

Kansas State University Foundation

Accountants' Report and Consolidated Financial Statements

June 30, 2011



Kansas State University Foundation
June 30, 2011

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Independent Accountants' Report

The Board of Directors of
Kansas State University Foundation
Manhattan, Kansas

We have audited the accompanying consolidated statement of financial position of Kansas State University 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.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above presents fairly, in all material respects, the financial position of the Kansas State University 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 accounting principles generally accepted in the United States of America.

As discussed in Note 15, in 2011 the Foundation retroactively changed its method of accounting for classification of net assets.

BKD, LLP

Kansas City, Missouri
October 18, 2011

Kansas State University Foundation
Consolidated Statement of Financial Position
June 30, 2011

Assets

Cash and cash equivalents	\$ 37,870,197
Investments	436,603,621
Pledges receivable – net of allowance and discounts	35,371,627
Receivables from estates	5,675,902
Loans receivable	551,318
Property and equipment, net of accumulated depreciation of \$4,494,830	1,475,549
Golf Course property and equipment, net of accumulated depreciation of \$806,644	8,276,682
Cash surrender value of life insurance policies	4,002,380
Other assets and accrued investment income	<u>2,282,919</u>
Total assets	<u><u>\$ 532,110,195</u></u>

Liabilities and Net Assets

Liabilities

Accounts payable, deposits and other liabilities	\$ 576,262
Accrued liabilities	1,687,630
Assets held for others	8,852,999
Unitrust and annuity liabilities	20,785,752
Long-term debt	<u>3,816,639</u>
Total liabilities	<u>35,719,282</u>

Net Assets

Unrestricted net assets	51,878,978
Temporarily restricted net assets	180,470,222
Permanently restricted net assts	<u>264,041,713</u>
Total net assets	<u>496,390,913</u>

Total Liabilities and Net Assets	<u><u>\$ 532,110,195</u></u>
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Kansas State University Foundation
Consolidated Statement of Activities
Year Ended June 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues, Gains and Other Support				
Contributions	\$ 599,917	\$ 62,698,991	\$ 17,298,326	\$ 80,597,234
Investment income	2,839,232	698,884	93,954	3,632,070
Net realized and unrealized gains on investments	22,248,847	33,030,592	647,153	55,926,592
Other support				
Operational service charges, management fees and other	3,522,335	-	-	3,522,335
Receipts for grants, research, supplies, travel and other University departmental activities and funding allotments, etc.	165,433	4,080,158	-	4,245,591
Actuarial gains (losses) on unitrusts and annuity obligations	(419,939)	(1,807,303)	4,186,980	1,959,738
Net assets released from restrictions and change in donor designation	47,653,272	(48,150,887)	497,615	-
Total revenues, gains and other support	<u>76,609,097</u>	<u>50,550,435</u>	<u>22,724,028</u>	<u>149,883,560</u>
Expenses and Support				
Direct University support				
Scholarships and other student awards	9,136,317	-	-	9,136,317
Academic	5,442,469	-	-	5,442,469
Administrative – Faculty and student support	30,519,260	-	-	30,519,260
Capital improvements	2,449,238	-	-	2,449,238
Subtotal	<u>47,547,284</u>	<u>-</u>	<u>-</u>	<u>47,547,284</u>
Investment – loan interest expense and write-off	352,020	-	-	352,020
Foundation administration	4,206,405	-	-	4,206,405
Foundation fundraising	6,212,199	-	-	6,212,199
Total expenses and support	<u>58,317,908</u>	<u>-</u>	<u>-</u>	<u>58,317,908</u>
Change in Net Assets	<u>18,291,189</u>	<u>50,550,435</u>	<u>22,724,028</u>	<u>91,565,652</u>
Net Assets, Beginning of Year, as Previously Reported	8,980,343	63,604,089	332,240,829	404,825,261
Restatement of Net Assets (Note 15)	<u>24,607,446</u>	<u>66,315,698</u>	<u>(90,923,144)</u>	<u>-</u>
Net Assets, Beginning of Year, Restated	<u>33,587,789</u>	<u>129,919,787</u>	<u>241,317,685</u>	<u>404,825,261</u>
Net Assets, End of Year	<u>\$ 51,878,978</u>	<u>\$ 180,470,222</u>	<u>\$ 264,041,713</u>	<u>\$ 496,390,913</u>

Kansas State University Foundation
Statement of Cash Flows
Year Ended June 30, 2011

Operating Activities	
Change in net assets	\$ 91,565,652
Items not requiring (providing) operating activities cash flows	
Depreciation	229,257
Net realized and unrealized gains on investments	(55,926,592)
Contributions and investment income received restricted for long-term investment and capital projects	(28,279,936)
Contributions for term endowment	(2,357,013)
Non-cash contributions	(19,679,610)
Non-cash transfers to Kansas State University	7,272,105
Net actuarial gains on unitrust and annuity obligations	(1,959,738)
Changes in	
Pledges receivable	(16,713,026)
Receivables from estates	2,816,010
Loans receivable	1,450,883
Other assets and accrued income	404,271
Accounts payable and accrued liabilities	(926,710)
Assets held for others	<u>1,386,617</u>
Net cash used in operating activities	<u>(20,717,830)</u>
Investing Activities	
Purchase of investments	(187,350,092)
Purchase of real estate	18,982
Proceeds from sale of investments	171,720,167
Expenditures for property	(1,443,758)
Cash surrender value of life insurance policies	<u>(247,390)</u>
Net cash used in investing activities	<u>(17,302,091)</u>
Financing Activities	
Proceeds from contributions and investment income restricted for long-term investment and capital projects	28,279,936
Contributions for term endowment	2,357,013
Principal payments on long-term debt	(803,957)
Proceeds from issuance of annuities and trusts payable	939,571
Payments on annuities and trusts payable	<u>(2,561,812)</u>
Net cash provided by financing activities	<u>28,210,751</u>
Net Decrease in Cash and Cash Equivalents	(9,809,170)
Cash and Cash Equivalents, Beginning of Year	<u>47,679,367</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 37,870,197</u></u>
Supplemental Disclosures of Cash Flow Information	
Cash paid during the year for interest	\$ 245,013

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The purpose of Kansas State University Foundation (the Foundation) is to encourage, receive and hold in trust any real or personal property given for the use of Kansas State University, its faculty and students; and to invest, disburse, manage and control all such gifts in accordance with donor intent and to provide those services to the University which are not or cannot be provided through state appropriations or student fees.

Income Taxes

Pursuant to determination letters received from the Internal Revenue Service (IRS), the Foundation is generally exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code as a public foundation. The Foundation is subject to income tax on the unrelated business income.

The Foundation files tax returns in the U.S. Federal jurisdiction. With a few exceptions, the Foundation is no longer subject to U.S. Federal examinations by tax authorities for years before 2008.

Supporting Organizations and Principles of Consolidation

The Foundation's financial statements include two supporting organizations, the Kansas State University Golf Course Management and Research Foundation, formed in 1997, and the Foundation for Engineering at Kansas State University, Inc., formed in 2009. The financial statements of these organizations have been consolidated with the Foundation's financial statements in accordance with accounting principles generally accepted in the United States of America. All significant inter-organizational accounts and transactions are eliminated in the consolidated financial statements.

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, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Foundation considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2011, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

Kansas State University Foundation

Notes to Financial Statements

June 30, 2011

One or more of the financial institutions holding the Foundation's cash accounts are participating in the FDIC's Transaction Account Guarantee Program. Under the program, through December 31, 2012, all noninterest-bearing transaction accounts at these institutions are fully guaranteed by the FDIC for the entire amount in the account.

For financial institutions opting out of the FDIC's Transaction Account Guarantee Program or interest-bearing cash accounts, the FDIC's insurance limits were permanently increased to \$250,000, effective July 21, 2010. At June 30, 2011, the Foundation's cash accounts exceeded federally insured limits by approximately \$1,469,000.

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Investments in pooled separate accounts, private capital funds and hedge funds are recorded at the estimated net asset value per share of the investments. The Company has elected to record other investments consisting primarily of real estate at fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is recorded as temporarily restricted and then released from restriction. Other investment return is reflected in the statements of activities as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

The Foundation maintains pooled investment accounts for its endowments. Investment income and realized and unrealized gains and losses from securities in the pooled investment accounts are allocated to the individual endowments using the unitized share methodology similar to that of a mutual fund. Each unit represents a proportionate interest in the underlying assets and associated earnings and distributions proportionate to the units.

Receivables

The Foundation reports pledges receivable expected to be collected within one year at net realizable value. Pledges expected to be collected in future years are initially reported at fair value determined using the discounted present value of future contributions. The Foundation provides an allowance for doubtful collections, which is based upon a review of outstanding pledge receivables, historical collection information and existing economic conditions. Pledge receivables are considered past due if they are not received by their payment instrument due date. Delinquent pledges are written off based on individual credit evaluation and specific circumstances of the donor.

Receivables from estates are recorded at the time the Foundation is notified of the death of a donor and the amount receivable from the estate can be reasonably measured.

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

Loans receivable, including student loans, real estate mortgages and other loans, are recorded at amounts advanced to borrowers less principal repayments received. Uncollectible loans are written off using the direct write-off method. A loan is considered uncollectible when management determines the borrower is failing to meet repayment terms or other reasons. Interest income is recognized as earned.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful life of each asset.

The Foundation's capitalization policy is to capitalize any fixed asset over \$1,000 at cost.

Long-lived Asset Impairment

The Foundation evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

An impairment loss of approximately \$1,659,000 was recognized on a real estate project for the year ended June 30, 2011, based on changes regarding its intended use. The loss is included in net realized and unrealized gains in the accompanying statement of activities. Fair value was determined based on estimated market value.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Foundation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Foundation in perpetuity.

Contributions

Gifts of cash and other assets received without donor stipulations are reported as unrestricted revenue and net assets. Gifts received with a donor stipulation that limits their use are reported as temporarily or permanently restricted revenue and net assets. When a donor stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Gifts having donor stipulations which are satisfied in the period the gift is received are reported as temporarily restricted and then released from restriction.

Kansas State University Foundation
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Gifts of land, buildings, equipment, and other long-lived assets are reported at estimated or appraised values at the time of receipt as unrestricted revenue and net assets unless explicit donor stipulations specify how such assets must be used, in which case the gifts are reported as temporarily or permanently restricted revenue and net assets. Absent explicit donor stipulations for the time long-lived assets must be held, expirations of restrictions resulting in reclassification of temporarily restricted net assets as unrestricted net assets are reported when the long-lived assets are placed in service.

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value, determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Conditional gifts depend on the occurrence of a specified future and uncertain event to bind the potential donor and are recognized as assets and revenue when the conditions are substantially met and the gift becomes unconditional.

Contributions Establishing Charitable Trusts

The Foundation accepts donor contributions to establish trust agreements in exchange for a named beneficiary to receive a fixed dollar annual return or a specific percentage of the fair value of the trust assets for the beneficiary's lifetime or a specific time period. A portion of the donation is considered to be a charitable contribution and the remaining portion represents a liability equal to the present value of future payments. The liability is revalued annually based on actuarially computed present values.

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the date the transaction occurs.

Operational Service Charges and Management Fees

The Foundation provides services to Kansas State University, its colleges and other entities affiliated with the University for which the Foundation is reimbursed. Revenue from these services is recognized by the Foundation as they provide such services.

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

Note 2: Investments and Investment Return

Investment management is governed by policies and procedures established by the Asset Management Committee, a committee of the Board of Directors, in collaboration with staff and consultants. Staff implements the policies through: 1) the selection of investment strategies; 2) the hiring, monitoring and changing of investment managers; and 3) rebalancing the portfolios. Investment results are monitored by the committee quarterly through manager and portfolio performance and due diligence reporting.

Private capital and hedge funds are included in the endowment pool to diversify assets, provide portfolio return enhancement and dampen volatility. Hedge fund managers run proprietary strategies employing securities and instruments such as cash, stocks, partnerships, bonds and derivative instruments including options, futures and swaps in various combinations, sometimes shorting various securities and employing leverage to construct desired risk/return characteristics that are less correlated to the major asset classes.

The Foundation's investments include debt and equity securities for liquidity, donated assets and real estate, as well as a managed portfolio of long-term investments. The Foundation's investments at June 30, 2011, were as follows:

	Endowment Pool	Other Investments	Total Investments
Equity securities	\$ 14,095,307	\$ 5,798,356	\$ 19,893,663
Short-term investments and certificates of deposit	-	350,000	350,000
Mutual funds			
Equity securities	53,099,016	21,187,963	74,286,979
Fixed income securities	-	13,314,867	13,314,867
Pooled separate funds			
Equity securities	68,380,895	-	68,380,895
Fixed income securities	15,526,533	6,518,266	22,044,799
Natural resources	16,672,575	-	16,672,575
U.S. government and agency obligations	3,198,314	4,972,027	8,170,341
Private capital			
Real estate investments	1,804,934	-	1,804,934
Venture capital	17,674,227	526,889	18,201,116
Domestic private equity	29,406,329	-	29,406,329
International private equity	15,860,633	-	15,860,633
Private capital distressed debt	15,328,757	-	15,328,757
Natural resources	12,561,429	-	12,561,429
Hedge funds			
Absolute return	19,466,033	5,604,031	25,070,064
Marketable alternatives	48,191,867	-	48,191,867
Closely held common stock	-	21,934,109	21,934,109
Real estate held for investment	-	25,040,555	25,040,555
Other securities and investments	-	89,709	89,709
	<u>\$ 331,266,849</u>	<u>\$ 105,336,772</u>	<u>\$ 436,603,621</u>

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The Foundation's endowment pool strives to achieve long term capital appreciation and consistent income by utilizing a "total return investment strategy." The Foundation uses an inflation adjusted distribution policy attempting to provide a stable revenue stream to the university as well as to maintain intergenerational equity. The distributions from the endowment pool are calculated by adjusting the prior year's distribution amount annually for inflation. To avoid potential unconscionable under-distributions or unsustainable over-distributions relative to the endowment pool market value, the annual inflation adjusted distribution is limited to maximum and minimum total distributions to purpose. The maximum distributions to purpose are 5 percent of market value and the minimum distributions are 3 percent, both of which are calculated annually using the market value at the beginning of the fiscal year. This action is consistent with the Board of Directors' long term strategic plans and attempts to treat all generations equitably and protect future purchasing power.

Investment managers' fees totaled approximately \$2,228,000 for the year ended June 30, 2011.

Total investment return is comprised of the following:

Interest and dividends	\$ 3,632,070
Net realized and unrealized gains on investments reported at fair value	55,926,592
	\$ 59,558,662

At June 30, 2011, the fair value of the following investments has been estimated using the net asset value per share of the investments.

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Pooled separate accounts (A)				
Equity securities	\$ 68,380,895	\$ -	Monthly	5-45 days
Fixed income securities	22,044,799	-	Monthly	5-45 days
Natural resources	16,672,575	-	Monthly	5-45 days
Private capital (B)				
Real estate investments	1,804,934	-	None	None
Venture capital	18,201,116	16,060,494	None	None
Domestic private equity	29,406,329	13,855,850	None	None
International private equity	15,860,633	12,631,646	None	None
Private capital distressed debt - Liquid	11,372,646	4,058,600	Annual	120 days
Private capital distressed debt - Illiquid	3,956,111	652,798	None	None
Natural resources	12,561,429	5,584,500	None	None
Hedge funds				
Absolute return (C)	25,070,064	-	Monthly to Annually	30-90 days
Marketable alternatives (D)	48,191,867	-	Monthly to Annually	30-90 days

Kansas State University Foundation

Notes to Financial Statements

June 30, 2011

- (A) This category includes investments in pooled separate accounts which hold exchange-traded equity securities, fixed income securities and a multi-strategy commodities fund. While the underlying securities in these accounts are primarily highly liquid, exchange-traded securities, the nature of this type of account only allows for monthly liquidity at a month end net asset value.
- (B) This category includes investments in private equity and venture capital that invest primarily in domestic and international private companies. Private capital funds are structured as closed-end, commitment-based investment funds where a specified amount of capital is committed upon inception of the fund which is then drawn down over a period of three to five years, and distributions are received through the liquidation of underlying assets of the fund. The typical term of these investments is 12-15 years. Such funds generally do not provide redemption options for investors.
- (C) This category includes investments in hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The funds' composite portfolio includes investments in U.S. common stocks, global real estate projects and arbitrage investments. Certain funds may have the ability to impose a suspension or postponement of redemptions until further notice (a "Gate"). In addition, certain funds may delay payment of a portion of redemption proceeds (a "Holdback") until the annual audited financial statements are distributed.
- (D) This category includes investments in hedge funds that take both long and short positions, primarily in U.S. common stocks. Management of the funds has the ability to shift investments among differing investment strategies. Certain funds may have the ability to impose a suspension or postponement of redemptions until further notice (a "Gate"). In addition, certain funds may delay payment of a portion of redemption proceeds (a "Holdback") until the annual audited financial statements are distributed.

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

Note 3: Disclosures About Fair Value of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, 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. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying statement of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The inputs used by pricing models to determine fair value may include one, or a combination of observable inputs, such as benchmark yields, broker/dealer quotes, issuer spreads, benchmark securities, and reference data market research publications. Investments valued using net asset value (or its equivalent), as a practical expedient, are classified as Level 2 inputs if the Foundation has the ability to redeem its investment with the investment manager at net asset value (or its equivalent) at the measurement date. All other investments not valued using quotes or the inputs discussed above are classified as Level 3 inputs.

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying statement of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2011:

	Fair Value Measurements			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Equity securities	\$ 19,893,663	\$ 19,893,663	\$ -	\$ -
Mutual funds				
Equity securities	74,286,979	74,286,979	-	-
Fixed income securities	13,314,867	13,314,867	-	-
Pooled separate funds				
Equity securities	68,380,895	-	68,380,895	-
Fixed income securities	22,044,799	-	22,044,799	-
Natural resources	16,672,575	-	16,672,575	-
U.S. Government and agency obligations	8,170,341	112,061	8,058,280	-
Private capital				
Real estate investments	1,804,934	-	-	1,804,934
Venture capital	18,201,116	-	-	18,201,116
Domestic private equity	29,406,329	-	-	29,406,329
International private equity	15,860,633	-	-	15,860,633
Private capital distressed debt	15,328,757	-	-	15,328,757
Natural resources	12,561,429	-	-	12,561,429
Hedge funds				
Absolute return	25,070,064	19,979	25,050,085	-
Marketable alternatives	48,191,867	-	47,777,418	414,449
Closely held common stock	21,934,109	-	-	21,934,109
Real estate held for investment	25,040,555	-	-	25,040,555
Other securities and investments	89,709	-	-	89,709
	<u>\$ 436,253,621</u>	<u>\$ 107,627,549</u>	<u>\$ 187,984,052</u>	<u>\$ 140,642,020</u>
	100%	25%	43%	32%

Kansas State University Foundation
Notes to Financial Statements
June 30, 2011

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying statement of financial position using significant unobservable (Level 3) inputs:

	Asset (Alternative Investments)	Asset (Closely Held Common Stock)	Asset (Real Estate Held for Investments)	Asset (Other Investments and Securities)
Balance, July 1, 2010	\$ 79,017,144	\$ 14,296,418	\$ 26,236,523	\$ 66,659
Total realized and unrealized gains and losses included in change in net assets	16,114,614	899,766	(2,590,868)	10,250
Purchases/donations	8,603,966	8,456,000	1,461,345	12,800
Sales/redemptions	(10,158,077)	(1,718,075)	(66,445)	-
Balance, June 30, 2011	<u>\$ 93,577,647</u>	<u>\$ 21,934,109</u>	<u>\$ 25,040,555</u>	<u>\$ 89,709</u>
Total gains or losses for the period included in change in net assets attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date				
Year ended June 30, 2011	<u>\$ 13,509,224</u>	<u>\$ 899,766</u>	<u>\$ (2,599,909)</u>	<u>\$ 10,250</u>

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying statement of net assets at amounts other than fair value. For each of the following, management has concluded the carrying amount approximates fair value.

Cash and Cash Equivalents

The carrying amount approximates fair value.

Pledges and Estimated Receivables

Fair value is estimated at the present value of the future payments expected to be received.

Loans Receivable

Fair value is estimated by discounting the future cash flows using the rates at which similar notes would be written for the same remaining maturities.

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Notes to Financial Statements
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Notes Payable

Fair value is estimated based on borrowing rates currently available to the Foundation for bank loans with similar terms and maturities.

Liability for Annuities Payable

The liability for annuities payable is based on the annuitants' life expectancies and a discounted cash flow of payments estimated to be paid to the beneficiaries. The liability is amortized each year based upon the life expectancies of the beneficiaries.

Management Assessment

The detail of asset levels presented in Note 3 is in accordance with accounting principles generally accepted in the United States of America and may not fully disclose the actual liquidity available to investment managers. Management has performed an internal review of the pooled separate accounts, private capital and hedge fund investments that details Level 1 underlying assets at 47%, Level 2 underlying assets at 25% and Level 3 underlying assets at 28% on a look-through basis to the underlying assets held by each investment manager. However, the investments as a whole are subject to the redemption features disclosed in the table on page 10.

Note 4: Endowment

The Foundation's endowment consists of approximately 2,800 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the governing body to function as endowments (board-designated endowment funds). As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's governing body has interpreted the State of Kansas Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring 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 donor-restricted endowment funds is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the

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standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. Duration and preservation of the fund
2. Purposes of the Foundation and the fund
3. General economic conditions
4. Possible effect of inflation and deflation
5. Expected total return from investment income and appreciation or depreciation of investments
6. Other resources of the Foundation
7. Investment policies of the Foundation

The composition of net assets by type of endowment fund at June 30, 2011 were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowments				
Market value of endowments	\$ (4,653,857)	\$ 17,782,193	\$ 257,535,823	\$ 270,664,159
Board-designated endowments				
Board designated	26,024,501	-	-	26,024,501
Board policy to address underwater endowments	29,408,383	-	-	29,408,383
Quasi and term endowments	-	47,411,293	-	47,411,293
	<u>\$ 50,779,027</u>	<u>\$ 65,193,486</u>	<u>\$ 257,535,823</u>	<u>\$ 373,508,336</u>

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The following items are included in the Net Assets at June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Funds (per above)	\$ 50,779,027	\$ 65,193,486	\$ 257,535,823	\$ 373,508,336
Non-endowment funds available for expenditure for purpose Donor-restricted expendable gifts	-	18,315,723	-	18,315,723
Pledges receivable	17,600	25,299,926	10,054,101	35,371,627
Cash surrender value	268,087	2,360,068	1,374,223	4,002,378
Receivables from estates	-	3,640,815	2,035,087	5,675,902
Charitable gift annuities	-	1,538,040	7,090,085	8,628,125
Market value adjustment for real estate	2,072,243	947,455	2,955,191	5,974,889
Unitrust and annuity liabilities	-	(3,831,753)	(16,953,999)	(20,785,752)
Funds held for others	-	(8,804,201)	(48,798)	(8,852,999)
Accrued payroll liabilities	(1,257,979)	-	-	(1,257,979)
	<u>\$ 51,878,978</u>	<u>\$ 180,470,222</u>	<u>\$ 264,041,713</u>	<u>\$ 496,390,913</u>

Changes in endowment net assets for the year ended June 30, 2011, were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets - Beginning of year	\$ 31,919,655	\$ 49,724,439	\$ 236,863,134	\$ 318,507,228
Investment return	14,566,994	33,729,476	-	48,296,470
Contributions and collections on pledges and estates	-	2,393,179	20,672,689	23,065,868
Appropriation of endowment assets for expenditure	(182,834)	(20,653,608)	-	(20,836,442)
Transfers to Board-designated	4,475,212	-	-	4,475,212
Endowment net asset - End of year	<u>\$ 50,779,027</u>	<u>\$ 65,193,486</u>	<u>\$ 257,535,823</u>	<u>\$ 373,508,336</u>

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Amounts of donor-restricted endowment funds classified as permanently and temporarily restricted net assets at June 30, 2011 consisted of:

Permanently restricted net assets - portion of perpetual endowment funds required to be retained permanently by explicit donor stipulation or UPMIFA	<u><u>\$257,535,823</u></u>
Portion of perpetual endowment funds subject to a time restriction under UPMIFA with purpose restrictions	<u><u>\$ 65,193,486</u></u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the Foundation is required to retain as a fund of perpetual duration pursuant to donor stipulation or UPMIFA. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets and aggregated \$4,653,857 at June 30, 2011. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after investment of new permanently restricted contributions and continued appropriation for certain purposes that was deemed prudent by the governing body.

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and other items supported by its endowment while seeking to maintain the purchasing power of the endowment. Endowment assets include those assets of donor-restricted endowment funds the Foundation must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds.

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 current yield (investment income such as dividends and interest) and capital appreciation (both realized and unrealized). The Foundation targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints. For the fiscal year ended June 30, 2011, the total return of the Endowment Pool was 19%.

The Foundation's Board of Directors determines the Endowment Pool's percentage distribution of total return to the participating funds. The distributions approved by the Board of Directors are:

1. A distribution to purpose, annually adjusted by inflation but always within a range between three and five percent of the market value. This percentage was made available to the participating funds for spending. This inflation based method is intended to address current University needs as well as preserve purchasing power for future generations.
2. .25% of the market value will be distributed to the campus units as discretionary funds.
3. 1.5% of the market value for fiscal year 2011 will be distributed to the Foundation for allocation as determined each year by the Board of Directors.
4. The balance of the total return remains in the participating funds.

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For those participating accounts with a market value less than the donor's liquidated contributed value, commonly known as "underwater endowments," current income (interest, dividends, rents) is distributed based upon the following prioritization:

1. The Foundation allocation is distributed to the extent there is sufficient current investment income to do so.
2. To the extent current investment income remains available, a distribution is made for funding the purpose of the participating account, up to that amount that would have been distributed had the account's market value been greater than the historic book value.
3. To the extent current investment income remains available, a distribution to the campus unit's discretionary fund will be made, up to that amount that would have been distributed had the account's market value been greater than the historic book value.
4. Remaining current investment income, if any, and the remainder of the approved distribution will be returned to the account.

To the extent current investment income remains available, a distribution is made for funding the purpose of the participating account, up to that amount that would have been distributed had the account's market value been greater than the historic book value.

Quasi- or term endowed accounts are invested in the same manner as permanently endowed accounts and share the same endowment pool operating costs. They differ from permanently endowed accounts in that quasi-endowment distributions may utilize the donor's gift and earnings/investment growth to make the distribution to purpose and the distribution rate is specific to the donor memo of understanding.

A donor to a quasi-endowment account may choose from three distribution options:

1. Fixed dollar option pays distributions in multiples of \$500; or
2. Fixed percentage option pays distributions of 4, 5, 6 or 8 percent of market value annually;
or
3. Situational option pays distributions of 50 or 100 percent of tuition and fees for the number of hours taken by an average full-time student.

Quasi-endowed accounts are to be established at a financial amount expected to last for 10 years or more.

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Note 5: Asset Holdings

The Foundation has a general policy of investing assets to maximize rates of return, consistent with sound and safe business principles. The Foundation also holds certain assets for the benefit of Kansas State University which do not provide a market rate of return on funds invested. Some examples of these investments and other direct benefits provided to the University include:

University Real Estate Fund – Certain real estate holdings vital to the mission of the University were purchased and are held for current and potential University use.

Smith Scholarship House – The Foundation has provided the building rent-free in order to maintain the House in operation for the benefit of the students.

Holiday Inn (formerly Ramada Inn) and Wildcat BP (formerly University Amoco) – The hotel and service station located adjacent to the University were built on land acquired by the Foundation to meet the needs of public lodging and service facilities close to the University.

Faculty and Accommodation Loans – The Foundation provides faculty loans at favorable interest rates to University faculty and staff to enable them to conduct business travel pending reimbursement from the University. Non-interest bearing accommodation loans are available to faculty and staff when their salary payment cannot be processed by the University by payday.

Total real estate held for investment for the benefit of Kansas State University at June 30, 2011 was \$25,040,555 (*see Note 2*).

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Note 6: Pledges Receivable

Pledges receivable consisted of the following at June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Promised contributions	\$ 124,552	\$ 28,421,923	\$ 10,860,482	\$ 39,406,957
Less allowance for doubtful accounts	<u>(18,750)</u>	<u>(851,250)</u>	<u>(274,000)</u>	<u>(1,144,000)</u>
	105,802	27,570,673	10,586,482	38,262,957
Less present value component	<u>(9,569)</u>	<u>(2,120,380)</u>	<u>(761,381)</u>	<u>(2,891,330)</u>
	<u>\$ 96,233</u>	<u>\$ 25,450,293</u>	<u>\$ 9,825,101</u>	<u>\$ 35,371,627</u>
Amount expected:				
Within one year	\$ 30,458	\$ 7,727,401	\$ 2,940,616	\$ 10,698,475
One to five years	89,094	19,340,757	7,219,636	26,649,487
Over five years	<u>5,000</u>	<u>1,353,765</u>	<u>700,230</u>	<u>2,058,995</u>
	<u>\$ 124,552</u>	<u>\$ 28,421,923</u>	<u>\$ 10,860,482</u>	<u>\$ 39,406,957</u>

Discount rate used on pledges receivable was 3.25% at June 30, 2011.

Approximately 24% of pledges receivable as of June 30, 2011 are due from two donors.

See significant estimate discussion regarding the allowance for doubtful collections in Note 14.

Approximately \$6,233,000 of contributions receivable are due from related parties as of June 30, 2011.

Note 7: Property and Equipment

Property and equipment at June 30, 2011, consisted of:

Buildings and improvements	\$ 2,527,335
Furniture and equipment	3,154,754
Other	253,459
Construction in process	<u>34,831</u>
	5,970,379
Less accumulated depreciation and amortization	<u>(4,494,830)</u>
	<u>\$ 1,475,549</u>

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Golf Course assets are reported net of accumulated depreciation on the Foundation's financial statements. Property and equipment for the Golf Course consist of:

Land and land improvements	\$ 3,269,344
Buildings and improvements	5,159,824
Other	654,158
	9,083,326
Less accumulated depreciation and amortization	(806,644)
	\$ 8,276,682

Note 8: Net Assets

Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2011 are available for the following purposes or periods:

Departmental Support/Excellence	\$ 102,180,919
Student scholarships and support	44,247,391
Property, plant and equipment	18,081,194
Professorships and faculty support	9,085,911
Research	6,874,807
	\$ 180,470,222
	\$ 180,470,222

Permanently Restricted Net Assets

Permanently restricted net assets at June 30, 2011 are restricted to support:

Student scholarships and support	\$ 154,702,779
Departmental support	50,339,617
Professorships and faculty support	45,565,402
Research	10,193,378
Property, plant and equipment	3,240,537
	\$ 264,041,713
	\$ 264,041,713

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Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors.

Scholarships and other student awards	\$ 9,136,317
University support - Academic	5,408,602
University support - Administrative	30,204,620
University support - Capital improvements	2,472,869
Other support	430,864
	430,864
	\$ 47,653,272

Note 9: Unitrust and Annuity Liabilities

The Foundation has been the recipient of several gift annuities which require future payments to the donor or their named beneficiaries. Beneficiary annuity rates typically follow the guidelines recommended by the American Council on Gift Annuities and range from 5% to 12%. The assets received from donors are recorded at fair value. The Foundation has recorded a liability at June 30, 2011, totaling \$4,064,478, which represents the present value of the future annuity obligations. The liability has been determined using a discount rate of 2.8%.

The Foundation administers various charitable remainder trusts. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime or a specific time period). At the end of the trust's term, the remaining assets are available for the Foundation's use. The portion of the trust attributable to the future interest of the Foundation is recorded in the statement of activities as temporarily restricted contributions or permanently restricted contributions as designated by the donor, in the period the trust is established. Assets held in the charitable remainder trusts are recorded at fair value in the Foundation's statement of financial position. On an annual basis, the Foundation revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions. The present value of the estimated future payments is calculated using a discount rate of 2.8% and applicable mortality tables and amounted to \$16,721,274 at June 30, 2011. Total actuarial gain related to these agreements amounted to \$1,959,738 during 2011.

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Note 10: Employee Benefit Plan

The Foundation's board of trustees has established the Kansas State University Foundation Defined Contribution Retirement Plan (the Plan). The Plan provides for an employer matching contribution of 8.5% for each year. Employees are fully vested when plan contributions are made. Employer contributions paid by the Foundation were \$453,443 for the year ended June 30, 2011.

Employees are eligible to immediately participate on a voluntary basis upon being hired. An eligible employee is required to begin participation in the Plan no later than upon the completion of two years of service at the Foundation.

Note 11: Consolidation of Supporting Organization – KSUGCMRF

The Kansas State University Golf Course Management and Research Foundation (KSUGCMRF) is a supporting organization of the Foundation formed to build, own and operate a golf course. This not-for-profit corporation was formed in 1997 based on a request from the University to provide a golf course to further the University's mission. The corporation was granted tax-exempt status by the Internal Revenue Service. Although consolidated for financial reporting purposes, KSUGCMRF is a separate corporation, and its assets and liabilities are separate from those of the Foundation. The Foundation is not liable for and has not guaranteed the debts or obligations of KSUGCMRF. A summary of financial information for KSUGCMRF at June 30, 2011 is as follows:

Assets	
Cash	\$ 539,482
Real estate and other depreciable assets (net of depreciation)	8,276,682
Pledges receivable	2,006,236
Other assets	<u>136,372</u>
Total assets	<u>10,958,772</u>
Liabilities	
Accrued liabilities	394,403
Mortgage payable	<u>1,964,284</u>
Total net assets	<u><u>\$ 8,600,085</u></u>

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Revenue, gains and other support	\$ 1,851,472
Expenses and support	<u>(1,228,317)</u>
Change in Net Assets	623,155
Net Assets – Beginning of Year	<u>7,976,930</u>
Net Assets – End of Year	<u><u>\$ 8,600,085</u></u>

Note 12: Consolidation of Supporting Organization – FEKSU

The Foundation for Engineering at Kansas State University, Inc. (FEKSU) is a supporting organization formed for charitable and educational purposes exclusively to support the Kansas State University Foundation benefiting the College of Engineering at Kansas State University. This not-for-profit corporation was formed in 2009 based on a request from donors with the objective of providing resources to attract and retain faculty and students through scholarships and enhanced college resources. The corporation has applied for and received tax-exempt status with the Internal Revenue Service. A summary of financial information for FEKSU at June 30, 2011, is as follows:

Assets	
Cash	\$ 1,719,254
Closely held stock (at market value)	<u>21,934,109</u>
Total net assets	<u><u>\$ 23,653,363</u></u>
Sources	
Contributions	\$ 8,456,000
Interest income	743
Net realized and unrealized gains	<u>899,766</u>
Change in Net Assets	9,356,509
Net Assets, Beginning of Year	<u>14,296,854</u>
Net Assets, End of Year	<u><u>\$ 23,653,363</u></u>

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Note 13: Long-term Debt

Nanoscale Note Payable, Commerce Bank (A)	\$ 1,407,851
Printing Services Note Payable, UMB Bank (B)	444,504
KSUGCMRF Notes Payable, Kansas State Bank (C)	<u>1,964,284</u>
	<u><u>\$ 3,816,639</u></u>

- (A) Due July 2022; payable \$13,268 monthly, including interest at 4.25% adjustable every three years; secured by research/office facility leased to Nanoscale Materials, Inc.
- (B) Due January 2013; payable \$6,893 monthly, plus final payment of \$360,624, including interest at 6.25%; secured by a warehouse/office building on Corporate Drive in Manhattan, Kansas.
- (C) Consists of two notes payable from KSUGCMRF with Kansas State Bank, both due August 2015 with interest rate at 5.5% payable \$46,396 and \$233,085 bi-annually; secured by certain property and equipment. Notes are guaranteed personally by certain donors.

Scheduled maturities of long-term debt are payable during the year ending June 30 as follows:

2012	\$ 380,326
2013	960,635
2014	603,551
2015	636,298
2016	376,482
Thereafter	<u>859,347</u>
	<u><u>\$ 3,816,639</u></u>

Total interest expense on long-term debt amounted to \$245,013 during 2011.

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Note 14: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Contributions

Approximately 15% of total contributions received during the year ended June 30, 2011 were related to the basketball facility campaign.

Litigation

Management is not aware of any significant outstanding litigation. The Foundation is subject to claims and lawsuits that arise primarily in the ordinary course of its activities. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position, change in net assets and cash flows of the Foundation.

Investments

The Foundation invests in various 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 change could materially affect the amounts reported in the accompanying statement of financial position.

Allowance for Doubtful Collections on Pledges Receivable

Management estimates an allowance for doubtful collections on pledges based on historical trends, individual donor circumstances and current economic conditions. Actual future collections on pledges could result in material future losses.

Note 15: Restatement of Prior Years' Financial Statements

During 2011, management identified certain net assets which were misclassified, mainly due to the handling of certain cumulative gains or losses on endowment funds and the classification of the Foundation's interest in trusts. Management has restated the beginning net assets for 2011, and this restatement had no net effect on the Foundation's total net assets as of June 30, 2010 or total changes in net assets for the year then ended.

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The following financial statement line items were affected by the correction:

Statement of Net Assets	As Previously Reported	Adjustment	As Restated
Unrestricted net assets	\$ 8,980,343	\$ 24,607,446	\$ 33,587,789
Temporarily restricted net assets	63,604,089	66,315,698	129,919,787
Permanently restricted net assets	<u>332,240,829</u>	<u>(90,923,144)</u>	<u>241,317,685</u>
 Total net assets	 <u>\$ 404,825,261</u>	 <u>\$ -</u>	 <u>\$ 404,825,261</u>

Note 16: Conditional Promises

Conditional promises are not recognized in the financial statements due to the unknown occurrence of a specified future and uncertain event. Donors have notified the Foundation of conditional promises approximating \$201,000,000 and \$38,000,000 and at June 30, 2011, in the form of bequests and life insurance policies, respectively. Future amounts received may vary significantly as the potential donor has no obligation to retain the Foundation as the beneficiary. Additionally, the timing of any receipts on conditional promises is unknown. As a result, the Foundation has not applied a discount rate to these amounts.

Note 17: Subsequent Events

Subsequent events were evaluated through October 18, 2011, which is the date the financial statements were available to be issued.

The U.S. stock market has suffered significant declines since June 30, 2011. Due to the lag experienced in obtaining information used to report fair values for certain portfolio holdings (primarily pooled separate accounts, private capital and hedge funds), management has not yet quantified the impact of this subsequent decline on its investment portfolio at October 18, 2011.