



UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Financial Statements and Consolidating Information

June 30, 2011

(With Independent Auditors' Report Thereon)

UNIVERSITY OF MINNESOTA FOUNDATION

Table of Contents

	Page
Independent Auditors' Report	1
Consolidated Statement of Financial Position	2
Consolidated Statement of Activities	3
Consolidated Statement of Cash Flows	4
Notes to Consolidated Financial Statements	5
Consolidating Information:	
Consolidating Statement of Financial Position	23
Consolidating Statement of Activities	24



KPMG LLP
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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, 2011, 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 2010 consolidated financial statements and, in our report dated October 7, 2010, we expressed an unqualified opinion on those consolidated 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, 2011, 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.

Our audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations and changes in net assets of the individual entities. The consolidating information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

October 10, 2011

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Statement of Financial Position

June 30, 2011

(with comparative information as of June 30, 2010)

Assets	2011	2010
Cash and cash equivalents	\$ 9,268,746	14,652,916
Investments, at fair value	1,511,556,019	1,306,779,141
Receivables from pending liquidations	15,513,616	26,020,719
Pledges receivable, net	74,148,962	60,955,415
Other receivables, primarily interest	1,937,211	2,639,255
Split interest agreements:		
Beneficial interest in perpetual trusts	23,898,480	22,371,194
Assets held in charitable trusts	28,276,326	24,613,322
Beneficial interest in trusts	3,344,687	2,885,566
Gift annuities	32,163,789	26,876,861
Office property and equipment, net	914,742	954,048
University of Minnesota Foundation – Dinnaken Housing, LLC	27,071,840	—
Total assets	\$ 1,728,094,418	1,488,748,437
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 10,832,675	8,511,171
Gift annuities payable	18,744,826	17,035,813
Liability under charitable trust agreements	10,290,378	9,071,328
Investments held for custody of others	207,484,593	184,319,254
Total liabilities	247,352,472	218,937,566
Net assets:		
Unrestricted	56,219,719	34,048,954
Temporarily restricted	835,676,588	690,994,532
Permanently restricted	588,845,639	544,767,385
Total net assets	1,480,741,946	1,269,810,871
Total liabilities and net assets	\$ 1,728,094,418	1,488,748,437

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION
Consolidated Statement of Activities
Year ended June 30, 2011
(with summarized information for the year ended June 30, 2010)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total 2011</u>	<u>Total 2010</u>
Revenue:					
Contributions	\$ 7,519,020	67,882,322	40,667,747	116,069,089	88,367,992
Investment income, net of investment expenses of \$2,493,490 and \$2,130,725 in 2011 and 2010, respectively	1,977,322	5,461,220	10,276	7,448,818	6,379,236
Net realized and unrealized gains on investments	11,823,967	192,797,896	—	204,621,863	82,091,311
Change in carrying value of trusts	—	4,400,779	3,400,231	7,801,010	5,364,576
Support services revenue	2,410,520	—	—	2,410,520	2,457,520
University of Minnesota Foundation – Dinnaken Housing, LLC rental revenue	2,864,647	—	—	2,864,647	—
Miscellaneous revenue	1,138,636	—	—	1,138,636	1,388,495
Net assets released from restriction	125,860,161	(125,860,161)	—	—	—
Total revenue	<u>153,594,273</u>	<u>144,682,056</u>	<u>44,078,254</u>	<u>342,354,583</u>	<u>186,049,130</u>
Expenses:					
Program services: Distributions for University purposes	107,022,889	—	—	107,022,889	99,207,991
Support services: Management and general: Operational expenses	6,012,735	—	—	6,012,735	6,971,933
Legal and accounting fees	445,075	—	—	445,075	224,883
Depreciation	207,862	—	—	207,862	201,799
Other expenses	268,228	—	—	268,228	140,153
Fundraising: Promotion and development	14,847,425	—	—	14,847,425	14,684,397
University of Minnesota Foundation – Dinnaken Housing, LLC: Operational expenses	1,976,066	—	—	1,976,066	—
Depreciation	643,228	—	—	643,228	—
Total expenses	<u>131,423,508</u>	<u>—</u>	<u>—</u>	<u>131,423,508</u>	<u>121,431,156</u>
Change in net assets	22,170,765	144,682,056	44,078,254	210,931,075	64,617,974
Net assets at beginning of year	34,048,954	690,994,532	544,767,385	1,269,810,871	1,205,192,897
Net assets at end of year	<u>\$ 56,219,719</u>	<u>835,676,588</u>	<u>588,845,639</u>	<u>1,480,741,946</u>	<u>1,269,810,871</u>

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidated Statement of Cash Flows

Year ended June 30, 2011

(with comparative information for the year ended June 30, 2010)

	2011	2010
Cash flows from operating activities:		
Change in net assets	\$ 210,931,075	64,617,974
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized and unrealized gains on investments	(204,621,863)	(82,091,311)
Change in net carrying value of trusts	(8,008,276)	(7,322,766)
Depreciation expense	851,090	201,799
Noncash contributions	(11,981,708)	(5,775,589)
Contributions restricted for long-term investment	(40,667,747)	(24,259,384)
Changes in operating assets and liabilities:		
Pledges receivable	(13,193,547)	7,184,824
Other receivables	702,044	(484,284)
Accounts payable	2,321,504	4,310,936
Net cash used in operating activities	(63,667,428)	(43,617,801)
Cash flows from investing activities:		
Purchases of property and equipment	(1,702,124)	(170,950)
Investments held for custody of others	23,165,339	81,197,261
Proceeds from sales of investments	670,508,253	1,277,004,040
Purchase of investments	(674,355,957)	(1,306,735,777)
Changes in payable under investment loan agreement	—	(23,764,079)
Net cash provided by investing activities	17,615,511	27,530,495
Cash flows from financing activity:		
Proceeds from contributions restricted for long-term investment	40,667,747	24,259,384
Net cash provided by financing activity	40,667,747	24,259,384
Net change in cash	(5,384,170)	8,172,078
Cash and cash equivalents at beginning of year	14,652,916	6,480,838
Cash and cash equivalents at end of year	\$ 9,268,746	14,652,916
Noncash investing activity:		
Receivables from pending liquidations	\$ 15,513,616	26,020,719
Contributions of securities and property	11,981,708	5,775,589
Reclassification of Dinnaken Housing from investments to University of Minnesota Foundation – Dinnaken Housing, LLC	26,180,000	—
Transfers of securities related to investments held for others	—	51,673,226

See accompanying notes to consolidated financial statements.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(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 (U.S. GAAP). 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 entities, the University of Minnesota Foundation Investment Advisors (UMFIA) and the University of Minnesota Foundation – Dinnaken Housing, LLC (Dinnaken Housing). UMFIA is a nonprofit organization established to oversee the investment and management of the investments of the Foundation. Dinnaken Housing is a limited liability corporation established primarily to provide housing to University of Minnesota students. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Prior to December 7, 2010, the Foundation's partial ownership of Dinnaken Housing was included in investments in the consolidated statement of financial position. Effective December 7, 2010, the Foundation was gifted 100% control of Dinnaken Housing, LLC and changed the legal name to the University of Minnesota Foundation – Dinnaken Housing, LLC. The Foundation has consolidated the assets and liabilities of Dinnaken Housing within the consolidated statement of financial position and the related revenues and expenses since such date on the consolidated statement of activities. This resulted in a reclassification of \$26,180,000 from investments to University of Minnesota Foundation – Dinnaken Housing, LLC on the consolidated statement of financial position.

The Foundation does not report its 50% voting interest in 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. GAAP, 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.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

- 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. 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.

(c) Basis of Accounting

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

(d) New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-06 (ASU 2010-06), *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, which requires new disclosures related to the fair value measurements and clarifies existing disclosure requirements about the level of disaggregation, inputs and valuation techniques. Additionally, this guidance requires disclosures about significant transfers between Levels 1 and 2 measurement categories and separating the presentation of purchases, sales and settlements. This guidance was effective for periods beginning after December 15, 2009, except for the disclosures regarding the separation of the presentation of purchases, sales and settlements, which is effective for periods beginning after December 15, 2010. ASU 2010-06 was adopted by the Foundation effective July 1, 2010 with the exception of separating the presentation of purchases, sales and settlements. There was no impact to the Foundation's consolidated statement of financial position or consolidated statement of activities due to the adoption of this new guidance. The clarification of existing disclosure requirements about the level of disaggregation, inputs and valuation techniques is included in note 3. The Foundation will adopt the required disclosure provisions of this new guidance relating to the separation of the presentation of purchases, sales and settlements effective July 1, 2011.

(e) Cash and Cash Equivalents

Cash and cash equivalents on the consolidated statement of cash flows consist of cash held in checking and temporary investments with maturities of less than three months.

(f) 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 consolidated

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

statement of financial position. Changes in the fair value of derivatives during the year are reported in the consolidated statement of activities.

(g) Contributions

Contributions, including unconditional promises to give, are recognized as revenues on an accrual basis. 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.

(h) Assets Held in Charitable Trusts

The Foundation has entered into unitrust and annuity agreements as trustee 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 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.

(i) 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 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.

(j) 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.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(k) *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.

FASB ASC 740-10, *Accounting for Uncertainty in Income Taxes*, provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Income tax positions must meet a more-likely than-not recognition threshold to be recognized. This interpretation also provides guidance on measurement derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Foundation recorded no liabilities in 2011 for unrecognized tax positions.

(l) *Investments*

Investments in cash equivalents, corporate bonds, other fixed income securities, equity securities, and Treasury inflation protected securities with readily determinable fair values are reported at fair value based on quoted market prices (traditional structures). Investments held in alternative structures are recorded at net asset values provided by external investment managers as a practical expedient in determining fair value. Because such investments are not readily marketable, the estimated value is subject to uncertainty and therefore may differ materially from the value that would have been used had a ready market for such investments existed.

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.

Receivables from pending liquidations represent sales of investments made prior to the end of the fiscal year, but settled after the fiscal year end.

(m) *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(l). Pledges receivable, net are reported at the present value of expected future cash flows using discount rates established at the date of gift and 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.

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.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(n) 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.

(o) Dinnaken Housing

Dinnaken Housing, which includes four student housing facilities, an office building, and a parking lot, was recorded at fair value as of the date the Foundation received 100% control. Rental revenues are recorded as earned over the lives of the associated lease agreements related to the housing facilities and office building.

Dinnaken Housing property and equipment are stated at fair value as of the date the Foundation received 100% control, less accumulated depreciation, and are depreciated over their estimated useful lives using the straight-line method (Furniture and fixtures – 3 – 7 years, building/building improvements – 27.5 years). Dinnaken Housing also holds nondepreciable land and all properties are exempt from real estate taxes.

(p) Investments Held for Custody of Others

The Foundation manages certain investments on behalf of other charitable organizations, including the University of Minnesota Alumni Association, Minnesota 4-H Foundation, Association of Public and Land-grant Universities, Immigration History Research Center, Minnesota Landscape Arboretum Foundation, and the Walker Art Center (the Walker). The management of these investments are subject to agreements with each that govern the arrangements, including the timing of additions and redemptions. At June 30, 2011, investments held for custody of others were \$207,484,593.

(q) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP 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 these estimates.

(r) 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. GAAP. Accordingly, such information should be read in conjunction with the Foundation's consolidated financial statements for the year ended June 30, 2010, from which the summarized information was derived.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(2) Investments

The investments at June 30, 2011 are summarized as follows:

	<u>Traditional structures</u>	<u>Alternative structures</u>	<u>Total</u>
Cash and cash equivalents	\$ 135,762,855	—	135,762,855
Fixed income	125,984,580	23,597,127	149,581,707
Global equity	43,195,550	195,931,283	239,126,833
Hedge funds	—	345,090,879	345,090,879
Natural resources	—	117,861,725	117,861,725
Treasury Inflation Protected Securities (TIPS)	100,455,202	—	100,455,202
Real estate	—	71,872,408	71,872,408
Private equity	—	375,947,461	375,947,461
Total	<u>\$ 405,398,187</u>	<u>1,130,300,883</u>	<u>1,535,699,070</u>
Other investments not categorized above			<u>6,233,526</u>
Subtotal			1,541,932,596
Less charitable gift annuities reported separately			<u>(30,376,577)</u>
Total			<u>\$ 1,511,556,019</u>

Fixed income investments include high yield bonds, bank loans, mortgage, and related securitizations.

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.

Net asset values provided by external investment managers for alternative structures include estimates, appraisals, assumptions and methods that are reviewed by management. It is possible that the redemption rights may be restricted by the funds in the future in accordance with the underlying fund agreements. Changes in market conditions and the economic environment may impact the net asset value of the funds and, consequently, the fair value of the Foundation's interests in the funds. The Foundation has \$1,130,300,883 of investments in alternative structures which are reported at net asset value as a practical expedient. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is, therefore, reasonably possible that if the Foundation were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value, and the discount could be significant.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(3) Fair Value Measurements

FASB ASC 820 established a three-tier fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the organization has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fixed income securities are generally traded in the over-the-counter market and are valued at a price that reflects fair value as quoted by dealers in these securities or by an independent pricing service. These prices are based on observable market data for the same or similar securities, including quoted prices in markets that are not active, or matrix pricing or other similar techniques that use observable market inputs, such as benchmark yields, expected prepayment speeds and volumes, and issuer ratings.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

The following table summarizes the Foundation's financial assets measured at fair value on a recurring basis at June 30, 2011:

	Fair value measurements using			Total fair value of assets at June 30, 2011
	Level 1	Level 2	Level 3	
Investments:				
Cash and cash equivalents	\$ 135,762,855	—	—	135,762,855
Fixed income:				
Asset backed securities	—	4,048,727	—	4,048,727
Mortgages	—	14,169,025	—	14,169,025
Alternative structures	—	—	23,597,127	23,597,127
Corporate bonds	—	7,985,972	—	7,985,972
Government	—	98,312,449	—	98,312,449
Other	—	1,468,407	—	1,468,407
Global equity:				
Small cap	19,993,952	—	—	19,993,952
Large cap	23,201,598	—	—	23,201,598
Alternative structures	—	—	195,931,283	195,931,283
Hedge funds:				
Directional long biased equity	—	—	114,952,031	114,952,031
Fixed income arbitrage	—	—	94,011,455	94,011,455
Fund of funds	—	—	44,401,866	44,401,866
Long/short nonequity	—	—	52,541,813	52,541,813
Market neutral equity	—	—	39,183,714	39,183,714
Natural resources	—	—	117,861,725	117,861,725
Real estate	—	—	71,872,408	71,872,408
Treasury Inflation Protected Securities (TIPS)	—	100,455,202	—	100,455,202
Private equity:				
Buyout	—	—	137,492,805	137,492,805
Distressed	—	—	67,877,308	67,877,308
Special situations	—	—	11,610,884	11,610,884
Venture capital	—	—	158,966,464	158,966,464
Other investments	—	—	6,233,526	6,233,526
Total investments	\$ 178,958,405	226,439,782	1,136,534,409	1,541,932,596
Gift annuities not categorized above	\$ 1,787,212	—	—	1,787,212
Beneficial interest in perpetual trusts	—	—	23,898,480	23,898,480
Beneficial interest in trusts	—	—	3,344,687	3,344,687

There were no transfers between Level 1 and Level 2 during the year ended June 30, 2011.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

The changes in investments measured at fair value on a recurring basis included as Level 3 measurements are summarized as follows:

	<u>Beginning balance at July 1, 2010</u>	<u>Investment income</u>	<u>Net realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Transfers</u>	<u>Ending balance at June 30, 2011</u>	<u>Net change in unrealized gains (losses) included in change in net assets for the period relating to investments held at June 30, 2011</u>
Fixed income:								
Alternative structures	\$ 38,469,124	—	5,889,297	8,991,006	(29,752,300)	—	23,597,127	5,575,322
Global equity:								
Alternative structures	150,544,892	842,668	35,257,969	25,319,221	(16,033,467)	—	195,931,283	35,367,226
Hedge funds:								
Directional long- biased equity	115,839,955	—	18,161,665	15,000,000	(34,049,589)	—	114,952,031	17,948,221
Fixed income arbitrage	70,158,464	—	1,928,679	25,000,000	(3,075,688)	—	94,011,455	2,097,541
Fund of funds	73,870,898	—	530,968	—	(30,000,000)	—	44,401,866	612,294
Long/short non-equity	48,461,819	—	5,910,690	—	(1,830,696)	—	52,541,813	5,960,230
Market neutral equity	38,254,631	—	2,550,996	15,000,000	(16,621,913)	—	39,183,714	2,550,997
Natural resources	105,312,712	—	44,927,782	6,545,959	(30,979,163)	(7,945,565)	117,861,725	45,957,705
Real estate	62,489,840	—	9,168,885	11,768,975	(11,555,292)	—	71,872,408	8,168,205
Private equity:								
Buyout	105,124,136	—	26,389,363	15,139,080	(17,105,339)	7,945,565	137,492,805	20,010,055
Distressed	60,845,584	—	11,811,448	2,770,684	(7,550,408)	—	67,877,308	10,321,533
Special situations	3,064,975	—	(1,645,317)	10,860,687	(669,461)	—	11,610,884	(2,065,690)
Venture capital	103,761,073	—	61,784,594	18,237,540	(24,816,743)	—	158,966,464	56,372,842
Other investments	32,382,626	1,203	(39,800)	547,416	(477,919)	(26,180,000)	6,233,526	(27,762)
	<u>\$ 1,008,580,729</u>	<u>843,871</u>	<u>222,627,219</u>	<u>155,180,568</u>	<u>(224,517,978)</u>	<u>(26,180,000)</u>	<u>1,136,534,409</u>	<u>208,848,719</u>

The changes in other investments or financial assets measured at fair value on a recurring basis included as Level 3 measurements are summarized as follows:

	<u>Beginning balance at July 1, 2010</u>	<u>Change in carrying value of trusts</u>	<u>Net realized and unrealized gains (losses)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Ending balance at June 30, 2011</u>	<u>Net change in unrealized gains (losses) included in change in net assets for the period relating to investments held at June 30, 2011</u>
Beneficial interest in trusts	\$ 25,256,760	1,986,407	—	—	—	27,243,167	1,986,407

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

The following is a summary of the investments whose net asset value approximates fair value and the related unfunded commitments and redemption restrictions associated with each major category at June 30, 2011:

	<u>Total fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice periods</u>
Alternative investments:				
Fixed income (a)	\$ 23,597,127	1,927,359	none	none
Global equity (b)	195,931,283	—	none or daily to quarterly	none or 0 – 60 days
Hedge funds (c)	345,090,879	—	monthly to biannually	30 – 180 days
Natural resources (d)	117,861,725	32,111,072	none or annually	none or 60 days
Real estate (e)	71,872,408	38,973,519	none	none
Private equity (f)	375,947,461	97,143,632	none	none
Other investments (g)	6,233,526	—	none	none
	<u>\$ 1,136,534,409</u>	<u>170,155,582</u>		

- (a) Fixed Income – this category includes direct investments in private funds that invest in debt securities. The fair value of these investments has been estimated using the percentage share of the Foundation’s ownership interest in partner’s capital. Distributions from each fund are received when the underlying investments in the funds create distributable cash flow and when underlying investments are liquidated. These investments cannot be redeemed. It is estimated that the underlying assets of the fund will be liquidated over the next two to five years.
- (b) Global Equity – this category includes investments of \$191,607,369 in funds that invest in common stocks. The managers of the funds have the flexibility to change their exposure based on their view of particular securities and the overall market. Certain of the funds have redemption and notice of redemption requirements that generally limit the ability to liquidate the positions in a short period of time. The fair values of the investments have been estimated using the net asset value per share of the investments. This category also includes direct investments of \$4,323,914 in private funds that invests in less liquid but publicly traded common stocks. The fair value of this investment has been estimated using the percentage share of the Foundation’s ownership interest in partner’s capital. Distributions from the fund are received when the underlying investments in the fund create distributable cash flow and when underlying investments are liquidated. This investment cannot be redeemed. It is estimated that the underlying assets of the fund will be liquidated over the next six years.
- (c) Hedge Funds – this category includes investments in hedge funds and funds of hedge funds that invest in equity, debt, structured products and derivative securities. Debt securities include corporate debt, mortgage debt, and sovereign debt. The managers of these funds have the flexibility to change their exposure based on their view of particular securities and the overall market. The strategies of these funds include event-driven, relative value, arbitrage, and directional strategies. Certain of these funds have various redemption and notice of redemption requirements that generally limit the ability

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

to liquidate them in a short period of time. The fair values of these investments have been estimated using the net asset value per share of the investments.

- (d) Natural Resources – this category includes direct investments of \$108,960,976 in real asset funds, generally through limited partnerships, that invest in natural resources. The fair value of these investments has been estimated using the percentage share of the Foundation’s ownership interest in partner’s capital. Distributions from each fund are received when the underlying investments in the funds create distributable cash flow and when underlying investments are liquidated. Certain of these investments cannot be redeemed. It is estimated that the underlying assets of the fund will be liquidated over the next one to ten years. This category also includes investments of \$8,900,749 in funds that invest in natural resources common stock and derivative securities. The manager of the fund has the flexibility to change their exposure based on their view of particular securities and the overall market. The fund has redemption and notice of redemption requirements that generally limit the ability to liquidate the position in a short period of time. The fair value of the investment has been estimated using the net asset value per share of the investment.
- (e) Real Estate – this category includes direct investments in real asset funds, generally through limited partnerships, that invest in real estate. The fair value of these investments has been estimated using the percentage share of the Foundation’s ownership interest in partner’s capital. Distributions from each fund are received when the underlying investments in the funds create distributable cash flow and when underlying investments are liquidated. These investments cannot be redeemed. It is estimated that the underlying assets of the fund will be liquidated over the next one to ten years.
- (f) Private Equity – this category includes direct investments in private equity funds, generally through limited partnerships, that invest in private companies, private debt, intellectual property, structured products and special situations. The fair value of these investments has been estimated using the percentage share of the Foundation’s ownership interest in partner’s capital. Distributions from each fund are received when the underlying investments in the funds create distributable cash flow and when underlying investments are liquidated. These investments cannot be redeemed. It is estimated that the underlying assets of the fund will be liquidated over the next one to ten years.
- (g) Other investments – this category includes direct investments in property, limited partnerships, contract for deeds, and cash surrender value of life insurance that were gifted to the Foundation. The fair value of these investments has been estimated using the appropriate measurement for the type of investment, including fair value, appraisals, and percentage share of the Foundation’s ownership interest in partner’s capital.

The Foundation’s alternative investments which are redeemable at net asset value under the original terms of the partnership agreements and/or subscription agreements and operations of the underlying funds may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by the funds, changes in market conditions and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the Foundation’s interest in the funds.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(4) Pledges Receivable

Pledges receivable, net of unamortized discount (at rates of 2.65% – 5.15%) of \$7,334,908 are summarized as follows at June 30, 2011:

Unconditional promises expected to be collected in:	
Less than one year	\$ 22,998,925
One year to five years	43,601,445
Greater than five years	<u>12,463,131</u>
	79,063,501
Reserve for uncollectible pledges	<u>(4,914,539)</u>
Pledges receivable	<u><u>\$ 74,148,962</u></u>

In addition, the Foundation has received conditional promises to give in the amount of \$6,798,592 as of June 30, 2011. 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 office property and equipment at June 30, 2011:

Leasehold improvements	\$ 690,461
Furniture and fixtures	842,756
UMFIA	187,641
Less accumulated depreciation	<u>(806,116)</u>
	<u><u>\$ 914,742</u></u>

The following is a summary of Dinnaken Housing property and equipment at June 30, 2011:

Land	\$ 5,292,007
Property and equipment	22,423,061
Less accumulated depreciation	<u>(643,228)</u>
	<u><u>\$ 27,071,840</u></u>

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(6) Temporarily Restricted Net Assets

Temporarily restricted net assets are available as of June 30, 2011 for the following purposes:

The portion of unexpended investment return generated from donor-restricted endowment funds subject to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) consists of:	
Capital improvement/facilities	\$ 7,219,794
Faculty support	7,349,013
Scholarships and fellowships	96,091,089
Lectureships, professorships, and chairs	155,072,762
College program support	53,736,527
Research	8,956,508
Other	1,752,682
Subtotal	<u>330,178,375</u>
Gifts and other unexpended revenues and gains available for:	
Capital improvement/facilities	71,764,707
Faculty support	11,094,306
Scholarships and fellowships	117,402,507
Lectureships, professorships, and chairs	35,976,747
College program support	227,972,121
Research	25,580,683
Trusts	9,478,633
Other	6,228,509
Subtotal	<u>505,498,213</u>
Total temporarily restricted net assets	<u>\$ 835,676,588</u>

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(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, 2011 are as follows:

Capital improvement/facilities	\$ 3,647,677
Faculty support	13,290,035
Scholarships and fellowships	278,967,049
Lectureships, professorships, and chairs	185,382,097
College program support	57,614,430
Research	11,271,926
Trusts	37,043,973
Other	1,628,452
	<hr/>
	\$ 588,845,639
	<hr/> <hr/>

(8) Endowment Funds

Effective August 1, 2008, the Foundation adopted the provisions of FASB ASC 958, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*. ASC 958 provides guidance on the net asset classification of donor restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and also requires disclosures about endowment funds, both donor restricted and board designated endowment funds.

(a) Interpretation of Relevant Law

The board of trustees has interpreted UPMIFA to require that endowment fund investment and spending policies be designed with the aim of preserving the amount of each endowment fund which is prudent for the uses, benefits, purposes and duration for which each endowment fund was established. For accounting purposes only, the Foundation has classified as permanently restricted net assets the following: (a) the original value of gifts donated to its endowment funds, (b) the original value of subsequent gifts to such endowment funds, and (c) accumulations to such endowment funds made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of a 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 organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(b) Endowment Net Asset Composition by Type of Fund as of June 30, 2011

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (3,281,260)	330,178,375	538,889,932	865,787,047
Board-designated endowment funds	<u>8,916,429</u>	<u>—</u>	<u>—</u>	<u>8,916,429</u>
	<u>\$ 5,635,169</u>	<u>330,178,375</u>	<u>538,889,932</u>	<u>874,703,476</u>

(c) Changes in Endowment Net Assets for the Year Ended June 30, 2011

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (5,521,800)	254,866,803	502,350,825	751,695,828
Total investment return	11,634,493	108,703,899	10,276	120,348,668
Cash contributions and pledge receipts	—	—	35,715,947	35,715,947
Change in carrying value of trusts	—	—	812,884	812,884
Appropriation of assets	<u>(477,524)</u>	<u>(33,392,327)</u>	<u>—</u>	<u>(33,869,851)</u>
Endowment net assets, end of year	<u>\$ 5,635,169</u>	<u>330,178,375</u>	<u>538,889,932</u>	<u>874,703,476</u>

(d) Funds with Deficiencies (Underwater Funds)

At June 30, 2011, as a result of investment losses and Board authorized distributions, the fair value of certain endowment assets was less than the related donor-restricted amounts. In accordance with U.S. GAAP, deficiencies of this nature are reported in unrestricted net assets and totaled \$3,281,260. The reporting of such deficiencies as a reduction of Foundation-controlled unrestricted net assets does not legally create an affirmative obligation of the Foundation to restore the fair value of those funds from unrestricted assets.

(e) Return Objectives and Risk Parameters

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Foundation must hold indefinitely or for a donor-specified period(s) as well as board-designated funds. Under this policy, the investment goal is to achieve an annualized return of six percentage points in excess of inflation; thereby providing designated programs with a revenue source that keeps pace with inflation. Actual returns in any given year may vary from this amount.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(f) *Strategies Employed for Achieving Objectives*

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

(g) *Spending Policy and How the Investment Objectives Relate to Spending Policy*

In developing its spending policy, the Foundation considers certain of the following factors which it determines relevant:

1. The duration and preservation of the fund;
2. The purposes of the Foundation and the donor-restricted endowment fund;
3. General economic conditions;
4. The possible effect of inflation and deflation;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the Foundation; and
7. The investment policies of Foundation.

The board of trustees of the Foundation has adopted a policy of appropriating for distribution each year 4.5% of its endowment funds' five year trailing average. In establishing this policy, the Foundation considered the long-term expected return on its endowment. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(9) *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 consolidated statement of activities. Accordingly, certain costs have been allocated among the programs and support services benefited.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(10) Loan Guarantee

The Foundation guarantees the principal and interest payments on the long-term debt related to Gateway's outstanding Series 1997B, 2002, 2006, and 2009 bonds. The total amount of long-term debt outstanding at June 30, 2011 subject to the guarantee is \$52,921,554. Since the guarantee may expire without being drawn upon, the total guarantee does not necessarily represent future cash requirements. As of June 30, 2011, 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.

(11) Summarized Financial Data for Gateway (Unaudited)

Summarized financial data for Gateway as of and for the year ended June 30, 2011 was as follows:

Total assets	\$ 75,111,742
Total liabilities	<u>56,135,620</u>
Net assets	<u>\$ 18,976,122</u>
Income	\$ 5,831,570
Expenses	<u>5,252,368</u>
Net operating income	579,202
Depreciation/other changes in net assets	<u>3,110,124</u>
Increase in net assets	<u>\$ 3,689,326</u>

(12) Commitments

The Foundation has a 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, including amounts paid for common area maintenance charges, for the year ended June 30, 2011 was \$930,962. Minimum annual payments under the terms of these leases are as follows:

Year ending June 30:	
2012	\$ 637,415
2013	637,415
2014	637,415
2015	637,415
2016	637,415
Thereafter	5,099,320

(13) Retirement Plans

The Foundation staff members participate in the University's retirement plans. The University manages all plan administration, payment, and disclosure obligations. The Foundation has no unfunded liabilities with respect to the plans.

UNIVERSITY OF MINNESOTA FOUNDATION

Notes to Consolidated Financial Statements

June 30, 2011

(14) Subsequent Events

In connection with the preparation of the consolidated financial statements, the Foundation evaluated subsequent events after the consolidated statement of financial position date of June 30, 2011 through October 10, 2011 which was the date the consolidated financial statements were issued.

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidating Statement of Financial Position

June 30, 2011

Assets	University of Minnesota Foundation	University of Minnesota Foundation Investment Advisors	University of Minnesota Foundation – Dinnaken Housing, LLC	Eliminations	Total
Cash and cash equivalents	\$ 6,766,545	918,441	1,583,760	—	9,268,746
Investments, at fair value	1,511,556,019	—	5,519,856	(5,519,856)	1,511,556,019
Receivables from pending liquidations	15,513,616	—	—	—	15,513,616
Pledges receivable, net	74,148,962	—	—	—	74,148,962
Other receivables, primarily interest	1,893,503	135	43,573	—	1,937,211
Split interest agreements:					
Beneficial interest in perpetual trusts	23,898,480	—	—	—	23,898,480
Assets held in charitable trusts	28,276,326	—	—	—	28,276,326
Beneficial interest in trusts	3,344,687	—	—	—	3,344,687
Gift annuities	32,163,789	—	—	—	32,163,789
Office property and equipment, net	799,786	114,956	—	—	914,742
University of Minnesota Foundation – Dinnaken Housing, LLC	—	—	27,071,840	—	27,071,840
Total assets	\$ 1,698,361,713	1,033,532	34,219,029	(5,519,856)	1,728,094,418
Liabilities and Net Assets					
Liabilities:					
Accounts payable	\$ 10,402,114	—	430,561	—	10,832,675
Gift annuities payable	18,744,826	—	—	—	18,744,826
Liability under charitable trust agreements	10,290,378	—	—	—	10,290,378
Investments held for custody of others	213,004,449	—	—	(5,519,856)	207,484,593
Total liabilities	252,441,767	—	430,561	(5,519,856)	247,352,472
Net assets:					
Unrestricted	21,397,719	1,033,532	33,788,468	—	56,219,719
Temporarily restricted	835,676,588	—	—	—	835,676,588
Permanently restricted	588,845,639	—	—	—	588,845,639
Total net assets	1,445,919,946	1,033,532	33,788,468	—	1,480,741,946
Total liabilities and net assets	\$ 1,698,361,713	1,033,532	34,219,029	(5,519,856)	1,728,094,418

See accompanying independent auditors' report.

UNIVERSITY OF MINNESOTA FOUNDATION

Consolidating Statement of Activities

Year ended June 30, 2011

	<u>University of Minnesota Foundation</u>	<u>University of Minnesota Foundation Investment Advisors</u>	<u>University of Minnesota Foundation – Dinnaken Housing, LLC</u>	<u>Eliminations</u>	<u>Total</u>
Revenue:					
Contributions	\$ 116,069,089	—	—	—	116,069,089
Investment income, net of investment expenses	6,919,811	—	22,155	506,852	7,448,818
Net realized and unrealized gains on investments	204,496,841	—	125,022	—	204,621,863
Change in carrying value of trusts	7,801,010	—	—	—	7,801,010
Support services revenue	2,410,520	2,387,000	—	(2,387,000)	2,410,520
University of Minnesota Foundation – Dinnaken Housing, LLC rental revenue	—	—	2,864,647	—	2,864,647
Miscellaneous revenue	1,138,636	727,562	—	(727,562)	1,138,636
Net assets released from restriction	—	—	—	—	—
Total revenue	<u>338,835,907</u>	<u>3,114,562</u>	<u>3,011,824</u>	<u>(2,607,710)</u>	<u>342,354,583</u>
Expenses:					
Program services:					
Distributions for University purposes	107,022,889	—	—	—	107,022,889
Support services:					
Management and general:					
Operational expenses	6,012,735	2,607,710	—	(2,607,710)	6,012,735
Legal and accounting fees	445,075	—	—	—	445,075
Depreciation	190,913	16,949	—	—	207,862
Other expenses	268,228	—	—	—	268,228
Fundraising:					
Promotion and development	14,847,425	—	—	—	14,847,425
University of Minnesota Foundation – Dinnaken Housing, LLC:					
Operational expenses	—	—	1,976,066	—	1,976,066
Depreciation	—	—	643,228	—	643,228
Total expenses	<u>128,787,265</u>	<u>2,624,659</u>	<u>2,619,294</u>	<u>(2,607,710)</u>	<u>131,423,508</u>
Change in net assets	210,048,642	489,903	392,530	—	210,931,075
Net assets at beginning of year	1,235,871,304	543,629	33,395,938	—	1,269,810,871
Net assets at end of year	\$ <u>1,445,919,946</u>	<u>1,033,532</u>	<u>33,788,468</u>	<u>—</u>	<u>1,480,741,946</u>

See accompanying independent auditors' report.