

JANNEY MONTGOMERY SCOTT LLC

Statement of Financial Condition

Year ended June 30, 2014 (Unaudited)

Janney Montgomery Scott LLC

Financial Statements and Supplemental Information

For the year ended June 30, 2014

**Contents**

Statement of Financial Condition .....	1
Notes to Statement of Financial Condition.....	2

Janney Montgomery Scott LLC  
Statement of Financial Condition  
June 30, 2014

<b>Assets:</b>	
Cash and cash equivalents	\$ 14,992,404
Receivable from brokers, dealers and clearing organizations:	
Securities borrowed	1,974,601,969
Securities failed to deliver	8,848,788
Clearing organizations	9,489,660
Receivable from customers (net of allowance for doubtful accounts of \$217,645)	260,509,528
Receivable from non-customer	733,111
Securities owned, at fair value	279,255,062
Investments in partnerships, at fair value	5,551,067
Furniture, equipment and leasehold improvements (net of accumulated depreciation of \$68,214,575 and grant contra assets of \$9,358,071)	38,428,490
Intangible assets (net of accumulated amortization of \$8,073,250)	626,750
Goodwill	49,601,576
Corporate owned life insurance (“COLI”)	96,252,794
Employee loans and advances (net of allowance for doubtful accounts of \$403,754)	140,154,987
Deferred tax asset, net	46,107,027
Mutual fund commissions receivable	6,857,303
Deposits with clearing organizations and others	19,016,789
Other assets	33,110,601
Total assets	<u>\$ 2,984,137,906</u>
 <b>Liabilities and equity:</b>	
Short-term bank loans	\$ 110,475,222
Payable to brokers, dealers and clearing organizations:	
Securities loaned	1,921,362,762
Clearing organizations	41,331,236
Securities failed to receive	13,607,471
Payable to customers	166,051,524
Securities sold, not yet purchased, at fair value	128,285,218
Deferred rent payable	23,425,142
Accrued compensation	105,739,087
Accounts payable and accrued liabilities	84,248,744
Total liabilities	<u>2,594,526,406</u>
Liabilities subordinated to the claims of general creditors	205,000,000
Member’s equity	183,465,518
Accumulated other comprehensive income	1,145,982
Total liabilities and equity	<u>\$ 2,984,137,906</u>

*See accompanying notes*

Janney Montgomery Scott LLC  
Notes to Statement of Financial Condition  
June 30, 2014

**1. Organization**

Janney Montgomery Scott LLC (the “Company”) is a broker-dealer registered with the Securities Exchange Commission (“SEC”) and in fifty states, the District of Columbia and Puerto Rico, and a wholly owned subsidiary of Independence Square Properties LLC (the “Member”), which is a wholly owned subsidiary of The Penn Mutual Life Insurance Company (“Penn Mutual”). The Company is a member of the Financial Industry Regulatory Authority (“FINRA”) and a member of the Securities Industry Protection Corporation (“SIPC”).

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

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

**Cash and Cash Equivalents**

Cash and cash equivalents include deposits held at financial institutions, which are available for the Company’s use with no restrictions, with original maturities of 90 days or less. At June 30, 2014 the Company did not hold any cash equivalents.

**Segregated Cash**

In accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, a broker-dealer carrying client accounts is subject to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients.

**Securities Transactions**

Proprietary and customer transactions in securities and listed options, including the related revenues and expenses, are recorded on a trade-date basis.

Receivable from customers includes amounts due on cash and margin transactions. The value of securities owned by customers and held as collateral for these receivables is not reflected in the Statement of Financial Condition. The Company reserves for doubtful accounts when the customer receivable becomes partially unsecured.

## **2. Summary of Significant Accounting Policies (continued)**

Securities owned, at fair value and securities sold, not yet purchased, at fair value are valued at quoted market prices with the exception of certain fixed income instruments whose fair value is determined by matrix pricing utilized by a recognized independent pricing service, which management believes to approximate fair value. Firm inventory positions are not typically held for more than thirty days.

### **Investment Banking**

Investment banking revenues are recorded as follows: management fees and underwriting fees as of the commitment date, related sales commissions on trade date, and advisory fees when earned.

### **Securities Lending Activities**

Securities borrowed and securities loaned are generally reported as collateralized financings. Securities borrowed transactions require the Company to deposit 102% of the contract value with cash, letters of credit, or other collateral with the lender. With respect to securities loaned, the Company receives collateral of 102% of the contract value in the form of cash or other collateral. In both types of transactions, the collateral deposited or received is in an amount generally in excess of the fair value of securities borrowed or loaned. The Company monitors the fair value of securities borrowed and securities loaned on a daily basis, with additional collateral obtained, deposited, or refunded as necessary.

### **Financial Instruments**

The Company's financial instruments are measured at fair value in accordance with ASC 820, "*Fair Value Measurement and Disclosures*". ASC 820 defines fair value as the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs by requiring that the most observable inputs be used when available. Observable inputs are based on market pricing data obtained from sources independent of the Company. Unobservable inputs reflect management's judgment about the assumptions market participants would use in pricing the asset or liability. The fair value hierarchy includes three levels based on the objectivity of the inputs as follows:

- Level 1 inputs are quoted prices in active markets as of the measurement date for identical assets or liabilities that the Company has the ability to access. This category includes actively traded exchange traded-funds, mutual funds, government obligations, and equity securities.
- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, whether directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs

## 2. Summary of Significant Accounting Policies (continued)

other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. This category includes corporate fixed income securities, certificates of deposit, unit investment trusts, and municipal debt securities.

- Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little if any, market activity for the asset or liability. This category includes auction rate securities, investments in partnerships, and certain equity and fixed income securities not actively traded.

### Valuation Techniques

The Company generally utilizes third-party pricing services to value investment securities. The Company reviews the methodologies and assumptions used by the third-party pricing services and evaluate the values provided, principally by comparison with other available market quotes for similar instruments and/or analysis based on third-party market data. As a result of the review, the Company may occasionally adjust certain values provided by the third-party pricing service when the adjusted price most appropriately reflects the fair value of the particular security.

Equity Securities (corporate stocks) – All equity securities that are publically traded stocks with observable prices in active markets receive a Level 1 rating, the highest in the hierarchy. Equity securities which are not actively traded, but which are priced based on similar assets traded in active markets are given a Level 2 rating. All Equity securities which not actively traded and valued with unobservable inputs are classified as Level 3.

Corporate Obligations – Corporate obligations which are priced based on similar assets traded in active markets or other observable inputs are given a Level 2 rating.

Government Obligations – The fair value of government obligations are generally based on quoted prices in active markets and are classified as Level 1. If quoted prices are not available, the fair value is based on observable market data and is therefore classified as Level 2 securities.

Municipal Obligations – Municipal Obligations are valued daily using current market data and are categorized as Level 2 securities. In order to validate reasonability, prices are reviewed through comparison with directly observed recent market trades or comparison of all significant inputs used in the validation to management's observations of those inputs in the market.

Investment in Partnerships – Fair value of investments in the partnerships is based on unobservable market inputs based on discussions with the partnerships' management and market comparables. Investments in partnerships are categorized as Level 3 securities.

## **2. Summary of Significant Accounting Policies (continued)**

### **Employee Loans and Advances**

The Company provides certain financial consultants with loans as part of the Company's recruiting and retention strategy for key revenue producing employees. These loans are generally repayable through bonuses over a four to ten year period based upon continued employment with the Company. If the employee leaves before the term of the loan expires, the balance becomes immediately due and payable. The Company carries a reserve for uncollectible amounts for these terminated employees based on historical collection rates and management's knowledge of the circumstances of individual loans. Employee loans of \$140,154,987 are net of reserve for uncollectible amounts of \$403,754 and the corresponding accrued bonuses of \$10,208,855 are reflected in accrued compensation on the Statement of Financial Condition.

### **Taxes**

For income tax reporting purposes, the Company is treated as a disregarded entity and its income is included within a consolidated federal income tax return filed by Penn Mutual. In accordance with the tax allocation policy of the consolidated group, the Company determines its federal income tax liability on a separate-return basis and makes the required tax payments to the Member.

Deferred income tax assets and liabilities are established to reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred tax assets or liabilities are measured by using the enacted tax rates expected to apply to taxable income in the period in which the deferred tax liabilities or assets are expected to be settled or realized. The Company accounts for income taxes according to ASC 740, "*Income Taxes*".

Penn Mutual, as a mutual insurance company, is generally not subject to state income taxes. As a result, the Company, as a consolidated entity, has limited state income tax liability.

### **Investments in Partnerships**

Investments in partnerships, at fair value include the Company's investments in limited partnerships and limited liability companies which, in accordance with ASC 810, "*Consolidation Topic*", do not meet the requirements for consolidation. Within these investments are two non-managing interests in limited partnerships (the "LPs") in which the Company has a material variable interest but is not the primary beneficiary under ASC 810. The Company's determination of the primary beneficiary for each of the LPs for which it has a variable interest requires judgment and is based on all relevant facts and circumstances, including the following: (1) our risk of loss is limited to our investment in the LPs, and (2) the Company does not have controlling interest or any management input into the operations of the LPs. The LPs were organized in February 2000 and March 2006 for the purpose of investing in start-up entities with the goal of capital appreciation.

## **2. Summary of Significant Accounting Policies (continued)**

These investments are recorded at fair value and valued based on the prior quarter-end portfolio valuations provided by the applicable General Partner, with consideration for changes in the value of the underlying investments during the fourth quarter. We believe this represents the Company's best estimate of fair value as of June 30, 2014. Because of the inherent uncertainty of this valuation, however, these estimated values may differ significantly from the values that would have been used had an active market for these underlying securities existed and the differences could be material.

### **Furniture, Equipment, and Leasehold Improvements**

All furniture, equipment, and leasehold improvements are recorded at cost, net of accumulated depreciation. Depreciation on leasehold improvements is provided on a straight-line basis over the length of the lease. Furniture and equipment are depreciated using the straight-line method generally over three to seven years. As of June 30, 2014 furniture and equipment and leasehold improvements are \$64,316,941 and \$51,684,195, respectively. Accumulated depreciation on furniture and equipment and leasehold improvements are \$47,497,800 and \$20,716,775, respectively. Also included in furniture, equipment, and leasehold improvements are the grant contra assets and relative accumulated depreciation of \$11,000,000 and \$1,641,929, respectively. Please see Grant Agreement note below.

### **Grant Agreement**

In 2012 the Company received grants from the Commonwealth of Pennsylvania under the Redevelopment Authority Capital Program ("RACP") and Opportunity Grant Program. The grants allow for reimbursement of eligible capital expenditures after demonstrating compliance with special conditions of the program, which include, but are not limited to, requesting bids, usage of domestic steel in manufacturing, providing union payrolls, etc. Under the Opportunity Grant Program the Grant was awarded based on the Company meeting certain future contingencies which include headcount growth, minimum private investment, and the Company remaining at the project site for a minimum of five years. The State retains the right to pursue repayment of the grants, or withhold reimbursement of funds if the special conditions are not met.

The Company is following the guidance from International Accounting Standard ("IAS") No. 20, *"Accounting for Government Grants and Disclosure of Government Assistance"* to account for the grant funds. The funds received from the grant are recorded to the Statement of Financial Condition under "Furniture, equipment, and leasehold improvements at cost" as contra assets, so that they are matched on the Statement of Financial Condition as an offset to the specific assets for which the Company received reimbursement. As of June 30, 2014, the Company had \$9,358,071 in deferred grant revenue recorded as contra assets in the Statement of Financial Condition.



## 2. Summary of Significant Accounting Policies (continued)

### Derivative Instrument Designated and Qualifying as a Cash Flow Hedge

The Company maintains a deferred award program for its financial advisors in which awards are granted based on prior year gross production. These awards cliff vest over 5 or 7 year periods. Financial advisors must be present at the time of vesting to be paid the award. The Company allows the financial advisors to select from a menu of investment options upon which the applicable cumulative investment gains or losses will be paid at the time of full vesting. Beginning with the award granted in 2013, the Company uses a total return swap designated as a cash flow hedge under ASC 815, “*Derivatives and Hedging*” in order to hedge its market risk associated with investment elections, provide the market returns and match the appropriate gains/losses on the hedge to the associated compensation liability. Net cash settlements are passed between the parties on a monthly basis and then reestablished each month based on the current market value and any cumulative changes in the underlying elections by the financial advisors. Cash collateral is posted throughout the month on any market movements in excess of \$250,000. The maximum length of time which the Company is hedging its exposure to the variability in future cash flows is seven years.

At inception, the Company determined that the total return swap met the criteria for hedge accounting. Ongoing effectiveness evaluations are made for the total return swap that is designated and qualifying as a hedge.

The following table provides the notional value and fair value of the Company’s derivative instrument designated as a hedging instrument under ASC 815 as of June 30, 2014:

	<u>Number of Contracts</u>	<u>Notional Value</u>	<u>Statement of Financial Condition</u>	<u>Receivable Fair Value</u>
Total return swap	2	\$ 26,246,075	Other assets	\$ 479,883

### 3. Fair Value Measurements

The Company's financial instruments recorded at fair value have been categorized based upon a fair value hierarchy in accordance with ASC 820. See Note 2 to these financial statements for a further discussion on the Company's policies regarding this hierarchy. The Company had no significant transfers of financial instruments between Levels during the fiscal year ended June 30, 2014.

The following table presents information about the Company's financial instruments measured at fair value on a recurring basis as of June 30, 2014:

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Totals
<b>Assets</b>				
<b>Securities owned at fair value</b>				
Equities, ETFs, & options	\$ 519,820	\$ -	\$ 129,853	\$ 649,673
Preferred stock	-	10,720,160	3,080	10,723,240
Auction rates	-	-	225,000	225,000
Corporate bonds	-	117,775,981	13,052	117,789,033
Municipal bonds	-	121,225,380	9,866	121,235,246
Government & agency obligations	-	28,632,870	-	28,632,870
Total securities owned, at fair value	519,820	278,354,391	380,851	279,255,062
<b>Investments in subsidiaries and partnerships</b>				
Investment in partnerships	-	-	5,551,067	5,551,067
Total investments in subsidiaries and partnerships	-	-	5,551,067	5,551,067
<b>Total assets measured at fair value on a recurring basis</b>	<b>\$ 519,820</b>	<b>\$ 278,354,391</b>	<b>\$ 5,931,918</b>	<b>\$ 284,806,129</b>
<b>Liabilities</b>				
<b>Securities sold, not yet purchased, at fair value:</b>				
Equities, ETFs, & options	\$ (1,079,236)	\$ -	\$ -	\$ (1,079,236)
Preferred stock	-	(957,279)	-	(957,279)
Corporate bonds	-	(21,929,852)	-	(21,929,852)
Municipal bonds	-	(135,150)	-	(135,150)
Government & agency obligations	-	(104,183,701)	-	(104,183,701)
Total securities sold at fair value	\$ (1,079,236)	\$ (127,205,982)	\$ -	\$ (128,285,218)

The following table presents information about the Company's financial instruments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of June 30, 2014:

	Equities, ETFs, & options	Preferred stock	Auction rates	Corporate bonds	Municipal bonds	Investment in partnerships	Totals
Balance, beginning of period	\$ 65,693	\$ 1,878	\$ 225,000	\$ 1,153,931	\$ 5,141	\$ 5,389,581	\$ 6,841,224
Unrealized gains (losses)	28,087	587	-	12,902	(174)	295,726	337,128
Realized gains (losses)	(11,737)	43	-	(10,292)	49	-	(21,937)
Purchases	47,930	575	-	-	4,850	67,500	120,855
Sales	(120)	(3)	-	(1,143,489)	-	(201,740)	(1,345,352)
Issuances	-	-	-	-	-	-	-
Settlements	-	-	-	-	-	-	-
Transfers in to level 3	-	-	-	-	-	-	-
Balance at end of the period	\$ 129,853	\$ 3,080	\$ 225,000	\$ 13,052	\$ 9,866	\$ 5,551,067	\$ 5,931,918

### 3. Fair Value Measurements (continued)

The Company's policy is that the end of each reporting period determines when transfers of assets between levels are recognized. There were no transfers between Level 1, Level 2, or Level 3 for the six months ending June 30, 2014.

The following table represents quantitative information about significant Level 3 fair value measurements:

Level 3 financial instrument	Fair value at December 31, 2013	Valuation techniques	Unobservable input	Range (weighted average)
Auction rates	\$ 225,000	Recent Trades	Observed trades of other comparable securities	100% of par (100%)
Investment in partnerships	5,551,067	Market comparables	Multiple of Revenue EBITA Multiple	2.0 (2.0) 7.0 (7.0)

The following represent financial instruments which are not carried at fair value on our Statement of Financial Condition:

*Short Term Financial Instruments:* The carrying amount of short-term financial instruments, including cash & cash equivalents, segregated cash, and short term bank loans are recorded at amounts that approximate fair value of these instruments. These instruments have no stated maturity and carry interest rates that approximate fair value.

*Receivable and other assets:* Receivables from customers, broker-dealers, and other operating receivables are recorded at amounts that approximate fair value. These assets are generally short term in nature.

*COLI:* These financial instruments are carried at cash surrender value of the policies which approximate fair value.

*Employee loans and advances:* These financial instruments have a stated maturity with a fixed interest rate, so fair value does not approximate the carrying amount. The Company estimated fair value based on estimated future cash flows and estimated discount rates.

*Payables:* Payable to customers, broker-dealers, and other payables are recorded at amounts that approximated fair value. These liabilities are generally short term in nature.

*Liabilities subordinated to the claims of general creditors:* These financial instruments have a stated maturity with a fixed interest rate. The Company estimated fair value based on estimated future cash flows and estimated discount rates.

### 3. Fair Value Measurements (continued)

The following table presents the estimated fair values of financial instruments not measured at fair value on the Statement of Financial Condition as of June 30, 2014:

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Carrying amount
<b>Financial Assets</b>				
Cash & cash equivalents	\$ 14,992,404	\$ -	\$ -	\$ 14,992,404
Receivable from customers	-	-	260,509,528	260,509,528
COLI	-	96,252,794	-	96,252,794
Receivable from broker dealers & clearing orgs.	-	1,992,940,917	-	1,992,940,917
Other receivables	-	-	105,091,720	105,091,720
Employee loans & advances	-	-	122,312,486	140,154,987
<b>Financial Liabilities</b>				
Short term bank loans	-	110,475,222	-	110,475,222
Payable to brokers dealers & clearing orgs.	-	1,976,301,469	-	1,976,301,469
Payable to customers	166,051,524	-	-	166,051,524
Other	-	-	213,412,973	213,412,973
Liabilities subordinated to the claims of general creditors	-	-	238,730,215	205,000,000

### 4. Short-term Bank Loans

The Company borrows from four banks in connection with the securities settlement process and to finance margin loans made to customers. The Company is required to fully collateralize these loans. At June 30, 2014, these banks extended short-term bank loans in the amount of \$83,200,000 which were collateralized by customer-owned securities valued at approximately \$1,844,432 and Company owned securities valued at \$162,096,892. Certain collateral amounts exceed the minimum requirements to allow for daily fluctuations. The bank loans are demand obligations and generally require interest based upon the federal funds rate. At June 30, 2014, the weighted-average interest rate on these borrowings was approximately 0.90%. All of the remaining bank loans, which consist of overdrafts of depository accounts of \$27,275,222, are not collateralized.

## 5. Liabilities Subordinated to the Claims of General Creditors

The liabilities subordinated to the claims for general creditors (the “Notes”) may only be repaid upon the Company’s continued compliance with its minimum net capital requirements. The Notes were approved by FINRA and amounts borrowed against the Notes are available in computing net capital under the Securities & Exchange Commission’s Uniform Net Capital Rule (“Rule 15c3-1”).

<b>Lender</b>	<b>Note Amount</b>	<b>Borrowed Amount</b>	<b>Maturity Date</b>	<b>Interest Rate</b>
<b>Penn Mutual</b>	<b>65,000,000</b>			
Penn Mutual (03/26/2009)		15,000,000	3/13/2029	10%
Penn Mutual (04/16/2009)		30,000,000	3/13/2029	10%
Penn Mutual (08/29/2011)		10,000,000	3/13/2029	7%
<b>Penn Mutual</b>	<b>50,000,000</b>			
Penn Mutual (01/27/2010)		5,000,000	1/15/2030	10%
Penn Mutual (04/26/2012)		10,000,000	1/15/2030	9%
Penn Mutual (05/29/2012)		10,000,000	1/15/2030	9%
Penn Mutual (11/13/2012)		25,000,000	1/15/2030	7%
<b>PA Insurance &amp; Annuity Co*</b>	<b>40,000,000</b>	40,000,000	8/19/2031	9%
<b>Penn Mutual</b>	<b>80,000,000</b>	60,000,000	1/25/2033	3%
*Pennsylvania Insurance & Annuity Company is a fully owned subsidiary of Penn Mutual				

## 6. Member’s Equity

The Company entered into an operating agreement with the Member which sets forth the rights, obligations, and duties with respect to the Company. According to the operating agreement, the Member shall not be personally liable to creditors of the Company for debts, obligations, liabilities, or losses of the Company, except as required by law. The Member has the right, but is not required, to make capital contributions upon request of the Company. The Member may require the Company to make distributions of cash or property at such times and amounts as it determines, subject to regulatory limitations and approval.

During the year ended June 30, 2014, the Company paid quarterly distributions equal to 100% of net income, after tax, to the Member. The Company has accrued \$6,104,102 at June 30, 2014 for the fourth quarter distribution payable to the Member, which is included in accounts payable and accrued liabilities in the Statement of Financial Condition.

## 7. Taxes

The income taxes attributable to net income are different from the amounts determined by multiplying net income before income taxes by the expected federal income tax rate. The difference between the amount of tax at the U.S. federal income tax rate of 35% and the tax provision is summarized as follows:

	<b>Amount</b>	<b>Rate</b>
Tax expense @ 35%	\$ 5,091,058	35%
(Decrease)/increase income taxes resulting from:		
COLI gains	(1,058,503)	-6%
Tax exempt interest	(344,876)	-2%
Meals & entertainment	342,168	2%
Other	(8,660)	0%
Federal Income Tax Expense	<b>4,021,186</b>	<b>29%</b>
State Income Tax Expense	<b>43,332</b>	<b>0%</b>
Total Provision for Income Tax	<b>\$ 4,064,518</b>	<b>23%</b>

Deferred income taxes reflect the impact for financial statement reporting purposes of temporary differences between the financial statement carrying amounts and tax basis of assets and liabilities. The significant temporary differences that give rise to the deferred tax assets and liabilities at June 30, 2014 relate to the following:

	<b>2014</b>
<b>Deferred tax assets:</b>	
Employee benefit liabilities	\$ 32,391,289
Accrued rent	8,198,799
Grant income	3,275,325
Depreciation	2,592,598
Partnership investments	429,919
Loss contingencies	256,426
Total deferred tax asset	<b>47,144,356</b>
<b>Deferred tax liabilities:</b>	
Parker/Hunter intangible	(259,085)
Other comprehensive income	(617,068)
Other	(161,176)
Total deferred tax liability	<b>(1,037,329)</b>
Deferred tax asset, net	<b>\$ 46,107,027</b>

## **7. Taxes (continued)**

The Company made tax reimbursements during the year of \$11,767,999 to the Member. There are no tax positions, at June 30, 2014, for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility.

The Company recognizes penalties and/or interest as a component of tax expense. No penalties were recognized or accrued. The Internal Revenue Service (“IRS”) has completed its examination of Penn Mutual’s income tax returns through the year 2007 and is currently reviewing tax years 2008, 2009, and 2010. Management believes that an adequate provision has been made for potential adjustments. However, actual adjustments could differ from current provisions.

## **8. Net Capital Requirements**

The Company is subject to Rule 15c3-1 of the Securities and Exchange Commission (“SEC”) and the capital rules of the New York Stock Exchange (“NYSE”). The Company has elected to use the alternative method permitted by Rule 15c3-1 which requires that it maintain minimum net capital, as defined, equal to the greater of \$1,000,000 or 2% of aggregate debit balances arising from customer transactions, as defined. The NYSE may prohibit a member firm from expanding its business or paying cash dividends/distributions if resulting net capital would be less than 5% of aggregate debit items, as defined, and may require a member firm to reduce its business if its net capital is less than 4% of aggregate debit items, as defined. At June 30, 2014, the Company’s net capital was \$68,098,953 which was \$62,518,967 in excess of 2% of aggregate debit items, as defined, and the Company’s net capital percentage was 24.41%.

## **9. Goodwill and Intangible Assets**

ASC 350, “*Intangibles – Goodwill and Other*” provides that goodwill is not amortized and the value of an identifiable intangible asset must be amortized over its useful life, unless the asset is determined to have an indefinite useful life. Goodwill is analyzed at least annually for impairment and more often if triggering events are identified. Management performed annual impairment testing as of September 30, 2013. Management’s qualitative analysis did not indicate impairment of the goodwill asset.

In connection with the 2005 acquisition of Parker/Hunter, the Company acquired \$8,700,000 of identifiable intangible assets with a weighted average useful life of approximately 11 years. The intangible assets that make up that amount include a trade name of \$300,000 (2-year useful life), and customer related intangibles of \$8,400,000 (11-year weighted average useful life). As of June 30, 2014, the Company has fully amortized the intangible asset associated with the trade name and has recorded \$7,773,250 in accumulated amortization associated with customer related intangibles.

## 9. Goodwill and Intangible Assets (continued)

Estimated amortization expense on identifiable intangible assets, for each of the next five fiscal years is as follows:

2014	\$ 112,500
2015	172,250
2016	117,750
2017	88,250
2018	84,000
2019 and thereafter	72,000
	<hr/>
	\$ 646,750

## 10. Commitments and Contingencies

At June 30, 2014, the Company's future minimum rental commitments on the leases for its main office and 108 branch offices under noncancelable operating leases were as follows:

2015	\$ 18,207,607
2016	17,380,694
2017	15,036,188
2018	12,191,438
2019	10,894,312
2020 and thereafter	52,497,902
	<hr/>
	\$ 126,208,141

The Company also has additional leases which will expire during 2014, which have yet to be renewed or negotiated and therefore not included in the chart above. Certain leases contain provisions for escalations.

The Company, together with various other brokers, dealers, corporations, and individuals, has been named as a defendant in a number of actual and threatened class-action lawsuits, many of which involve material or undeterminable amounts and alleged violations of federal and state securities laws. The Company is also a defendant in other lawsuits and regulatory matters incidental to its securities business. Management of the Company believes, after consultation with outside legal counsel, that the resolution of these various matters will not result in any material adverse impact on the financial position of the Company. However, the results of operations could be materially affected during any period if liabilities in that period differ from the Company's prior estimates, and the Company's cash flow could be materially affected during any period in which these matters are resolved. In accordance with ASC 450, "Contingencies", the Company has established provisions for estimated losses from pending complaints, legal actions, investigations, and proceedings. The ultimate costs of litigation-related charges can vary significantly from period to period, depending on such factors as market conditions, the size and volume of customer complaints and claims, including class action suits and recoveries from indemnification, contribution or insurance reimbursements.



## **10. Commitments and Contingencies (continued)**

The Company has investments in various partnerships to which it is required to commit a maximum amount of capital. As of June 30, 2014, the Company has contributed \$9,320,000 as an investment and is committed to an additional \$180,000. Under the terms of the partnership agreements, certain losses are allocated to the Company and the general partners before being allocated to the limited partners. The Company may in the future, under certain conditions, be required to contribute the additional committed capital with no resulting investment value.

The Company has outstanding underwriting agreements and when-issued contracts which commit it to purchase securities at specified future dates and prices. The Company pre-sells such issues to manage risk exposure related to these off-balance-sheet commitments. Subsequent to June 30, 2014, such transactions settled with no material effect on the financial statements as of that date.

The Company has outstanding commitments, which the Company estimates to be approximately \$12,606,835, to provide certain existing financial consultants with loans as part of the Company's recruiting strategy for key revenue producing employees. The loans will be issued if the financial consultants achieve certain revenue targets during the year.

## **11. Financial Instruments with Off-Balance-Sheet Risk and Concentrations of Credit Risk**

In the normal course of business, the Company's customer activities involve the execution, settlement, and financing of various customer securities transactions. These activities may expose the Company to off-balance-sheet risk in the event the customer or other broker is unable to fulfill its contracted obligations and the Company has to purchase or sell the financial instrument underlying the contract at a loss.

In addition, the Company has sold securities, on a proprietary basis, that it does not currently own and will therefore be obligated to purchase such securities at a future date. The Company has recorded these obligations in the financial statements at June 30, 2014, at fair values of the related securities, and will incur a loss if the fair value of the securities increases subsequent to June 30, 2014.

The Company may hold cash or cash equivalents in certain financial institutions over and above the Federal Depository Insurance Corporation ("FDIC") insurance limits of \$250,000 per bank.

The Company's customer securities activities are transacted on either a cash or margin basis. In margin transactions, the Company extends credit to its customers, subject to various regulatory and internal margin requirements, collateralized by cash and securities in the customers' accounts. In connection with these activities, the Company executes and clears customer transactions involving the sale of securities not owned by the customers, substantially all of which are transacted on a margin basis subject to individual exchange regulations. Such transactions may expose the Company to significant off-balance-sheet risk in the event margin requirements are not sufficient to fully cover losses that customers may

## **11. Financial Instruments with Off-Balance-Sheet Risk and Concentrations of Credit Risk (continued)**

incur. In the event the customer fails to satisfy its obligations, the Company may be required to purchase or sell financial instruments at prevailing market prices to fulfill the customer's obligations. The Company seeks to control the risks associated with its customer activities by requiring customers to maintain margin collateral in compliance with various regulatory and internal guidelines. The Company monitors required margin levels daily and; pursuant to such guidelines, requires the customer to deposit additional collateral or to reduce positions when necessary.

The Company's customer financing and securities settlement activities require the Company to pledge customer securities as collateral in support of various secured financing sources such as bank loans and securities loaned. In the event the counterparty is unable to meet its contractual obligation to return customer securities pledged as collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices in order to satisfy its customer obligations. The Company controls this risk by monitoring the fair value of securities pledged on a daily basis and by requiring adjustments of collateral levels in the event of excess market exposure. In addition, the Company establishes credit limits for such activities and monitors compliance on a daily basis.

At June 30, 2014, customer margin securities of \$316,280,668 and stock borrowings of approximately \$1,974,601,969 were available to the Company to utilize as collateral on various borrowings or other purposes. The Company utilized \$1,844,432 of these available securities as collateral for bank loans and \$1,921,362,762 for stock loan agreements.

At June 30, 2014, the Company had utilized \$147,742,632.27 of securities owned by customers as collateral for Option Clearing Corporation ("OCC") margin requirements.

## **12. Employee Benefit Plans**

The Company has a qualified defined contribution profit-sharing plan which covers all employees who meet certain eligibility requirements. Contributions to this plan are determined on a discretionary basis by the Board of Managers.

The Company has a nonqualified deferred compensation plan for certain financial consultants, which provides for full vesting after five or ten years. The participants' balances change based on a variable rate of return. At June 30, 2014, Corporate Owned Life Insurance (COLI) was held to fund this plan, which is carried at the cash surrender value of the underlying policies of \$88,653,942. The Company also holds additional COLI policies to insure key financial advisors, which are also carried at the cash surrender value of the underlying policies of \$7,598,852.

### **13. Related Party Transactions**

During the year the Company entered into transactions with Penn Mutual to provide annuity and insurance contracts to its customers as part of its normal course of business. These transactions were conducted on terms equivalent to those prevailing in an arm's length transaction.