



UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Financial Statements

June 30, 2007

(With Independent Auditors' Report Thereon)

UNIVERSITY OF MINNESOTA FOUNDATION

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Board of Trustees
University of Minnesota Foundation:

We have audited the accompanying consolidated statement of financial position of the University of Minnesota Foundation (the Foundation) as of June 30, 2007, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from the Foundation's fiscal year 2006 financial statements and, in our report dated October 10, 2006, we 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2007, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 8, 2007

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Statement of Financial Position

June 30, 2007

(With comparative information as of June 30, 2006)

Assets	2007	2006
Cash	\$ 8,851,929	8,897,636
Investments, at fair value	1,401,657,534	1,146,730,010
Investments loaned to broker	42,534,099	62,917,800
Investment collateral	43,605,958	64,053,057
Pledges receivable, net	64,414,485	52,376,663
Other receivables, primarily interest	2,707,220	2,255,061
Split interest agreements:		
Beneficial interest in perpetual trusts	29,628,978	25,994,176
Assets held in charitable trusts	30,999,414	26,719,249
Beneficial interest in trusts	5,067,549	5,129,843
Gift annuities	35,091,512	28,653,707
Office property and equipment, net	846,017	686,015
Total assets	<u>\$ 1,665,404,695</u>	<u>1,424,413,217</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 4,021,244	4,761,182
Gift annuities payable	16,139,954	14,417,215
Liability under charitable trust agreements	13,127,784	11,881,085
Investments held for custody of others	70,463,357	58,064,939
Payable under investment loan agreement	43,605,958	64,053,057
Total liabilities	<u>147,358,297</u>	<u>153,177,478</u>
Net assets:		
Unrestricted	84,453,188	48,366,650
Temporarily restricted	960,070,104	791,866,231
Permanently restricted	473,523,106	431,002,858
Total net assets	<u>1,518,046,398</u>	<u>1,271,235,739</u>
Total liabilities and net assets	<u>\$ 1,665,404,695</u>	<u>1,424,413,217</u>

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Statement of Activities

Year ended June 30, 2007

(With summarized information for the year ended June 30, 2006)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2007</u>	<u>Total 2006</u>
Revenue:					
Contributions	\$ 26,650,000	73,441,459	34,667,278	134,758,737	90,230,305
Investment income, net of investment expenses of \$3,031,674 and \$3,567,772 in 2007 and 2006, respectively	6,947,585	8,271,239	788,082	16,006,906	12,070,508
Net realized and unrealized gains (losses) on investments	13,842,572	167,679,540	(5,787)	181,516,325	152,157,090
Change in carrying value of trusts	(77,422)	4,126,227	7,070,675	11,119,480	4,850,968
Support services revenue	2,725,000	—	—	2,725,000	2,750,125
Miscellaneous revenue	833,525	—	—	833,525	627,410
Net assets released from restriction	85,314,592	(85,314,592)	—	—	—
Total revenue	<u>136,235,852</u>	<u>168,203,873</u>	<u>42,520,248</u>	<u>346,959,973</u>	<u>262,686,406</u>
Expenses:					
Program services:					
Distributions for educational purposes	80,456,366	—	—	80,456,366	74,570,843
Support services:					
Management and general:					
Operational expenses	6,775,007	—	—	6,775,007	5,824,734
Legal and accounting fees	181,847	—	—	181,847	146,493
Depreciation	177,632	—	—	177,632	232,863
Other expenses	535,318	—	—	535,318	527,337
Fundraising:					
Promotion and development	12,023,144	—	—	12,023,144	11,108,763
Total expenses	<u>100,149,314</u>	<u>—</u>	<u>—</u>	<u>100,149,314</u>	<u>92,411,033</u>
Increase in net assets	36,086,538	168,203,873	42,520,248	246,810,659	170,275,373
Net assets at beginning of year	48,366,650	791,866,231	431,002,858	1,271,235,739	1,100,960,366
Net assets at end of year	\$ <u>84,453,188</u>	<u>960,070,104</u>	<u>473,523,106</u>	<u>1,518,046,398</u>	<u>1,271,235,739</u>

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Statement of Cash Flows

Year ended June 30, 2007

(With comparative information for the year ended June 30, 2006)

	2007	2006
Cash flows from operating activities:		
Increase in net assets	\$ 246,810,659	170,275,373
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Net realized and unrealized gains on investments	(181,516,325)	(152,157,090)
Change in net carrying value of trusts	(11,321,040)	(4,240,587)
Depreciation expense	177,632	232,863
Noncash contributions	(28,460,051)	(338,578)
Contributions restricted for long-term investment	(34,667,278)	(33,397,388)
Changes in operating assets and liabilities:		
Pledges receivable	(12,037,822)	(9,612,969)
Other receivables	(452,159)	3,311
Investments held for custody of others	12,398,418	6,442,184
Accounts payable	(739,938)	576,556
Net cash used in operating activities	(9,807,904)	(22,216,325)
Cash flows from investing activities:		
Purchases of property and equipment	(337,634)	(145,423)
Proceeds from sales of investments	930,379,331	617,783,106
Purchase of investments	(934,499,679)	(586,737,245)
Changes in payable under investment loan agreement	(20,447,099)	(37,866,443)
Net cash used in investing activities	(24,905,081)	(6,966,005)
Cash flows from financing activities:		
Proceeds from contributions restricted for long-term investment	34,667,278	33,397,388
Net cash provided by financing activities	34,667,278	33,397,388
Net change in cash	(45,707)	4,215,058
Cash at beginning of year	8,897,636	4,682,578
Cash at end of year	\$ 8,851,929	8,897,636

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2007

(1) **Organization and Summary of Significant Accounting Policies**

The University of Minnesota Foundation (the Foundation) was incorporated as a not-for-profit corporation in the state of Minnesota in 1962 and operates exclusively for the benefit of the University of Minnesota (the University).

The accounting policies of the Foundation conform to U.S. generally accepted accounting principles. The following is a summary of the more significant accounting policies:

(a) *Principles of Consolidation*

The consolidated financial statements include those of the Foundation and its related entity, the University of Minnesota Foundation Investment Advisors (UMFIA). UMFIA is a nonprofit organization established to oversee the investment and management of the investments of the Foundation. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

The Foundation does not report the University Gateway Corporation (Gateway) as part of its consolidated financial statements. Gateway is a nonprofit organization established to construct, own, and operate a facility to be used to support its beneficiary organizations and the University in student recruiting, alumni relations, fundraising activities, and general operations. Under U.S. generally accepted accounting principles, consolidation of Gateway is permitted, but not required.

(b) *Basis of Presentation*

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Net assets of the Foundation and changes therein are classified into the following three categories:

- Unrestricted net assets represent the portion of expendable funds that are available for support of the operations of the Foundation.
- Temporarily restricted net assets consist of contributions that have been restricted by the donor for specific purposes or are time restricted.
- Permanently restricted net assets consist of contributions that have been restricted by the donor that stipulate the resources be maintained permanently, but permit the Foundation to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by donor-imposed restrictions. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

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Notes to Consolidated Financial Statements

June 30, 2007

(c) ***Basis of Accounting***

The consolidated financial statements of the Foundation have been prepared on the accrual basis of accounting.

(d) ***Derivative Financial Instruments***

The Foundation invests in various stock indexes, fixed income, and foreign currency derivatives. The Foundation uses derivatives with the objectives of reducing portfolio risk and/or lowering investment costs. Derivative uses include managing the duration of the fixed-income portfolio, gaining investment exposure to specific markets, and maintaining investment policy allocation. Derivative instruments are measured at fair value and reported as assets or liabilities in the statement of financial position. Changes in the fair value of derivatives during the year are reported in the statement of activities.

(e) ***Contributions***

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions to be received after one year are discounted at rates of 2.65% – 5.15% based on when the contribution was made. Amortization of discounts is recorded as additional contribution revenue. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history.

Contributions as stated in the consolidated statement of activities include \$785,843 of indirect support received by the Foundation.

(f) ***Assets Held in Charitable Trusts***

The Foundation has entered into unitrust and annuity agreements as trustee that provides, among other matters, that the trustee shall pay to the beneficiaries an annual income payment until the income obligation is completed in accordance with the donor's trust agreement. The Foundation records the assets held in these trusts at fair value and the corresponding liability at the actuarially determined present value of payments to be made to the designated beneficiaries. The residual amount is recorded as contribution revenue at the time the trust is established. In subsequent periods, the liability under charitable trust agreements is adjusted and changes therein are reported as a component of the change in carrying value of trusts in the consolidated statement of activities. Upon termination of the income obligation, the assets of the trust are held by the Foundation in accordance with the donor's trust agreement.

(g) ***Gift Annuity Agreements***

The Foundation has entered into gift annuity agreements that provide that the Foundation shall pay to the designated beneficiaries an annual amount until the death of the designated beneficiaries. The payments continue even if the assets of the gift annuity fund have been exhausted. The Foundation records the assets received at fair value and a corresponding liability is recorded for the actuarially determined present value of payments to be made to the designated beneficiaries, with the residual

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Notes to Consolidated Financial Statements

June 30, 2007

amount recorded as contribution revenue. Upon the death of the beneficiaries, the assets of the gift annuity fund are held by the Foundation in accordance with the agreements.

(h) *Beneficial Interest in Trusts*

The Foundation has beneficial interests in charitable remainder, lead, and perpetual trusts that are held by other entities such as banks or charitable organizations. The Foundation records its interest in these trusts, upon discovery of their existence, at fair value as determined using the present value of the estimated future cash receipts to be received from the trust. Because of the complex issues related to collecting the data for these transactions, there can be a time delay in the recording of the asset because of the time needed for discovery, verification of the Foundation's rights, and the determination of the valuation of future payments.

(i) *Income Taxes*

The Internal Revenue Service has ruled that the Foundation is a publicly supported organization under Internal Revenue Code, Section 170(b)(1)(A) and is not a private foundation as defined under Section 509(a)(1). The Foundation is a tax-exempt organization under Section 501(c)(3) and, as such, is subject to federal and state income tax only on net unrelated business income.

(j) *Investments*

Investments in marketable equity and debt securities are carried at fair value as established by the major securities markets. Investments for which quoted market prices are not available are carried at values as provided by the respective fund managers or general partners. These valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information. The estimated values as determined by the fund managers and general partners may differ from the values that would have been used had ready markets for the investments existed and the differences could be significantly higher or lower for any specific holding. The Foundation reviews the valuations provided by the fund managers and general partners for reasonableness.

Donated investments are recorded at their fair values, as determined on the date of donation. Investment income and gains and losses are recorded in the period incurred.

For management efficiency, investments of the unrestricted and restricted net assets are pooled, except for certain net assets that the board of trustees or the donors have designated to be segregated and maintained separately.

(k) *Fair Value of Financial Instruments*

The carrying amounts of cash, other receivables, and accounts payable approximate fair value because of the short maturity of these instruments. Investments are reported at fair value as described in note 1(j). Investment collateral is reported at fair value using public market quotations of the underlying investments. Pledges receivable are reported at approximate fair value. The fair value of interest in unitrusts, pooled income, annuity trusts, and gift annuities is based on quoted market prices at the reporting date of the underlying investments.

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Notes to Consolidated Financial Statements

June 30, 2007

Investments held for the custody of others are reported at fair value based on the fair value of the underlying investments. Payable under investment loan agreement is reported at fair value using public market quotations of the underlying investments. Split interest agreement liabilities are carried at the present value of the estimated expected future cash flows using discount rates assumptions established upon initial recognition of the liability. Given the number of these agreements, it is not practicable to estimate their fair value.

(l) Office Property and Equipment

Office property and equipment are stated at cost, less accumulated depreciation, and are depreciated over their estimated useful lives using the straight-line method.

(m) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

(n) Prior Year Information

The consolidated financial statements include certain prior year information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in accordance with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2006, from which the summarized information was derived.

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Notes to Consolidated Financial Statements

June 30, 2007

(2) Investments

The investments at June 30, 2007 are summarized as follows:

	<u>Traditional structures</u>	<u>Alternative structures</u>	
Values based on quoted market prices or alternative structures with underlying investments whose values are based on quoted market prices:			
Cash and cash equivalents	\$ 166,468,926	—	
Treasury Inflation Protected Securities (TIPS)	41,487,807	—	
Fixed Income Corporate Bonds	78,801,133	—	
U.S. Equity	111,149,065	78,253,746	
Foreign Equity	78,127,905	26,725,569	
Hedge Funds	—	34,730,538	
Subtotal	<u>476,034,836</u>	<u>139,709,853</u>	
Values based on estimates provided by fund managers or general partners:			
Hedge Funds	—	250,913,775	
Natural Resources	—	65,908,561	
Real Estate	—	80,770,159	
Private Equity	—	289,741,143	
Foreign Equity exposure	—	107,349,672	
Treasury Inflation Protected Securities (TIPS) exposure	—	9,889,479	
U.S. Equity exposure	—	21,782,080	
Subtotal	<u>—</u>	<u>826,354,869</u>	
Total	\$ <u>476,034,836</u>	<u>966,064,722</u>	1,442,099,558
Other investments not categorized above			35,315,064
Less investments loaned to broker			(42,534,099)
Less charitable gift annuities reported separately			<u>(33,222,989)</u>
Total			\$ <u><u>1,401,657,534</u></u>

Investments held in traditional structures represent those held directly by the Foundation in custodial accounts with financial institutions. Investments held in alternative structures include those held through interests in collective trust funds, limited partnerships, commingled funds, and limited liability companies.

Investments include funds held for the custody of others of \$70,463,357 at June 30, 2007.

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Notes to Consolidated Financial Statements

June 30, 2007

(3) Securities Lending

The Foundation participates in securities lending transactions. Under terms of its securities lending agreement, the Foundation requires collateral of value at least equal to 102% of the then fair value of the loaned securities and accrued interest, if any. The risks to the Foundation of securities lending are that the borrower may not provide additional collateral when required or return the securities when due. The securities lending transactions at and for the year ended June 30, 2007 are summarized as follows:

Investments loaned to broker	\$ 42,534,099
Investments collateral	43,605,958
Income from securities lending	64,365

(4) Pledges Receivable

Pledges receivable, net of unamortized discount (at rates of 2.65% – 5.15%) of \$7,921,123 are summarized as follows at June 30, 2007:

Unconditional promises expected to be collected in:	
Less than one year	\$ 24,738,415
One year to five years	30,804,633
Greater than five years	<u>10,365,930</u>
	65,908,978
Reserve for uncollectible pledges	<u>(1,494,493)</u>
Pledges receivable	<u><u>\$ 64,414,485</u></u>

In addition, the Foundation has received conditional promises to give in the amount of \$13,945,128 as of June 30, 2007. These gifts are primarily conditioned on completion of building or fundraising projects, evaluation of progress on projects, or matching funds.

(5) Office Property and Equipment

The following is a summary of office property and equipment at June 30, 2007:

Leasehold improvements	\$ 649,569
Furniture and fixtures	3,431,911
UMFIA	204,757
Less accumulated depreciation	<u>(3,440,220)</u>
	<u><u>\$ 846,017</u></u>

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Notes to Consolidated Financial Statements

June 30, 2007

(6) Temporarily Restricted Net Assets

Temporarily restricted net assets are available as of June 30, 2007 for the following purposes:

Capital improvement/facilities	\$ 98,947,967
Faculty support	21,572,027
Scholarships and fellowships	248,369,469
Lectureships, professorships, and chairs	263,568,543
College program support	267,994,604
Research	37,953,094
Trusts	13,674,687
Other	7,989,713
	<u>\$ 960,070,104</u>

(7) Permanently Restricted Net Assets

Permanently restricted net assets are restricted to investment in perpetuity. The permanently restricted net asset balances and purposes the income is expendable to support as of June 30, 2007 are as follows:

Capital improvement/facilities	\$ 3,676,284
Faculty support	13,395,937
Scholarships and fellowships	192,593,691
Lectureships, professorships, and chairs	161,694,072
College program support	52,312,595
Research	7,890,900
Trusts	40,308,275
Other	1,651,352
	<u>\$ 473,523,106</u>

(8) Support Services Revenue and Expense

The Foundation provides much of the development functions for the University. An annual amount is allocated by the University to reimburse the Foundation for a portion of the direct costs of support services provided by the Foundation on behalf of the University.

The costs of the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and support services benefited.

(9) Loan Guarantee

The Foundation guarantees the principal and interest payments on the long-term debt related to Gateway's outstanding Series 1997A and 1997B, 2002, and 2006 bonds. The total amount of long-term debt outstanding at June 30, 2007 subject to the guarantee is \$66,195,000. The proceeds of \$22,700,000 from the issuance of the Series 2006 bonds are being held in escrow to pay in full the balance of the

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Notes to Consolidated Financial Statements

June 30, 2007

Series 1997A bonds in December 2007. Since the guarantee may expire without being drawn upon, the total guarantee does not necessarily represent future cash requirements. As of June 30, 2007, no amounts have been recognized as a liability under the financial guarantee in the consolidated statement of financial position as the likelihood that Gateway would be unable to fulfill its obligation in full or in part under the debt agreement is not considered to be probable.

(10) Summarized Financial Data for Gateway (Unaudited)

Summarized financial data for Gateway as of and for the year ended June 30, 2007 was as follows:

Total assets	\$	80,855,127
Total liabilities		<u>68,101,550</u>
Net assets	\$	<u>12,753,577</u>
Revenues/other increases	\$	10,187,708
Expenses		<u>7,320,008</u>
Increase in net assets		<u>2,867,700</u>

(11) Commitments

(a) Lease Agreement

The Foundation has an operating lease for office space with Gateway, a related party. Terms of the lease call for minimum base rent of \$637,415 annually through 2024. Rent expense for the year ended June 30, 2007 was \$929,952. Minimum annual payments under the terms of these leases are as follows:

Year ending June 30:		
2008	\$	637,415
2009		637,415
2010		637,415
2011		637,415
2012		637,415
Thereafter		7,808,334

(b) Investment Commitment

The Foundation is committed as of June 30, 2007 to invest approximately \$211,000,000 in certain investment managers for long-term investment purposes.