on related investments for general or specific purposes.

Unconditional contributions are reported as increases in the appropriate category of net assets. Unconditional contributions with donor-imposed restrictions related to awards activities that are met in the same fiscal year they are received are included in unrestricted support. Unconditional contributions for other programs with donor-imposed restrictions that are met in the same fiscal year they are received are included in temporarily restricted net assets. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets, unless their use is restricted by explicit donor stipulations or by law. Expirations of temporary restrictions recognized on net assets are reported as reclassifications from temporarily restricted net assets to unrestricted net assets.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Horatio and the Fund. All significant intercompany accounts and transactions have been eliminated in consolidation.

Measure of operations: The Association considers operations to include all changes in net assets, exclusive of investment income (loss) and changes in value of its beneficial interest in perpetual trust.

Cash and cash equivalents: The Association considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents.

Financial risk: The Association maintains cash in bank deposit accounts which, at times, may exceed federally insured limits. The Association has not experienced any losses in such accounts. The Association believes it is not exposed to any significant financial risk on cash.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

The Association invests in a professionally managed portfolio that contains various securities that are exposed to risks, such as interest, market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term could materially affect investment balances and the amounts reported in the consolidated financial statements. The money market funds and cash held within the portfolio are presented with cash and cash equivalents.

Contributions: Contributions, which include unconditional promises to give, are recognized as support in the period received net of allowance for estimated uncollectible amounts and net of discount to present value for pledges expected to be received in future periods greater than one year. Unconditional contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved. Amortization of the discount is recorded as additional support and is used in accordance with donor-imposed restrictions, if any, on the contributions. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Management determines the allowance for doubtful contributions receivable based on historical experience regarding collections. Contributions are written off when deemed uncollectible.

Investments: Investments in corporate fixed income, partnership and hedge funds, equity mutual funds, common stock, exchange traded funds and money market funds are reported at fair value. Fair value is determined by using quoted market prices on marketable securities. The partnerships and hedge funds are reported at estimated fair values based on a practical expedient, the net asset value per share or equivalent, provided by the investment managers. The Association believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because these alternative investments are not readily marketable, their estimated value is subject to additional uncertainty and, therefore, values realized upon disposition may vary significantly from currently reported values.

Investment income (loss), recorded in the consolidated statement of activities, consists of unrealized and realized gains and losses and interest and dividends.

Furniture, equipment and leasehold improvements: Furniture, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on a straight-line basis over the shorter of the estimated useful lives or lease terms of the assets, which range from two to ten years. The Association capitalizes all property and equipment purchased with a cost of \$500 or more.

Beneficial interest in perpetual trust: The Association recorded its beneficial interest in perpetual trust as a permanently restricted contribution in the period in which it was notified of the irrevocable nature of the trust. The Association determines the fair value of its trust interest based on the fair value of the underlying assets within the trust. Changes in the value of the Association's interest are recorded in each subsequent period in the permanently restricted change in net assets. Support received on this trust, which is paid annually, is classified as unrestricted support in the accompanying consolidated statement of activities. For the year ended December 31, 2016, the gain incurred on this trust was \$40,255.

Valuation of long-lived assets: Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less cost to sell.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Scholarships: The Association records an expense and payable when a scholarship is awarded to a student and the likelihood of payment of the scholarship is considered probable. The Association records an estimate for forfeitures at the time the scholarship is awarded. Scholarships expected to be paid in future periods greater than one year are discounted to present value based on expected future cash flows at an appropriate discount rate commensurate with the risks involved.

Income tax: Horatio and the Fund have been recognized as exempt from federal income taxes by the Internal Revenue Service under Section 501(c)(3) of the Internal Revenue Code and each has been classified as an organization that is not a private foundation.

Management evaluated the tax positions and concluded that Horatio and the Fund have taken no uncertain tax positions that require adjustment to the consolidated financial statements to comply with the provisions of this guidance. Generally, Horatio and the Fund are no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2013.

Functional allocation of expenses: The costs of providing the Association's programs and activities have been summarized on a functional basis in the consolidated statement of activities. Expenses that can be identified with a specific program or supporting service are allocated directly. Certain other costs have been allocated among the programs and supporting services benefited.

Use of estimates: The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reporting of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. The Association is also required to make estimates and assumptions that affect the reported amounts of support and revenue and expenses during the reporting period. Actual results could differ from those estimates.

Pending accounting pronouncements: In August 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. The ASU will be effective for fiscal years beginning after December 15, 2017. Earlier adoption is permitted.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. A lessee is required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The ASU is expected to impact the Association's consolidated financial statements as the Association has certain operating lease arrangements for which it is the lessee. The standard is effective on January 1, 2020, with early adoption permitted.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Prior year information: The consolidated financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Association's consolidated financial statements for the year ended December 31, 2015, from which the summarized information was derived.

Subsequent events: The Association evaluated subsequent events through August 9, 2017, which is the date the consolidated financial statements were available to be issued.

Note 2. Contributions Receivable

Contributions receivable represent the uncollected balance of unconditional promises to give. The majority of the Association's contributions are made by members and represent giving club contributions, awards activities and scholarship funds/capital campaign contributions. The balance of contributions receivable, net of discount and allowance for uncollectible contributions, consists of the following at December 31, 2016:

Amounts Due in	Giving Clubs	Awards Activities	Scholarships/ Capital Campaign	Total
Less than one year	\$ 1,031,069	\$ 1,642,500	\$ 9,540,538	\$ 12,214,107
One to five years	1,985,000	-	14,506,844	16,491,844
Greater than five years	-	-	404,000	404,000
Gross contributions receivable	3,016,069	1,642,500	24,451,382	29,109,951
Less unamortized discount on contributions receivable (4%)	(140,555)	-	(1,072,858)	(1,213,413)
Less allowance for uncollectible contributions	(59,317)	(31,850)	(568,404)	(659,571)
Contributions receivable, net	\$ 2,816,197	\$ 1,610,650	\$ 22,810,120	\$ 27,236,967

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 3. Fair Value Measurements

The Association follows the Codification topic, Fair Value Measurement. The topic applies to all assets and liabilities that are being measured and reported on a fair value basis. The topic establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. The topic enables the reader of the consolidated financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The topic requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities

Level 2: Observable market based inputs or unobservable inputs corroborated by market data

Level 3: Unobservable inputs not corroborated by market data

In determining the appropriate levels, the Association performs a detailed analysis of the assets and liabilities that are subject to the Codification. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 3. Fair Value Measurements (Continued)

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy:

	Level 1	Level 2	Level 3	Total
Assets:				
Equity mutual funds:				
Large blend	\$ 16,037,072	\$ -	\$ -	\$ 16,037,072
Small cap	2,091,294	-	-	2,091,294
Total equity mutual funds	<u>18,128,366</u>	<u>-</u>	<u>-</u>	<u>18,128,366</u>
Corporate fixed income:				
Services	-	16,733,651	-	16,733,651
Technology	-	14,284,456	-	14,284,456
Financial	-	6,164,648	-	6,164,648
Industrial	-	5,553,555	-	5,553,555
Healthcare	-	4,728,858	-	4,728,858
Basic materials	-	2,836,674	-	2,836,674
Total corporate fixed income	<u>-</u>	<u>50,301,842</u>	<u>-</u>	<u>50,301,842</u>
Common stock:				
Financial	8,658,308	-	-	8,658,308
Services	3,995,147	-	-	3,995,147
Technology	3,319,415	-	-	3,319,415
Basic materials	2,886,181	-	-	2,886,181
Consumer goods	2,670,823	-	-	2,670,823
Industrial	2,326,930	-	-	2,326,930
Healthcare	2,036,589	-	-	2,036,589
Utilities	819,837	-	-	819,837
Total common stock	<u>26,713,230</u>	<u>-</u>	<u>-</u>	<u>26,713,230</u>
Alternative investments valued using a net asset value per share or equivalent as a practical expedient (a)	-	-	-	52,069,821
Total investments at fair value	<u>44,841,596</u>	<u>50,301,842</u>	<u>-</u>	<u>147,213,259</u>
Money market funds in cash and cash equivalents	2,562,957	-	-	2,562,957
Beneficial interest in perpetual trust	-	-	1,674,387	1,674,387
Investments in deferred compensation plan:				
Multi-strategy mutual funds	1,402,973	-	-	1,402,973
Multi-strategy exchange traded funds	198,243	-	-	198,243
Equities	275,006	-	-	275,006
Money market funds	212,807	-	-	212,807
Total investments in deferred compensation plan	<u>2,089,029</u>	<u>-</u>	<u>-</u>	<u>2,089,029</u>
Total assets at fair value	<u>\$ 47,679,559</u>	<u>\$ 50,301,842</u>	<u>\$ 1,674,387</u>	<u>\$ 151,725,609</u>
Liabilities:				
Deferred compensation plan obligations	\$ -	\$ 2,089,029	\$ -	\$ 2,089,029
Total liabilities at fair value	<u>\$ -</u>	<u>\$ 2,089,029</u>	<u>\$ -</u>	<u>\$ 2,089,029</u>

(a) In accordance with the Association's adopting of ASU No. 2015-07, certain investments that were measured at a net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts of those investments presented in this table are intended to permit reconciliation of the fair value hierarchy to the line item presented in the consolidated statement of financial position.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 3. Fair Value Measurements (Continued)

The mutual funds, common stock, exchange traded funds and money market funds are classified as Level 1 instruments, as they are actively traded on public exchanges with identical assets.

The corporate fixed income securities are classified as Level 2 instruments, as there are not quoted market prices in active markets for identical assets. Their value is determined using models and other valuation methodologies, which are corroborated by market data.

The beneficial interest in perpetual trust is classified as a Level 3 instrument, as there is no market for the Association's interest in the trust. Further, the Association's asset is the right to receive cash flows from the trust, not the assets of the trust themselves. Although the trust assets may be investments for which quoted prices in an active market are available, the Association does not control those investments.

The deferred compensation plan obligations are based on the fair market value of the deferred compensation plan investments, which are observable inputs; however, the liabilities are not publicly traded and are therefore considered Level 2 items.

At December 31, 2016, the Association had a pending purchase of a hedge fund investment for \$17,000,000 that is presented with cash on the balance sheet. This purchase was finalized subsequent to December 31, 2016.

For assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the Codification requires reconciliation of the beginning and ending balances separately for each major category of assets and liabilities, except for derivative assets and liabilities, which may be presented net. The table below represents the reconciliation of the Association's assets measured at fair value on a recurring basis using significant unobservable inputs:

	<u>Beneficial Interest in Perpetual Trust</u>
Beginning balance of assets, January 1, 2016	\$ 1,634,132
Change in value of beneficial interest in perpetual trust	40,255
Ending balance of assets, December 31, 2016	<u>\$ 1,674,387</u>

For fair value measurements categorized within Level 3 of the fair value hierarchy, the Association is required to provide quantitative information about significant unobservable inputs used in the fair value measurement. The following table provides the required information for the Association:

Type	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range
Beneficial interest in trust	\$ 1,674,387	Percentage of Assets Held by Custodian	Market Activity	5%

Investment income, net for the year ended December 31, 2016, consists of the following:

Interest and dividends	\$ 3,834,094
Unrealized and realized gain, net	12,160,737
Investment fees	(436,722)
	<u>\$ 15,558,109</u>

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 3. Fair Value Measurements (Continued)

The following presents further information regarding the composition of the partnerships and hedge funds at December 31, 2016:

Strategy Category	Fair Value	Redemption Frequency	Redemption Notice Period
Emerging markets (a)	\$ 18,969,321	See note (a) below	See note (a) below
Global equity – long-term growth (b)	12,079,799	See note (b) below	See note (b) below
International long-term growth – mid/large cap (c)	10,811,985	See note (c) below	See note (c) below
Global equity – small/micro cap (d)	7,267,424	See note (d) below	See note (d) below
International long-term growth – mid/small cap (e)	2,716,367	See note (e) below	See note (e) below
Distressed (f)	119,799	See note (f) below	See note (f) below
Multi-strategy (g)	105,126	See note (g) below	See note (g) below
	<u>\$ 52,069,821</u>		

Emerging markets: (a) This category includes a diversified portfolio of foreign commingled funds for the purpose of trading and investing in securities. This category employs a long-term strategy for all of its investments. 100% of the investments in this category are liquid as the capital contributed to the fund is redeemable on a monthly basis. Withdrawals can be made from the fund on the last day of each month. The participant must notify the investment manager at least 30 days before the prior month-end to make a withdrawal request.

Global equity – long-term growth: (b) This category includes a diversified portfolio of global equity investments with the primary goal of achieving long-term growth. 100% of the investments in this category are liquid as the capital contributed to the fund is redeemable on a monthly basis. Participants must notify the investment manager at least six business days before the month-end to make a withdrawal request. Withdrawal legal documents must be returned to the investment manager and the custodial trustee at least four business days before the month-end.

International long-term growth – mid/large cap: (c) This category includes a diversified portfolio of international equities to afford participants an opportunity to obtain long-term capital gains from a diversified portfolio of mid and large capitalization equity securities generally located in any country other than the United States. 100% of the investments in this category are liquid as the capital contributed to the fund is redeemable on a monthly basis. The participant must notify the investment manager in writing at least 30 days before the withdrawal date.

Global equity – small/micro cap: (d) This category includes a diversified portfolio of global equities with a strong bias towards small and micro cap companies. Investments include companies based in the U.S., developed foreign countries and emerging/frontier markets. 100% of the investments in this category are liquid as the capital contributed to the fund is redeemable on a monthly basis. Participants must notify the investment manager at least 30 business days before the month-end to make a withdrawal request.

International long-term growth – mid/small cap: (e) This category includes a diversified portfolio of international equities to afford participants an opportunity to obtain long-term capital gains and income from a diversified portfolio of mid and small capitalization equity securities generally located in any country other than the United States and Canada. 100% of the investments in this category are liquid as the capital contributed to the fund is redeemable on a monthly basis. The participant must notify the investment manager at least ten business days before the prior month-end to make a withdrawal request. Withdrawal legal documents must be returned to the investment manager and the custodial trustee at least four business days before the month-end.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 3. Fair Value Measurements (Continued)

Distressed: (f) This category includes investments made into distressed or stressed companies. The manager can invest in any instrument across a company's capital structure, including equity, debt, bank loans, dips (debtor in possession), convertible bonds and more. The companies can be in various stages of stress or distress, including bankruptcy and post-bankruptcy reorganization. 100% of the investments in this category are considered illiquid, as the capital contributed to the partnership is not redeemable for a period of ten years from the initial closing date of the fund, which was in March 2007. The Association expects to redeem the remaining funds during the year ending December 31, 2017.

Multi-strategy: (g) This category includes a combination of strategies. Managers have the flexibility to invest across all asset classes and to change their allocations to various strategies and instruments as they see fit. Instruments include equities, options, futures, bonds, loans, derivatives and others. In addition, the fund may pursue the value-oriented strategy through short-selling and investments in private or less liquid instruments.

The Association has no unfunded commitments to the funds described above.

Note 4. Furniture, Equipment and Leasehold Improvements

At December 31, 2016, furniture, equipment and leasehold improvements consist of the following:

Furniture and equipment	\$ 449,379
Leasehold improvements	338,180
	<u>787,559</u>
Less accumulated depreciation and amortization	759,365
	<u><u>\$ 28,194</u></u>

Depreciation and amortization expense for the year ended December 31, 2016, was \$26,225

Note 5. Scholarships

During the year ended December 31, 2016, the Association awarded \$14,465,340 of scholarships, with forfeitures of \$874,660. The scholarships are recorded as State Scholarship Program, National Scholars' Program and other scholarship programs expenses in the accompanying consolidated statement of activities. At December 31, 2016, \$22,857,647 of scholarships, net of the allowance and discount of \$1,441,072 and \$507,160, respectively, remained to be disbursed. The expected future payments on the awarded scholarships at December 31, 2016, are as follows:

Years ending December 31:	
2017	\$ 14,789,807
2018	6,516,892
2019	3,499,180
	<u><u>\$ 24,805,879</u></u>

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 6. Employee Benefit Plans

The Association has a tax deferred annuity plan available to all full-time employees. Participating employees may defer up to 50% of their gross salary, and after one year of employee service, the Association will match the amount of deferral up to 10%. The amount of the expense incurred under this plan was \$90,781 for the year ended December 31, 2016.

The Association maintains a deferred compensation plan. Assets and obligations under this plan at December 31, 2016, were \$2,089,029. For the year ended December 31, 2016, the Association contributed approximately \$500,000 to this plan.

Note 7. Temporarily Restricted Net Assets

Changes in temporarily restricted net assets during the year ended December 31, 2016, are as follows:

	December 31, 2015	Additions	Releases	December 31, 2016
Purpose restricted:				
Scholarships and other	\$ 4,562,370	\$ 9,997,291	\$ (6,212,934)	\$ 8,346,727
Horatio Alger Membership Programs and Induction Ceremonies	1,267,457	3,330,382	(1,267,457)	3,330,382
Capital campaign	-	5,794,331	(5,794,331)	-
Time restricted:				
Capital campaign	19,720,896	1,596,896	(5,766,356)	15,551,436
Giving clubs	2,268,931	1,769,252	(972,633)	3,065,550
	<u>\$ 27,819,654</u>	<u>\$ 22,488,152</u>	<u>\$ (20,013,711)</u>	<u>\$ 30,294,095</u>

Note 8. Board-Designated Endowment and Permanently Restricted Net Assets

The Association follows the Codification Subtopic, Reporting Endowment Funds. The Codification addresses accounting issues related to guidelines in the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA).

The Association has adopted investment and spending policies for permanently restricted cash contributions that attempt to provide a predictable stream of funding to programs while maintaining purchasing power. Permanently restricted net assets consist of three endowments held by the Association and a perpetual trust held by a third party. The balance as of December 31, 2016, was \$4,782,210. Annual investment income earned on the endowments held by the Association is to be used to fund scholarships in current and future years.

Distributions of income earned on the perpetual trust are to be used by the Association to fund scholarships or promote other Association goals.

The Association may utilize up to 5% and additional amounts as determined by the Board of Directors of the endowment fund cash and investment balance to underwrite educational programs and scholarship expenses. The previous end-of-year endowment fund balance shall be the basis for determining the allowable withdrawal, and this process shall be incorporated into the Association's annual budget presentation to the Board of Directors. If any of the funds are not needed by the end of the fiscal year, they will remain in the endowment.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 8. Board-Designated Endowment and Permanently Restricted Net Assets (Continued)

The Association considers all capital campaign contributions to be part of the Association's board-designated endowment. Capital campaign contributions received by the Association not fully collected when received, are temporarily restricted due to time and are included in the temporarily restricted portion of the donor-restricted endowment. When the Association collects the cash related to these contributions, and therefore satisfies the time restriction, the funds are released from the temporary restriction. At that time, the funds are included in the board-designated endowment. Capital campaign contributions collected in full when received are temporarily restricted for purpose. These contributions are included in the temporary restricted portion of the donor-restricted endowment and are released into in the board designated endowment. Temporarily restricted Capital Campaign contributions received during the year ended December 31, 2016, were \$7,391,227.

Transfers from temporarily restricted net assets relating to capital campaign contributions during the year ended December 31, 2016, were comprised of cash collections and write-offs totaling \$11,560,687.

The Association's endowment funds consist of the following at December 31, 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 15,551,436	\$ 4,782,210	\$ 20,333,646
Board-designated endowment funds	148,812,482	-	-	148,812,482
	<u>\$ 148,812,482</u>	<u>\$ 15,551,436</u>	<u>\$ 4,782,210</u>	<u>\$ 169,146,128</u>

For the year ended December 31, 2016, the Association had the following endowment-related activities:

	Board-Designated Endowment	Temporarily Restricted	Permanently Restricted	Total
Net assets, December 31, 2015	\$ 129,256,314	\$ 19,720,896	\$ 4,741,955	\$ 153,719,165
Contributions	-	7,391,227	-	7,391,227
Current year designations	486,663	-	-	486,663
Transfers from temporarily restricted and permanently restricted net assets	11,560,687	(11,560,687)	-	-
Net investment gain	15,020,617	-	-	15,020,617
Change in value of beneficial interest in perpetual trust	-	-	40,255	40,255
Appropriation of endowment assets for expenditure	(7,511,799)	-	-	(7,511,799)
Net assets, December 31, 2016	<u>\$ 148,812,482</u>	<u>\$ 15,551,436</u>	<u>\$ 4,782,210</u>	<u>\$ 169,146,128</u>

The board-designated and permanently restricted endowment assets are primarily comprised of the Association's investments, as detailed in Note 3, and a \$500,000 contribution receivable. The remaining board-designated endowment assets are comprised of money market funds, which are included in cash and cash equivalents in the accompanying consolidated statement of financial position. The ending balance of temporarily restricted endowment assets are comprised of outstanding Capital Campaign contributions at December 31, 2016.

Horatio Alger Association of Distinguished Americans, Inc. and Affiliate

Notes to Consolidated Financial Statements

Note 9. Leases

The Association has a lease for office and parking spaces that runs through April 2026. The lease is subject to annual escalations of 3%. Rent expense for the year ended December 31, 2016 was approximately \$240,000.

Future minimum lease payments for this operating lease at December 31, 2016, are due as follows:

Years ending December 31:	
2017	\$ 282,780
2018	291,250
2019	300,003
2020	304,478
2021	286,996
Thereafter	1,375,731
	<u>\$ 2,841,238</u>

Note 10. Related Party Transactions

The Association receives significant support in the form of contributions from Board members. During the year ended December 31, 2016, total gross support from Board members was \$20,841,693 and as of December 31, 2016, total gross contributions receivable from Board members was \$23,664,896.

Horatio Alger Association of Canada (HAA – Canada) is a charitable organization dedicated to the belief that hard work, honesty and determination can conquer all obstacles. The Board of Directors of HAA – Canada is comprised of six individuals, five of which are also on the Board of Directors of the Association. The Association has no financial interest in HAA – Canada and thus there is no consolidation. During the year ended December 31, 2016, the Association provided HAA – Canada approximately \$460,000 of contributions.

Note 11. Commitments

The Association has in place a signed employment agreement with its Executive Director, which includes a severance package to be paid if employment is terminated without cause. The employment agreement with the Executive Director of the Association also provides certain deferred compensation benefits.

The Association has entered into several agreements for meeting space through 2019. In the event of cancellation, the Association is required to pay various costs as stipulated in the contracts, the amounts of which are dependent upon the date of cancellation. This amount is not accrued in the accompanying consolidated financial statements, as management does not believe any losses will be incurred under these contracts.