

**NORTHERN ARIZONA
UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

**NORTHERN ARIZONA
UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of

NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC. AND SUBSIDIARIES

We have audited the accompanying consolidated statement of financial position of **Northern Arizona University Foundation, Inc. and Subsidiaries** at June 30, 2011, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of **Northern Arizona University Foundation, Inc. and Subsidiaries'** management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. 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 consolidated 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 **Northern Arizona University Foundation, Inc. and Subsidiaries** at June 30, 2011, and the changes in their net assets and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Phoenix, Arizona
September 30, 2011

A handwritten signature in black ink that reads "Mayer Hoffman McCann P.C." in a cursive, flowing script.

NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2011

ASSETS

CASH AND CASH EQUIVALENTS	\$ 2,501,894
PLEDGES RECEIVABLE, net	6,757,270
BEQUESTS RECEIVABLE	2,000
OTHER RECEIVABLES	178,741
NET INVESTMENT IN DIRECT FINANCING LEASE	3,162,931
INVESTMENTS	90,645,526
FURNITURE AND EQUIPMENT, net	18,487
EBS LICENSES, net	5,129,470
DONATED ASSETS HELD FOR SALE	49,333
ASSETS HELD UNDER SPLIT INTEREST AGREEMENTS	2,652,569
CASH SURRENDER VALUE OF LIFE INSURANCE	2,076,121
BENEFICIAL INTEREST IN PERPETUAL TRUSTS	<u>3,254,769</u>
TOTAL ASSETS	<u>\$ 116,429,111</u>

LIABILITIES AND NET ASSETS

ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	\$ 197,466
ASSETS HELD IN CUSTODY FOR OTHERS	19,193,176
DEFERRED REVENUE	5,429,810
OBLIGATIONS UNDER SPLIT INTEREST AGREEMENTS	<u>1,295,152</u>
TOTAL LIABILITIES	<u>26,115,604</u>
NET ASSETS	
Unrestricted	28,823,767
Temporarily restricted	22,262,804
Permanently restricted	<u>39,226,936</u>
TOTAL NET ASSETS	<u>90,313,507</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 116,429,111</u>

See Notes to Consolidated Financial Statements

NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended June 30, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
SUPPORT AND REVENUES				
Public contributions	\$ 33,556	\$ 5,715,341	\$ 2,847,411	\$ 8,596,308
EBS revenue	3,219,561	-	-	3,219,561
Investment return	2,906,168	10,615,745	40,495	13,562,408
Change in cash surrender value of life insurance	868,419	-	-	868,419
Loss on uncollectible pledges	-	(333,239)	-	(333,239)
Loss on sale of assets held for sale	-	-	(13,145)	(13,145)
Other income and support	10,221	460,221	10,713	481,155
Reclassification of donor intent	39,550	(44,723)	5,173	-
Net assets released from restrictions	<u>9,553,830</u>	<u>(9,553,830)</u>	<u>-</u>	<u>-</u>
TOTAL SUPPORT AND REVENUES	<u>16,631,305</u>	<u>6,859,515</u>	<u>2,890,647</u>	<u>26,381,467</u>
EXPENSES				
Program expenses:				
Disbursements for educational purposes	1,809,992	-	-	1,809,992
Scholarships	1,771,380	-	-	1,771,380
Facilities	2,458,374	-	-	2,458,374
Other University programs	859,364	-	-	859,364
Total program expenses	<u>6,899,110</u>	<u>-</u>	<u>-</u>	<u>6,899,110</u>
Supporting services:				
Fundraising	2,382,927	-	-	2,382,927
Management and general	451,597	-	-	451,597
Amortization of EBS licenses	1,425,503	-	-	1,425,503
Total supporting services	<u>4,260,027</u>	<u>-</u>	<u>-</u>	<u>4,260,027</u>
TOTAL EXPENSES	<u>11,159,137</u>	<u>-</u>	<u>-</u>	<u>11,159,137</u>
CHANGE IN NET ASSETS	5,472,168	6,859,515	2,890,647	15,222,330
NET ASSETS, BEGINNING OF YEAR	<u>23,351,599</u>	<u>15,403,289</u>	<u>36,336,289</u>	<u>75,091,177</u>
NET ASSETS, END OF YEAR	<u>\$ 28,823,767</u>	<u>\$ 22,262,804</u>	<u>\$ 39,226,936</u>	<u>\$ 90,313,507</u>

See Notes to Consolidated Financial Statements

NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended June 30, 2011

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net assets	\$ 15,222,330
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Change in present value of discount on pledges receivable	(146,573)
Change in allowance for uncollectible pledges	231,644
Net realized and unrealized gains on investments	(11,333,123)
Donated securities	(1,829,204)
Loss on sale of assets held for sale	13,145
Change in value of beneficial interest in perpetual trusts	(454,689)
Net change in value of split-interest agreements	(387,110)
Depreciation and amortization	18,488
Amortization of EBS licenses	1,425,503
Decrease (increase) in:	
Pledges receivable	1,118,881
Bequests receivable	603,890
Other receivables	(6,682)
Increase (decrease) in:	
Accounts payable and accrued liabilities	137,366
Deferred revenue	(2,058,227)
Net cash provided by operating activities	<u>2,555,639</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property, plant, and equipment	(3,327,267)
Purchase of EBS licenses	(2,025,000)
Purchases of investments	(14,553,634)
Proceeds from sales of investments	3,247,831
Change in cash surrender value of life insurance	(868,419)
Change in assets held in custody for others	12,413,267
Proceeds from sale of assets held for sale	2,750
Collections on investment in net financing lease	164,336
Net cash used in investing activities	<u>(4,946,136)</u>
CHANGE IN CASH AND CASH EQUIVALENTS	(2,390,497)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>4,892,391</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 2,501,894</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES	
Donated investment securities	<u>\$ 1,829,204</u>
Change in cash surrender value of life insurance	<u>\$ 868,419</u>
Unrealized gains on assets held in custody for others	<u>\$ 1,280,529</u>
Change in beneficial interest in perpetual trust for assets held in custody of others	<u>\$ 76,506</u>
Sale of property, plant, and equipment under direct financing lease (Note 4)	<u>\$ 3,327,267</u>

See Notes to Consolidated Financial Statements

NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies

Foundation operations - The Northern Arizona University Foundation, Inc. (the "Foundation") was incorporated as a not-for-profit organization in the state of Arizona in January 1959 and operates exclusively for the benefit of Northern Arizona University (the "University"). The Foundation receives gifts and bequests, administers and invests securities and property, and disburses payments to and on behalf of the University for the advancement of its mission.

During 2009, the Foundation formed Northern Arizona Real Estate Holdings, LLC ("NAREH"), a wholly owned subsidiary. NAREH was established to construct, develop, equip, operate, maintain, lease and hold real estate investments on behalf of the Foundation.

During 2010, the Foundation formed NAU Ventures, LLC ("NAUV"), a wholly owned subsidiary. NAUV was established to license or otherwise commercialize the intellectual property owned or controlled by the Arizona Board of Regents, the University or the Foundation, to perform other technology transfer and intellectual property management services for the University, and to perform other services from time to time.

The significant accounting policies followed by the Foundation and its subsidiaries (collectively referred to as "the Foundation") are summarized below:

The Financial Accounting Standards Board ("FASB") sets U.S. generally accepted accounting principles ("GAAP") to ensure consistent reporting. References to GAAP are to the *FASB Accounting Standards Codification* ("FASB ASC").

Basis of presentation - The consolidated financial statements are presented in accordance with FASB ASC 958-205, *Not-for-Profit - Presentation of Financial Statements*. Under FASB ASC 958-205 the Foundation is required to report information regarding its consolidated financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Consolidated financial statements - The accompanying consolidated financial statements include the accounts of the Foundation and its subsidiaries, NAREH and NAUV. All significant interorganization transactions and accounts have been eliminated in consolidation.

Management's 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 consolidated 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 - For purposes of reporting cash flows, cash and cash equivalents include liquid accounts with original maturities of three months or less that are not designated for investment purposes. Investments carried at fair value include certain liquid accounts which are generally not used in operations. Amounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC). Cash and cash equivalent balances, including those classified as investments, totaling \$2,536,764 at June 30, 2011 contain donor imposed restrictions limiting the use of the cash and investments for specified purposes.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies (continued)

Pledges receivable - Unconditional promises to give (pledges) that are to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are initially recorded at the fair value of their estimated future cash flows as of the date of the promise to give through the use of a present value discount technique. In periods subsequent to initial recognition, unconditional promises to give are reported at the amount management expects to collect and are discounted over the collection period using the same discount rate as determined at the time of initial recognition. The discount rate determined at the initial recognition of the unconditional promise to give is based upon management's assessment of many factors, including when the receivable is expected to be collected, the creditworthiness of the other parties, the Foundation's past collection experience and its policies concerning the enforcement of promises to give, expectations about possible variations in the amount or timing, or both, of the cash flows, and other factors concerning the receivable's collectibility. Amortization of the discounts is included in support from contributions. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Bequests receivable - Bequests receivable are recognized as contribution revenue in the period the Foundation receives notification the court has found the will of the donor's estate to be valid and all conditions have been substantially met. Bequests receivable are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible bequests receivable based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible bequests receivable and a credit to bequests receivable. At June 30, 2011, bequests receivable are considered by management to be fully collectible and, accordingly, an allowance for uncollectible bequests receivable has not been provided.

Contributions - Contributions are recorded in accordance with FASB ASC 958-605, *Not-for-Profit – Revenue Recognition*. In accordance with FASB ASC 958-605, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restrictions.

Contributed assets and services - Donations of securities, land, buildings and other non-monetary assets which can be objectively measured are recorded at their fair value at the date of contribution. Donated assets are held until they can be sold. Included in these assets are land and miscellaneous other assets. Certain real estate and other non-monetary assets such as art objects, equipment and books that were donor designated for direct use by the University or one of its departments are not included in these consolidated financial statements. Assets that cannot be objectively measured are not included in these consolidated financial statements. Donated services of volunteers have not been recorded in the accompanying consolidated financial statements since they do not meet the recognition criteria established in FASB ASC 958-605.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies (continued)

Revenue recognition - Revenue from exchange transactions, investment activities, management fees, other fees and charges, and other non-contribution related revenue are recognized as earned. Revenue received in advance is recorded as deferred revenue in the accompanying consolidated statement of financial position.

Investments - The Foundation accounts for its investments in accordance with FASB ASC 958-320, *Not-for-Profit - Investments-Debt and Equity Securities*. Under FASB ASC 958-320, the Foundation is required to report investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. The fair value is based on quoted market prices. Investment securities without quoted market prices are valued at estimated fair value using appropriate valuation methods that consider the underlying assets and financial reports.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the near term could materially affect account balances and the amounts reported in the accompanying consolidated financial statements.

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

The Foundation investment policy is approved by the Investment Committee of the Foundation's Board of Directors. The spending policy defines the calculation of the amount made available for spending from the endowment pools which is based on a three year rolling average.

Split interest agreements - The Foundation is trustee for two types of split interest agreements.

- a. *Charitable remainder trusts* - Charitable remainder trusts consist of assets donated to the Foundation and held by the Foundation with the Foundation as the sole or one of the remaindermen of the trusts. The Foundation assets held in trust are determined by multiplying the Foundation remainder interest in each trust by the fair value of the assets held in each trust. Earnings from the investment of each trust corpus and the trust corpus are used to pay certain periodic payments to beneficiaries under the terms of each trust agreement. The corpus of each trust may be invaded in cases where investment earnings are not sufficient to make the required periodic payments. If the corpus of the trust is invaded to the extent that it is depleted, the Foundation has no further financial obligation to the applicable donors, beneficiaries or other remaindermen, if any. Upon the death of the applicable beneficiaries, any remaining corpus of the trust reverts to the Foundation or the other charitable remaindermen, if any, as specified in each trust agreement. A corresponding Foundation liability, based upon actuarial tables, is also recorded to reflect the present value of the future periodic payments to be made to the beneficiaries.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies (continued)

- b. *Charitable gift annuities* - The Foundation receives funds from various contributors through gift annuity agreements, under which the Foundation is obligated to pay annuitants periodic fixed amounts for the remainder of their lives. The Foundation has invested the funds in investments that 1) provide interest and dividend income, as well as market gain or loss, and 2) are used to meet the required payments. A corresponding Foundation liability, based upon actuarial tables, is also recorded to reflect the present value of the future periodic payments to be made to the beneficiaries. Contribution support is recognized at the date the annuities are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The original contribution and the investment earnings may not be sufficient to make the required periodic payments. If these amounts are not sufficient, the Foundation has a continuing financial commitment to each annuitant until their death. At June 30, 2011, these amounts were sufficient to make planned payments to annuitants.

Cash surrender value of life insurance policies - The Foundation is the owner and beneficiary of fifteen life insurance policies covering the lives of certain donors to the Foundation. The face amounts of the policies total approximately \$23.3 million. The policies are recorded at their cash surrender value of \$2,076,121 at June 30, 2011. Policy earnings and expenses are included in the accompanying consolidated statement of activities.

Beneficial interest in perpetual trusts - Beneficial interest in perpetual trusts represents the Foundation's irrevocable right to receive the income earned from the trusts' assets in perpetuity. The Foundation will never receive the trusts' assets. The trust agreements are administered and related assets are invested by an individual or organization other than the Foundation. Initial recognition and subsequent adjustments to the assets carrying value are recognized based on quoted market prices as public contributions and changes in value of perpetual trusts, respectively, and are classified as permanently restricted. Income earned is reported as increases in unrestricted, temporarily or permanently restricted net assets depending on the nature of the restrictions of each trust.

Furniture and equipment and related depreciation and amortization - Purchased furniture and equipment are recorded at cost. Donated furniture and equipment are recorded at the fair value at the date of donation to the Foundation. Betterments or renewals in excess of \$5,000 are capitalized. Depreciation and amortization is computed using the straight-line method over estimated useful lives of 5 to 10 years.

Impairment of long-lived assets - The Foundation accounts for long-lived assets in accordance with the provisions of FASB ASC 360, *Property, Plant, and Equipment*. FASB ASC 360 requires that long-lived assets be 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 future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. No impairment was recorded in 2011.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies (continued)

Net assets - Net assets and changes therein are classified and reported as follows:

- a. *Unrestricted net assets* - Includes unrestricted amounts associated with the operating activities of the Foundation. Certain unrestricted net assets have been designated as quasi-endowments by the Board of Directors of the Foundation.
- b. *Temporarily restricted net assets* - Includes amounts for which donor-imposed restrictions have not been met. Donor-restricted contributions for which restrictions are met within the same fiscal year as they are received are reported as temporarily restricted net assets. Expenditures that fulfill the temporary restriction are shown as expenses in unrestricted net assets and a reduction in temporarily restricted revenue as a release from restriction.
- c. *Permanently restricted net assets* - Includes amounts for which the donor-imposed restrictions state that the corpus is to be invested in perpetuity with the income to be made available for specified programs or uses.

The majority of the Foundation's funds are subject to donor-imposed temporary and permanent restrictions. The Foundation holds certain donated funds as donor-restricted endowments, which have principal amounts to be held in perpetuity and are classified as permanently restricted net assets. The Foundation's Board of Directors has, through agreements between Foundation's management and University representatives, designated certain gifts as quasi-endowments, which are classified as temporarily restricted net assets based on the original gift purpose.

With the exception of certain permanently restricted contributions that the donor requires to be separately invested, all permanently restricted contributions are consolidated in an investment pool. Appreciation, depreciation, income and expense relative to the pooled endowment investments are allocated to each endowment based upon the ratio of that endowment's investment balance to the total investment pool and are shown as a change in temporarily restricted net assets.

Functional expense allocation - Expenses are charged to program services and supporting services categories based on direct expenditures incurred. Any expenditure not directly chargeable to a functional expense category is allocated based on appropriate allocation methods.

Reclassification of donor intent - At times the Foundation receives requests by donors or their designees to change the use for which the donor's original gift was intended. These donor requests are reviewed by the Foundation for approval, and if approved, may result in the reclassification of net assets between unrestricted, temporarily restricted, or permanently restricted net assets. These reclassifications are reflected in the consolidated statement of activities for the year ended June 30, 2011 as reclassification of donor intent.

Limited liability company - Based on the type of organization of NAREH and NAUV, as otherwise provided in the operating agreement executed by the members of the respective companies, no member is personally liable for any acts, debts or liabilities beyond the members' capital contributions. The LLCs have no defined finite lives.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(1) Foundation operations and summary of significant accounting policies (continued)

Income tax status - The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) as described in Sections 509(a)(1) and 170(b)(1)(A)(iv) of the Internal Revenue Code (the "Code") and, accordingly, there is no provision for income taxes. In addition, the Foundation qualifies for the charitable contribution deduction under Section 170 of the Code and has been classified as an organization that is not a private foundation. NAREH and NAUV are treated as disregarded entities for income tax purposes, and accordingly, all income and expenses are passed through to the Foundation. Income determined to be unrelated business taxable income (UBTI) would be taxable. The Foundation evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts.

The Foundation's federal Return of Organization Exempt from Income Tax (Form 990) for the years ended 2008, 2009 and 2010 are subject to IRS examination, generally for three years after filing. As of the date of this report, the Foundation's 2011 return had not yet been filed.

Subsequent events - The Foundation has evaluated events through September 30, 2011 which is the date the consolidated financial statements were available to be issued.

(2) Pledges receivable

Pledges receivable consist of the following unconditional promises to give:

Gross amounts due in:	
Less than one year	\$ 2,674,409
One to five years	4,731,254
More than five years	<u>431,806</u>
Gross pledges receivable	7,837,469
Discount to present value	(683,466)
Allowance for uncollectible pledges	<u>(396,733)</u>
Total pledges receivable, net	<u>\$ 6,757,270</u>

Pledges receivable are stated at the amount management expects to collect and are discounted over the collection period using discount rates ranging from 0.18% to 5.2%. Management provides for uncollectible pledges receivable through a charge to earnings and a credit to the allowance for uncollectible pledges receivable. Balances still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible pledges receivable and a credit to pledges receivable. Approximately 72% of the gross pledges receivable balance at June 30, 2011 is from one donor.

Members of the Foundation's Board of Directors have made contributions and pledges to the Foundation in the current and prior years. At June 30, 2011, gross unconditional pledges receivable from these members total approximately \$459,000. During fiscal year 2011, the Foundation recognized contribution revenue from these donors of approximately \$79,000.

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(3) Investments

The cost and fair value of the Foundation's investments at June 30, 2011 are as follows:

	<u>Fair Value</u>	<u>Cost</u>
U.S. government/agency bond mutual funds	\$ 12,203,442	\$ 6,845,082
Corporate bond mutual funds		
Intermediate term	7,339,543	4,600,804
Short term	4,817,619	2,956,404
Other	<u>4,075,231</u>	<u>4,069,746</u>
Total corporate bond mutual funds	16,232,393	11,626,954
Equity mutual funds		
Large cap – blend	24,074,015	19,120,585
Large cap – growth	8,245,289	6,735,997
Large cap – value	8,132,375	6,488,517
Other	<u>2,456,632</u>	<u>732,471</u>
Total equity mutual funds	42,908,311	33,077,570
International equity mutual funds		
Diversified emerging markets	3,990,195	2,887,033
Diversified developed international	13,504,482	12,575,212
Other	<u>51,789</u>	<u>53,325</u>
Total international equity mutual funds	17,546,466	15,515,570
Money market funds	<u>1,754,914</u>	<u>1,754,914</u>
Total investments	<u>\$ 90,645,526</u>	<u>\$ 68,820,090</u>

Investments include funds held in custody for others of \$18,031,495 at June 30, 2011. The Foundation has recorded a custodial liability for these investments.

Expenses relating to investment income, including custodial fees and investment advisory fees, totaled \$58,851 and have been netted against investment earnings in the accompanying consolidated statement of activities.

Investment return for the year ended June 30, 2011 consists of the following:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Dividends and interest	\$ 612,908	\$ 956,392	\$ -	\$ 1,569,300
Realized investment gains	-	293,260	-	293,260
Change in value of perpetual trusts	-	454,689	-	454,689
Change in value of split interest agreements	-	264,147	-	264,147
Unrealized investment gains	2,352,111	8,647,257	40,495	11,039,863
Investment management fees	<u>(58,851)</u>	<u>-</u>	<u>-</u>	<u>(58,851)</u>
Net investment return	<u>\$ 2,906,168</u>	<u>\$ 10,615,745</u>	<u>\$ 40,495</u>	<u>\$ 13,562,408</u>

**NORTHERN ARIZONA UNIVERSITY FOUNDATION, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended June 30, 2011

(4) Net investments in direct financing lease

During the year, NAREH constructed a restaurant on certain property owned by the Arizona Board of Regents with a total initial direct cost of \$3,327,267, which is also the initial net investment in direct financing lease. NAREH then leased the restaurant to Sodexo America, LLC under a direct financing lease. The lease with Sodexo America, LLC originated in fiscal 2011 and has a 6 year term.

Net investment in direct financing lease consists of:

Minimum lease receivables	\$ 3,775,867
Less unearned interest income	<u>(612,936)</u>
Net investment in direct financing lease	<u>\$ 3,162,931</u>

Minimum future lease receipts as of June 30, 2011 are as follows.

<u>Years Ending June 30</u>	
2012	\$ 656,700
2013	656,700
2014	656,700
2015	656,700
2016	656,700
Thereafter	<u>492,367</u>
	<u>\$ 3,775,867</u>

(5) Furniture and equipment

Furniture and equipment consists of:

Cost or donated value:	
Office equipment	\$ 13,281
Computer software	<u>92,438</u>
Total cost or donated value	105,719
Accumulated depreciation and amortization	<u>(87,232)</u>
Furniture and equipment, net	<u>\$ 18,487</u>

Depreciation and amortization expense charged to operations was \$18,488 for 2011.

(6) Assets held under split interest agreements

The Foundation is currently the beneficiary of certain charitable remainder trusts. The charitable remainder trusts provide for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, the remaining assets are available for use by the Foundation as specified by the grantor. The portion of the trust attributable to the present value of the future benefits to be received by the Foundation is recorded as a temporarily restricted contribution in the period the trust is established. Investments held in the charitable remainder trusts are invested in equities and bonds and reported at fair value. The present value of the estimated annuity payments is calculated using rates of return ranging from 5.6% to 8.2% for 2011 based on the applicable mortality tables, and is shown in the table below.

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Year Ended June 30, 2011

(6) Assets held under split interest agreements (continued)

The Foundation currently administers certain charitable gift annuities. The assets contributed under the charitable gift annuities are invested in equities and bonds and are carried at fair value. Contribution support is recognized at the date the annuities are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. On an annual basis, the Foundation revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions. Adjustments to reflect the valuation of the present value of the estimated annuity payments and changes in actuarial assumptions are included as a component of net investment return in the consolidated statement of activities. The present value of the estimated annuity payments associated with the gift annuities is calculated using rates of return ranging from 2.4% to 7.6% for 2011 based on applicable mortality tables, and is shown in the table below.

Assets held under split-interest agreements consist of:

Charitable remainder trusts	
US government/agency bond mutual funds	\$ 39,123
Corporate bond mutual funds	264,981
Equity mutual funds	519,739
International equity mutual funds	107,876
Emerging markets equity mutual funds	70,092
Real estate trust mutual funds	27,885
Alternative funds	28,238
Money market funds	<u>45,477</u>
Total charitable remainder trusts	<u>1,103,411</u>
Charitable gift annuities	
Corporate bond mutual funds	485,696
Equity mutual funds	685,451
International equity mutual funds	141,957
Emerging markets equity mutual funds	94,200
Real estate trust mutual funds	31,667
Commodities mutual funds	17,396
Alternatives funds	39,018
Money market funds	<u>53,773</u>
Total charitable gift annuities	<u>1,549,158</u>
Total assets held under split-interest agreements	<u>\$ 2,652,569</u>

Obligations under split-interest agreements consist of:

Charitable remainder trusts	\$ 496,944
Charitable gift annuities	<u>798,208</u>
Total obligations under split-interest agreements	<u>\$ 1,295,152</u>

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(7) Assets held in custody for others

The Foundation maintains certain asset balances on behalf of others, which consists of the following at June 30, 2011:

Cash	\$ 577,315
Unconditional promises to give	419
Investments	18,031,495
Beneficial interest in perpetual trusts	<u>583,947</u>
Total assets held in custody for others	<u>\$ 19,193,176</u>

Assets are held on behalf of:

Northern Arizona University	\$ 18,934,745
Parents' Association	<u>258,431</u>
Total	<u>\$ 19,193,176</u>

(8) Restricted net assets

Temporarily restricted net assets are primarily available for scholarships and discretionary spending. Discretionary spending net assets are gifts that were designated by the donor to be spent by a specific area or school for general needs. Additionally, for the year ended June 30, 2011 approximately \$326,027 of the temporarily restricted net asset balance is restricted for various building projects that are occurring on the University campus. Permanently restricted net assets are primarily funds restricted for endowments as disclosed further in Note 9.

(9) Endowments

The Foundation's endowments consist of 651 individual funds established for a variety of purposes. Its endowments include both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. As required by U.S. generally accepted accounting principles (GAAP), net assets associated with endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

In September 2008, the State of Arizona enacted ARS§ 10-11801 et seq Investments for Eleemsynary Purposes (IFEP). The Board of Directors of the Foundation has interpreted IFEP as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary.

As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by IFEP.

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Year Ended June 30, 2011

(9) Endowments (continued)

The endowment net asset composition by type of fund as of June 30, 2011 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (16,835)	\$ 4,214,572	\$ 37,693,614	\$ 41,891,351
Quasi-endowments	-	2,429,609	-	2,429,609
Board-designated endowment funds	6,880,439	-	-	6,880,439
	<u>\$ 6,863,604</u>	<u>\$ 6,644,181</u>	<u>\$ 37,693,614</u>	<u>\$ 51,201,399</u>

The changes in endowment net assets for the year ended June 30, 2011 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 3,861,130	\$ 624,740	\$ 34,952,454	\$ 39,438,324
Contributions and additions	164,394	228,156	2,700,665	3,093,215
Investment return:				
Investment income	612,908	623,517	-	1,236,425
Net appreciation	2,352,111	6,867,602	40,495	9,260,208
Appropriation of endowment assets for expenditure	<u>(126,939)</u>	<u>(1,699,834)</u>	<u>-</u>	<u>(1,826,773)</u>
Endowment net assets, end of year	<u>\$ 6,863,604</u>	<u>\$ 6,644,181</u>	<u>\$ 37,693,614</u>	<u>\$ 51,201,399</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or IFEP requires the Foundation to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets total \$16,835 as of June 30, 2011. These deficiencies resulted from unfavorable market fluctuations.

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 endowments while seeking to maintain the purchasing power of the endowment assets. The Foundation's spending and investment policies work together to achieve this objective. Actual returns in any given year may vary from this amount.

To achieve its investment objectives over long periods of time, the Foundation has adopted an investment strategy that invests in domestic and international equities, and fixed income securities. The majority of assets are invested in equity or equity-like securities. Fixed income securities are used to lower short-term volatility. Diversification by asset class, investment style, investment manager, etc. is employed to avoid undue risk concentration and enhance total return. The primary performance objective is to achieve an annualized total rate of return, net of investment fees, that is equal to or greater than 4% plus inflation over long periods of time.

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Year Ended June 30, 2011

(9) Endowments (continued)

The spending policy determines the amount of money in a given year that will be distributed from the Foundation's various endowment assets, which includes donor advised, agency, designated, scholarship, field of interest and unrestricted. The current spending policy is at the discretion of the Board of Directors and is based on a three year rolling average. Based on the spending policy, over the long-term, the Foundation expects its endowment assets to grow at the rate of inflation. This is consistent with the Foundation's objective to maintain the purchasing power of endowment assets as well as to provide additional real growth through new gifts and investment return.

(10) Leases

Office space - The Foundation has entered into an operating lease with the Arizona Board of Regents for and on behalf of the University for office space, utilities, office furniture and equipment, custodial service and other such facilities for \$20 per square foot per year. The Foundation is currently using 378 square feet and pays this lease annually. The lease is renewable annually and cancelable with 30 days notice by either party without penalties or other contingent rental payments. Lease expense totaled \$7,560 for the year ended June 30, 2011.

Educational broadcast system licenses - The Foundation has been granted several educational broadcast system (EBS) licenses from the Federal Communications Commission (FCC). Additionally, the Foundation has entered into an agreement to purchase EBS licenses with funding from an outside corporation. Under the agreement, which is considered an exchange transaction and not a contribution under FASB ASC 958-605, the Foundation will purchase the EBS licenses and then lease the licenses to the outside corporation. In fiscal year 2008, the Foundation received approximately \$15,000,000 from the outside corporation to purchase the licenses. As of June 30, 2011, the cumulative purchased EBS licenses totaled \$8,810,045. There were purchases of \$2,025,000 and \$0 of EBS licenses in fiscal year 2011 and 2010, respectively. In addition, the Foundation received a onetime bonus of \$1,300,000 in fiscal year 2010. The remaining balance to be purchased plus \$539,855 in interest earned on investments of the advanced funds comprise the deferred revenue balance in the accompanying consolidated statement of financial position. For the year ended June 30, 2011, amortization expense of \$1,425,503 was computed using the straight-line method over estimated useful lives of 4 to 10 years and accumulated amortized expense at June 30, 2011 totaled \$3,680,575.

The Foundation leases the licenses to various companies. The licenses are granted for ten-year terms, which are due to expire through July 2019. The terms of the related lease agreements correspond with the terms of the licenses. Most leases have renewal clauses, which provide for a maximum lease term of 30 years.

The FCC has certain educational programming requirements. As part of the lease agreements, the lessees' are responsible for ensuring that the educational requirements are met. After the educational requirements are met, there is excess frequency capacity that can be used. The Foundation receives monthly lease payments for the use of the excess capacity. In addition to the monthly payment terms, several leases required the lessee to pay an initial fee. Total revenue received from these agreements was \$3,219,561 for the year ended June 30, 2011.

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Year Ended June 30, 2011

(10) Leases (continued)

The future minimum lease payments to be received under these agreements are as follows:

Years Ending June 30

2012	\$ 1,273,678
2013	735,314
2014	420,770
2015	282,999
2016	201,038
Thereafter	<u>327,797</u>
	<u>\$ 3,241,596</u>

(11) Retirement plan

The Foundation employees participate in the retirement plans sponsored by the University. Two of the Foundation employees participate in the Arizona State Retirement System and contributed 9.6% of their salary to the plan for the year ended June 30, 2011. The other Foundation employees participate in a defined contribution plan and contributed 7% of their salary. Participation in a retirement plan is required of all employees who are scheduled to work 20 hours or more per week. The Foundation matches 100% of the employees' contributions to the plans. For the year ended June 30, 2011 the Foundation's contribution expense was \$14,695.

(12) Fair value measurements

FASB ASC 820-10, *Fair Value Measurements*, establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. FASB ASC 820-10 establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values. FASB ASC 820-10 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2: Inputs to the valuation methodology include quoted prices from similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in inactive markets; inputs other than quoted market prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Unobservable inputs for the asset or liability.

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Year Ended June 30, 2011

(12) Fair value measurements (continued)

The following table summarizes the valuation of the Foundation's assets and liabilities measured at fair value by the above FASB ASC 820-10 categories as of June 30, 2011:

	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
U.S. government/agency bond mutual funds	\$ 12,203,442	\$ 12,203,442	\$ -	\$ -
Corporate bond mutual funds				
Intermediate term	7,339,543	7,339,543	-	-
Short term	4,817,619	4,817,619	-	-
Other	<u>4,075,231</u>	<u>4,075,231</u>	-	-
Total corporate bond mutual funds	16,232,393	16,232,393	-	-
Equity mutual funds				
Large cap – blend	24,074,015	24,074,015	-	-
Large cap – growth	8,245,289	8,245,289	-	-
Large cap – value	8,132,375	8,132,375	-	-
Other	<u>2,456,632</u>	<u>2,456,632</u>	-	-
Total equity mutual funds	42,908,311	42,908,311	-	-
International equity mutual funds				
Diversified emerging markets	3,990,195	3,990,195	-	-
Diversified developed international	13,504,482	13,504,482	-	-
Other	<u>51,789</u>	<u>51,789</u>	-	-
Total international equity mutual funds	17,546,466	17,546,466	-	-
Money market funds	1,754,914	1,754,914	-	-
Assets held under split interest agreements	2,652,569	2,652,569	-	-
Beneficial interest in perpetual trusts	3,254,769	-	-	3,254,769
Assets held in custody for others	<u>(19,193,176)</u>	-	<u>(19,193,176)</u>	-
Total	<u>\$ 77,359,688</u>	<u>\$ 93,298,095</u>	<u>\$ (19,193,176)</u>	<u>\$ 3,254,769</u>

The Foundation measures the fair value of assets held in custody for others based on a pooling of investments based on an agreed percentage of the assets held for others.

The Foundation measures the fair value of beneficial interests in trusts based on investment statements from those trusts.

The table below presents the changes in fair value measurements that used Level 3 inputs during the year ended June 30, 2011:

	<u>Beneficial interest in trusts</u>
Balances at July 1, 2010	\$ 2,723,574
Change in value recognized in earnings	454,689
Change in value of custodial assets	76,506
Balance at June 30, 2011	<u>\$ 3,254,769</u>

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Year Ended June 30, 2011

(12) Fair value measurements (continued)

The Foundation had no other assets or liabilities measured at fair value other than at initial recognition.

The Foundation currently has no other financial instruments subject to fair value measurement other than at initial recognition as disclosed above. For financial instruments not subject to fair value measurement after initial recognition, the Foundation estimates the fair values at June 30, 2011 as follows:

Cash and cash equivalents, bequests receivable, other receivables, accounts payable and accrued liabilities - Fair value does not materially differ from the aggregate carrying values of its financial instruments recorded in the accompanying combined statements of financial position due to the short maturities of those instruments.

Pledges receivable - The fair value approximates the carrying value and is estimated by discounting the future cash flows using current rates at which similar instruments would be made with similar credit ratings and for similar maturities.

Cash surrender value of life insurance - The life insurance policies are reported at the estimated cash surrender value of the policy as of the reporting date. Due to uncertainties regarding the timing and value of the ultimate payout of the life insurance policies, the cash surrender value is estimated to approximate the fair value of the life insurance policies.

Net investment in direct financing lease - The fair value approximates the carrying value and is based upon the estimated fair value of the leased property and the implicit capital lease interest rate that approximates a market interest rate. The fair value of the leased property was based upon the recent construction costs as provided for within FASB ASC 840, *Leases*.

Obligations under split interest agreements - The fair value approximates the carrying value and is based upon the present value of the cash flows of the annuity which are discounted using the payout rates of each agreement, based on the life expectancy of the annuitants as actuarially determined.