



UNIVERSITY OF HAWAII FOUNDATION

Financial Statements

June 30, 2005 and 2004

(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, 2005 and 2004, 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, 2005 and 2004, 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 8, 2005

UNIVERSITY OF HAWAII FOUNDATION

Statements of Financial Position

June 30, 2005 and 2004

Assets	2005	2004
Cash and cash equivalents	\$ 2,124,864	1,186,413
Contributions receivable, net (note 2)	9,727,777	6,721,195
Prepaid expenses and other receivables	962,001	997,434
Property and equipment, at cost, net of accumulated depreciation and amortization of \$1,688,766 in 2005 and \$1,623,245 in 2004	2,237,155	2,276,733
Other assets, at cost	1,185,001	500,400
Investments (notes 3 and 10)	153,398,841	137,249,275
Beneficial interest in trusts held by others	11,649,455	10,940,941
Total assets	\$ 181,285,094	159,872,391
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 1,065,951	576,124
Liabilities under split-interest agreements	3,390,482	3,400,334
Amounts held for others	2,590,911	2,486,644
Other liabilities	339,199	440,306
Total liabilities	7,386,543	6,903,408
Net assets:		
Unrestricted (note 10)	1,880,642	1,250,768
Temporarily restricted (note 7)	75,218,285	64,190,376
Permanently restricted (note 7)	96,799,624	87,527,839
Total net assets	173,898,551	152,968,983
Commitments (notes 5, 6, 9, and 10)		
Total liabilities and net assets	\$ 181,285,094	159,872,391

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statement of Activities

Year ended June 30, 2005

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Revenues:				
Contributions	\$ 198,164	20,959,670	7,430,837	28,588,671
Change in contributions	—	—	(285,031)	(285,031)
Fees, honoraria, royalties, and other (notes 6 and 9)	3,249,872	970,340	1,562,701	5,782,913
Investment return (note 3)	1,255,585	9,308,488	646,967	11,211,040
Administrative fees	2,383,462	(2,299,601)	(83,689)	172
Fund-raising events and projects	—	744,131	—	744,131
	<u>7,087,083</u>	<u>29,683,028</u>	<u>9,271,785</u>	<u>46,041,896</u>
Net assets released from restrictions (note 7)	<u>18,655,119</u>	<u>(18,655,119)</u>	<u>—</u>	<u>—</u>
	<u>25,742,202</u>	<u>11,027,909</u>	<u>9,271,785</u>	<u>46,041,896</u>
Expenses:				
Program services:				
Extension and public services	516,722	—	—	516,722
Academic support	2,941,773	—	—	2,941,773
Research	2,333,870	—	—	2,333,870
Student aid and services	5,866,234	—	—	5,866,234
Faculty and staff support	1,112,754	—	—	1,112,754
Capital projects	770,043	—	—	770,043
Athletics	1,871,746	—	—	1,871,746
Special and other	3,241,977	—	—	3,241,977
Total program services	<u>18,655,119</u>	<u>—</u>	<u>—</u>	<u>18,655,119</u>
Supporting services:				
Administrative, management, and fiscal services (note 6)	2,310,960	—	—	2,310,960
Development	4,146,249	—	—	4,146,249
Total supporting services	<u>6,457,209</u>	<u>—</u>	<u>—</u>	<u>6,457,209</u>
Change in net assets	629,874	11,027,909	9,271,785	20,929,568
Net assets at beginning of year	<u>1,250,768</u>	<u>64,190,376</u>	<u>87,527,839</u>	<u>152,968,983</u>
Net assets at end of year	<u>\$ 1,880,642</u>	<u>75,218,285</u>	<u>96,799,624</u>	<u>173,898,551</u>

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statement of Activities

Year ended June 30, 2004

	Net assets			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Revenues:				
Contributions	\$ 244,295	17,125,459	5,311,082	22,680,836
Fees, honoraria, royalties, and other (notes 6 and 9)	3,117,156	812,025	3,125,291	7,054,472
Investment return (note 3)	1,687,666	16,197,579	(303,573)	17,581,672
Administrative fees	2,461,208	(2,373,027)	(88,168)	13
Fund-raising events and projects	—	1,046,772	—	1,046,772
	<u>7,510,325</u>	<u>32,808,808</u>	<u>8,044,632</u>	<u>48,363,765</u>
Net assets released from restrictions (note 7)	<u>15,717,246</u>	<u>(15,717,246)</u>	<u>—</u>	<u>—</u>
	<u>23,227,571</u>	<u>17,091,562</u>	<u>8,044,632</u>	<u>48,363,765</u>
Expenses:				
Program services:				
Extension and public services	473,152	—	—	473,152
Academic support	3,396,007	—	—	3,396,007
Research	920,783	—	—	920,783
Student aid and services	4,965,661	—	—	4,965,661
Faculty and staff support	1,448,400	—	—	1,448,400
Capital projects	96,698	—	—	96,698
Athletics	1,752,059	—	—	1,752,059
Special and other	2,664,486	—	—	2,664,486
Total program services	<u>15,717,246</u>	<u>—</u>	<u>—</u>	<u>15,717,246</u>
Supporting services:				
Administrative, management, and fiscal services (note 6)	2,285,992	—	—	2,285,992
Development	4,416,971	—	—	4,416,971
Total supporting services	<u>6,702,963</u>	<u>—</u>	<u>—</u>	<u>6,702,963</u>
Change in net assets	807,362	17,091,562	8,044,632	25,943,556
Net assets at beginning of year	<u>443,406</u>	<u>47,098,814</u>	<u>79,483,207</u>	<u>127,025,427</u>
Net assets at end of year	\$ <u><u>1,250,768</u></u>	<u><u>64,190,376</u></u>	<u><u>87,527,839</u></u>	<u><u>152,968,983</u></u>

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Statements of Cash Flows

Years ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from contributions	\$ 18,294,643	15,157,468
Cash received for fees, honoraria, royalties, and other	4,332,673	3,638,221
Investment return received	3,547,907	4,729,951
Program and supporting service expenses paid	<u>(24,692,626)</u>	<u>(22,782,632)</u>
Net cash provided by operating activities	<u>1,482,597</u>	<u>743,008</u>
Cash flows from investing activities:		
Purchase of investments	(92,069,821)	(283,404,962)
Proceeds from sale of investments	83,763,467	277,144,428
Purchases of property and equipment	<u>(68,432)</u>	<u>(89,942)</u>
Net cash used in investing activities	<u>(8,374,786)</u>	<u>(6,350,476)</u>
Cash flows provided by financing activity:		
Amounts restricted for long-term investment	<u>7,830,640</u>	<u>6,483,159</u>
Net increase in cash and cash equivalents	938,451	875,691
Cash and cash equivalents at beginning of year	<u>1,186,413</u>	<u>310,722</u>
Cash and cash equivalents at end of year	<u>\$ 2,124,864</u>	<u>1,186,413</u>
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	\$ 20,929,568	25,943,556
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	108,010	156,640
Loss on sale of other assets	—	10,000
Realized and unrealized gains on investments	(7,062,544)	(14,575,640)
Increase in contributions receivable	(3,006,582)	(2,662,456)
Decrease (increase) in prepaid expenses and other receivables	35,433	(527,094)
Increase in other assets	(684,601)	—
Increase (decrease) in accounts payable	489,827	(279,524)
Increase (decrease) in liabilities under split-interest agreements	(9,852)	828,760
Increase in amounts held for others, net	56,230	581,586
Decrease in other liabilities	(101,107)	(3,405)
Amounts restricted for long-term investment	<u>(9,271,785)</u>	<u>(8,729,415)</u>
Net cash provided by operating activities	<u>\$ 1,482,597</u>	<u>743,008</u>

Supplemental information of noncash activities:

The Foundation received noncash contributions in the amount of \$1,441,145 and \$2,246,256 in 2005 and 2004, respectively.

Unrealized losses on assets held for others were \$48,037 and \$212,556 for the years ended June 30, 2005 and 2004, respectively.

See accompanying notes to financial statements.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(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 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from 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.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(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 risk-free interest rates applicable 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

Equity securities and mutual funds with readily determinable fair values and all investments in debt securities are reported at fair value with unrealized gains and losses included in the statements of activities. Certain investments in nonmarketable securities are carried at cost. 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 five to ten years, commencing at the time the asset is placed into service.

The Foundation reports gifts of property and equipment 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.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(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% to 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, 2005 and 2004, contributions revenue included \$906,945 and \$1,177,729, respectively, attributable to split-interest agreements. For the years ended June 30, 2005 and 2004, investment return included \$553,037 and \$(470,778), 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 are recognized as assets and contribution revenues when the Foundation is notified of its existence. The carrying value of the assets is adjusted to fair value.

(2) **Contributions Receivable**

At June 30, 2005 and 2004, contributions receivable, net of discount for present value and allowance for uncollectible contributions, consisted of the following:

	2005	2004
Contributions receivable	\$ 10,291,562	7,336,666
Less discount to present value (2 – 5% discount rate)	193,290	153,261
Subtotal	10,098,272	7,183,405
Less allowance for uncollectible pledges	370,495	462,210
Contributions receivable, net	\$ 9,727,777	6,721,195
Amounts to be collected in:		
Less than one year	\$ 4,700,588	4,518,946
One year to five years	5,590,974	2,817,720
Total	\$ 10,291,562	7,336,666

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(3) Investments

Investments in securities are stated at fair value. Fair values are primarily based on quoted market prices. The following schedule summarizes fair values and cost of the components of investments at June 30, 2005 and 2004:

	2005		2004	
	Fair values	Cost	Fair values	Cost
Domestic common stocks	\$ 39,591,953	32,864,310	42,544,017	35,325,945
Fixed income securities	44,096,328	44,300,478	37,108,125	37,603,151
Foreign common stocks	30,312,057	26,043,039	26,457,498	23,751,933
Money market funds	502,750	502,750	538,257	538,257
Mutual funds:				
Absolute return	18,790,264	17,538,747	18,019,428	17,538,747
Real assets	9,396,172	6,829,870	7,115,475	6,363,206
Other	9,222,359	9,145,396	4,748,279	4,734,896
Partnerships	50,143	8,389	50,143	8,389
	<u>\$ 151,962,026</u>	<u>137,232,979</u>	<u>136,581,222</u>	<u>125,864,524</u>

In addition to the aforementioned investments, certain investments in nonmarketable securities are carried at cost. The following schedule summarizes the components of the Foundation's cost method investments at June 30, 2005 and 2004:

	2005	2004
Partnerships	\$ 714,244	516,795
Private equity securities	584,646	126,258
Real estate	137,925	25,000
	<u>\$ 1,436,815</u>	<u>668,053</u>

Cost method investments are primarily comprised of partnerships, private equity securities, and real estate where the Foundation does not exercise significant influence over the operating and financial policies of the investee. These cost method investments have not been evaluated to determine if there have been any other than temporary declines in carrying value as there were no identified events or changes in circumstances that may have a significant adverse effect on the carrying value of the investments nor was it practicable to estimate fair value.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

At June 30, 2005 and 2004, investments are classified as short-term and long-term as follows:

	<u>2005</u>	<u>2004</u>
Short-term	\$ 66,822,378	59,364,146
Long-term:		
Split-interest agreements	4,118,655	4,257,908
Permanently restricted	82,457,808	73,627,221
Total long-term	<u>86,576,463</u>	<u>77,885,129</u>
	\$ <u>153,398,841</u>	<u>137,249,275</u>

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 2005 and 2004, \$4,282,044 and \$3,659,666, respectively, were made available to support programs. Investment management fees amounted to \$227,953 in 2005 and \$262,202 in 2004. The following schedule summarizes the investment return and its classification in the statements of activities:

	<u>Net assets</u>			
	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
2005:				
Dividends and interest	\$ 775,190	3,100,359	272,947	4,148,496
Realized and unrealized gains, net	480,395	6,208,129	374,020	7,062,544
Total return on investments	\$ <u>1,255,585</u>	<u>9,308,488</u>	<u>646,967</u>	<u>11,211,040</u>
2004:				
Dividends and interest	\$ 693,652	2,112,914	199,466	3,006,032
Realized and unrealized gains (losses), net	994,014	14,084,665	(503,039)	14,575,640
Total return on investments	\$ <u>1,687,666</u>	<u>16,197,579</u>	<u>(303,573)</u>	<u>17,581,672</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.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(4) Income Taxes

The Foundation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Contributions to the Foundation are deductible for tax purposes by the donor, subject to the normal limitations imposed by the taxing authorities.

(5) Retirement Annuity Plan

The Foundation has a defined contribution retirement annuity plan with Teachers Insurance and Annuity Association and College Retirement Equities Fund covering substantially all of its employees. The Foundation recorded contribution expense of \$357,088 in 2005 and \$300,832 in 2004.

(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 \$212,868 and \$209,382 in 2005 and 2004, respectively.

(7) Restricted Net Assets

Restricted net assets consisted of the following restricted amounts at June 30, 2005 and 2004:

	Temporarily restricted	Permanently restricted
2005:		
Extension and public services	\$ 2,403,417	889,808
Academic support	12,412,260	8,870,245
Research	7,291,360	645,340
Student aid and services	19,101,186	43,108,060
Faculty and staff support	11,352,480	29,040,412
Capital projects	3,726,237	997,065
Athletics	3,711,298	232,895
Special and other	15,220,047	13,015,799
Total	\$ 75,218,285	96,799,624
2004:		
Extension and public services	\$ 2,288,447	851,989
Academic support	12,378,399	8,703,257
Research	3,592,468	485,213
Student aid and services	17,384,883	40,492,271
Faculty and staff support	9,307,459	23,556,042
Capital projects	4,342,806	859,180
Athletics	2,110,437	228,711
Special and other	12,785,477	12,351,176
Total	\$ 64,190,376	87,527,839

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(8) 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, 2005 and 2004. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

	2005		2004	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	\$ 2,124,864	2,124,864	1,186,413	1,186,413
Contributions receivable, net	9,727,777	9,727,777	6,721,195	6,721,195
Other receivables	908,754	908,754	964,771	964,771
Investments	153,398,841	153,398,841	137,249,275	137,249,275
Interest in trusts held by others	11,649,455	11,649,455	10,940,941	10,940,941
Accounts payable	1,065,951	1,065,951	576,124	576,124
Liabilities under split interest agreements	3,390,482	3,390,482	3,400,334	3,400,334
Amounts held for others	2,590,911	2,590,911	2,486,644	2,486,644
Other liabilities	339,199	339,199	440,306	440,306

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 are 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. The carrying value of interest and other receivables approximates fair value because of the short maturity of these instruments.

Investments, interest in trusts held by others, and amounts held for others: The fair value of investments and interest in trusts held by others are based primarily on quoted market prices. The fair value for amounts held for others is based on the fair value of the underlying investment.

(9) Transactions with the University

The Foundation has an agreement with the University to provide fund-raising and alumni services through December 31, 2007. Annual compensation to the Foundation amounted to \$3,012,676 and \$2,876,723 for the years ended June 30, 2005 and 2004, respectively, of which approximately \$314,000 and \$429,350 was payable to the Foundation at June 30, 2005 and 2004, respectively. Amounts received for the year ended June 30, 2005 include reimbursement for half the compensation cost of certain development personnel.

UNIVERSITY OF HAWAII FOUNDATION

Notes to Financial Statements

June 30, 2005 and 2004

(10) Commitments

The Foundation has commitments to contribute additional amounts to its existing investments of up to approximately \$10,400,000 at June 30, 2005.