

**UNIVERSITY OF MINNESOTA FOUNDATION**

Consolidated Financial Statements

June 30, 2002

(With Independent Auditors' Report Thereon)

# UNIVERSITY OF MINNESOTA FOUNDATION

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## **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, 2002 and the related consolidated statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Foundation's fiscal 2001 financial statements and, in our report dated August 31, 2001, 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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, 2002 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

September 6, 2002

**UNIVERSITY OF MINNESOTA FOUNDATION**

Consolidated Statement of Financial Position

June 30, 2002

(With comparative information as of June 30, 2001)

<b>Assets</b>	<b>2002</b>	<b>2001</b>
Cash	\$ 6,382,954	1,821,245
Investments, substantially at fair market value	753,474,451	713,117,842
Investments loaned to broker	58,094,643	109,621,468
Investment collateral	59,883,754	112,744,526
Pledges receivable, net	67,817,991	78,470,431
Other receivables, primarily interest	4,044,165	4,395,230
Due from related parties	19,924	18,732
Interest in unitrusts, pooled income, and annuity trusts	38,875,139	41,031,062
Gift annuities	17,522,968	17,002,919
Property and equipment, net	1,559,702	1,859,294
Total assets	\$ <u>1,007,675,691</u>	<u>1,080,082,749</u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable	\$ 2,737,380	2,228,332
Gift annuities payable	11,123,758	10,530,024
Unitrusts, pooled income, and annuity trusts payable	9,471,657	10,683,948
Investments held for custody of others	49,824,674	50,711,791
Payable under investment loan agreement	59,883,754	112,744,526
Total liabilities	<u>133,041,223</u>	<u>186,898,621</u>
Net assets:		
Unrestricted	40,540,830	42,560,198
Temporarily restricted	509,880,104	544,386,269
Permanently restricted	324,213,534	306,237,661
Total net assets	<u>874,634,468</u>	<u>893,184,128</u>
Total liabilities and net assets	\$ <u>1,007,675,691</u>	<u>1,080,082,749</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF MINNESOTA FOUNDATION**

Consolidated Statement of Activities

Year ended June 30, 2002

(With summarized information for year ended June 30, 2001)

	<b>Unrestricted</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	<b>Total 2002</b>	<b>Total 2001</b>
Revenue:					
Contributions	\$ 2,365,440	44,798,193	16,668,886	63,832,519	116,721,033
Investment income, net	7,543,622	10,042,093	1,638	17,587,353	20,423,482
Net realized and unrealized losses on investments	(129,117)	(12,401,738)	—	(12,530,855)	(5,843,996)
Change in carrying value of trusts	(104,886)	(501,580)	706,049	99,583	(1,076,110)
Support services revenue	3,634,599	—	—	3,634,599	3,734,599
Miscellaneous revenue	547,448	—	—	547,448	567,681
Net assets released from	75,843,833	(76,443,133)	599,300	—	—
<b>Total revenue</b>	<b>89,700,939</b>	<b>(34,506,165)</b>	<b>17,975,873</b>	<b>73,170,647</b>	<b>134,526,689</b>
Expenses:					
Program services:					
Distributions for educational purposes	74,499,135	—	—	74,499,135	75,474,681
Support services:					
Management and general:					
Operational expenses	4,260,655	—	—	4,260,655	4,168,158
Legal and accounting fees	107,656	—	—	107,656	77,919
Investment and trust management fees	2,390,604	—	—	2,390,604	2,586,008
Depreciation	493,168	—	—	493,168	455,614
Other expenses	110,091	—	—	110,091	407,531
Fund raising:					
Promotion and development	9,858,998	—	—	9,858,998	8,546,163
<b>Total expenses</b>	<b>91,720,307</b>	<b>—</b>	<b>—</b>	<b>91,720,307</b>	<b>91,716,074</b>
<b>Increase (decrease) in net assets</b>	<b>(2,019,368)</b>	<b>(34,506,165)</b>	<b>17,975,873</b>	<b>(18,549,660)</b>	<b>42,810,615</b>
Net assets at beginning of year	42,560,198	544,386,269	306,237,661	893,184,128	850,373,513
Net assets at end of year	\$ 40,540,830	509,880,104	324,213,534	874,634,468	893,184,128

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF MINNESOTA FOUNDATION**

Consolidated Statement of Cash Flows

Year ended June 30, 2002

(with comparative information for the year ended June 30, 2001)

	<b>2002</b>	<b>2001</b>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ (18,549,660)	42,810,615
Adjustments to reconcile increase in net assets to net cash used for operating activities:		
Net realized and unrealized losses on investments	12,530,855	5,843,996
Changes in carrying value of trusts	1,017,317	2,275,798
Depreciation expense	493,168	455,614
Non-cash contributions	(5,185,936)	(13,098,374)
Contributions restricted for long-term investment	(17,975,873)	(31,813,863)
(Increase) decrease in pledges receivable	10,652,440	(29,051,642)
(Increase) decrease in other receivables	349,873	(93,276)
Increase (decrease) in held for custody of others	(887,117)	9,442,263
Increase in accounts payable	509,048	587,151
Net cash used for operating activities	<b>(17,045,885)</b>	<b>(12,641,718)</b>
Cash flows from investing activities:		
Purchases of property and equipment	(193,576)	(725,884)
Proceeds from sales of investments	494,309,100	773,191,494
Purchase of investments	(437,623,031)	(905,087,539)
Increase (decrease) in payable under investment loan agreement	(52,860,772)	112,744,526
Net cash provided by (used for) investing activities	<b>3,631,721</b>	<b>(19,877,403)</b>
Cash flows from financing activities:		
Proceeds from contributions restricted for long-term investment	17,975,873	31,813,863
Net cash provided by financing activities	<b>17,975,873</b>	<b>31,813,863</b>
Net increase (decrease) in cash	4,561,709	(705,258)
Cash, at beginning of year	1,821,245	2,526,503
Cash, at end of year	<b>\$ 6,382,954</b>	<b>1,821,245</b>

See accompanying notes to consolidated financial statements.

# UNIVERSITY OF MINNESOTA FOUNDATION

## Notes to Financial Statements

June 30, 2002

### (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 accounting principles generally accepted in the United States of America. The following is a summary of the more significant 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 accounting principles generally accepted in the United States of America, 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.

# UNIVERSITY OF MINNESOTA FOUNDATION

## Notes to Financial Statements

June 30, 2002

**(c) Basis of Accounting**

The 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. Fiscal year 2002 contributions to be received after one year are discounted at 3.68%. Prior years' contributions to be received after one year are discounted at 5.00%. 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 statement of activities include \$537,351 of indirect support received by the Foundation.

**(f) Unitrusts, Pooled Income, and Annuity Agreements**

The Foundation has entered into unitrust, pooled income, and annuity agreements that provide, 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 its interest in these trusts at the current market value of the related assets and a corresponding liability recorded for the actuarially determined present value of payments to be made to the designated beneficiaries with the residual amount recorded for the purposes designated when the gift is received. Upon termination of the income obligation, property in the trust or pooled income fund is 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 these gift annuities at market 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 amount recorded for the purposes designated when the gift is received. Upon the death of the beneficiaries, property in the gift annuity fund is held by the Foundation in accordance with the agreements.

# UNIVERSITY OF MINNESOTA FOUNDATION

## Notes to Financial Statements

June 30, 2002

**(h) *Trusts Held by Other Entities***

The Foundation may be a charitable remainder or perpetual beneficiary of trust accounts that are held by another entity such as a bank or another charitable organization. The Foundation records these trusts, after discovery of their existence, at the present value of the estimated future cash receipts from the assets of 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 income tax only on net unrelated business income.

**(j) *Investments***

Marketable securities, mutual funds, and derivative instruments are recorded at fair value using public market quotations. Limited partnerships are recorded at the fair value determined by the partnership. Contract for deed is recorded at the remaining outstanding principal balance. Land is recorded at the fair market value at the date of donation.

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, due from related parties, and accounts payable approximate fair value because of the short maturity of these instruments. Investment collateral is reported at fair value using public market quotations of the underlying investments. The fair value of pledges receivable is determined as the present value of expected future cash flows using a discount rate. The fair value of interest in unitrusts, pooled income, and annuity trusts, and gift annuities is based on quoted market prices at the reporting date of the underlying investments.

Unitrusts, pooled income, and annuity trusts payable, and gift annuities payable are reported at fair value based on the life expectancy of the beneficiaries and the present value of expected cash flows using a discount rate. 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.

# UNIVERSITY OF MINNESOTA FOUNDATION

## Notes to Financial Statements

June 30, 2002

**(l) Property and Equipment**

Property and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method.

**(m) Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements 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 accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2001, from which the summarized information was derived.

**(2) Investments**

The investments at June 30, 2002 are summarized as follows:

Marketable securities:	
Cash and cash equivalents	\$ 45,158,727
Corporate stocks & bonds	276,859,651
U.S. Government obligations	167,310,345
Equity mutual funds and other investments	96,429,657
Total marketable securities	585,758,380
Limited partnerships	224,697,145
Contract for deed	38,886
Land	1,074,683
Total investments	811,569,094
Less investments loaned to broker	58,094,643
Total	\$ 753,474,451

Investments include funds held for the custody of others of \$49,824,674 at June 30, 2002.

The Foundation's investment in limited partnerships includes approximately \$28,508,967 invested in a limited partnership with an objective to earn a total rate of return in excess of the Standard and Poor's 500 Index. The investment approach of the partnership is to trade directly and indirectly in common stock, derivative stock index instruments, other stock derivatives, debt securities, and other fixed income securities.

**UNIVERSITY OF MINNESOTA FOUNDATION**

Notes to Financial Statements

June 30, 2002

**(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, 2002 are summarized as follows:

Investments loaned to broker	\$ 58,094,643
Investments collateral	59,883,754
Income from securities lending	203,239

**(4) Pledges Receivable**

Pledges receivable, net of unamortized discount (prior years computed at 5%, 2002 computed at 3.68%) of \$8,779,698 are summarized as follows at June 30, 2002:

Unconditional promises expected to be collected in:	
Less than one year	\$ 24,996,819
One year to five years	35,310,413
Greater than five years	<u>8,636,915</u>
	68,944,147
Reserve for uncollectible pledges	<u>(1,126,156)</u>
Pledges receivable	<u>\$ 67,817,991</u>

In addition, the Foundation has received conditional promises to give in the amount of \$17,913,296 as of June 30, 2002. These gifts are primarily conditioned on completion of building or fundraising projects, evaluation of progress on projects, or matching funds.

**(5) Property and Equipment**

The following is a summary of property and equipment at June 30, 2002:

Leasehold improvements	\$ 472,305
Furniture & fixtures	2,732,748
UMFIA	24,846
Less accumulated depreciation	<u>(1,670,197)</u>
	<u>\$ 1,559,702</u>

**UNIVERSITY OF MINNESOTA FOUNDATION**

Notes to Financial Statements

June 30, 2002

**(6) Temporarily Restricted Net Assets**

Temporarily restricted net assets are available as of June 30, 2002 for the following purposes:

Capital improvement/facilities	\$ 50,964,798
Faculty support	10,032,756
Scholarships and fellowships	103,038,689
Lectureships, professorships, and chairs	125,341,194
College program support	180,881,324
Research	23,633,105
Trusts	11,673,841
Other	4,314,397
	<u>\$ 509,880,104</u>

**(7) Permanently Restricted Net Assets**

Permanently restricted net assets are restricted to investment in perpetuity. The permanent restricted net asset balances and purposes the income is expendable to support as of June 30, 2002 are as follows:

Capital improvement/facilities	\$ 3,403,923
Faculty support	9,169,498
Scholarships and fellowships	101,392,217
Lectureships, professorships, and chairs	140,874,720
College program support	34,982,812
Research	8,362,864
Trusts	24,281,000
Other	1,746,500
	<u>\$ 324,213,534</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 Guaranty**

The Foundation is the guarantor of principal and interest payments on long-term debt outstanding that is the obligation of Gateway. The total amount of long-term debt outstanding subject to this guaranty is \$46,840,000.

**UNIVERSITY OF MINNESOTA FOUNDATION**

Notes to Financial Statements

June 30, 2002

**(10) Summarized Financial Data for Gateway (Unaudited)**

Summarized financial data for Gateway as of and for the year ended June 30, 2002 was as follows:

Total assets	\$ 56,602,729
Total liabilities	<u>47,852,500</u>
Net assets	<u><u>\$ 8,750,229</u></u>
Revenues	\$ 4,838,222
Expenses	<u>7,005,076</u>
Decrease in net assets	<u><u>\$ (2,166,854)</u></u>

**(11) Leases**

The Foundation has an operating lease for office space with the University Gateway Corporation, 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, 2002 was \$844,834. Minimum annual payments under the terms of these leases are as follows:

2003	\$ 637,415
2004	637,415
2005	637,415
2006	637,415
2007	637,415
Thereafter	10,995,409