

**SOUTHERN CALIFORNIA SCHOOL OF
THEOLOGY**
(dba CLAREMONT SCHOOL OF THEOLOGY)

FINANCIAL STATEMENTS
June 30, 2012 and 2011
And For The Years Then Ended

Together with Independent Auditor's Report



**SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba CLAREMONT SCHOOL OF THEOLOGY)**

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June 30, 2012 and 2011**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Southern California School of Theology:

We have audited the accompanying statements of financial position of Southern California School of Theology (dba Claremont School of Theology) (the "School") as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of the School. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the U.S. Comptroller General. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the School, as of June 30, 2012 and 2011 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 26, 2013 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

STANISLAWSKI & HARRISON

February 26, 2013

Member of:
American Institute of Certified Public Accountants
Division of CPA Firms/Private Companies Practice Section
California Society of Certified Public Accountants

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

STATEMENTS OF FINANCIAL POSITION
As of June 30, 2012 and 2011

ASSETS:	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 933,633	\$ 556,656
Investments, at fair value (notes 2 and 3)	16,564,067	17,531,840
Pledges receivable, net (note 4)	3,895,014	5,700,735
Other receivables:		
Accounts receivable, net of allowance for doubtful accounts of \$71,524 in 2012 and 2011	94,681	63,619
Related parties and employee loans (note 5)	350,000	350,000
Student loans, net of allowance for doubtful accounts of \$147,350 in 2012 and 2011	487,912	289,476
Prepaid expense and other assets	32,655	145,679
Land held for sale (note 6)	835,265	835,265
Beneficiary interest in split-interest agreements (notes 3 and 7)	11,589,262	11,691,746
Property and equipment, net of accumulated depreciation (note 8)	15,972,121	16,215,481
Total assets	\$ 50,754,610	\$ 53,380,497
LIABILITIES AND NET ASSETS:		
Accounts payable and accrued expenses	\$ 237,442	\$ 358,530
Line of credit (note 9)	987,730	1,499,381
Student deposits	110,263	97,700
Unearned revenue	36,745	46,745
Advances from the federal government	308,159	308,159
Notes and loans payable (note 10)	3,526,012	3,954,913
Liability under split-interest agreements (note 7)	1,835,674	2,116,306
Total liabilities	7,042,025	8,381,734
Commitments (note 16)		
Net assets:		
Unrestricted	2,256,793	3,195,734
Temporarily restricted (note 12)	7,414,858	7,979,359
Permanently restricted (notes 12 and 13)	34,040,934	33,823,670
Total net assets	43,712,585	44,998,763
Total liabilities and net assets	\$ 50,754,610	\$ 53,380,497

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

STATEMENT OF ACTIVITIES

For the year ended June 30, 2012

With comparative totals for the year ended June 30, 2011

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total	
				2012	2011
REVENUES:					
Student tuition and fees	\$ 3,109,330	\$ -	\$ -	\$ 3,109,330	\$ 2,681,268
Less scholarships, fellowships and other assistance	(1,796,006)	-	-	(1,796,006)	(1,607,779)
Net tuition and fees	1,313,324	-	-	1,313,324	1,073,489
Contributions	2,123,417	3,724,458	150,925	5,998,800	3,890,258
Investment return (note 2)	85,749	42,161	66,339	194,249	3,371,829
Change in value of split-interest agreements	-	2,481	-	2,481	7,260
Rental income	1,121,127	-	-	1,121,127	1,047,044
Other income	152,665	-	-	152,665	524,692
TOTAL REVENUES	4,796,282	3,769,100	217,264	8,782,646	9,914,572
Net assets released from restrictions (note 12)	4,333,601	(4,333,601)	-	-	-
TOTAL REVENUES AND NET ASSETS RELEASED FROM RESTRICTIONS	9,129,883	(564,501)	217,264	8,782,646	9,914,572
EXPENSES:					
Instruction	3,359,991	-	-	3,359,991	3,359,850
Academic support	667,905	-	-	667,905	623,952
Sponsored programs	367,487	-	-	367,487	397,561
Student services	1,023,044	-	-	1,023,044	1,089,517
Institutional support	2,181,154	-	-	2,181,154	2,677,656
Plant operation and maintenance	2,132,404	-	-	2,132,404	2,023,577
Community service	336,839	-	-	336,839	349,640
TOTAL EXPENSES (note 11)	10,068,824	-	-	10,068,824	10,521,753
INCREASE (DECREASE) IN NET ASSETS	(938,941)	(564,501)	217,264	(1,286,178)	(607,181)
NET ASSETS- BEGINNING OF YEAR	3,195,734	7,979,359	33,823,670	44,998,763	45,605,944
NET ASSETS- END OF YEAR	\$ 2,256,793	\$ 7,414,858	\$ 34,040,934	\$ 43,712,585	\$ 44,998,763

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

STATEMENT OF ACTIVITIES
For the year ended June 30, 2011

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
REVENUES:				
Student tuition and fees	\$ 2,681,268	\$ -	\$ -	\$ 2,681,268
Less scholarships, fellowships and other assistance	(1,607,779)	-	-	(1,607,779)
Net tuition and fees	1,073,489	-	-	1,073,489
Contributions	2,820,318	854,207	215,733	3,890,258
Investment return (note 2)	3,010,560	(193,581)	554,850	3,371,829
Change in value of split-interest agreements	-	7,260	-	7,260
Rental income	1,047,044	-	-	1,047,044
Other	524,692	-	-	524,692
TOTAL REVENUES	8,476,103	667,886	770,583	9,914,572
Net assets released from restrictions (note 12)	401,937	(401,937)	-	-
TOTAL REVENUES AND NET ASSETS RELEASED FROM RESTRICTIONS	8,878,040	265,949	770,583	9,914,572
EXPENSES:				
Instruction	3,359,850	-	-	3,359,850
Academic support	623,952	-	-	623,952
Sponsored programs	397,561	-	-	397,561
Student services	1,089,517	-	-	1,089,517
Institutional support	2,677,656	-	-	2,677,656
Plant operation and maintenance	2,023,577	-	-	2,023,577
Community service	349,640	-	-	349,640
TOTAL EXPENSES (note 11)	10,521,753	-	-	10,521,753
INCREASE (DECREASE) IN NET ASSETS	(1,643,713)	265,949	770,583	(607,181)
NET ASSETS- BEGINNING OF YEAR	4,839,447	7,713,410	33,053,087	45,605,944
NET ASSETS- END OF YEAR	\$ 3,195,734	\$ 7,979,359	\$ 33,823,670	\$ 44,998,763

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

STATEMENTS OF CASH FLOWS
For the years ended June 30, 2012 and 2011

CASH FLOWS from OPERATING ACTIVITIES:	<u>2012</u>	<u>2011</u>
Change in Net Assets from Operating Activities	\$ (1,286,178)	\$ (607,181)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	668,318	644,876
Net realized and unrealized losses (gains) on investments	453,130	(2,864,381)
Contributions restricted for long-term purposes	(150,925)	(215,733)
Forgiveness of notes and loans payable	(150,000)	-
(Increase) decrease in operating assets:		
Accounts receivable, net	(31,062)	67,830
Pledges receivable	1,805,721	557,621
Related parties and employee loans	-	51,361
Student loans, net	(198,436)	(1,754)
Prepaid expense and other assets	113,024	(79,752)
Beneficiary interest in split interest agreements	102,484	(7,112)
Increase (decrease) in operating liabilities:		
Accounts payable and accrued expenses	(121,088)	87,615
Student deposits	12,563	(724)
Unearned revenue	(10,000)	(36,621)
Liability under split-interest agreements	(280,632)	107,109
Net cash provided by (used in) operating activities	<u>926,919</u>	<u>(2,296,846)</u>
 CASH FLOWS from INVESTING ACTIVITIES:		
Purchase of property and equipment	(424,958)	(367,266)
Proceeds from sale of investments	1,367,079	3,518,866
Purchase of investments	(852,436)	(1,774,651)
Net cash provided by investing activities	<u>89,685</u>	<u>1,376,949</u>
 CASH FLOWS from FINANCING ACTIVITIES:		
Payments under line of credit arrangement, net	(511,651)	-
Principal payments on notes and loans payable	(278,901)	(326,841)
Contributions restricted for long-term purposes	150,925	215,733
Net cash provided used in financing activities	<u>(639,627)</u>	<u>(111,108)</u>
 Net increase (decrease) in cash and cash equivalents	376,977	(1,031,005)
Cash and cash equivalents at the beginning of the year	<u>556,656</u>	<u>1,587,661</u>
Cash and cash equivalents at the end of the year	<u>\$ 933,633</u>	<u>\$ 556,656</u>
 Cash paid for interest	<u>\$ 257,978</u>	<u>\$ 275,375</u>
 NONCASH TRANSATION:		
Forgiveness of notes and loans payable	<u>\$ 150,000</u>	<u>\$ -</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization

The Southern California School of Theology (dba Claremont School of Theology) (the "School") is a multi-religious and globally oriented graduate school of theology primarily sponsored by the United Methodist Church. The School, located in Claremont, California, offers the M.A., M.Div., D.Min and Ph.D. degrees.

In 2008, the School initiated the University Project, a multi-faith collaboration among the School, the Academy for Jewish Religion-CA and the Islamic Center of Southern California. The three partners signed a Memorandum of Understanding ("MOU") in 2010, agreeing to create a future university comprised of multiple faith traditions learning and working together. The University Project was incorporated as Claremont Lincoln University ("University") in December 2010, but continued to be incubated by the School as a Division within it. During this extended period of incubation, the School has provided to the University time and effort related to academic and administrative support. The services were provided to support day-to-day operations of the University, which included delivery of academic programs to 30 degree-seeking students; administrative and management support, and support of co-curricular and public programs related to the University's programmatic and public service goals; institutional formation and governance; and institutional control. The School's provision of expertise and capacity in these matters supports the complementary missions of both institutions, and greatly facilitates the rapid development of the new university. For the year ended June 30, 2012, the School incurred costs of \$3,699,488 on behalf of the University; these expenses were recorded in various expense line items of the School and presented as part of release from restriction. There were no substantial activities of the incubated University for the year ended June 30, 2011 that was reported within these financial statements.

Basis of Accounting and Presentation

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

To ensure observance of certain constraints and restrictions placed on the use of resources, the accounts of the School are maintained in accordance with the principles of net asset accounting. This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into net asset classes that are in accordance with specified activities or objectives. Accordingly, all the financial transactions have been recorded and reported by net asset class as follows:

Unrestricted – These generally result from revenues generated by receiving unrestricted contributions, providing services, and receiving interest from investments less expenses incurred in providing program related services, raising contributions, and performing administrative functions.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (continued)

Temporarily Restricted – The School reports gifts of cash and other assets as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions.

Permanently Restricted – These net assets are received by donors who stipulate that resources are to be maintained permanently, but permits the School to expend all of the income (or other economic benefits) derived from the donated assets.

Endowment - Return Objectives and Risk Parameters

The School has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the School must hold in perpetuity or for a donor-specified period. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. The School expects its endowment funds, over time, to provide an average rate of return of no less than inflation plus 5 percent annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the School 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 School targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Endowment Spending Policy

The School has a policy of appropriating for distribution each year an amount which is calculated by multiplying the Board-Authorized Percentage (BAP) of 6.5% with the 12-Quarter Mean Endowment Pool Value as of December 31 (MEV). This is consistent with the School's objective to support the School's cash needs as described in the annual budget and maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Cash and Cash Equivalents

Cash and cash equivalents include cash in bank as well as all highly liquid investments with initial maturity of three months or less.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (continued)

Investments

The fair value of the School's Level 1 financial assets such as money market funds and mutual funds are stated at net asset value (NAV) as reported by fund managers. Corporate equities are based on quoted market prices of the identical underlying security. The fair value of the School's Level 2 financial assets such as short-term, intermediate-term and long-term bonds are obtained from over-the-counter markets at the last reported sale price or in the absence of a recorded sale, at the values between the most recent bid and asked prices. Certificate of deposits are valued at amortized cost, which approximates fair value.

Promises to Give

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded as a contribution receivable at the present value of their estimated future cash flows. The discounts on those amounts are computed using a market rate of return. Amortization of the discounts is included in contribution revenue. Conditional promises to give are not included as support until the conditions are substantially met.

Split-Interest Agreements

The School issues and administers charitable remainder trust agreements in which a donor establishes and funds a trust with specified distributions to be made to a designated beneficiary or beneficiaries over the term of the trust. Upon termination, the School receives the remaining assets of the trust. The obligations under the trusts are based on life expectancy tables provided by the Annuity 2000 Mortality Tables. The School records the obligations as "liability under split-interest agreements" based on the terms of the trust agreements. The discount rate used for the years ended June 30, 2012 and 2011, was 6%. The net assets associated with these trusts are reflected in temporarily and permanently restricted net assets.

For perpetual trusts, which are accounted under permanently restricted net assets, the fair value of the contribution is measured using the fair value of the assets contributed to the trust, because the facts and circumstances indicate that the fair value of the beneficial interest does not differ from the fair value of the assets contributed to the trust.

Property and Equipment

Property and equipment are recorded at historical cost or the fair market value at the date of donation, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets of 6 to 60 years.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (continued)

Impairment of Long-Lived Assets

The School evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset were less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value.

Collection Items

The collections, which were acquired through purchases and contributions since the School's inception, are not recognized as assets on the statements of financial position. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired or as temporarily or permanently restricted net assets if the assets used to purchase the items are restricted by donors. Proceeds from deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes.

Unearned Revenue

Unearned revenue represents grant funds received for services to be performed by the School which have not yet been expended under the terms of the grant agreement and which do not meet the criteria for reporting as contributions. The School recognizes these amounts as revenue when such funds are expended.

Revenue and Expense Recognition

Contributions, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Contributions where donor restrictions are met within the same fiscal year as the contribution are included in unrestricted net assets. Contributions of assets other than cash are recorded at their estimated fair value. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met.

Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments, investment income and other revenues are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation.

Functional Allocation of Expenses

The costs of providing the program and supporting activities of the School have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the program, administrative, and fund raising functions, based upon the estimated benefit received by each function.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (continued)

Income Taxes

The School is a nonprofit, tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income and state franchise taxes on related income pursuant to Section 501(a) of the Code and similar provisions of the California Franchise Tax Code. The School does not engage in any significant unrelated trades or businesses. Accordingly, no provision for income taxes is required.

The open tax years available for inspection by the government are three years for federal and four years for state taxes.

Federal Student Financial Aid Program

The School is a participant in the federal government Title IV program, from which the School receives and distributes to qualified students unsubsidized loans, subsidized loans, and Perkins loans.

Concentration of Credit Risks

The School places its temporary cash investments with quality financial institutions. At times, such investments may be in excess of the Federal Deposits Insurance Corporation insurance limit. The School has not incurred credit losses related to these investments. As of June 30, 2012 and 2011, one donor accounted for 55% and 73% of the pledges receivable balances, respectively. The same donor accounted for 18% of the total contribution revenue for the year ended June 30, 2012. As of June 30, 2012, a second donor accounted for 34% of the pledges receivable and 23% of total contribution revenue. However, management believes realization losses on pledges receivable amounts at the end of 2012 will be immaterial. Concentration of credit risk for student receivables is generally limited due to the dispersion of these items over a wide student base. The School continually monitors its receivables and establishes valuation reserves as considered appropriate.

Use of Accounting Estimates

The preparation of 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events

Subsequent events have been evaluated through February 26, 2013, the date that these financial statements are available to be issued. There were no subsequent events that would require adjustments to or disclosure in these financial statements except as already disclosed in these financial statements.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 2 – INVESTMENTS:

The composition of investments, stated at fair value at June 30, 2012 and 2011, is as follows:

	<u>2012</u>	<u>2011</u>
Cash and money market accounts	\$ 396,167	\$ 533,750
Money market funds	976,781	1,050,740
Mutual funds	1,105,425	-
Certificate of deposit	2,280,272	2,440,360
Corporate equities:		
Communication services	6,074	-
Consumer discretionary	1,307,139	1,210,792
Consumer staples	759,765	609,836
Energy	736,559	928,055
Financials	1,295,318	1,496,210
Healthcare	1,386,974	1,438,413
Industrials	1,120,940	952,565
Information technology	1,875,096	1,873,504
Materials	414,126	627,638
Telecommunication services	352,589	744,945
Utilities	47,168	178,271
Fixed income:		
Long-Term bond	366,099	1,696,324
Intermediate-Term bond	1,858,178	1,404,127
Short-Term bond	279,397	261,935
Fixed income bond	-	84,375
Total investments	<u>\$ 16,564,067</u>	<u>\$ 17,531,840</u>

The composition of investment return for the years ended June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Dividends and interest	\$ 647,379	\$ 507,448
Net realized and unrealized gain (loss)	<u>(453,130)</u>	<u>2,864,381</u>
Total investment return	<u>\$ 194,249</u>	<u>\$ 3,371,829</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS:

Fair Value Standards (ASC 820-10) establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring fair value. This hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 – Quoted market prices are available in active market for identical assets or liabilities as of the reporting date.

Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3 – Pricing inputs are unobservable and shall be used to measure fair value to the extent that observable inputs are not available. The inputs into the determination of fair value are based upon the best information available and require significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS: (continued)

The following is the fair value measurement for investments and split interest agreements measured on a recurring basis at June 30, 2012 and 2011:

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 976,781	\$ 976,781	\$ -	\$ -
Cash and money market accounts	396,167	396,167	-	-
Certificate of deposit	2,280,272	-	2,280,272	-
Mutual funds:				
Loomis mutual funds	876,510	876,510	-	-
iShares MSCI funds	52,772	52,772	-	-
Focus growth fund	15,042	15,042	-	-
Diversified dividend fund	16,576	16,576	-	-
Short duration plus fund	46,173	46,173	-	-
Global bond fund	26,941	26,941	-	-
Growth and income fund	42,971	42,971	-	-
Large cap value fund	28,440	28,440	-	-
Corporate equities:				
Communication services	6,074	6,074	-	-
Consumer discretionary	1,307,139	1,307,139	-	-
Consumer staples	759,765	759,765	-	-
Energy	736,559	736,559	-	-
Financials	1,295,318	1,295,318	-	-
Healthcare	1,386,974	1,386,974	-	-
Industrials	1,120,940	1,120,940	-	-
Information technology	1,875,096	1,875,096	-	-
Materials	414,126	414,126	-	-
Telecommunication services	352,589	352,589	-	-
Utilities	47,168	47,168	-	-
Fixed income:				
Long-Term bond	366,099	-	366,099	-
Intermediate-Term bond	1,858,178	-	1,858,178	-
Short-Term bond	279,397	-	279,397	-
Total Investments	<u>\$ 16,564,067</u>	<u>\$ 11,780,121</u>	<u>\$ 4,783,946</u>	<u>\$ -</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS: (continued)

2012	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Gift Annuities	\$ 828,523	\$ 828,523	\$ -	\$ -
Perpetual Trusts:				
United Methodist Foundation of Sun City	7,163,017	-	-	7,163,017
Los Angeles United Methodist Foundation	1,000,000	-	-	1,000,000
Floy Van Nuys Trust	674,438	-	-	674,438
Total Perpetual Trusts	<u>8,837,455</u>	<u>-</u>	<u>-</u>	<u>8,837,455</u>
Charitable Remainder Trusts:				
Spoelstra Trust	443,146	-	-	443,146
Elizabeth Smith Trust	191,746	-	191,746	-
Balkins Trust managed by Wells Fargo	662,425	-	662,425	-
Trusts managed by Clifford Swan	625,967	-	625,967	-
Total Charitable Remainder Trusts	<u>1,923,284</u>	<u>-</u>	<u>1,480,138</u>	<u>443,146</u>
 Total Split-Interest Agreements	 <u>\$ 11,589,262</u>	 <u>\$ 828,523</u>	 <u>\$ 1,480,138</u>	 <u>\$ 9,280,601</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS: (continued)

2011	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 1,050,740	\$ 1,050,740	\$ -	\$ -
Cash and money market accounts	533,750	533,750	-	-
Certificate of deposit	2,440,360	-	2,440,360	-
Corporate equities:				
Consumer discretionary	1,210,792	1,210,792	-	-
Consumer staples	609,836	609,836	-	-
Energy	928,055	928,055	-	-
Financials	1,496,210	1,496,210	-	-
Healthcare	1,438,413	1,438,413	-	-
Industrials	952,565	952,565	-	-
Information technology	1,873,504	1,873,504	-	-
Materials	627,638	627,638	-	-
Telecommunication services	744,945	744,945	-	-
Utilities	178,271	178,271	-	-
Fixed income:				
Long-Term bond	1,696,324	178,438	1,517,886	-
Intermediate-Term bond	1,404,127	-	1,404,127	-
Short-Term bond	261,935	-	261,935	-
Fixed income bond	84,375	84,375	-	-
Total Investments	<u>\$ 17,531,840</u>	<u>\$ 11,907,532</u>	<u>\$ 5,624,308</u>	<u>\$ -</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS: (continued)

2011	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Split-Interest Agreements:				
Gift Annuities	\$ 1,095,122	\$ 1,095,122	\$ -	\$ -
Perpetual Trusts:				
United Methodist Foundation of Sun City	7,013,928	-	-	7,013,928
Los Angeles United Methodist Foundation	1,000,000	-	-	1,000,000
Floy Van Nuys Trust	690,020	-	-	690,020
Total Perpetual Trusts	8,703,948	-	-	8,703,948
Charitable Remainder Trusts:				
Spoelstra Trust	446,357	-	-	446,357
Elizabeth Smith Trust	105,404	-	105,404	-
Balkins Trust managed by Wells Fargo	668,425	-	668,425	-
Trusts managed by Clifford Swan	672,490	-	672,490	-
Total Charitable Remainder Trusts	1,892,676	-	1,446,319	446,357
Total Split-Interest Agreements	\$ 11,691,746	\$ 1,095,122	\$ 1,446,319	\$ 9,150,305

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 3 – FAIR VALUE MEASUREMENTS: (continued)

The following is the activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30, 2012 and 2011:

2012	Beginning Balance	Total unrealized gains or (losses)	Purchases, issuances, and settlements	Transfers in and / or out of Level 3	Ending Balance
Split-Interest Agreements:					
United Methodist Foundation of Sun City	\$ 7,013,928	\$ 149,089	\$ -	\$ -	\$ 7,163,017
Los Angeles United Methodist Foundation	1,000,000	-	-	-	1,000,000
Floy Van Nuys Trust	690,020	(15,582)	-	-	674,438
Spoelstra Trust	446,357	(3,211)	-	-	443,146
Total	\$ 9,150,305	\$ 130,296	\$ -	\$ -	\$ 9,280,601
<hr/>					
2011					
Split-Interest Agreements:					
United Methodist Foundation of Sun City	\$ 6,254,445	\$ 759,483	\$ -	\$ -	\$ 7,013,928
Los Angeles United Methodist Foundation	1,000,000	-	-	-	1,000,000
Floy Van Nuys Trust	611,964	78,056	-	-	690,020
Spoelstra Trust	603,767	(157,410)	-	-	446,357
Total	\$ 7,858,212	\$ 680,129	-	\$ -	\$ 9,150,305

The amount attributable to the change in unrealized gains relating to assets still held at year end was \$130,296 and \$680,129 for the years ended June 30, 2012 and 2011, respectively.

NOTE 4 – PLEDGES RECEIVABLE:

As of June 30, 2012 and 2011, pledges receivable, net of discount to present value (at discount rates 4% to 7%), were as follows:

	2012	2011
Within one year	\$ 865,804	\$ 2,212,632
Within two and five years	2,887,586	4,178,871
Thereafter	873,058	-
Gross pledges receivable	4,626,448	6,391,503
Less allowance for uncollectible pledges	(28,000)	-
Less discount to present value	(703,434)	(690,768)
Total	\$ 3,895,014	\$ 5,700,735

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 5 – RELATED PARTIES:

Related parties to the School include the California-Pacific Annual Conference of The United Methodist Church, the Desert Southwest Annual Conference of The United Methodist Church, and officials and faculty of the School. Contributions to the School for the years ended June 30, 2012 and 2011, were \$33,619 and \$79,837, respectively, from the California-Pacific Annual Conference and \$43,101 and \$46,065, respectively, from the Desert Southwest Annual Conference.

At June 30, 2012 and 2011, the outstanding balances of loans to an officer and some faculty members of the School aggregated \$350,000. Such loans were made in connection with the purchases of personal residences. In the majority of cases, the School participates in the appreciation of the respective property in lieu of interest. These loans are payable in full to the School within one year of sale of the property or when the faculty's affiliation with the School is terminated.

NOTE 6 – LAND HELD FOR SALE:

Land held for sale consists of the following properties at June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Blythe, California	\$ 665,000	\$ 665,000
Barstow, California	135,765	135,765
Other	<u>34,500</u>	<u>34,500</u>
Total	<u>\$ 835,265</u>	<u>\$ 835,265</u>

Land held for sale is comprised of land donated to the School and has been recorded at the estimated fair market value at the date of donation and carried at cost for subsequent periods.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 7 –SPLIT-INTEREST AGREEMENTS:

The composition of beneficiary interest in split-interest agreements, stated at fair value at June 30, 2012 and 2011, is as follows:

	<u>2012</u>	<u>2011</u>
Perpetual Trusts:		
United Methodist Foundation of Sun City	\$ 7,163,017	\$ 7,013,928
Los Angeles United Methodist Foundation	1,000,000	1,000,000
Floy Van Nuys Trust	674,438	690,020
Total Perpetual Trusts	<u>8,837,455</u>	<u>8,703,948</u>
Charitable Remainder Trusts:		
Spoelstra Trust	443,146	446,357
Elizabeth Smith Trust	191,746	105,404
Trusts Administered by the School:		
Balkans Trust	662,425	668,425
Other Trusts	625,967	672,490
Total Charitable Remainder Trusts	<u>1,923,284</u>	<u>1,892,676</u>
Gift Annuities - Administered by the School	<u>828,523</u>	<u>1,095,122</u>
Total Beneficiary Interest in Split-Interest Agreements	<u>\$ 11,589,262</u>	<u>\$ 11,691,746</u>

The School administers charitable gift annuities in which a donor contributes assets to the School in exchange for a promise by the School to pay a fixed amount for a specified period of time to the donor or to individuals or organizations designated by the donor. The obligations under the gift annuity are based on life expectancy provided in the 1994 Group Annuity Mortality (GAM) Tables. The School records the obligations as “liability under split-interest agreements” based on the terms of the annuities. The discount rate used for the years ended June 30, 2012 and 2011, was 6%.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 8 – PROPERTY AND EQUIPMENT:

Property and equipment consist of the following at June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Land	\$ 315,253	\$ 315,253
Buildings and improvements	17,995,876	17,987,593
Furniture and fixtures	2,174,172	2,174,172
Equipment and vehicles	2,871,042	2,619,025
Library books	4,449,795	4,285,137
Other	15,601	15,601
Total	<u>27,821,739</u>	<u>27,396,781</u>
Less: accumulated depreciation	<u>(11,849,618)</u>	<u>(11,181,300)</u>
Total Property and Equipment, net	<u>\$ 15,972,121</u>	<u>\$ 16,215,481</u>

NOTE 9 – LINE OF CREDIT:

The School has a line of credit with a financial institution with available borrowings up to \$1,500,000. This line of credit is secured by a certificate of deposit valued at \$1,500,000. The line of credit carried an interest rate of 3.55% and 3.80% for 2012 and 2011, respectively, and will expire within the next fiscal year. At June 30, 2012 and 2011, the outstanding balance under the line of credit was \$987,730 and \$1,499,381, respectively.

NOTE 10 – NOTES AND LOANS PAYABLE:

At June 30, 2012 and 2011, the School has an unsecured note payable to Watson Family Trust for \$1,388,525 and \$1,729,779, respectively. The note bears interest at 4% with monthly principal and interest payments of \$26,735 through July 31, 2017. Effective May 30, 2012, the Watson Family agreed to forgive \$150,000 on May 30 of each year until the note is fully forgiven. The School recorded interest forgiveness as temporarily restricted support and an increase in contribution receivable net of discount in the amount of \$1,141,326 during the year ended June 30, 2012.

At June 30, 2012 and 2011, the School had a secured loan payable to United Methodist Federal Credit Union totaling \$2,128,901 and \$2,204,724, respectively, maturing within 13 years. The loan is secured by the campus building and bears interest which is adjustable starting at 6.0% tied to five-year Treasury-Bill plus a margin of 2.5% with monthly principal and interest payments of \$17,396 through July 31, 2023.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 10 – NOTES AND LOANS PAYABLE: (continued)

At June 30, 2012 and 2011, the School had a capital lease loan payable to Verizon totaling \$8,586 and \$20,409, respectively. The loan expires June 30, 2013.

Scheduled principal payments on the above debt at June 30, 2012 are expected to be paid by the School as follows:

<u>Year Ending June 30</u>		
2013	\$	238,749
2014		235,230
2015		240,618
2016		246,346
2017		252,436
Thereafter		<u>2,312,633</u>
Total	\$	<u><u>3,526,012</u></u>

NOTE 11 – FUNCTIONAL EXPENSES:

The functional allocation of expenses for the years ended June 30, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Program Expenses	\$ 7,419,643	\$ 7,491,529
General and Administrative	1,265,646	1,489,872
Fundraising	<u>1,383,535</u>	<u>1,540,352</u>
Total	<u><u>\$ 10,068,824</u></u>	<u><u>\$ 10,521,753</u></u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 12 – NET ASSETS:

At June 30, 2012 and 2011, temporarily restricted net assets were available for the following purposes:

	<u>2012</u>	<u>2011</u>
Restricted for the University Project	\$ 6,017,350	\$ 6,525,358
Purpose restriction for scholarship	380,000	395,000
Split-interest agreements	913,304	868,662
Time restricted	<u>104,204</u>	<u>190,339</u>
Total Temporarily Restricted Net Assets	<u>\$ 7,414,858</u>	<u>\$ 7,979,359</u>

Amounts released from temporary restrictions during the years ended June 30, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
University Project and split-interest agreements	\$ 3,828,262	\$ 129,679
Purpose restriction for scholarship	315,000	-
Time restricted	<u>190,339</u>	<u>272,258</u>
Total	<u>\$ 4,333,601</u>	<u>\$ 401,937</u>

Permanently restricted net assets are restricted to investment in perpetuity, the income from which is expendable to support scholarships, instruction, lectures, research, student loans, the library, and other projects.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 13 – ENDOWMENT:

The School’s endowment consists of several individual funds established for a variety of purposes. Its endowment comprises of donor-restricted endowment funds only. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Trustees of the School has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the School classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the School in a manner consistent with the standard of prudence prescribed by SPMIFA.

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

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

The School’s endowment by net asset class at June 30, 2012 and 2011, in total and by type of endowment fund, showing donor-restricted endowment funds are as follows:

2012	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor- restricted endowment funds	\$ (11,135,502)	\$ -	\$ 34,040,934	\$ 22,905,432
2011	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor- restricted endowment funds	\$ (9,195,291)	\$ -	\$ 33,823,670	\$ 24,628,379

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 13 – ENDOWMENT: (continued)

Changes in endowment assets for the year ended June 30, 2012 and 2011, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, July 1, 2010	\$ (6,422,026)	\$ -	\$ 33,053,087	\$ 26,631,061
Net appreciation (realized and unrealized)	(320,476)	-	554,850	234,374
Contributions (during the year)	-	-	215,733	215,733
Appropriation of endowment assets for expenditure *	<u>(2,452,789)</u>	<u>-</u>	<u>-</u>	<u>(2,452,789)</u>
Endowment net assets, June 30, 2011	<u>(9,195,291)</u>	<u>-</u>	<u>33,823,670</u>	<u>24,628,379</u>
Net depreciation (realized and unrealized)	(809,777)	-	66,339	(743,438)
Contributions (during the year)	-	-	150,925	150,925
Appropriation of endowment assets for expenditure *	<u>(1,130,434)</u>	<u>-</u>	<u>-</u>	<u>(1,130,434)</u>
Endowment net assets, June 30, 2012	<u>\$ (11,135,502)</u>	<u>\$ -</u>	<u>\$ 34,040,934</u>	<u>\$ 22,905,432</u>

* Includes endowment assets eligible for expenditure in light of the School's spending policy.

Declines in the market value of the investment pool and annual borrowings out of the endowment pool have created a situation where the market value of certain endowments is less than the cost basis of the original gift. This condition has been referred to as an “underwater endowment.” Net losses on permanently restricted endowment funds are recorded as decreases in unrestricted net assets.

At June 30, 2012, the School’s endowment was deficient, or “underwater,” by \$11,135,502, reflecting annual appropriations per School’s investment policy totaling \$1,130,434. At June 30, 2011, the endowment was deficient, or “underwater,” by \$9,195,291, reflecting annual appropriations per School’s investment policy totaling \$1,074,876 and authorized borrowing out of the endowment pool of \$1,377,913.

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 14 – RETIREMENT PLAN:

The School participates in a defined contribution plan for its faculty, administrators, and staff. Under the plan, the School contributed \$436,791 and \$424,159 for the years ended June 30, 2012 and 2011, respectively. Such contribution is calculated based on 6% of salaries for employees that have been with the School for 90 days to four years and 12% of salaries for employees that have been with the School for more than four years. Contribution to faculty are determined by rank (6% for assistant professors, 12% for associate professors and professors).

NOTE 15 – COLLECTION ITEMS:

The School's collections are made up of artifacts of historical significance and art objects that are held for educational, research, and curatorial purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for collections.

During June 2000, a significant number of Asian artifacts were contributed to the School, with a restriction that limited any future proceeds from deaccessions to acquisitions of artifacts from a similar period. No collection items were deaccessioned or destroyed as of June 30, 2012 and 2011.

NOTE 16 – COMMITMENTS:

The School entered into lease agreements during the year ended June 30, 2011 for certain office equipment to be payable through June 30, 2015. Future minimum lease payments are as follows:

<u>Year Ending June 30</u>	
2013	\$ 26,517
2014	26,517
2015	<u>12,951</u>
	<u>\$ 65,985</u>

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011

NOTE 17 – CONDITIONAL ASSET RETIREMENT OBLIGATIONS:

The School has some conditional asset retirement obligations related to asbestos and other hazardous material in a number of its buildings. Regulations put into place after the construction of those buildings require the School to handle and dispose of these types of materials in a special manner if the building undergoes major renovations, is sold or demolished. Otherwise, the School is not required to remove the materials from the buildings. The School believes it does not have sufficient information to estimate the fair value of the asset retirement obligations because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique.

There are no plans or expectations of plans to undertake major renovations of the areas of the buildings that would require removal of the materials or demolition. Also, the School has not identified a need for major renovations for the purpose of technology or operational changes, or other factors.

NOTE 18 – IRREVOCABLE LETTER OF CREDIT:

In order to participate in Title IV programs, an institution must demonstrate that it is financially responsible. Part of the way the U.S. Department of Education determines financial responsibility is through the use of the equity, primary reserve, and net income ratios that yield a composite score of at least 1.5 over a three year period. The U. S. Department of Education performed an analysis of the fiscal year ended June 30, 2011 financial statements yielded a composite score of 0.6. As a result of this, the School was required to establish an irrevocable letter of credit required by the U.S. Department of Education in the amount of \$173,375. A letter of credit in the amount of \$866,873 has been issued by United Methodist Federal Credit Union on August 11, 2011 which expired on August 11, 2012. On July 18, 2012, the bank renewed the letter of credit which will expire on July 17, 2013.



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**Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statement
Performed in Accordance with *Government Auditing Standards***

Board of Trustees
Southern California School of Theology
1325 N. College Ave.
Claremont, CA 91711

We have audited the financial statements of Southern California School of Theology (dba Claremont School of Theology) (the "School") as of and for the year ended June 30, 2012, and have issued our report thereon dated February 26, 2013. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of the School is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses as item 12-1 that we consider to be significant deficiencies in internal control over financial reporting. 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.

**Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statement
Performed in Accordance with *Government Auditing Standards*
(Continued)**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of 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 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*.

We also noted certain other matters that we reported to the management of the School, in a separate letter dated February 26, 2013.

The School's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the School's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information of the board of trustees, audit committee, management, the U.S. Department of Education, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



STANISLAWSKI & HARRISON

February 26, 2013

SOUTHERN CALIFORNIA SCHOOL OF THEOLOGY
(dba Claremont School of Theology)

Schedule of Findings and Questioned Costs
Year Ended June 30, 2012

12-1 – Audit Adjustment

Finding: We proposed, and management concurred and recorded in School's accounting records, two audit adjustments, as follows:

- The forgiveness of the loan balance (\$150,000 per year over nine years) should have been recognized as contribution revenue in the current year and amortized over the term of the forgiveness. The School only recorded the portion that related to the year ended June 30, 2012 (i.e., 150,000).
- The School did not reconcile its general ledger balance for Perkins Loans to the detailed records maintained by the Department of Education. This resulted in an adjustment as well as a noncompliance finding in the School's Single Audit Report.

Recommendation: We recommend that the School comply with recognition guidance for unconditional promises to give (FASB ASC 958-605-25) which require recognition at the time of the receipt of the promise.

We also recommend the periodic reconciliation of Perkins Loan balances to subsidiary records maintained by the Department of Education.

Management Response: As noted in the finding, management concurred and recorded the change to the treatment of the loan forgiveness. The donor explicitly asked that the loan forgiveness not be recorded as a pledge, but the donor's intent to pledge is clear.

On the matter of Perkins loan program, management concurs that this program will require further reconciliation and oversight to ensure that such deficiencies do not occur. Regular, periodic reconciliation of government records and of third party servicer records to the School records will be performed. Management recognizes that the Perkins loan deficiency will appear on the Single Audit Report.