

U. S. ENDOWMENT
FOR FORESTRY AND
COMMUNITIES, INC. AND SUBSIDIARY

Consolidated Financial Statements

December 31, 2012 and 2011

(with Independent Auditors'
Report thereon)

**U. S. ENDOWMENT FOR FORESTRY
AND COMMUNITIES, INC. AND SUBSIDIARY**

December 31, 2012 and 2011
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Independent Auditors' Report

The Board of Directors
U.S. Endowment for Forestry and Communities, Inc. and Subsidiary
Greenville, South Carolina

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of U.S. Endowment for Forestry and Communities, Inc. and Subsidiary (the "Endowment") which comprise the consolidated statements of financial position as of December 31, 2012 and 2011, and the related consolidated statement of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Endowment, as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
U.S. Endowment for Forestry and Communities, Inc. and Subsidiary
Page Two

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidated schedules of functional expenses is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audit of States, Local Governments and Non-Profit Organizations*, and is not a required part of the consolidated financial statements.

The consolidated schedules of functional expenses and schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, consolidated schedules of functional expenses and schedule of expenditures of federal awards are fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2013 on our consideration of the Endowment's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Endowment's internal control over financial reporting and compliance.

September 27, 2013

Dixon Hughes Goodman LLP

U. S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
Consolidated Statements of Financial Position
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>Assets</u>		
Cash and cash equivalents	\$ 1,872,505	\$ 1,540,737
Grants receivable	565,131	342,954
Other receivables	48,893	35,327
Due from investment broker	8,632,843	2,000,000
Prepaid expenses	10,976	13,961
Notes receivable, net of allowance for doubtful accounts of approximately \$541,000 and \$402,000	449,583	2,214,250
Investments	177,547,761	173,738,902
Investment in North Star Jefferson, LLC	-	138,066
Financing costs	353,800	-
Property and equipment, net	<u>2,067,600</u>	<u>452,442</u>
 Total assets	 <u>\$ 191,549,092</u>	 <u>\$ 180,476,639</u>
<u>Liabilities and Net Assets</u>		
Accounts payable and other accruals	\$ 1,623,017	\$ 1,166,332
Deferred revenue	535,410	1,169,794
Notes payable	<u>318,688</u>	<u>337,085</u>
Total liabilities	2,477,115	2,673,211
Net assets:		
Unrestricted		
Unrestricted	(11,264,458)	(22,260,077)
Temporarily restricted	336,435	63,505
Permanently restricted	<u>200,000,000</u>	<u>200,000,000</u>
Total net assets	<u>189,071,977</u>	<u>177,803,428</u>
 Total liabilities and net assets	 <u>\$ 191,549,092</u>	 <u>\$ 180,476,639</u>

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

U. S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY

Consolidated Statements of Activities

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted support, revenues and gains (losses):		
Interest and dividend income, net of investment fees	\$ 2,008,944	\$ 2,749,485
Net realized and unrealized gains (losses) on investments	14,957,582	(13,284,804)
Equity interest in loss of North Star Jefferson, LLC	-	(90,002)
Federal support	1,800,815	2,806,286
Non-federal support	79,944	209,960
Net assets released from restrictions	68,488	266,422
Total support, revenues and gains (losses)	<u>18,915,773</u>	<u>(7,342,653)</u>
Expenses:		
Program	7,309,524	5,902,905
Management and general	610,630	438,755
Total expenses	<u>7,920,154</u>	<u>6,341,660</u>
Increase (decrease) in unrestricted net assets	<u>10,995,619</u>	<u>(13,684,313)</u>
Temporarily restricted support and revenue:		
Non-federal support	341,418	120,000
Releases from restriction	(68,488)	(266,422)
Increase (decrease) in temporarily restricted net assets	<u>272,930</u>	<u>(146,422)</u>
Total increase (decrease) in net assets	11,268,549	(13,830,735)
Net assets at beginning of year	<u>177,803,428</u>	<u>191,634,163</u>
Net assets at end of year	\$ <u>189,071,977</u>	\$ <u>177,803,428</u>

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

U. S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 11,268,549	\$ (13,830,735)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Net realized and unrealized (gains) losses on investments	(14,957,582)	13,284,804
Equity interest in loss of North Star Jefferson, LLC	-	90,002
Depreciation	16,205	9,453
Net changes in operating assets and liabilities:		
Grants receivables	(222,177)	259,697
Other receivable	(13,566)	(23,876)
Notes receivable	1,764,667	(1,568,750)
Due from investment broker	(6,632,843)	743,662
Prepaid expenses	2,985	(5,357)
Accounts payable and other accruals	456,685	432,864
Deferred revenue	(634,384)	221,547
Net cash used in operating activities	<u>(8,951,461)</u>	<u>(386,689)</u>
Cash flows from investing activities:		
Sales of investments	122,587,467	143,488,255
Purchases of investments	(111,438,744)	(142,214,844)
Investment in North Star Jefferson, LLC	138,066	(228,068)
Purchases of property and equipment	<u>(1,631,363)</u>	<u>(263,033)</u>
Net cash provided by investing activities	<u>9,655,426</u>	<u>782,310</u>
Cash flows from financing activities:		
Repayments of note payable	(18,397)	-
Proceeds from note payable	-	337,085
Financing costs	<u>(353,800)</u>	<u>-</u>
Net cash (used in) provided by financing activities	<u>(372,197)</u>	<u>337,085</u>
Net increase in cash	331,768	732,706
Cash and cash equivalents at beginning of year	<u>1,540,737</u>	<u>808,031</u>
Cash and cash equivalents at end of year	\$ <u><u>1,872,505</u></u>	\$ <u><u>1,540,737</u></u>

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

**U.S. ENDOWMENT FOR FORESTRY AND
COMMUNITIES, INC. AND SUBSIDIARY**

Notes to the Consolidated Financial Statements
December 31, 2012 and 2011

1. **Summary of Significant Accounting Policies**

Organization - The U.S. Endowment for Forestry and Communities, Inc. (the “Endowment”) is a not-for-profit organization incorporated and established in 2006 at the request of the governments of the United States and Canada in accordance with the terms of the Softwood Lumber Agreement (“SLA”) between the two countries. The Endowment is one of three entities designated to share in a one-time infusion of funds to support “meritorious initiatives” in the United States. It was endowed with \$200 million under the terms of the SLA. The Endowment has been chartered with two purposes: 1) educational and charitable causes in timber-reliant communities; and 2) educational and public-interest projects addressing forest management issues that affect timber-reliant communities, or the sustainability of forests as sources of building materials, wildlife habitat, bio-energy, recreation and other values.

During 2011, the Endowment formed a wholly owned subsidiary, Community Wealth Through Forestry, Inc (“CWF”). The purpose of CWF is to support sustainable green energy development that captures and distributes benefits to rural forest-reliant communities. CWF became operational in November 2011 and its activity has been consolidated in the financial statements for the year ended December 31, 2012. As of December 31, 2012, CWF owned 75% of the outstanding member units in North Star Jefferson, LLC, a limited liability company. The activity of the limited liability company has been consolidated in the financial statements for the year ended December 31, 2012 (See Note 4).

Principles of Consolidation - The consolidated financial statements include the accounts of the Endowment and the Subsidiary. All material intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates could also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents - For the purpose of the consolidated statements of cash flows, the Endowment considers unrestricted highly liquid investments with a remaining maturity of three months or less when purchased to be cash equivalents.

At times throughout the year, the Endowment may temporarily maintain cash balances at financial institutions in excess of FDIC insured limits. Management attempts to minimize this exposure by minimizing un-invested cash balances and monitoring the strength of the financial institutions with which it has accounts.

Grants Receivable - Grants receivable consist of unsecured balances due from grantor agencies for reimbursement of allowable grant expenditures and do not bear interest.

Notes Receivable - The Endowment's notes receivable are due primarily from for-profit organizations that are working on various projects related to the Endowment's purpose and are recorded at estimated net realizable value. Credit is extended to the for-profit organizations and collateral is not required. Notes are due between fiscal years of 2013 to 2016, and accrued interest is deferred for the first three years of the note and then due semi-annually. Interest rates on the notes are 3% per annum simple interest. Management reviews the receivables periodically and provides an allowance for uncollectible accounts at a level which, in management's judgment, is adequate to absorb potential losses inherent in uncollectible notes receivables.

Investments - The Endowment's investments are recorded at fair value.

The Endowment has estimated the fair value of certain investments in investment companies for which the investment does not have a readily determinable fair value using the investment's net asset value per share or its equivalent, such as partners' capital per share, without adjustment. The total fair value of these investments estimated based on the investment's net asset value per share is \$173,672,525 and \$169,936,298 at December 31, 2012 and 2011, respectively. Also included in investments are money market funds valued at \$3,875,236 and \$3,802,604 at December 31, 2012 and 2011.

Investments in common trust or commingled funds valued at \$144,435,855 and \$120,871,119 at December 31, 2012 and 2011, respectively, do not have quoted market prices. The fair value of such investments is based upon the net asset value of the respective funds, which are based upon the estimated fair values of the underlying investments. The fair values of the underlying investments are based upon quoted market prices, where applicable, or upon estimated fair values determined by the respective fund managers and are subject to review by the Endowment and independent annual financial statement audits.

The consolidated financial statements also include investments in hedge funds, venture capital funds, international and domestic private equity funds, distressed debt funds and real estate funds valued at \$29,236,670 and \$49,065,179 at December 31, 2012 and 2011, respectively. The fair values of these funds have been estimated by management at net asset value (or its equivalent) in the absence of readily determinable fair values. The recorded market price for such investments is estimated by the individual investment manager of the funds taking into account such factors as the financial condition of each investee, economic and market conditions affecting their operations, any changes in management, the length of time since the initial investment, recent arm's-length transactions involving the securities of the investee, the value of similar securities issued by companies in the same or similar

businesses, and limited marketability of the portfolio. The fair value in such investments is subject to review by the Endowment and independent annual financial statement audits.

Investment securities are exposed to several risks, such as changes in interest rates, market fluctuations, and credit risks. Due to the risks associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the Endowment's consolidated financial statements.

Due from Investment Broker - Amounts due from investment broker consists of funds that were not settled as a result of investment sales at December 31; these funds were awaiting transfer to the Endowment's investment money market account.

Property and Equipment - Property and equipment are reported at cost, if purchased, or fair value at the date of donation. The Endowment's policy is to capitalize property and equipment with value greater than \$2,500. Depreciation is computed on a straight-line basis over the estimated useful life of the assets. Depreciation expense was \$16,205 and \$9,453 for the years ended December 31, 2012 and 2011, respectively.

Deferred Revenue - Certain grants received by the Endowment and paid in advance are deferred until the sub-recipient of the grant submits a reimbursement request which includes documentation of actual expenditures incurred under the grant.

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

Unrestricted - Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets may be designated for specific purposes by the Endowment or may otherwise be limited by contractual agreements with outside parties.

Temporarily Restricted - Net assets whose use by the Endowment is subject to donor-imposed stipulations that can be fulfilled by actions of the Endowment pursuant to those stipulations or that expire by the passage of time.

Permanently Restricted - Net assets subject to donor-imposed stipulations that they be maintained in perpetuity by the Endowment.

Restricted and Unrestricted Revenue and Support - Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted

net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Consolidated Statement of Activities as net assets released from restrictions.

In-Kind Contributions - The Endowment records in-kind contributions at their fair value at the date of the contribution.

Functional Expenses - The cost of providing various programs and supporting services has been reported on a functional basis in the statements of activities. Accordingly, certain costs have been allocated to the program initiatives and supporting services based on estimates made by management.

Fair Value of Financial Instruments - The fair value of the financial instruments of the Endowment are set forth as follows:

Cash and cash equivalents, receivables, due from broker, prepaid expenses, accounts payable, other accruals and notes payable - The carrying amounts approximate fair value due to the immediate or short-term maturity of these instruments.

Notes receivable - Notes receivable are recorded at carrying amount of approximately \$450,000 and \$2,214,000 for the years ended December 31, 2012 and 2011. The fair value of notes receivable is estimated to be approximately \$367,000 and \$1,900,000 for the years ended December 31, 2012 and 2011. The fair value was estimated using discounted cash flow analyses, using interest rates for corporate bonds with similar maturities for borrowers of similar credit quality.

Investments - Investments are carried at fair value as determined by quoted market prices or other available information (Note 3).

Income Taxes - The Endowment has obtained nonprofit status under Internal Revenue Code Section 501(c)(3), and as such, is exempt from income taxes except on unrelated business income. Accordingly, the accompanying financial statements do not reflect a provision or liability for Federal and state income taxes. The Endowment has determined that there are no material unrecognized tax benefits or obligations as of December 31, 2012. Fiscal years ending on or after December 31, 2009 remain subject to examination by federal and state tax authorities.

Community Wealth through Forestry, Inc. is classified as a C Corporation under the Internal Revenue Code. CWF reported a net loss for the year ended December 31, 2012, therefore there was no tax expense. Accordingly, no provision has been made for federal or state income taxes.

Reclassifications – Certain reclassifications have been made to the 2011 consolidated financial statements to conform to the 2012 consolidated financial statement presentation. The reclassification was between expense categories and had no impact on the 2011 decrease in net assets reported of the statement of activities.

2. **Investments**

The estimated fair values of investments at December 31 follows:

	<u>2012</u>	<u>2011</u>
Money market funds	\$ 3,875,236	\$ 3,802,604
Equity funds	98,079,995	73,614,230
Fixed income funds	31,037,137	30,992,760
Real asset funds	7,967,124	11,183,207
Natural resource stock index fund	7,351,599	5,080,922
Hedge funds	19,439,650	40,190,206
Real estate partnership	1,117,042	1,587,245
Private equity partnerships	3,764,297	3,020,395
Venture capital partnership	2,627,740	2,280,221
Distressed debt partnership	2,287,941	1,987,112
Total investments	<u>\$ 177,547,761</u>	<u>\$ 173,738,902</u>

The investments detailed above represent all investments held by the investment manager at December 31, 2012 and do not include programmatic investments.

Interest and dividend income is reported net of custodial and investment management fees approximating \$190,000 and \$194,000 for the years ended December 31, 2012 and 2011, respectively.

3. **Fair Value of Measurements**

Accounting standards establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Endowment has the ability to access.

Level 2 – Inputs to the valuation methodology include

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. All assets reported at fair value have been valued using a market approach, except for Level 3 assets.

For level 3 assets, the Endowment's management's consulting with its investment committee and a third-party investment advisory firm, determines the fair value measurement valuation policies and procedures. At least annually, management and the investment committee determines if the current valuation techniques used in the fair value measurements are still appropriate and evaluates and adjusts unobservable inputs used in the fair value measurements based on current market conditions and third-party information. There were no changes in the valuations techniques during 2012.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Endowment believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables sets forth by level within the fair value hierarchy the Endowment's assets accounted for at fair value on a recurring basis as of December 31, 2012 and 2011:

	Fair value at December 31, 2012	Fair value measurements at December 31, 2012 using:		
		Quoted prices in active markets for identical assets and liabilities (Level 1 inputs)	Quoted prices for similar assets and liabilities (Level 2 inputs)	Significant unobservable inputs (Level 3 inputs)
<u>Assets measured at fair value:</u>				
Money market funds	\$ 3,875,236	\$ 3,875,236	\$ -	\$ -
Equity funds:				
Global	75,245,565	-	75,245,565	-
S&P 500 index	12,601,488	-	12,601,488	-
SSG equity	10,232,942	-	10,232,942	-
Total equity funds	98,079,995	-	98,079,995	-
Fixed income funds:				
High quality bond	20,051,449	-	20,051,449	-
Real return bond	5,617,746	-	5,617,746	-
Global bond	5,367,942	-	5,367,942	-
Total fixed income funds	31,037,137	-	31,037,137	-
Real asset funds:				
Multi-strategy commodities	7,967,124	-	7,967,124	-
Natural resource stock index	7,351,599	-	7,351,599	-
Hedge funds:				
Relative value and event driven	12,327,926	-	-	12,327,926
Diversified	7,111,724	-	-	7,111,724
Total hedge funds	19,439,650	-	-	19,439,650
Realty investors partnership	1,117,042	-	-	1,117,042
Private equity partnerships	3,764,297	-	-	3,764,297
Venture capital partnership	2,627,740	-	-	2,627,740
Distressed equity partnership	2,287,941	-	-	2,287,941
Totals	\$177,547,761	\$ 3,875,236	\$144,435,855	\$ 29,236,670

	Fair value at December 31, 2011	Fair value measurements at December 31, 2011 using:		
		Quoted prices in active markets for identical assets and liabilities (Level 1 inputs)	Quoted prices for similar assets and liabilities (Level 2 inputs)	Significant unobservable inputs (Level 3 inputs)
<u>Assets measured at fair value:</u>				
Money market funds	\$ 3,802,604	\$ 3,802,604	\$ -	\$ -
Equity funds:				
Emerging markets	18,768,255	-	18,768,255	-
Multi-strategy	11,983,056	-	11,983,056	-
International	11,435,943	-	11,435,943	-
All-Cap	9,354,874	-	9,354,874	-
SSG equity	9,991,749	-	9,991,749	-
Core equity	12,080,353	-	12,080,353	-
Total equity funds	<u>73,614,230</u>	<u>-</u>	<u>73,614,230</u>	<u>-</u>
Fixed income funds:				
High quality bond	20,178,414	-	20,178,414	-
Real return bond	5,970,031	-	5,970,031	-
Global bond	4,844,315	-	4,844,315	-
Total fixed income funds	<u>30,992,760</u>	<u>-</u>	<u>30,992,760</u>	<u>-</u>
Real asset funds:				
Multi-strategy commodities	11,183,207	-	11,183,207	-
Natural resource stock index	5,080,922	-	5,080,922	-
Hedge funds:				
Global hedged	7,942,453	-	-	7,942,453
Relative value and event driven	21,054,894	-	-	21,054,894
Diversified	11,192,859	-	-	11,192,859
Total hedge funds	<u>40,190,206</u>	<u>-</u>	<u>-</u>	<u>40,190,206</u>
Realty investors partnership	1,587,245	-	-	1,587,245
Private equity partnerships	3,020,395	-	-	3,020,395
Venture capital partnership	2,280,221	-	-	2,280,221
Distressed equity partnership	1,987,112	-	-	1,987,112
Totals	<u>\$173,738,902</u>	<u>\$ 3,802,604</u>	<u>\$120,871,119</u>	<u>\$ 49,065,179</u>

**U.S. ENDOWMENT FOR FORESTRY
AND COMMUNITIES, INC. AND SUBSIDIARY**

Notes to Financial Statements, continued

The following table illustrates the activity of Level 3 assets measures at fair value on a recurring basis from December 31, 2011 to December 31, 2012:

	Fair Value Measurements Using Unobservable Inputs (Level 3)							
	Global Hedged	Relative Value and Event Driven	Diversified	Realty Investors Partnership	Private Equity Partnerships	Venture Capital Partnership	Distressed Debt Partnership	Total
Beginning balance, December 31, 2011	\$ 7,942,453	\$ 21,054,894	\$ 11,192,859	\$ 1,587,245	\$ 3,020,395	\$ 2,280,221	\$ 1,987,112	\$ 49,065,179
Total gains or losses included in changes in net assets:								
Unrealized gains (losses)	759,506	1,424,713	(101,703)	7,845,832	173,333	62,366	215,634	10,379,681
Realized gains (losses)	(206,942)	481,162	20,568	(7,514,017)	228,722	(10,179)	26,595	(6,974,091)
Purchases, issuances/subscriptions, and sales:								
Purchases	-	-	-	-	-	-	-	-
Issuances/subscriptions	-	-	-	-	1,047,500	405,000	58,600	1,511,100
Sales/distributions	(8,495,017)	(10,632,843)	(4,000,000)	(802,018)	(705,653)	(109,668)	-	(24,745,199)
Ending balance, December 31, 2012	<u>\$ -</u>	<u>\$ 12,327,926</u>	<u>\$ 7,111,724</u>	<u>\$ 1,117,042</u>	<u>\$ 3,764,297</u>	<u>\$ 2,627,740</u>	<u>\$ 2,287,941</u>	<u>\$ 29,236,670</u>

The following table illustrates the activity of Level 3 assets measures at fair value on a recurring basis from December 31, 2010 to December 31, 2011:

	Fair Value Measurements Using Unobservable Inputs (Level 3)							
	Global Hedged	Relative Value and Event Driven	Diversified	Realty Investors Partnership	Private Equity Partnerships	Venture Capital Partnership	Distressed Debt Partnership	Total
Beginning balance, December 31, 2010	\$ 16,889,689	\$ 12,877,347	\$ 2,891,204	\$ 127,986	\$ 2,141,951	\$ 1,393,746	\$ 1,761,580	\$ 38,083,503
Total gains or losses included in changes in net assets:								
Unrealized gains (losses)	(1,130,409)	(1,787,036)	(468,913)	2,517,292	29,047	274,795	(24,133)	(589,357)
Realized gains (losses)	183,174	(535,417)	(229,431)	(1,058,033)	124,397	11,680	13,465	(1,490,165)
Purchases, issuances/subscriptions, and sales:								
Purchases	1,334,584	25,535,830	11,165,930	-	-	-	-	38,036,344
Issuances/subscriptions	-	-	-	-	725,000	622,500	236,200	1,583,700
Sales	(9,334,585)	(15,035,830)	(2,165,931)	-	-	(22,500)	-	(26,558,846)
Ending balance, December 31, 2011	<u>\$ 7,942,453</u>	<u>\$ 21,054,894</u>	<u>\$ 11,192,859</u>	<u>\$ 1,587,245</u>	<u>\$ 3,020,395</u>	<u>\$ 2,280,221</u>	<u>\$ 1,987,112</u>	<u>\$ 49,065,179</u>

Total net losses for level 3 assets for the periods above are included in net realized and unrealized gains (losses) on investments in the statement of activities. There were no transfers in or out of Level 3 for the years ended December 31, 2012 and 2011.

The Endowment has investments in various common and collective equity funds of \$98,079,995 and \$73,614,230 at December 31, 2012 and 2011. Interests in these funds are generally redeemable on a monthly basis with 5 to 30 business days' notice and include various U.S domestic large, mid and small cap securities and international equity securities including equity securities of companies located in the less developed countries of the world.

The Endowment has investments in various common and collective fixed income funds of \$31,037,137 and \$30,992,760 at December 31, 2012 and 2011, respectively. Interests in these funds are generally redeemable on a monthly basis with 5 to 30 business days' notice and include various fixed income investments in the sovereign bonds and other fixed income securities in the U.S and worldwide in an attempt to outperform both the broad U.S. bond market and the broad worldwide bond market. These funds also invest in investment grade inflation-indexed securities, including U.S. Treasury inflation indexed securities and no-U.S. dollar denominated inflation-indexed securities.

The Endowment has an investment in a common and collective real asset fund of \$7,967,124 and \$11,183,207 at December 31, 2012 and 2011, respectively. Interests in this fund is generally redeemable on a monthly basis with 5 to 30 days business notice and include various assets across a broad spectrum of commodity-oriented asset categories pursuing a multi-strategy approach to investing in the commodities markets, which include futures, options on futures and forward contracts on exchange traded agricultural goods, metals, minerals, energy products and foreign currencies.

The Endowment has an investment in a common and collective natural resource fund of \$7,351,599 and 45,080,922 at December 31, 2012 and 2011, respectively. Interest in this fund is generally redeemable on a daily basis. The investment objective of the fund is to approximate the performance of the MSCI World Resource Industry: Paper & Forest Products, Metals & Mining, Oil & Gas, and Energy & Equipment.

The Endowment has investments in directional and relative value hedge funds of \$19,439,650 and \$40,190,206 at December 31, 2012 and 2011, respectively. The Endowment may redeem its interests in the funds on a quarterly (\$11,192,859 and \$19,135,313 at December 31, 2012 and 2011, respectively), or annual basis (\$12,327,926 and \$21,054,893 at December 31, 2012 and 2011, respectively) with generally 65-95 days' notice. The funds pursue multiple strategies to diversify risks and reduce volatility while seeking to deliver positive returns regardless of the direction of the broader market.

The Endowment has an investment in a real estate fund of \$1,117,042 and \$1,587,245 at December 31, 2012 and 2011, respectively. The fund is generally ineligible for redemption except the Endowment may elect during September of each year to have the fund redeem up to 20% of the units owned for at least 5 years, provided the fund has not commenced a general liquidation. September 2013 would be the first year the Endowment would be

eligible to be issued any redemption. Redemptions are paid prior to the end of the subsequent calendar year and at the net asset value determined at the date of the redemption period. The Endowment committed total funds of \$16,000,000 and has no unfunded commitments to this fund as of December 31, 2012. The real estate fund generally invests in a variety of real estate assets in the U.S.

The Endowment has investments in international and domestic private equity partnerships of \$3,764,297 and \$3,020,395 at December 31, 2012 and 2011, respectively. The Endowment has committed a total of \$6,000,000 and has unfunded commitments of \$2,160,000 as of December 31, 2012. These funds are ineligible for redemption and the typical life of the partnerships is 12 years from the date of formation but can be extended under certain circumstances. These partnerships generally seek to generate higher returns over the long-term than those generally available on the foreign and domestic securities exchanges through investments in a diversified portfolio of international and domestic private capital funds.

The Endowment has an investment in a venture capital partnership of \$2,627,740 and \$2,280,221 at December 31, 2012 and 2011, respectively. The Endowment has committed a total of \$3,000,000 and has unfunded commitments of \$705,000 as of December 31, 2012. These funds are ineligible for redemption and the typical life of the partnership is 12 years from the date of formation but can be extended under certain circumstances. This partnership seeks to earn returns above those on publically traded stocks by investing in early stage, high growth private companies, principally in the information technology and life sciences/healthcare fields.

The Endowment has an investment in a distressed debt partnership of \$2,287,941 and \$1,987,112 at December 31, 2012 and 2011, respectively. The Endowment has committed a total of \$2,000,000 and has unfunded commitments of \$367,800 as of December 31, 2012. The Endowment may redeem certain portions of its investment on each December 31, provided the fund has not commenced a general liquidation; however, interests in the fund with respect to longer-term investments as defined by the offering memorandum, are not redeemable by the Endowment until the corresponding longer-term investments are realized. The partnership seeks to pursue an investment program comprised of performing restructured debt, stressed debt, distressed debt and mezzanine debt investments that seeks to provide a net internal rate of return in the mid-teens.

4. **Business Combination**

During 2011, CWF entered into an operating agreement with North Star Renewable Power, LLC (“NSRP”) to form a limited liability company, North Star Jefferson, LLC (“NSJ”). The purpose of NSJ is to develop, construct, finance and operate a biomass fired renewable energy power plant in Jefferson County, Georgia. CWF acquired 31% of the outstanding member units of NSJ. NSRP acquired 69% of the outstanding member units for services performed as the project developer and a capital contribution of \$100. In 2011, this investment was accounted for utilizing the equity method. Total capital contributions of \$228,068 were made by CWF and CWF’s portion of the net loss recognized by the limited liability company was \$(90,002) for the year ended December

31, 2011. In addition, during 2011, the Endowment provided a loan to NSJ of \$1,500,000 to fund development costs.

On January 13, 2012, CWF acquired a controlling interest in NSJ and as of December 31, 2012, CWF has acquired 75% of the outstanding member units of NSJ through additional capital contributions. Therefore, for 2012 the operations of NSJ are consolidated with CWF. The operations of NSJ are still in the start-up phase and the payments to date include development fees to NSRP, design fees, attorney fees, bond financing fees and down payments on equipment. At the date CWF acquired a controlling interest, the fair values of the controlling and non-controlling interests were determined to be negligible. There was no resulting goodwill recorded from this acquisition of NSJ. The assets acquired and the liabilities assumed at the acquisition date and consolidated into CWF were approximately \$1,600,000 and \$141,000, respectively. As of December 31, 2012, the assets of NSJ which were consolidated into CWF are approximately \$1,000 in cash, \$354,000 in capitalized bond financing costs and \$1,631,000 in capitalized project costs. Liabilities consolidated into CWF are approximately \$80,000. Operating costs expensed on the consolidated statement of activities and included in the decrease in consolidated net assets for the year ended December 31, 2012 are approximately \$1,250,000. Management assessed impairment of the assets of NSJ as of 12/31/12 and determined that no impairment existed. However, the future viability of the project is dependent upon securing financing and beginning construction by 12/31/13.

On July 1, 2013, CWF assumed management control and CWF and NSJ initiated a civil action in the state of Georgia against NSRP. The suit claims that NSRP made misrepresentations to CWF and mismanaged the project from inception. Additionally, there is a dispute over ownership percentages. CWF is seeking to gain management control of NSJ plus repayment of certain expenditures paid to NSRP and other entities. Likewise, NSRP has filed a countersuit against CWF and NSJ. These actions are in the preliminary stages and the discovery process is ongoing and, therefore, it is too early to predict the outcome of these actions. In a preliminary hearing on September 20, 2013, CWF's ownership interest was confirmed and CWF was determined to be the managing member.

5. **Property and Equipment**

Property and equipment at December 31, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Land	\$ 137,794	\$ 137,794
Building	324,101	324,101
Total property and equipment	<u>461,895</u>	<u>461,895</u>
Less: accumulated depreciation	<u>(25,658)</u>	<u>(9,453)</u>
	436,237	452,442
Construction in progress	<u>1,631,363</u>	<u>-</u>
	<u><u>\$ 2,067,600</u></u>	<u><u>\$ 452,442</u></u>

6. **Note Payable**

Note payable to a bank with six interest only payments through October 2011; then thirty monthly payments of \$2,361 including principle and interest at prime minus .26%. The bank's prime rate at December 31, 2011 is 3.25%. The note matures in March 2014. The note is collateralized by the building.

Total long-term debt

	<u>2012</u>	<u>2011</u>
	<u>\$ 318,688</u>	<u>\$ 337,085</u>
Total long-term debt	<u><u>\$ 318,688</u></u>	<u><u>\$ 337,085</u></u>

The aggregate annual maturities of long-term debt for the years subsequent to December 31, 2012 follow:

2013	\$ 19,067
2014	<u>299,621</u>
	<u><u>\$ 318,688</u></u>

7. **Employee Benefit Plan**

The Endowment sponsors a Simplified Pension Plan whereby deposits in an amount equal to 11% of each full-time employee's gross pay is deposited into a self-directed individual retirement account. Employees are eligible to participate in the plan from the first day of employment and are fully vested in all funds deposited into their accounts. The Endowment's contribution totaled approximately \$78,000 and \$76,000 for the years ended December 31, 2012 and 2011, respectively.

8. **Net Assets**

Temporarily restricted net assets are restricted for the following purposes at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Forest Health Initiative Phase II	\$ 50,000	\$ -
Forest Investment Zones	35,668	-
Hardwood check-off	2,500	45,488
Mississippi River Trust Project	167,750	-
National Conservation Easement Database Phase II	50,000	-
Paper & Pack check-off	12,500	-
Water from Forest Convening	18,017	18,017
	<u>\$ 336,435</u>	<u>\$ 63,505</u>

Permanently restricted net assets consists of a \$200,000,000 endowment received as a result of the SLA to be invested in perpetuity with the investments gains and investment earnings to be used for the Endowment's set purpose as described in Note 1. As of December 31, 2012 as a result of recent market declines, the fair value of Endowment assets was less than the Endowment corpus by \$13,819,422, which has been absorbed by unrestricted net assets.

9. **Endowment Funds**

The Endowment was organized to support educational and charitable causes in timber-reliant communities and educational and public interest projects addressing forest management issues that affect timber-reliant communities, or the sustainability of forests as sources of building materials, wildlife habitat, bio-energy, recreation, and other values. The Endowment's funds include donor-restricted endowment funds classified as permanently restricted.

The investment objectives of the donor-restricted endowment funds have been established in conjunction with a comprehensive review of the current and projected financial requirements. The investment objectives are:

- To achieve a favorable long term, real rate of return primarily through capital appreciation.
- To preserve principal through reasonable efforts, but preservation of principal shall not be imposed as a requirement on each individual investment.
- To produce current income, but only as a secondary consideration.
- To reduce risk by diversifying among markets, managers and time frames.

Interpretation of Relevant Law - The Board of Directors of the Endowment has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The Endowment follows the laws of UPMIFA in Delaware, the incorporation state, and South Carolina, the state in which the Endowment is headquartered. The Endowment has classified as permanently restricted net assets (a) the original value of gifts donated to the permanent

endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the required accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets, if positive, until those amounts are appropriated for expenditure by the Endowment in a manner consistent with the standard of prudence prescribed by UPMIFA.

Donor-restricted endowment net asset composition by type of fund as of December 31, 2012 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	<u>\$ (13,819,422)</u>	<u>\$ -</u>	<u>\$ 200,000,000</u>	<u>\$ 186,180,578</u>

Changes in donor-restricted endowment net asset 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, December 31, 2011	\$ (24,261,098)	\$ -	\$ 200,000,000	\$ 175,738,902
Investment return:				
Investment income, net	1,986,795	-	-	1,986,795
Net unrealized and realized investment gains	<u>14,957,582</u>	<u>-</u>	<u>-</u>	<u>14,957,582</u>
Total investment return	<u>16,944,377</u>	<u>-</u>	<u>-</u>	<u>16,944,377</u>
Appropriation of assets for expenditures	<u>(6,502,701)</u>	<u>-</u>	<u>-</u>	<u>(6,502,701)</u>
Endowment net assets, December 31, 2012	<u>\$ (13,819,422)</u>	<u>\$ -</u>	<u>\$ 200,000,000</u>	<u>\$ 186,180,578</u>

Donor-restricted endowment net asset composition by type of fund as of December 31, 2011 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	<u>\$(24,261,098)</u>	<u>\$ -</u>	<u>\$ 200,000,000</u>	<u>\$ 175,738,902</u>

Changes in donor-restricted endowment net asset 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, December 31, 2010	\$ (8,959,221)	\$ -	\$ 200,000,000	\$ 191,040,779
Investment return:				
Investment income, net	2,749,485	-	-	2,749,485
Net unrealized and realized investment losses	(13,284,804)	-	-	(13,284,804)
Total investment return	(10,535,319)	-	-	(10,535,319)
Appropriation of assets for expenditures	(4,766,558)	-	-	(4,766,558)
Endowment net assets, December 31, 2011	<u>\$ (24,261,098)</u>	<u>\$ -</u>	<u>\$ 200,000,000</u>	<u>\$ 175,738,902</u>

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Endowment to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were \$13,819,422 and \$24,261,098 as of December 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations.

Return Objectives and Risk Parameters

The Endowment has adopted investment and spending policies for endowment assets that are intended to provide an ongoing stream of funding of the Endowment's set mission. Endowment assets include those assets of donor-restricted funds that the Endowment must hold in perpetuity. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce a high level of total investment return consistent with a prudent level of portfolio risk.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Endowment relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Endowment targets a diversified asset allocation that places a greater emphasis on equity and fixed income-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Endowment's Board of Directors seeks to address twin objectives of deploying resources to achieve its mission and operating as prudent fiduciaries. The Endowment's long-range target is to distribute grants of up to 5% of the investment corpus annually, with the understanding that the distributions plus inflation (at an assumed rate of 2.5%), modest real growth (1%), and the costs of non-programmatic operating expenses (0.375%) will not

exceed total return from investment over rolling 5-year periods. This target assumes an 8.875% average annual rate of return which is a rate within the range of historic market returns. Recognizing that, from time to time, the realities of unfavorable market fluctuations could cause the fair value of its assets to decline below the level that the Endowment is required to retain, in May 2008, the Board amended its policy to address the event of “underwater” conditions. The amended policy provided for the spending of not more than 2.5% of corpus in the event of a decline below the \$200 million corpus, and further called for the Board to revisit the policy in the face of “exceptional downturns”, defined as declines in the fair value of assets to below \$190 million. To offer some level of stability to its emerging mission / programmatic investment during a period of radical declines in the fair market value of its assets, the Board voted to spend an average of \$5 million per year over the three-year period from 2009 – 2011. The Board believed that this interim policy was prudent and supportive of both the Endowment’s mission and fiduciary obligations.

10. **Commitments**

The Endowment makes multi-year commitments to fund specific research and public interest projects with other nonprofit organizations and universities. Committed funds totaled approximately \$5,388,356 at December 31, 2012. These contracts are committed for varying dates through 2015.

11. **Contingencies**

From time to time, the Endowment is a defendant in legal actions involving claims arising in the normal course of business. Management believes that, as a result of legal defenses, none of these activities should have a material adverse effect on its consolidated financial condition. However, the ultimate outcome of these matters cannot be estimated at the present time.

12. **Subsequent Events**

The Endowment evaluated the effect subsequent events would have on the financial statements through September 27, 2013, which is the date the financial statements were available to be issued.

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY

Consolidated Schedules of Functional Expenses
For the Years Ended December 31, 2012 and 2011

	2012			2011		
	Programmatic	Management and General	Total	Programmatic	Management and General	Total
Grant expenditures:						
NorthStar Jefferson	\$ 1,313,616	\$ -	\$ 1,313,616	\$ -	\$ -	\$ -
Other	5,072,434	-	5,072,434	5,049,721	-	5,049,721
Program expenses	72,938	-	72,938	116,042	-	116,042
Compensation - officers	226,138	56,534	282,672	217,440	54,360	271,800
Compensation - non-officers	283,510	196,595	480,105	277,139	160,107	437,246
Compensation - interns	26,406	6,602	33,008	26,288	6,572	32,860
Employee benefits	138,013	66,871	204,884	119,011	51,492	170,503
Travel	28,169	55,488	83,657	17,989	33,277	51,266
Communications	8,633	4,181	12,814	12,150	5,257	17,407
Rent/utilities/supplies	-	32,146	32,146	-	29,329	29,329
Professional services	-	166,623	166,623	-	66,780	66,780
Insurance	-	11,628	11,628	-	16,194	16,194
Interest expense	-	9,935	9,935	-	5,086	5,086
Uncollectible accounts	139,667	-	139,667	67,125	-	67,125
Other	-	4,027	4,027	-	10,301	10,301
	\$ 7,309,524	\$ 610,630	\$ 7,920,154	\$ 5,902,905	\$ 438,755	\$ 6,341,660

See accompanying Independent Auditors' Report.



Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Consolidated Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
U.S. Endowment for Forestry and Communities, Inc. and Subsidiary
Greenville, South Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of U.S. Endowment for Forestry and Communities, Inc. and Subsidiary (the "Endowment"), which comprises the consolidated statements of financial position as of December 31, 2012 and December 31, 2011, and the related consolidated statements of activities, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 27, 2013.

Internal Control Over Financial Reporting

In planning and performing our audits of the consolidated financial statements, we considered the Endowment's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Endowment's internal control. Accordingly, we do not express an opinion on the effectiveness of the Endowment's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Endowment's consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Endowment's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Endowment's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Endowment's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dixon Hughes Goodman LLP

September 27, 2013



Independent Auditors' Report on Compliance for Each Major Federal Program And Report on Internal Control Over Compliance

The Board of Directors
U.S. Endowment for Forestry and Communities, Inc. and Subsidiary
Greenville, South Carolina

Report on Compliance for Each Major Federal Program

We have audited U.S. Endowment for Forestry and Communities, Inc. and Subsidiary (the "Endowment") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Endowment's major federal programs for the year ended December 31, 2012. The Endowment's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Endowment's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Endowment's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Endowment's compliance.

Opinion on Each Major Federal Program

In our opinion, the Endowment complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Report on Internal Control Over Compliance

Management of the Endowment is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Endowment's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Endowment's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

September 27, 2013

Dixon Hughes Goodman LLP

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY

Schedule of Expenditures of Federal Awards

Year Ended December 31, 2012

<u>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U. S. Department of Agriculture		
<u>Direct Program:</u>		
Forestry Research	10.652	\$ 1,018,145
Cooperative Forestry Assistance	10.664	835,315
Forest Stewardship Program	10.678	38,217
Environmental Quality Incentives	10.912	<u>552,010</u>
Total U.S. Department of Agriculture		<u>2,443,687</u>
U. S. Department of the Interior Fish and Wildlife Service		
<u>Direct Program:</u>		
Service Training and Technical Assistance	15.649	<u>116,890</u>
U. S. Department of Defense		
<u>Direct Program:</u>		
Basic and Applied Scientific Research	12.300	<u>167,289</u>
Total expenditures of Federal awards		<u><u>\$ 2,727,866</u></u>

1. **Basis of Presentation**

The accompanying schedule of expenditures of Federal awards includes the Federal grant activity of U.S. Endowment for Forestry and Communities, Inc. and Subsidiary and is presented on the accrual basis of accounting.

2. **Sub recipients**

Of the Federal expenditures presented in this schedule, U.S. Endowment for Forestry and Communities, Inc. and Subsidiary provided Federal awards to sub recipients as follows:

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Amount Provided to Sub recipients</u>
Forestry Research	10.652	\$ 900,503
Environmental Quality Incentives	10.912	\$ 547,441
Cooperative Forestry Assistance	10.664	\$ 140,346

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
 Schedule of Findings and Questioned Costs
 For the Year Ended December 31, 2012

Section I—Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses? _____ Yes X None reported

Noncompliance material to financial statements noted? _____ Yes X No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses? _____ Yes X None reported

Type of auditors’ report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? _____ Yes X No

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
Schedule of Findings and Questioned Costs (continued)
For the Year Ended December 31, 2012

Section I—Summary of Auditors' Results (continued)

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
10.652	Forestry Research
10.912	Environmental Quality Incentives

Dollar threshold used to distinguish
between type A and type B programs: \$ 300,000

Auditee qualified as low-risk auditee? Yes No

Section II— Consolidated Financial Statement Findings

There were none.

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
Schedule of Findings and Questioned Costs (continued)
For the Year Ended December 31, 2012

Section III— Federal Award Findings and Questioned Costs

There were none.

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
Corrective Action Plan
For the Year Ended December 31, 2012

Section II— Consolidated Financial Statement Findings

None reported.

Section III— Federal Award Findings and Questioned Costs

None reported.

U.S. ENDOWMENT FOR FORESTRY AND COMMUNITIES, INC. AND SUBSIDIARY
Summary Schedule of Prior Audit Findings
For the Year Ended December 31, 2012

Finding 2011-1:	Monitoring
Status:	Resolved - Management has taken appropriate action to contact sub recipients and provided them with the information required by this compliance requirement.
Finding 2010-1:	Monitoring
Status:	Resolved - Management has taken appropriate action to contact sub recipients and provided them with the information required by this compliance requirement.