



UNIVERSITY OF HAWAII FOUNDATION

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Board of Trustees
University of Hawaii Foundation:

We have audited the accompanying statements of financial position of the University of Hawaii Foundation (the Foundation) as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years 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 audits.

We conducted our audits 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 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Hawaii Foundation as of June 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

November 14, 2012

UNIVERSITY OF HAWAII FOUNDATION

Statements of Financial Position

June 30, 2012 and 2011

Assets	2012	2011
Cash and cash equivalents	\$ 11,064,660	7,640,453
Contributions receivable, net	22,807,429	28,027,941
Prepaid expenses and other receivables	1,405,752	317,479
Property and equipment, at cost, net of accumulated depreciation and amortization of \$1,251,162 in 2012 and \$1,218,204 in 2011	2,252,536	2,069,180
Other assets, at cost	1,504,493	1,619,011
Investments	283,397,561	272,298,114
Beneficial interest in trusts held by others	14,030,874	14,656,628
Total assets	\$ 336,463,305	326,628,806
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 2,649,364	1,958,249
Liabilities under split-interest agreements	6,208,844	5,400,139
Amounts held for others	2,461,920	2,205,877
Other liabilities	452,246	408,397
Total liabilities	11,772,374	9,972,662
Net assets:		
Unrestricted	(3,483,362)	(140,746)
Temporarily restricted	143,105,983	135,899,381
Permanently restricted	185,068,310	180,897,509
Total net assets	324,690,931	316,656,144
Commitments		
Total liabilities and net assets	\$ 336,463,305	326,628,806

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statement of Activities

Year ended June 30, 2012

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Revenues:				
Contributions	\$ 169,404	40,251,894	5,482,483	45,903,781
Fees, honoraria, royalties, and other	3,791,319	1,660,842	3,103	5,455,264
Investment gain (loss)	(1,500,441)	2,053,527	(1,136,868)	(583,782)
Administrative fees	4,419,847	(4,152,108)	(267,739)	—
Fund-raising events and projects	—	2,403,153	89,822	2,492,975
	<u>6,880,129</u>	<u>42,217,308</u>	<u>4,170,801</u>	<u>53,268,238</u>
Net assets released from restrictions	<u>35,010,706</u>	<u>(35,010,706)</u>	<u>—</u>	<u>—</u>
	<u>41,890,835</u>	<u>7,206,602</u>	<u>4,170,801</u>	<u>53,268,238</u>
Expenses:				
Program services:				
Extension and public services	1,185,736	—	—	1,185,736
Academic support	5,653,479	—	—	5,653,479
Research	4,056,890	—	—	4,056,890
Student aid and services	9,172,217	—	—	9,172,217
Faculty and staff support	2,148,909	—	—	2,148,909
Capital projects	1,402,841	—	—	1,402,841
Athletics	3,539,261	—	—	3,539,261
Special and other	7,851,373	—	—	7,851,373
Total program services	<u>35,010,706</u>	<u>—</u>	<u>—</u>	<u>35,010,706</u>
Supporting services:				
Administrative, management, and fiscal services	3,404,661	—	—	3,404,661
Development	6,818,084	—	—	6,818,084
Total supporting services	<u>10,222,745</u>	<u>—</u>	<u>—</u>	<u>10,222,745</u>
Change in net assets	(3,342,616)	7,206,602	4,170,801	8,034,787
Net assets at beginning of year	(140,746)	135,899,381	180,897,509	316,656,144
Net assets at end of year	\$ <u>(3,483,362)</u>	<u>143,105,983</u>	<u>185,068,310</u>	<u>324,690,931</u>

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statement of Activities

Year ended June 30, 2011

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Revenues:				
Contributions	\$ 115,449	24,586,101	11,320,946	36,022,496
Fees, honoraria, royalties, and other	3,776,826	1,247,269	31,069	5,055,164
Investment gain	9,987,387	23,001,734	1,539,899	34,529,020
Administrative fees	3,390,864	(2,854,543)	(536,317)	4
Fund-raising events and projects	—	2,431,960	33,579	2,465,539
	<u>17,270,526</u>	<u>48,412,521</u>	<u>12,389,176</u>	<u>78,072,223</u>
Net assets released from restrictions	<u>30,846,499</u>	<u>(30,846,499)</u>	<u>—</u>	<u>—</u>
	<u>48,117,025</u>	<u>17,566,022</u>	<u>12,389,176</u>	<u>78,072,223</u>
Expenses:				
Program services:				
Extension and public services	1,226,840	—	—	1,226,840
Academic support	5,935,159	—	—	5,935,159
Research	3,263,403	—	—	3,263,403
Student aid and services	9,194,512	—	—	9,194,512
Faculty and staff support	2,060,152	—	—	2,060,152
Capital projects	400,504	—	—	400,504
Athletics	3,434,354	—	—	3,434,354
Special and other	5,331,575	—	—	5,331,575
Total program services	<u>30,846,499</u>	<u>—</u>	<u>—</u>	<u>30,846,499</u>
Supporting services:				
Administrative, management, and fiscal services	3,316,242	—	—	3,316,242
Development	6,265,649	—	—	6,265,649
Total supporting services	<u>9,581,891</u>	<u>—</u>	<u>—</u>	<u>9,581,891</u>
Change in net assets	7,688,635	17,566,022	12,389,176	37,643,833
Net assets at beginning of year	<u>(7,829,381)</u>	<u>118,333,359</u>	<u>168,508,333</u>	<u>279,012,311</u>
Net assets at end of year	\$ <u><u>(140,746)</u></u>	<u><u>135,899,381</u></u>	<u><u>180,897,509</u></u>	<u><u>316,656,144</u></u>

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statements of Cash Flows

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from contributions	\$ 47,739,851	29,481,503
Cash received for fees, honoraria, royalties, and other	5,452,161	5,024,095
Investment return received	6,259,616	3,801,624
Program and supporting service expenses paid	<u>(44,866,431)</u>	<u>(40,011,336)</u>
Net cash provided by (used in) operating activities	<u>14,585,197</u>	<u>(1,704,114)</u>
Cash flows from investing activities:		
Purchase of investments	(265,048,443)	(206,045,035)
Proceeds from sale of investments	251,390,534	201,190,409
Purchases of property and equipment	<u>—</u>	<u>—</u>
Net cash used in investing activities	<u>(13,657,909)</u>	<u>(4,854,626)</u>
Cash flows from financing activity:		
Amounts restricted for long-term investment	<u>2,496,919</u>	<u>11,764,652</u>
Net cash provided by financing activity	<u>2,496,919</u>	<u>11,764,652</u>
Net increase in cash and cash equivalents	3,424,207	5,205,912
Cash and cash equivalents at beginning of year	<u>7,640,453</u>	<u>2,434,541</u>
Cash and cash equivalents at end of year	\$ <u><u>11,064,660</u></u>	\$ <u><u>7,640,453</u></u>
Reconciliation of change in net assets to net cash provided by (used in) operating activities:		
Change in net assets	\$ 8,034,787	37,643,833
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	32,958	49,457
Realized and unrealized losses (gains) on investments	4,641,784	(30,289,650)
(Decrease) increase in allowance for uncollectible pledges	(67,631)	695,767
Loss on disposition of property and equipment	—	928
Decrease in contributions receivable	5,288,143	1,882,799
(Increase) decrease in prepaid expenses and other receivables	(1,088,273)	92,182
Decrease (increase) in other assets	114,518	(71,125)
Increase (decrease) in accounts payable	691,115	(495,311)
Increase in liabilities under split-interest agreements	808,705	916,223
Increase in amounts held for others, net	256,043	185,927
Increase in other liabilities	43,849	74,032
Amounts restricted for long-term investment	<u>(4,170,801)</u>	<u>(12,389,176)</u>
Net cash provided by (used in) operating activities	\$ <u><u>14,585,197</u></u>	\$ <u><u>(1,704,114)</u></u>

Supplemental disclosures of noncash activities:

The Foundation received noncash contributions in the amount of \$5,032,961 and \$1,329,863 in 2012 and 2011, respectively.

Unrealized (losses) and gains on assets held for others were \$(156,359) and \$203,476 for the years ended June 30, 2012 and 2011, respectively.

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2012 and 2011

(1) Summary of Significant Accounting Policies

(a) *Organization*

The University of Hawaii Foundation (the Foundation) is a not-for-profit entity established to solicit and manage funds for the benefit of the University of Hawaii (University). The Foundation is governed by a self-perpetuating board of trustees primarily consisting of elected volunteers.

(b) *Financial Statement Presentation*

The financial statements have been prepared to focus on the Foundation as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of net assets and transactions into three classes (unrestricted, temporarily restricted, or permanently restricted) as follows:

Unrestricted Net Assets – net assets that represent resources generated from operations or that are not subject to donor-imposed stipulations.

Temporarily Restricted Net Assets – net assets subject to donor-imposed stipulations that may or will be met by actions of the Foundation and/or by the passage of time.

Permanently Restricted Net Assets – net assets subject to donor-imposed stipulations that must be maintained permanently by the Foundation. Generally, the donor of these assets permits the Foundation to use all or part of the income earned on related investments for general or specific purposes in support of the University.

(c) *Amounts Held for Others*

Resources received in transactions that the Foundation acts as an agent are reported as amounts held for others. Investment income earned on amounts received increases amounts held for others. Distributions to specified recipients decrease amounts held for others.

(d) *Use of Estimates*

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

(e) *Cash Equivalents*

Short-term investments held for operations with original maturities of three months or less are classified as cash equivalents. Cash equivalents include short-term U.S. Treasury securities and other short-term, highly liquid investments and are carried at cost, which approximates fair value. Short-term investments held for investment purposes are reflected as investments.

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Notes to Financial Statements

June 30, 2012 and 2011

(f) Contributions

Contributions received and unconditional promises to give are measured at their fair values and are reported as an increase in net assets.

The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. Certain noncash contributions are reported as other assets until liquidation. When a donor restriction expires, that is, when a stipulated time restriction ends or the purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Unconditional promises to give (contributions receivable) that are expected to be collected within one year are recorded at net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using an interest rate commensurate with the associated risk to the years in which the promises are received. Amortization of the discounts is included in contribution revenue. The Foundation provides an allowance for uncollectible pledges based upon historical experience with its donors as well as individual donor circumstances.

(g) Investments

Traditional Structures – Values Based on Quoted Market Prices

These structures include debt and equity securities with readily determinable fair values and are reported at fair value based on quoted market prices.

Alternative Structures – Underlying Investment Values Based on Quoted Market Price

These structures include pooled investments that are not publicly traded. The underlying debt and equity securities are publicly traded and there is visibility to the individual securities within each pooled investment. The value is based on the quoted market prices of the underlying securities.

Alternative Structures – Underlying Investment Values Based on Estimates Provided by Fund Manager or General Partner

These structures include limited partnership investments in private equity, venture capital, real estate, and hedge funds including absolute return and long/short hedge funds. Fair value is generally based on information provided by the respective external investment manager at the most recent valuation date and from the valuation date to fiscal year-end, if applicable. The private equity, venture capital, and real estate investments are not readily marketable and involve assumptions and methods that are reviewed by management. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investment existed. A portion of the investments made by certain hedge funds is also not readily marketable; additionally, hedge fund managers may not provide the detail of their underlying marketable securities. The hedge fund valuation process is carefully reviewed by management with the assistance of an outside consultant. As described in note 1(k), the Foundation

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Notes to Financial Statements

June 30, 2012 and 2011

utilized the net asset value per share for certain investments in alternative structures as a practical expedient for the estimation of the fair value of these investments.

Gains and losses on investments are reported in the statements of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

(h) *Property and Equipment*

Property and equipment are stated at cost and include approximately \$2,000,000 in land. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets, ranging from 5 to 10 years, commencing at the time the asset is placed into service.

The Foundation reports gifts of property and equipment at fair value as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Foundation reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

(i) *Split-Interest Agreements*

The Foundation's split-interest agreements with donors consist of irrevocable pooled income funds, charitable remainder trusts, and charitable gift annuities for which the Foundation serves as trustee. Assets held under these split-interest agreements are included in investments. Contribution revenues are recognized at the date the split-interest agreements are established after recording liabilities for the present value (utilizing discount rates ranging between 2% and 5%) of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the split-interest agreements for changes in the fair value of the assets, accretion of the discount, and other changes in the estimates of future benefits. For the years ended June 30, 2012 and 2011, contributions revenue included \$2,352,114 and \$1,421,292, respectively, attributable to split-interest agreements. For the years ended June 30, 2012 and 2011, investment (losses) and gains included \$(511,145) and \$278,653, respectively, for changes in the value of split-interest agreements.

(j) *Interest in Trusts Held by Others*

The Foundation is also the beneficiary of certain trusts held and administered by others. The fair value of the estimated future cash receipts from the trusts is recognized as assets and contribution revenues when the Foundation is notified of their existence. The carrying value of the assets is fair value. For the years ended June 30, 2012 and 2011, contributions revenue, net of transfers to internal trusts, was \$(51,136) and \$1,490,998, respectively, attributable to their beneficial interest in trusts held by others. For the years ended June 30, 2012 and 2011, investment (losses) and gains included realized and unrealized (losses) and gains of \$(462,547) and \$1,387,736, respectively, associated with the beneficial interest in trusts held by others.

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Notes to Financial Statements

June 30, 2012 and 2011

(k) Fair Value Measurements

The Foundation applies the provisions of Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 820, *Fair Value Measurements*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 also establishes a framework for measuring fair value and expands disclosures about fair value measurements (note 9).

The Foundation applies the provisions of ASC Topic 820 to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

ASC Subtopic 820-10 (overall) clarifies the application of ASC Topic 820 in cases where the market for a financial instrument is not active and provides an example to illustrate key considerations in determining fair value in those circumstances. This Subtopic also provides additional guidance for estimating fair value in accordance with ASC Topic 820, when the volume and level of activity for the asset or liability have decreased. ASC Subtopic 820-10 expands disclosure requirements for all equity and debt securities measured at fair value. The Foundation has considered the guidance provided by ASC Subtopic 820-10 in its determination of estimated fair values and disclosures.

The Foundation applies the provisions of Accounting Standards Update (ASU) No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to its alternative investments. This standard amends ASC Topic 820 and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value, using net asset value per share or its equivalent as a practical expedient.

(l) Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The new standards do not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under International Financial Reporting Standards (IFRS) or U.S. GAAP. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. A nonpublic entity is required to apply the ASU prospectively for annual periods beginning after December 15, 2011. The Foundation expects that the adoption of ASU 2011-04 will not have a material impact on its financial statements.

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Notes to Financial Statements

June 30, 2012 and 2011

(2) Contributions Receivable

At June 30, 2012 and 2011, contributions receivable, net of discount for present value and allowance for uncollectible contributions, consisted of the following:

	2012	2011
Contributions receivable	\$ 24,984,693	30,355,417
Less discount to present value (0.2% – 0.7% discount rate)	(64,367)	(146,948)
Subtotal	24,920,326	30,208,469
Less allowance for uncollectible pledges	(2,112,897)	(2,180,528)
Contributions receivable, net	\$ 22,807,429	28,027,941
Amounts to be collected in:		
Less than one year	\$ 16,817,525	14,782,530
One year to five years	8,167,168	15,572,887
Total	\$ 24,984,693	30,355,417

(3) Investments

Investments at June 30, 2012 and 2011 consisted of the following:

	2012		2011	
	Fair value	Cost	Fair value	Cost
Domestic equities	\$ 19,876,005	14,810,056	18,407,393	13,268,018
Fixed income securities	101,606,806	99,448,891	92,324,104	87,958,935
Foreign equities	54,280,827	57,527,928	64,443,221	59,688,901
Money market funds	5,994,875	5,994,875	3,182,290	3,182,220
Hedge funds	63,719,945	54,960,138	59,527,535	51,829,274
Private equity securities	12,127,833	10,790,233	11,600,778	10,366,413
Natural resources/real estate	25,791,270	26,904,071	22,812,793	23,299,296
	\$ 283,397,561	270,436,192	272,298,114	249,593,057

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2012 and 2011

At June 30, 2012 and 2011, investments are classified as short-term and long-term as follows:

	<u>2012</u>	<u>2011</u>
Short-term	\$ 99,842,088	94,668,714
Long-term:		
Split-interest agreements	10,600,466	9,289,825
Permanently restricted	<u>172,955,007</u>	<u>168,339,575</u>
Total long-term	<u>183,555,473</u>	<u>177,629,400</u>
	<u>\$ 283,397,561</u>	<u>272,298,114</u>

The Foundation invests in various types of investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of financial position.

Certain hedge funds that the Foundation invests in were unable to meet redemption requests at June 30, 2012 and 2011 without liquidating investments at prices at which the hedge fund managers believed to be unreasonable. As a result, these investments have restricted redemptions for lock-up periods. In many cases, redemption requests are satisfied both in cash and through the distribution of shares/limited partnership interests in separate liquidating vehicles, which will pay out funds when market conditions improve and funds become available. The Foundation had one redemption request outstanding, totaling \$305,337 and \$311,458, respectively, at June 30, 2012 and 2011.

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June 30, 2012 and 2011

Investments are generally pooled and managed under various asset diversification strategies, depending upon the investment objectives and to avoid significant concentrations of market risk. Earnings on permanently restricted contributions (endowment), which the donor designates as being available for program operations, are considered temporarily restricted until the specific restrictions have been met. Under the Foundation's endowment spending policy, certain amounts (based on a percentage of the adjusted fair value of the investment pool) are appropriated and are available to support operations. In 2012 and 2011, \$8,475,510 and \$6,734,778, respectively, were made available to support programs. Investment management fees amounted to \$946,628 in 2012 and \$1,009,968 in 2011. The following schedule summarizes the investment return and its classification in the statements of activities:

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
2012:				
Dividends and interest	\$ 1,571,544	2,414,449	72,009	4,058,002
Realized and unrealized gains, net	<u>(3,071,985)</u>	<u>(360,922)</u>	<u>(1,208,877)</u>	<u>(4,641,784)</u>
Total (loss) gain on investments	\$ <u><u>(1,500,441)</u></u>	<u><u>2,053,527</u></u>	<u><u>(1,136,868)</u></u>	<u><u>(583,782)</u></u>

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
2011:				
Dividends and interest	\$ 1,392,703	2,725,371	121,296	4,239,370
Realized and unrealized gains, net	<u>8,594,684</u>	<u>20,276,363</u>	<u>1,418,603</u>	<u>30,289,650</u>
Total gain on investments	\$ <u><u>9,987,387</u></u>	<u><u>23,001,734</u></u>	<u><u>1,539,899</u></u>	<u><u>34,529,020</u></u>

(4) Income Taxes

The Foundation is an organization exempt from income tax under Section 501(c)(3) of the Internal Revenue Code and is generally not subject to federal income taxes. Contributions to the Foundation are deductible for tax purposes by the donor, subject to the normal limitations imposed by the taxing authorities. However, the Foundation is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the basic financial statements taken as a whole.

The Foundation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater

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Notes to Financial Statements

June 30, 2012 and 2011

than 50% likely of being realized. Changes in recognition or measurement are reflected in which the change in judgment occurs.

(5) Retirement Annuity Plan

The Foundation has defined contribution retirement annuity plans with Teachers Insurance and Annuity Association and College Retirement Equities Fund covering substantially all of its employees. The Foundation recorded contribution expense of \$635,903 in 2012 and \$569,665 in 2011.

(6) Leases

The Foundation leases office space from the University under an annual operating lease, which provides for a nominal rental amount. The estimated fair rental value of the property has been reported as unrestricted revenue with an offsetting amount charged to supporting services of \$334,420 and \$329,914, respectively, in 2012 and 2011.

(7) Restricted Net Assets

Restricted net assets consisted of the following restricted amounts at June 30, 2012 and 2011:

	Temporarily restricted	Permanently restricted
2012:		
Extension and public services	\$ 2,916,749	1,942,752
Academic support	28,280,709	13,941,316
Research	10,080,484	6,340,273
Student aid and services	18,476,412	74,399,667
Faculty and staff support	12,587,040	58,684,328
Capital projects	23,839,641	3,235,729
Athletics	4,954,157	436,443
Special and other	41,970,791	26,087,802
Total	\$ 143,105,983	185,068,310
	Temporarily restricted	Permanently restricted
2011:		
Extension and public services	\$ 3,136,906	1,942,705
Academic support	23,616,046	14,519,079
Research	10,555,201	8,338,933
Student aid and services	15,914,470	70,696,130
Faculty and staff support	11,008,174	55,511,718
Capital projects	14,334,503	3,202,244
Athletics	4,242,653	431,193
Special and other	53,091,428	26,255,507
Total	\$ 135,899,381	180,897,509

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Net assets are released from donor restrictions primarily by incurring expenses that satisfy the restricted purpose. For the years ended June 30, 2012 and 2011, net assets released from restriction totaled \$35,010,706 and \$30,846,499, respectively.

(8) Endowment

The Foundation's endowment consists of approximately 1,000 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by U.S. GAAP, net assets associated with endowment funds, including funds designated by the board of trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. At June 30, 2012 and 2011, the endowment net assets amounted to \$201,970,799 and \$204,525,424, respectively.

For the years ended June 30, 2012 and 2011, the changes in endowment net assets are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2010	\$ (10,533,772)	34,694,649	142,255,615	166,416,492
Investment return:				
Investment income	106,601	2,338,499	—	2,445,100
Net appreciation (realized and unrealized)	<u>8,904,447</u>	<u>20,497,366</u>	<u>—</u>	<u>29,401,813</u>
Total investment return	9,011,048	22,835,865	—	31,846,913
Contributions, net of expenses	—	140,740	15,059,648	15,200,388
Payout and fees	(526,681)	(9,257,402)	—	(9,784,083)
Net redemptions	<u>614</u>	<u>483,965</u>	<u>361,135</u>	<u>845,714</u>
Endowment net assets, June 30, 2011	<u>(2,048,791)</u>	<u>48,897,817</u>	<u>157,676,398</u>	<u>204,525,424</u>
Investment return:				
Investment income	88,730	2,018,384	—	2,107,114
Net depreciation (realized and unrealized)	<u>(4,793,954)</u>	<u>(21,858)</u>	<u>—</u>	<u>(4,815,812)</u>
Total investment return	(4,705,224)	1,996,526	—	(2,708,698)
Contributions, net of expenses	—	4,301,328	7,946,530	12,247,858
Payout and fees	(526,254)	(11,823,565)	—	(12,349,819)
Net redemptions	<u>645</u>	<u>346,042</u>	<u>(90,653)</u>	<u>256,034</u>
Endowment net assets, June 30, 2012	<u>\$ (7,279,624)</u>	<u>43,718,148</u>	<u>165,532,275</u>	<u>201,970,799</u>

(a) Interpretation of Relevant Law

The Board of Trustees of the Foundation has interpreted Hawaii's Uniform Prudent Management of Institutional Funds Act (HUPMIFA), which was enacted by the State of Hawaii on July 1, 2009, as

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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, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment 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 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 expended by the organization in a manner consistent with the standard of prudence prescribed by HUPMIFA. In accordance with HUPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization 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 organization
- (7) The investment policies of the organization

(b) *Funds with Deficiencies*

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 HUPMIFA requires the Foundation to retain as a fund of perpetual duration. At June 30, 2012 and 2011, in accordance with U.S. GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$8,095,809 and \$3,821,655, respectively. These deficiencies resulted from unfavorable market fluctuations and continued appropriation for certain programs that was deemed prudent by the Board of Trustees.

(c) *Return Objectives and Risks 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 organization must hold in perpetuity or for a donor-specified periods as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. The Foundation expects its endowment funds, over time, to provide an average rate of return of approximately 8.5% annually (including inflation). Actual returns in any given year may vary from this amount.

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(d) *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.

(e) *Spending Policy*

The Foundation has a policy of appropriating for distribution each year up to 5.5% of its endowment fund's average fair value over the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the Foundation considered the long-term expected return on its endowment. Accordingly, over the long term, the Foundation expects the current spending policy to allow its endowment to grow at an average of 3.0% annually. This is consistent with the organization'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) Fair Value Measurements

(a) *Fair Value of Financial Instruments*

The following table presents the carrying amounts and estimated fair values of the Foundation's financial instruments at June 30, 2012 and 2011. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	\$ 11,064,660	11,064,660	7,640,453	7,640,453
Contributions receivable, net	22,807,429	22,807,429	28,027,941	28,027,941
Other receivables	1,258,190	1,258,190	278,515	278,515
Investments	283,397,561	283,397,561	272,298,114	272,298,114
Beneficial interest in trusts held by others	14,030,874	14,030,874	14,656,628	14,656,628
Accounts payable	2,649,364	2,649,364	1,958,249	1,958,249
Liabilities under split-interest agreements	6,208,844	6,208,844	5,400,139	5,400,139
Amounts held for others	2,461,920	2,461,920	2,205,877	2,205,877
Other liabilities	452,246	452,246	408,397	408,397

The carrying amounts shown in the table are included in the balance sheets under the indicated captions.

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The fair values of the financial instruments shown in the above table as of June 30, 2012 and 2011 represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Foundation's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Foundation based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts payable, and other liabilities – the carrying amounts approximate fair value because of the short maturity of these instruments.

Contributions receivable, net, other receivables, and liabilities under split-interest agreements – the fair value of contribution receivables, other receivables, and liabilities under split-interest agreements is valued at the present value of expected future cash flows discounted at an interest rate commensurate with the risk associated with the respective financial instrument.

Investments, beneficial interest in trusts held by others, and amounts held for others – the fair value of investments in marketable securities and beneficial interest in trusts held by others is based primarily on quoted market prices. The fair value of other investments that do not have readily determinable fair values is generally based on quoted market prices of the underlying investments and information provided by the respective external investment managers at the most recent valuation date and adjusted for cash flows from the valuation date to fiscal year-end, if applicable. As described in note 1(k), the Foundation utilized the net asset value per share for certain investments in alternative structures as a practical expedient for the estimation of the fair value of these investments. The fair value for amounts held for others is based on the fair value of the underlying investments.

(b) Fair Value Hierarchy

ASC Topic 820 establishes a 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 the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Foundation has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

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The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety at the measurement date.

The following tables present assets that are measured at fair value on a recurring basis at June 30, 2012 and 2011:

	June 30, 2012	Fair value measurements at reporting date using		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Domestic equities	\$ 19,876,005	5,713,132	14,162,873	—
Fixed income securities	101,606,806	100,587,516	1,019,290	—
Foreign equities	54,280,827	10,306,586	43,974,241	—
Money market funds	5,994,875	5,994,875	—	—
Natural resources/real estate	25,791,270	—	3,464,259	22,327,011
Hedge funds	63,719,945	—	54,546,155	9,173,790
Private equity securities	12,127,833	—	—	12,127,833
Beneficial interest in trusts held by others	14,030,874	—	9,463,504	4,567,370
Total	<u>\$ 297,428,435</u>	<u>122,602,109</u>	<u>126,630,322</u>	<u>48,196,004</u>

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	June 30, 2011	Fair value measurements at reporting date using		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Domestic equities	\$ 18,407,393	5,887,487	12,519,906	—
Fixed income securities	92,324,104	81,963,014	10,361,090	—
Foreign equities	64,443,221	11,344,602	53,098,619	—
Money market funds	3,182,290	3,182,290	—	—
Natural resources/real estate	22,812,793	—	4,661,108	18,151,685
Hedge funds	59,527,535	—	48,920,210	10,607,325
Private equity securities	11,600,778	—	—	11,600,778
Beneficial interest in trusts held by others	14,656,628	—	10,909,577	3,747,051
Total	\$ <u>286,954,742</u>	<u>102,377,393</u>	<u>140,470,510</u>	<u>44,106,839</u>

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The following table presents the Foundation's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC Topic 820 for the years ended June 30, 2012 and 2011:

	<u>Assets</u>				<u>Total</u>
	<u>Hedge funds</u>	<u>Private equity securities</u>	<u>Natural resources/ real estate</u>	<u>Beneficial interest in trust held by others</u>	
Balance at June 30, 2010	\$ 25,422,139	10,108,269	12,546,860	2,364,999	50,442,267
Total gains included in income:					
Realized	491,195	880,070	784,522	—	2,155,787
Unrealized	595,607	1,206,717	1,852,486	108,834	3,763,644
Purchases	10,400,000	1,657,501	4,831,434	1,522,716	18,411,651
Settlements	(6,459,472)	(2,251,779)	(1,863,617)	(75,275)	(10,650,143)
Contributions	—	—	—	—	—
Net transfers into Level 3 (1)	—	—	—	181,004	181,004
Net transfers out of Level 3 (1)	(19,842,144)	—	—	(355,227)	(20,197,371)
Balance at June 30, 2011	10,607,325	11,600,778	18,151,685	3,747,051	44,106,839
Total gains (losses) included in income:					
Realized	133,576	1,003,578	1,083,822	—	2,220,976
Unrealized	(213,353)	103,235	570,551	(50,912)	409,521
Purchases	4,000,000	1,053,105	5,142,752	—	10,195,857
Settlements	(476,471)	(1,632,863)	(2,621,799)	—	(4,731,133)
Contributions	—	—	—	(241,389)	(241,389)
Net transfers into Level 3 (2)	2,278,304	—	—	1,112,620	3,390,924
Net transfers out of Level 3 (2)	(7,155,591)	—	—	—	(7,155,591)
Balance at June 30, 2012	\$ 9,173,790	12,127,833	22,327,011	4,567,370	48,196,004

- (1) The balance consists of the following transfers into and/or out of Level 3 in 2011:
- a. Hedge fund investment of \$19,842,144 previously classified as Level 3, which was reclassified to Level 2 due to the Foundation's ability to redeem its investment at net asset value per share (or its equivalent) at the measurement date.
 - b. Investments held by others of \$355,227 previously classified as Level 3, which were reclassified to Level 2 based on additional information obtained on the underlying securities within the investments.
 - c. Investments held by others of \$181,004 classified as Level 2, which were reclassified to Level 3 based on lack of information obtained on the underlying securities within the investments.

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- (2) The balance consists of the following transfers into and/or out of Level 3 in 2012:
- a. Hedge fund investment of \$728,387 previously classified as Level 2, which was reclassified to Level 3 due additional liquidity restrictions on the investments during 2012.
 - b. Hedge fund investment of \$5,605,674 previously classified as Level 3, which was reclassified to Level 2 due to the Foundation's ability to redeem its investment at net asset value per share (or its equivalent) at the measurement date.
 - c. Investments held by others of \$1,112,620 classified as Level 2, which were reclassified to Level 3 based on lack of information obtained on the underlying securities within the investments.

All realized and unrealized gains (losses) for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC Topic 820 are reported in investment return in the accompanying statements of activities.

The Foundation did not have any financial assets or financial liabilities measured at fair value on a nonrecurring basis at June 30, 2012 and 2011.

(10) Transactions with the University

The Foundation has an agreement with the University to provide fund-raising and alumni services through June 30, 2018. Annual compensation from this agreement amounted to \$3,000,000 for the years ended June 30, 2012 and 2011. Under separate agreements to provide fund-raising and alumni services for individual University units, compensation amounted to \$566,410 and \$512,417 for the years ended June 30, 2012 and 2011, respectively. For these payments, sources other than the University tuition and fees special fund were used.

(11) Commitments

The Foundation has commitments to contribute additional amounts to its existing investments of up to approximately \$8,400,000 at June 30, 2012.

(12) Subsequent Events

The Foundation has evaluated subsequent events from the balance sheet date through November 14, 2012, the date at which the financial statements were available to be issued, and determined there are no items to disclose.