

**HALF THE SKY FOUNDATION  
AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2011 and 2010

HALF THE SKY FOUNDATION AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS  
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## REPORT OF INDEPENDENT AUDITORS

To the Audit Committee and Board of Directors  
Half the Sky Foundation and Subsidiaries  
Berkeley, California

We have audited the accompanying consolidated statement of financial position of Half the Sky Foundation and subsidiaries (the "Foundation"), as of December 31, 2011, and the related consolidated statements of activities and changes in net assets, cash flows, and functional expenses for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2010 financial statements of Half the Sky Foundation and subsidiaries were audited by other auditors and whose report dated August 12, 2011 expressed an unqualified opinion on those financial statements.

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

In our opinion, the 2011 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Half the Sky Foundation and subsidiaries as of December 31, 2011, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

  
Crowe Horwath LLP

Sacramento, California  
July 26, 2012

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION  
December 31, 2011 and 2010

	2011	2010
<b>ASSETS</b>		
Assets:		
Cash and cash equivalents	\$ 2,729,641	\$ 2,270,046
Pledges receivable, net (Note 3)	2,564	109,944
Other receivables	4,277	14,624
Investments (Note 4)	-	1,060,246
Prepaid program expenses	146,372	101,906
Inventory	80,680	67,027
Property and equipment, net (Note 5)	34,250	54,800
Deposits	28,345	62,094
Total assets	\$ 3,026,129	\$ 3,740,687
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable	\$ 252,531	\$ 149,491
Accrued expenses	196,226	122,061
Deferred rent liability	11,957	13,337
Deferred income	-	359
Total liabilities	460,714	285,248
Commitments and contingencies (Note 9)		
Net assets:		
Unrestricted net assets	194,693	723,918
Designated by the Board for endowment	-	359,395
Total unrestricted net assets	194,693	1,083,313
Temporarily restricted (Note 6)	1,724,998	1,737,636
Permanently restricted (Note 8)	645,724	634,490
Total net assets	2,565,415	3,455,439
Total liabilities and net assets	\$ 3,026,129	\$ 3,740,687

See accompanying notes to consolidated financial statements.

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS  
Years Ended December 31, 2011 and 2010

	2011				2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, gains and other support:								
Contributions (Note 11)	\$ 3,877,546	\$ 5,289,700	\$ 11,234	\$ 9,178,480	\$ 3,209,548	\$ 4,463,834	\$ 15,782	\$ 7,689,164
Contributed services and materials	447,635	-	-	447,635	504,945	-	-	504,945
Merchandise sales	17,013	-	-	17,013	25,696	-	-	25,696
Interest and dividend income on investments (Note 4)	8,994	-	-	8,994	31,402	-	-	31,402
Other income	82,763	-	-	82,763	47,760	-	-	47,760
Net realized and unrealized gain on investments (Note 4)	11,107	38,431	-	49,538	12,101	67,637	-	79,738
Net assets released from restriction (Note 7)	<u>5,340,769</u>	<u>(5,340,769)</u>	<u>-</u>	<u>-</u>	<u>6,129,637</u>	<u>(6,129,637)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	<u>9,785,827</u>	<u>(12,638)</u>	<u>11,234</u>	<u>9,784,423</u>	<u>9,961,089</u>	<u>(1,598,166)</u>	<u>15,782</u>	<u>8,378,705</u>
Expenses:								
Program services	8,614,516	-	-	8,614,516	7,770,293	-	-	7,770,293
Fundraising:								
Donated goods and services	238,238	-	-	238,238	417,906	-	-	417,906
Other fundraising	<u>1,098,396</u>	<u>-</u>	<u>-</u>	<u>1,098,396</u>	<u>956,629</u>	<u>-</u>	<u>-</u>	<u>956,629</u>
Total fundraising	1,336,634	-	-	1,336,634	1,374,535	-	-	1,374,535
Merchandise costs	4,783	-	-	4,783	17,462	-	-	17,462
Management and general (Notes 9 and 10)	<u>718,514</u>	<u>-</u>	<u>-</u>	<u>718,514</u>	<u>661,149</u>	<u>-</u>	<u>-</u>	<u>661,149</u>
Total expenses	<u>10,674,447</u>	<u>-</u>	<u>-</u>	<u>10,674,447</u>	<u>9,823,439</u>	<u>-</u>	<u>-</u>	<u>9,823,439</u>
Change in net assets	(888,620)	(12,638)	11,234	(890,024)	137,650	(1,598,166)	15,782	(1,444,734)
Net assets, beginning of year	<u>1,083,313</u>	<u>1,737,636</u>	<u>634,490</u>	<u>3,455,439</u>	<u>945,663</u>	<u>3,335,802</u>	<u>618,708</u>	<u>4,900,173</u>
Net assets, end of year	<u>\$ 194,693</u>	<u>\$ 1,724,998</u>	<u>\$ 645,724</u>	<u>\$ 2,565,415</u>	<u>\$ 1,083,313</u>	<u>\$ 1,737,636</u>	<u>\$ 634,490</u>	<u>\$ 3,455,439</u>

See accompanying notes to consolidated financial statements.

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows used in operating activities:		
Change in net assets	\$ (890,024)	\$ (1,444,734)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	27,976	29,732
Net realized and unrealized gains on investments	(49,538)	(79,738)
Contributions restricted for long-term investment	(11,234)	(15,782)
Change in assets and liabilities:		
Pledges receivable, net	107,380	27,600
Other receivables	10,347	(7,060)
Prepaid program expenses	(44,466)	(44,999)
Inventory	(13,653)	18,081
Deposits	33,749	(22,091)
Accounts payable	103,040	74,968
Accrued expenses	74,165	60,402
Deferred rent liability	(1,380)	13,337
Deferred income	(359)	359
	(653,997)	(1,389,925)
Net cash used in operating activities		
Cash flows from investing activities:		
Acquisition of property and equipment	(7,426)	(8,142)
Purchases of investments	(11,143)	(40,598)
Proceeds from sale of investments	1,120,927	-
	1,102,358	(48,740)
Net cash provided by (used in) investing activities		
Cash flows provided by financing activities:		
Contributions restricted for long-term investment	11,234	15,782
Increase (decrease) in cash and cash equivalents	459,595	(1,422,883)
Cash and cash equivalents, beginning of the year	2,270,046	3,692,929
Cash and cash equivalents, end of the year	\$ 2,729,641	\$ 2,270,046

See accompanying notes to consolidated financial statements.

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
STATEMENTS OF FUNCTIONAL EXPENSES  
Years Ended December 31, 2011 and 2010

	2011					2010				
	Program Service	Fundraising	Merchandise Cost	Management and General	Total	Program Service	Fundraising	Merchandise Cost	Management and General	Total
Expenses (Notes 8, 9 and 10):										
Compensation and benefits for non-field staff	\$ 1,571,836	\$ 649,624	\$ -	\$ 449,929	\$ 2,671,389	\$ 1,200,757	\$ 633,440	\$ -	\$ 382,599	\$ 2,216,796
Consulting and professional services	49,189	-	-	90,933	140,122	99,665	-	-	96,262	195,927
Office expenses	49,336	51,374	-	29,767	130,477	45,844	93,097	-	34,968	173,909
Information technology	524,425	19,763	-	34	544,222	113,424	-	-	211	113,635
Occupancy	78,891	-	-	79,887	158,778	76,713	-	-	82,953	159,666
Travel	230,380	54,073	-	22,404	306,857	211,021	61,201	-	17,258	289,480
Conferences and meetings	172,807	-	-	-	172,807	185,830	-	-	-	185,830
Depreciation and amortization	-	-	-	27,976	27,976	-	-	-	29,732	29,732
Insurance	-	-	-	17,584	17,584	-	-	-	17,166	17,166
Compensation and benefits for field staff	3,688,504	-	-	-	3,688,504	2,884,115	-	-	-	2,884,115
Earthquake relief	-	-	-	-	-	47,857	-	-	-	47,857
Donated goods and services	54,140	238,238	-	-	292,378	12,300	417,906	-	-	430,206
Stipends and tuition	259,010	-	-	-	259,010	261,868	-	-	-	261,868
Orphanage Center construction, equipment and furnishings	70,152	-	-	-	70,152	163,609	-	-	-	163,609
Surgery and nurturing care in connection with China Care program	1,165,833	-	-	-	1,165,833	1,364,611	-	-	-	1,364,611
Family Village	83,646	-	-	-	83,646	265,817	-	-	-	265,817
Critical Care Fund	-	-	-	-	-	444,275	-	-	-	444,275
Training programs and materials	395,190	-	-	-	395,190	202,490	-	-	-	202,490
Event expense	-	245,194	-	-	245,194	-	107,893	-	-	107,893
All other expense	221,177	78,368	4,783	-	304,328	190,097	60,998	17,462	-	268,557
<b>Total functional expenses</b>	<b>\$ 8,614,516</b>	<b>\$ 1,336,634</b>	<b>\$ 4,783</b>	<b>\$ 718,514</b>	<b>\$10,674,447</b>	<b>\$ 7,770,293</b>	<b>\$ 1,374,535</b>	<b>\$ 17,462</b>	<b>\$ 661,149</b>	<b>\$ 9,823,439</b>

See accompanying notes to consolidated financial statements.

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010

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**NOTE 1 – ORGANIZATION AND OPERATION**

Half the Sky Foundation (the "Foundation" or "HTS"), a non-profit public benefit corporation, was incorporated in November 1998 with its corporate office located in Berkeley, California.

The Foundation formed a Beijing Representative Office in June 2008. Effective since January 1, 2008 the Foundation also qualifies in the Netherlands as a charitable fund ("ANBI").

Half the Sky Foundation (Asia) Limited ("Asia Ltd."), a supporting organization of the Foundation, was incorporated in Hong Kong in March 2006. Half the Sky Foundation United Kingdom Limited ("UK Ltd."), another supporting organization of the Foundation, was incorporated in England and Wales in April 2008.

The consolidated financial statements include the accounts of the Foundation and all of the supporting organizations.

The Foundation was created in order to enrich the lives and enhance the prospects for orphaned children in China. The Foundation creates and operates infant nurture and early education programs, provides personalized learning for older children, and establishes loving permanent family care and guidance for children whose disabilities prevent them from finding adoptive families. It is the Foundation's goal to ensure that every orphaned child has a caring adult in her life and a chance at a bright future. The Foundation works in 51 state-run welfare institutions in 24 provinces and municipalities in China and offers six primary programs:

The Infant Nurture (IN) Program: In this program, designed to give infants aged 0-2 years a healthy start in life, the Foundation employs "nannies"- retired or laid-off workers from the local community - to cuddle, love and provide orphaned infants (0-2 years) the physical and emotional stimulation essential to normal development. The Foundation renovates rooms in the welfare institutions and provides training, salaries, other program expenses and supervision of staff.

The Little Sisters Preschool (LSP) Program: In this program, the Foundation-trained teachers use a unique and progressive curriculum that blends principles of the Reggio Emilia approach to early childhood education with contemporary Chinese teaching methods. The program is designed not only to prepare the children (2-7 years) to succeed in Chinese schools, but also to help develop the "whole child", facilitating healthy emotional, physical and cognitive development. The Foundation renovates rooms in the welfare institution and provides training, salaries, other program expenses and supervision of staff.

The Youth Services (YS) Program: In this program, individualized learning opportunities are provided for older children (8-21 years) who remain in the institutions. The Foundation tailors each program to the specific child, offering such services as tutoring prior to entrance exams, tuition to vocational schools, funds for music, dance, computer or art classes, and tutors for learning a second language. The Foundation also provides school fees for a growing number of orphans to attend universities throughout China.

The Family Village (FV) Program: In this program, children whose disabilities or special needs preclude adoption, live in permanent foster families in comfortable apartments in or nearby the welfare institutions. This program enables children who will never be adopted to grow up knowing the love of family while also receiving the support services that the welfare institution and the Foundation programs provide. The children attend the Foundation preschools and then go on to enjoy the enrichment opportunities of the Big Sisters Program. The Foundation partners with local governments to renovate apartments, provide furnishings, a small stipend for foster parents, ongoing training and miscellaneous fees.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010

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**NOTE 1 – ORGANIZATION AND OPERATION** (Continued)

The China Care Program: In this program, medically fragile orphaned infants and toddlers are provided with specialized medical treatment and nurturing after-care. Whether receiving 24-hour loving attention in the HTS China Care Home's Special Care Nursery or adjacent Medical Family Care Unit or in a nearby Beijing hospital, these tiny children not only receive life-saving medical treatment, they also learn that they are not alone in this world.

Rainbow Program: Beginning in October 2011, the Foundation began its Rainbow Program Implementation Plan to transition the Foundation to be a training and mentoring organization. The Foundation will provide training to all sites over the next 5 years to transition the responsibility of the site programs over to the Chinese government. By the end of December 31, 2011, 6 provinces had completed 14 sessions of the primary training program. The Foundation has trained 763 caregivers from 206 welfare centers. They anticipate that after the 5-year rainbow training, they will have covered at least 1,000 welfare centers. The Foundation will transition its mission to include conducting effective joint provincial training with China Center for Child Welfare and Adoption as well as ensure the sites maintain the Half the Sky program quality.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Foundation and its supporting organizations. Inter-organization transactions and balances have been eliminated upon consolidation.

Foreign Currency: Assets and liabilities denominated in foreign currencies are translated into United States of America dollars, the reporting currency, at exchange rates in effect on reporting dates, and revenue and expenses are translated at rates which approximate those in effect on transaction dates. A significant amount of the Foundation's expenses were paid for using the Chinese Renminbi for the years ended December 31, 2011 and 2010. Translation gains and losses were not material to the consolidated financial statements taken as a whole and are not reflected separately in the consolidated financial statements.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The accounts payable, accrued expenses and other liabilities are particularly subject to change.

Basis of Presentation: The consolidated financial statements have been prepared on the accrual basis of accounting which recognizes revenue and support when earned and expenses when incurred.

The financial statement presentation follows the guidance of Financial Accounting Standards Board (the "FASB") *Accounting Standards Codification*<sup>™</sup> ("ASC") 958 - 205, *Not-for-Profit Entities – Presentation of Financial Statements* ("ASC 958 – 205"). Under ASC 958 – 205, the Foundation is required to report information regarding its financial position and activities classified as permanently restricted, temporarily restricted, and unrestricted net assets with the change in each of these classes of net assets to be presented in the consolidated statements of activities and changes in net assets.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010

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**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Unrestricted Net Assets - Unrestricted net assets have no donor-imposed restrictions and include those revenues and expenses associated with program and supporting services.

Temporarily Restricted Net Assets - Temporarily restricted net assets represent contributions that are limited in use by the Foundation in accordance with donor-imposed stipulations. These stipulations may expire with time or may be satisfied and removed by the actions of the Foundation according to the terms of the contribution. Upon satisfaction of such stipulations, net assets are released from temporarily restricted net assets and recognized as unrestricted net assets.

Permanently Restricted Net Assets - Permanently restricted net assets are restricted by the donor for investment in perpetuity, such as endowments. The income from such invested assets is available to support the activities of the Foundation.

Cash and Cash Equivalents: Cash and cash equivalents consist primarily of highly liquid investments with an original maturity of three months or less. Cash and cash equivalents are carried at cost which approximates fair value. The Foundation was unable to maintain a Chinese bank account under its name before the Beijing Representative Office registered. Accordingly, it set up two accounts maintained by the managing director of programs. The balance in these accounts was \$44,540 and \$5,277 at December 31, 2011 and 2010, respectively. Overseas program operations, such as employee salaries, are funded through wire transfers from the Foundation's Berkeley office.

Credit Risk: The Foundation maintains cash and cash equivalents with commercial banks and other major financial institutions. Cash equivalents include overnight investments and money market funds. Cash balances may exceed the Federal Deposit Insurance Corporation ("FDIC") limits from time to time. The Foundation's investments have been placed with high quality financial institutions. The Foundation monitors these investments and has not experienced significant credit losses. The credit risk in pledges receivable is addressed as the Foundation evaluates the collectibility of pledges based on knowledge and available information about the donors. Additionally, any pledges that are expected to be collected after one year have been discounted and are reflected in the consolidated financial statements at their net present value.

Pledges Receivable: The Foundation evaluates the collectibility of its pledges receivable on an ongoing basis and records a reserve for potential uncollectible pledges receivable.

Other Receivables: Other receivables include interest and stock sale settlements.

Investments: The Foundation invests in marketable securities and money market funds. All debt securities and equity securities are carried at fair value based on quoted market values as of the last trading date of the Foundation's fiscal year. Investment transactions are recorded on trade date. Contributions of public stock are recorded at quoted market prices at the date of donation. The Foundation sells donated securities received as soon as reasonably possible. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses resulting from sales or maturities are calculated on an adjusted cost basis. Adjusted cost is the estimated fair value of the security at the beginning of the year, or the cost if purchased during the year. Dividend and interest income are accrued when earned.

Property and Equipment, Net: Acquisitions of property and equipment in excess of \$500 are capitalized. Purchased property and equipment are stated at cost. Significant donated property and equipment are recorded at their estimated fair value on the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010

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**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Impairment of Long-Lived Assets and For Long-Lived Assets To Be Disposed Of: Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows, excluding interest, expected to be generated by the asset. If such assets are considered to be impaired, the impairment is recognized on an asset-by-asset basis. The impairment is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset (fair value determined by discounted cash flows, market comparison, or replacement cost). Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No assets have been determined to be impaired as of December 31, 2011 and 2010.

Inventory: Inventory consists principally of merchandise sold in the Foundation's on-line store and is stated at the lower of weighted average cost or market value.

Revenue Recognition: Contributions are recognized as revenue when they are received or unconditionally promised as prescribed by ASC 958 – 605, *Not-for-Profit Entities – Revenue Recognition* ("ASC 958 – 605"). The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor stipulation expires, that is, when a stipulated time restriction ends or the purpose is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Conditional promises to give are not recorded as contributions until the conditions on which they depend are substantially met.

Donor-restricted contributions whose restrictions are met in the same reporting period as the contribution is recorded are reported as temporarily restricted contributions and net assets released from restrictions as donor restrictions are met.

The Foundation recognizes revenues from on-line store sales upon the sale of merchandise.

Contributed Services and Materials: Contributed services and materials are recognized in accordance with ASC 958 – 605. The Foundation received and recorded contributed pro-bono legal services for the years ended December 31, 2011 and 2010, with estimated fair values of \$98,566 and \$107,894, respectively. The Foundation received contributed services for a director of development in Hong Kong at an estimated fair value of \$100,000 for the year ended December 31, 2010.

Contributed goods are recorded at estimated fair value at the date of receipt and amounted to \$349,068 and \$297,051 for the years ended December 31, 2011 and 2010, respectively.

Income Tax Status: The Foundation has been recognized as an organization exempt from tax pursuant to Internal Revenue Code Section 501(c)(3) and classified by the Internal Revenue Service as other than a private foundation, and has been recognized by the California Franchise Tax Board as exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d). Asia Ltd. has been granted tax exempt status by the Hong Kong Inland Revenue Department. UK Ltd. has been granted tax exempt status by UK HM Revenue & Customs. The Foundation is also qualified as a charitable fund ("ANBI") in the Netherlands for tax purposes. Canada Ltd. has been granted tax exempt status by the Canada Revenue Agency. Australia Ltd. has been granted tax exempt status by the Australian Taxation Office.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Current accounting standards require the Foundation to disclose the amount of potential benefit or obligation to be realized as a result of an examination performed by a taxing authority. For the years ended December 31, 2011 and 2010, management has determined that the Foundation does not have any tax positions that result in any uncertainties regarding the possible impact on the Foundation's financial statements. The Foundation is no longer subject to examination by taxing authorities for years before 2008. The Foundation does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months. The Foundation recognizes interest and/or penalties related to income tax matters in income tax expense. The Foundation did not have any amounts accrued for interest and penalties at December 31, 2011 and 2010.

Functional Expense Allocations: The costs of providing the various program and supporting services have been summarized on a functional basis in the consolidated statements of activities and changes in net assets. Accordingly, certain expenses have been allocated among program services and supporting services based on estimates made by management.

Fair Value of Financial Instruments: Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

The three levels are defined as follows:

*Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.*

*Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.*

*Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.*

Reclassifications: Certain prior year balances have been reclassified to conform with current year financial statement presentation. Reclassification had no impact on prior year change in net assets or total net assets.

**NOTE 3 – PLEDGES RECEIVABLE, NET**

Pledges receivable represent unconditional promises to give by donors and are recorded at net realizable value. Pledges receivables of \$2,564 and \$109,944 at December 31, 2011 and 2010, respectively, were expected to be collected within one year. There were no long-term pledge receivables at December 31, 2011 or 2010.

The Foundation has received notification of various conditional pledges. These pledges for which the conditions have not yet been substantially met are not included as revenues and are not included in total revenue on the accompanying consolidated statements of activities and changes in net assets for the years ended December 31, 2011 and 2010. There were conditional promises to give of \$613,913 and \$3,096,511 as of the years ended December 31, 2011 and 2010, respectively.

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(Continued)

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 4 – INVESTMENT SECURITIES**

Investment securities are recorded at fair value and are summarized as follows:

	December 31,	
	2011	2010
Mutual funds – equity securities	\$ -	\$ 683,435
Mutual funds – fixed income	-	376,811
	\$ -	\$ 1,060,246

The investment goal of the Foundation is to maintain or grow its asset size and spending power in real (inflation adjusted) terms with risk at a level appropriate to the Foundation's program objectives. All financial assets of the Foundation are managed by external investment management firms selected by the Foundation. All financial assets of the Foundation are held in custody by a major commercial bank.

The majority of the Foundation's assets are invested in equity funds, which are listed on national exchanges, treasury bonds of the U.S. government, and funds of investment grade corporate bonds for which active trading markets exist. Net realized and unrealized gains and losses on investments are reflected in the consolidated statements of activities and changes in net assets.

The following schedule summarizes the investment returns for the years ended December 31 2011 and 2010:

	2011	2010
Unrealized gains	\$ -	\$ 88,935
Realized gains	54,010	-
	54,010	88,935
Investment related expenses	(4,472)	(9,197)
Net realized and unrealized gains	\$ 49,538	\$ 79,738
Interest and dividend income on investment	\$ 8,994	\$ 31,402

The Foundation's cash equivalents, marketable equity securities and fixed income mutual funds are valued using Level 1 inputs.

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(Continued)

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 5 – PROPERTY AND EQUIPMENT, NET**

Property and equipment consisted of the following at December 31:

	<u>2011</u>	<u>2010</u>
Equipment	\$ 143,923	\$ 136,497
Furniture and fixtures	<u>25,284</u>	<u>25,284</u>
Total	169,207	161,781
Less: accumulated depreciation	<u>(134,957)</u>	<u>(106,981)</u>
Property and equipment, net	<u>\$ 34,250</u>	<u>\$ 54,800</u>

Depreciation expense for the years ended December 31, 2011 and 2010 amounted to \$27,976 and \$29,732, respectively.

**NOTE 6 – TEMPORARILY RESTRICTED NET ASSETS**

Temporarily restricted net assets were available for the following purpose-restricted programs or locations at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
2 HTS centers and 8 additional Family Village Projects	\$ 187,919	\$ 179,520
Beihai and Sanya	51,840	28,285
Blue Sky	-	180,821
Changchun	-	129,726
Changsha	247,045	167,329
Chengdu	11,563	27,584
Chenzhou	28,736	-
The China Care Project (TCCP)	28,938	-
Chuzhou nanny salary	1,226	-
Earnings on endowment funds	-	130,796
Fuzhou	2,888	31,878
Gaoyou LS	10,953	-
Guangzhou	197,697	-
Guilin	113,528	90,071
Haikou	71,809	320,819
Hefei	4,404	1,441
Hohhot LSP	15,733	-
National Training Program	241,325	-
Lianyungang	-	10,024
Little Sister Preschool in Chengdu, Shenyang, Xi'an, Chongqing and Harbin	145,808	-
Luoyang	35,091	46,958
Maoming	23,703	35,474
Maonan	8,578	26,111
Nanjing	51,669	68,059
National training curriculum	1,030	-

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
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**NOTE 6 – TEMPORARILY RESTRICTED NET ASSETS** (Continued)

	<u>2011</u>	<u>2010</u>
Qingdao and Shijiazhuang	\$ 9,707	\$ 63,392
Qingyuan Wuhan, Qingdao and Urumgi LS 2012	75,000	6,807
Shaoyang	20,550	-
Shenzhen	116,925	156,123
Wuzhou	9,162	5,811
Xiamen	-	19,470
Yiyang	1,404	3,384
YS newsletter project	<u>10,767</u>	<u>7,753</u>
Total temporarily restricted net assets	<u>\$ 1,724,998</u>	<u>\$ 1,737,636</u>

**NOTE 7 – NET ASSETS RELEASED FROM RESTRICTIONS**

Net assets were released from donor restrictions by incurring expense satisfying the purpose of the restriction or by the passage of time during the year ended December 31, 2011:

The China Care Project (TCCP)	\$ 1,129,600
JPMC National Training	758,675
Blue Sky	647,732
2 HTS centers and 8 additional Family Village projects	591,601
Haikou	399,110
Shenzhen	179,783
Earning on endowment funds	169,227
Changchun	130,227
Maoming	115,025
Youth Service Program	114,154
Lianyungang	110,254
Nanjing (All but FV program)	100,597
Changsha	83,663
National training curriculum	76,660
Wuzhou	66,308
Shijiazhuang, Tianjin and One CCH Room	63,392
Guilin	57,286
Little Sister Preschools in Chengdu, Shenyang, Xi'an, Chongqing and Harbin	44,192
Beihai and Sanya	39,986
Xiamen (IN)	38,392
Maonan	37,758
Guangzhou (IN and FV)	37,317
Fuzhou	34,774
Luoyang (LS)	32,866
Guangzhou (LS and YS) Q4 2011	28,408
Chengdu (FV)	27,584
Hefei	26,000
Qingyuan	20,867
YS newsletter project	18,162
China Care - training supervisor's salary	16,373
Chuzhou nanny salary	13,774

(Continued)

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
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**NOTE 7 – NET ASSETS RELEASED FROM RESTRICTIONS** (Continued)

Chenzhou	\$ 12,413
Wuhan	10,913
Gaoyou (all but LS)	10,250
Yibin	10,215
Changzhou (FV)	10,000
Shaoyang (LS)	8,868
Xiamen (LS)	8,053
Zhengzhou director's workshop	7,500
Hohhot (LSP from Q4 2011)	7,006
Gaoyou (LS)	5,438
Shaoguan	5,274
Shaoyang IN nanny salaries	5,000
China Care	4,348
Other	<u>25,744</u>
Total net assets released from restrictions	\$ <u>5,340,769</u>

**NOTE 8 – ENDOWMENTS**

The Foundation accounts for endowment gifts under the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). UPMIFA was enacted in California on September 30, 2009 with an effective date of January 1, 2009. Under UPMIFA, the Foundation may allow an endowed fund to spend into historic gift value if it can prudently do so after consideration of 7 factors that affect the spending and future earnings of the fund. Contributions to the funds are classified as permanently restricted net assets while net earnings activity is reclassified to temporarily restricted net assets. When a stipulated time restriction ends or purpose restriction is accomplished, generally through the payment of grants and fund expenses, endowed fund expenses are reclassified to unrestricted net assets and reported in the statements of activity and changes in net assets as net assets released from restrictions. A board designated endowment fund, one where the Foundation's board has set aside a permanent portion of its unrestricted net assets to support the Foundation for the long term, is classified in its entirety as unrestricted net assets.

Return Objectives and Risk Parameters: The Foundation 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 Foundation must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. During 2011, as approved by the Board of Directors, endowment funds were moved from the HTS U.S. account to the HTS Asia account and converted into Chinese Yuan to prevent the loss of exchange rate depreciation. Management anticipates a total return of 2% in certificates of deposit with bond funds as an additional investment alternative.

Strategies Employed for Achieving Objectives: To satisfy its long-term rate-of-return objectives, the Foundation 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 Foundation 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.

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(Continued)



HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 8 – ENDOWMENTS** (Continued)

Spending Policy and How the Investment Objectives Relate to Spending Policy: The Foundation has a policy of appropriating for distribution each year up to 5 percent of the endowment fund's average fair value over the prior 12 quarters through the calendar year-end proceeding the fiscal year in which the distribution is planned. In establishing this policy, the Foundation considered the long-term expected return on its endowment. Accordingly, over the long-term, the Foundation expects the current spending policy to allow its endowment to grow 2 percent annually. This is consistent with the Foundation's objective to 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. The Spending Policy will be reviewed and/or updated, and approved by the Board of Directors on an annual basis.

The endowment net asset composition by type of fund as of December 31, 2011, consist of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ -	\$ 645,724	\$ 645,724
Accumulated gains on donor-restricted endowment funds	-	-	-	-
Board-designated endowment funds	-	-	-	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 645,724</u>	<u>\$ 645,724</u>
Endowment net assets, beginning of year	\$ 359,395	\$ 130,796	\$ 634,490	\$ 1,124,681
Net appreciation (realized and unrealized)	-	38,431	-	38,431
Contributions	-	-	11,234	11,234
Appropriation of endowment assets for expenditure	-	(169,227)	-	(169,227)
Transfers to remove assets from board-designated endowment funds	<u>(359,395)</u>	<u>-</u>	<u>-</u>	<u>(359,395)</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 645,724</u>	<u>\$ 645,724</u>

During 2011 the Foundation transferred all board-designated endowment funds of \$359,395 and \$94,188 of related accumulated earnings to assist in funding operating expenses as the Foundation transitions to becoming a training and mentoring organization.

(Continued)

HALF THE SKY FOUNDATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 8 – ENDOWMENTS** (Continued)

The endowment net asset composition by type of fund as of December 31, 2010, consist of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ -	\$ 634,490	\$ 634,490
Accumulated gains on donor- restricted endowment funds	-	130,796	-	130,796
Board-designated endowment funds	<u>359,395</u>	<u>-</u>	<u>-</u>	<u>359,395</u>
	<u>\$ 359,395</u>	<u>\$ 130,796</u>	<u>\$ 634,490</u>	<u>\$ 1,124,681</u>
 Endowment net assets, beginning of year	 \$ 309,395	 \$ 63,160	 \$ 618,708	 \$ 991,263
Net appreciation (realized and unrealized)	-	67,636	-	67,636
Contributions	50,000	-	15,782	65,782
Appropriation of endowment assets for expenditure	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 359,395</u>	<u>\$ 130,796</u>	<u>\$ 634,490</u>	<u>\$ 1,124,681</u>

As of December 31, 2010, the board-designated endowment funds had accumulated earnings of \$74,087.

**NOTE 9 – COMMITMENTS AND CONTINGENCIES**

Lease Obligation: The Foundation leases office facilities in the United States, an apartment unit and an office facility in Beijing, People's Republic of China, and an office facility in Hong Kong. The operating leases expire at various dates through December 2014. Rent paid under these leases was approximately \$153,000 and \$158,000 for the years ended December 31, 2011 and 2010, respectively.

<u>Year Ending December 31,</u>	
2012	\$ 161,344
2013	61,639
2014	<u>57,396</u>
	<u>\$ 280,379</u>

Contingencies: The Foundation is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Foundation.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
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**NOTE 10 – EMPLOYEE BENEFIT PLANS**

In 2008, the Foundation had a 403(b) retirement plan for its employees. In January 1, 2009, the Foundation transferred all assets to a 401(k) plan, covering all employees who have met certain eligibility requirements. Under the 401(k) plan, employees may elect to contribute a certain percent of their eligible compensation to the 401(k) plan, subject to IRS limitations. The Foundation may make matching contributions during the year equal to a discretionary percentage, as determined by the Foundation, of the participant's salary reductions. Employer contributions vest at the rate of 20% per year with full vesting after 6 years of service with the Foundation. Total contributions made to the retirement plans by the Foundation for the years ended December 31, 2011 and 2010 were \$22,475 and \$19,266, respectively.

**NOTE 11 – RELATED PARTY TRANSACTIONS**

For the years ended December 31, 2011 and 2010, recorded contribution revenue from members of the Board of Directors of Half the Sky Foundation or companies or individuals with which the Board of Directors are affiliated were \$473,795 and \$184,365, respectively.

**NOTE 12 – AFFILIATED PARTIES**

Half the Sky Foundation Australia Limited ("Australia Ltd"), an affiliate of the Foundation, was incorporated in Victoria, Australia in May 2009. It has a joint development project with HTS in 2011. Half the Sky Foundation Canada Limited ("Canada Ltd"), another affiliate of the Foundation was incorporated in Canada in June 2009. It organized fundraising events in 2010 to collect funds for the programs of the Foundation. Canada Ltd contributed \$32,783 to the Foundation in 2011. There were no donations made from Canada Ltd to the Foundation in 2010.

Half the Sky Foundation Canada (Foundation HTS du Canada) was an independent charitable entity, registered with the Canadian government, which used to raise funds and make unrestricted donations to the Foundation until August 2010, at which point it was closed.

**NOTE 13 – MAJOR CONTRIBUTIONS**

For the year ended December 31, 2011, the Foundation had two donors with more than 25% of total contributions. For the year ended December 31, 2010, the Foundation had one donor with more than 20% of total contributions.

**NOTE 14 – COOPERATION AGREEMENT**

In early 2008, the Foundation entered into a cooperation agreement with the Ministry of Civil Affairs of the PRC ("MCA") known as the "Blue Sky Plan." Under this agreement, the Foundation works with the MCA to establish cooperative model centers and to develop relevant care and education programs in each of the provinces in the PRC. During the years ended December 31, 2011 and 2010, the Foundation received a designated grant of \$466,911 and \$699,500, respectively, from an international charity to implement this program, which is recorded in contributions revenue on the accompanying consolidated statements of activities and changes in net assets.

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HALF THE SKY FOUNDATION AND SUBSIDIARIES  
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**NOTE 15 – SUBSEQUENT EVENTS**

The Foundation has evaluated the effects of subsequent events that have occurred subsequent to December 31, 2011 and through July 26, 2012, which is the date the financial statements were available to be issued, and has determined that there were no subsequent events that require recognition or disclosure in the financial statements or notes therein.