

Indiana University Foundation

Financial Report
6.30.16

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RSM US LLP

Independent Auditor's Report

Board of Directors of the
Indiana University Foundation
Bloomington, Indiana

Report on the Financial Statements

We have audited the accompanying financial statements of the **Indiana University Foundation** (the "Foundation"), which comprise the statement of financial position as of June 30, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Indiana University Foundation as of June 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Board of Directors of the
Indiana University Foundation

Other Matter

The financial statements of the Indiana University Foundation, as of and for the year ended June 30, 2015, were audited by other auditors whose report dated September 30, 2015, expressed an unmodified opinion on those statements.

RSM US LLP

Indianapolis, Indiana
October 3, 2016

Indiana University Foundation

Statements of Financial Position

June 30, 2016 and 2015

(In thousands)

| | 2016 | 2015 |
|-----------------------------------------------|---------------------|---------------------|
| Assets | | |
| Cash and cash equivalents | \$ 65,214 | \$ 87,396 |
| Collateral under securities lending agreement | 99,083 | 95,016 |
| Receivables and other assets | 21,978 | 19,257 |
| Due from brokers | 74,628 | 33,542 |
| Promises to give, net | 196,358 | 154,819 |
| Investments | 2,099,995 | 2,190,545 |
| Property, plant, and equipment, net | 43,900 | 44,452 |
| | <u>2,601,156</u> | <u>2,625,027</u> |
| Total assets | \$ 2,601,156 | \$ 2,625,027 |
| Liabilities and Net Assets | | |
| Liabilities | | |
| Accounts payable and other | \$ 8,957 | \$ 4,787 |
| Due to brokers | 86,577 | 32,464 |
| Collateral under securities lending agreement | 99,083 | 95,016 |
| Split interest agreement obligations | 33,172 | 35,384 |
| Assets held for the University | 209,925 | 232,308 |
| Assets held for University affiliates | 38,194 | 39,092 |
| | <u>475,908</u> | <u>439,051</u> |
| Total liabilities | 475,908 | 439,051 |
| Net Assets | | |
| Unrestricted | 50,762 | 54,614 |
| Temporarily restricted | 831,736 | 839,191 |
| Permanently restricted | 1,242,750 | 1,292,171 |
| Total net assets | <u>2,125,248</u> | <u>2,185,976</u> |
| Total liabilities and net assets | \$ 2,601,156 | \$ 2,625,027 |

See notes to financial statements.

Indiana University Foundation

**Statement of Activities
Year Ended June 30, 2016
(In thousands)**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|----------------------------------------------|--------------|------------------------|------------------------|--------------|
| Support and Other Revenue | | | | |
| Contributions | \$ 2,279 | \$ 105,380 | \$ 83,228 | \$ 190,887 |
| Investment income (loss), net | 643 | 43,596 | (126,996) | (82,757) |
| Management/administrative fees | 18,860 | (15,753) | (39) | 3,068 |
| Grants | - | 1,780 | - | 1,780 |
| Other income | 8,603 | 4,388 | 1,337 | 14,328 |
| Development service fees from the University | 4,923 | - | - | 4,923 |
| Change in value of split interest agreements | (193) | (112) | (2,396) | (2,701) |
| Net assets released from restrictions | 151,289 | (146,734) | (4,555) | - |
| Total support and other revenue | 186,404 | (7,455) | (49,421) | 129,528 |
| Expenses | | | | |
| Grants and aid to the University | 140,173 | - | - | 140,173 |
| Management and general | 27,626 | - | - | 27,626 |
| Fundraising | 22,457 | - | - | 22,457 |
| Total expenses | 190,256 | - | - | 190,256 |
| Change in net assets | (3,852) | (7,455) | (49,421) | (60,728) |
| Net assets, beginning of year | 54,614 | 839,191 | 1,292,171 | 2,185,976 |
| Net assets, end of year | \$ 50,762 | \$ 831,736 | \$ 1,242,750 | \$ 2,125,248 |

See notes to financial statements.

Indiana University Foundation

**Statement of Activities
Year Ended June 30, 2015
(In thousands)**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|----------------------------------------------|--------------|------------------------|------------------------|--------------|
| Support and Other Revenue | | | | |
| Contributions | \$ 3,085 | \$ 74,711 | \$ 46,181 | \$ 123,977 |
| Investment income, net | 6,790 | 73,198 | (26,946) | 53,042 |
| Management/administrative fees | 17,330 | (14,614) | (38) | 2,678 |
| Grants | - | 10,784 | - | 10,784 |
| Other income | 10,528 | 6,127 | 1,349 | 18,004 |
| Development service fees from the University | 4,923 | - | - | 4,923 |
| Change in value of split interest agreements | (56) | (303) | (529) | (888) |
| Net assets released from restrictions | 152,369 | (151,822) | (547) | - |
| Total support and other revenue | 194,969 | (1,919) | 19,470 | 212,520 |
| Expenses | | | | |
| Grants and aid to the University | 156,755 | - | - | 156,755 |
| Management and general | 13,722 | - | - | 13,722 |
| Fundraising | 21,241 | - | - | 21,241 |
| Total expenses | 191,718 | - | - | 191,718 |
| Change in net assets | 3,251 | (1,919) | 19,470 | 20,802 |
| Net assets, beginning of year | 51,363 | 841,110 | 1,272,701 | 2,165,174 |
| Net assets, end of year | \$ 54,614 | \$ 839,191 | \$ 1,292,171 | \$ 2,185,976 |

See notes to financial statements.

Indiana University Foundation
Statements of Cash Flows
Years Ended June 30, 2016 and 2015
(In thousands)

| | 2016 | 2015 |
|----------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Cash Flows from Operating Activities | | |
| Change in net assets | \$ (60,728) | \$ 20,802 |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Depreciation | 2,649 | 1,982 |
| Change in discount on promises to give | (689) | (3,443) |
| Change in allowance on promises to give | 3,452 | 175 |
| Loss (gain) on investments | 109,045 | (60,735) |
| Change in split interest agreements | (246) | 2,467 |
| Real estate assets donated to the University | - | 789 |
| Loss (gain) on sale of property, plant, and equipment | 6 | (231) |
| Contributions restricted for long-term purposes including permanent endowments, charitable remainder trusts, and annuities | (98,572) | (50,868) |
| (Increase) decrease in: | | |
| Receivables, other assets, and due from broker | (43,807) | (15,825) |
| Promises to give | (1,918) | 7,988 |
| Increase (decrease) in: | | |
| Accounts payable, other, and due to broker | 57,786 | 11,474 |
| Assets held for the University and University affiliates | (23,280) | 3,993 |
| Net cash used in operating activities | (56,301) | (81,432) |
| Cash Flows from Investing Activities | | |
| Proceeds from sales of property, plant, and equipment | 44 | 4,433 |
| Proceeds from sales of investments | 2,111,233 | 2,183,348 |
| Purchase of investments | (2,129,728) | (2,165,543) |
| Purchases of property, plant, and equipment | (1,649) | (531) |
| Net cash (used in) provided by investing activities | (20,100) | 21,707 |
| Cash Flows from Financing Activities | | |
| Proceeds from contributions restricted for long-term purposes including: | | |
| Permanent endowments | 53,179 | 50,310 |
| Charitable remainder trusts and annuities | 3,009 | 558 |
| Proceeds from split interest agreement obligations | 1,984 | 784 |
| Payments on split interest agreement obligations | (3,950) | (4,308) |
| Principal payments on debt | (3) | (2,937) |
| Net cash provided by financing activities | 54,219 | 44,407 |
| Net decrease in cash and cash equivalents | (22,182) | (15,318) |
| Cash and cash equivalents, beginning of year | 87,396 | 102,714 |
| Cash and cash equivalents, end of year | \$ 65,214 | \$ 87,396 |

See notes to financial statements.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Note 1. Organization and Operations and Significant Accounting Policies

The Indiana University Foundation, Inc. (Foundation) is a not-for-profit corporation organized under the laws of the state of Indiana. The corporate purposes of the Foundation are to raise, receive, hold, invest and administer property and to make expenditures to or for the benefit of Indiana University, including its regional campuses and associated entities (such as the Purdue University schools housed at the Indiana University-Purdue University Indianapolis campus, the Indiana University Building Corporation, Riley Children's Foundation, the Indiana University Research & Technology Corporation, Indiana University Health, the Indiana University Alumni Association, and certain medical practice plans), herein referred to as the University.

The mission of the Foundation is to maximize private support for Indiana University by fostering lifelong relationships with key stakeholders and providing advancement leadership and fundraising services for campuses and units across the University.

The Foundation was originally incorporated in 1936 and is empowered to perform a wide range of services and conduct a variety of activities that support the University as it carries out its missions of teaching, research, and public service. The Foundation conducts general and special purpose fundraising programs, receives and acknowledges gifts for the benefit of the University, administers those gifts to ensure that they are used as specified by the donor, invests those gifts, serves as trustee for certain types of planned gift arrangements, and provides other services for the benefit of the University as requested from time to time.

Summary of significant accounting policies:

Basis of accounting: The accompanying financial statements have been prepared on the accrual basis of accounting and in conformity with accounting principles generally accepted in the United States of America.

Basis of presentation: The Foundation follows the accounting guidance on financial statements of not-for-profit organizations, which establishes standards for general-purpose external financial statements issued by not-for-profit organizations. It requires that net assets and related support and revenue, expenses, gains and losses be classified into three classes of net assets - unrestricted, temporarily restricted and permanently restricted, based upon the existence or absence of donor-imposed restrictions. A definition and description of each net asset class follows:

Unrestricted net assets: The unrestricted net asset class includes the general and board designated assets and liabilities of the Foundation. Support and other revenue received by the Foundation, without explicit donor restrictions, are reported as unrestricted. Certain fees and other income earned by the Foundation are also reported as unrestricted.

Temporarily restricted net assets: Temporarily restricted net assets relate to donor gifts and assets held in trust with explicit time or purpose restrictions. When donor restrictions are met, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restriction and expended from unrestricted net assets.

Permanently restricted net assets: The permanently restricted net asset class includes the fair value of nonexpendable assets and certain related liabilities where the donor has restricted the gift in perpetuity.

Cash and cash equivalents: The Foundation considers investments in marketable securities and other highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents managed by outside investment managers are included in investments. For these short-term instruments, cost approximates the fair market value. The cash balance exceeds federally insured limits. However, the Foundation has not experienced any losses in such accounts and management does not believe that it is exposed to any significant credit risk.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Receivables and other assets: Receivables and other assets primarily consist of life insurance receivables and other miscellaneous receivables. Based on historical experience and an analysis of specific accounts, management has determined that no allowance for doubtful accounts is necessary for receivables and other assets.

Due from brokers: The amount shown as due from broker represents a receivable from the broker for unsettled purchases and sales of securities as of June 30, 2016 and 2015.

Promises to give: Promises to give are recorded at present value, less an allowance for uncollectible amounts, to reserve against future bad debt losses. Management utilizes a rate consistent with the level of risk associated with a donor to discount promises to give. Management estimates the uncollectible reserve annually based on past due pledge installments and evaluates the estimate against actual results to determine reliability of the estimate.

Investments: Investments, are carried at fair value. Purchases and sales of securities are recorded on trade dates, and realized gains and losses are determined on the basis of the average cost of securities sold.

In connection with its investing and hedging activities, the Foundation enters into transactions, directly and indirectly through positions held by the underlying investment entities, with a variety of securities and derivative financial instruments. These derivative financial instruments may have market and/or credit risk in excess of the amounts recorded in the statements of financial position.

The Foundation's direct and indirect investments are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is 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 financial statements.

- **Market risk:** Market risk arises primarily from changes in the market value of financial instruments. Exposure to market risk is influenced by a number of factors, including the relationships between financial instruments, and the volatility and liquidity in the markets in which the financial instruments are traded. In many cases, the use of financial instruments serves to modify or offset market risk associated with other transactions and, accordingly, serves to decrease the Foundation's overall exposure to market risk. The Foundation attempts to control its exposure to market risk through various analytical monitoring techniques.
- **Credit risk:** Credit risk arises primarily from the potential inability of counterparties to perform in accordance with the terms of a contract. The Foundation's exposure to credit risk associated with counterparty nonperformance is limited to the current cost to replace all contracts in which the Foundation has a gain. Exchange-traded financial instruments generally do not give rise to significant counterparty exposure due to the cash settlement procedures for daily market movements and the margin requirements of individual exchanges. The Foundation seeks to mitigate its exposure to this credit risk by placing its cash with major institutions.
- **Concentration of credit risk:** The Foundation's managers currently invest with various managers and clearing brokers. In the event these counterparties do not fulfill their obligations, the Foundation may be exposed to risk. This risk of default depends on the creditworthiness of the counterparty to these transactions. The Foundation attempts to minimize this credit risk by monitoring the creditworthiness of the managers and clearing brokers.
- **Alternative investments:** The managers of underlying investment entities in which the Foundation invests, may utilize derivative instruments with off-balance-sheet risk. The Foundation's exposure to risk is limited to the amount of its investment.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Property, plant and equipment: Property, plant and equipment are recorded at cost at the date of acquisition or, if received by gift, at fair market value at the date of donation. Depreciation is computed using the straight-line method over the assets' estimated useful lives. Purchased real estate held to benefit the University is recorded as property, plant and equipment and is depreciated over its estimated useful life, generally 20 years.

Management reviews long-lived assets for possible impairment if there is a significant event that detrimentally affects operations. The primary financial indicator used by the Foundation to assess the recoverability of its long-lived assets held and used is undiscounted future cash flows from operations. The amount of impairment, if any, is measured based on estimated fair value or projected future cash flows using a discount rate reflecting the Foundation's average cost of funds. Management has not identified any triggering events during the years ended June 30, 2016 and 2015.

Due to brokers: The amount shown as due to broker represents a payable to the broker for unsettled purchases and sales of securities as of June 30, 2016 and 2015.

Split interest agreement obligations: The Foundation has entered into split interest agreements, including charitable remainder trusts and gift annuities which provide that the Foundation, as trustee, make payments to designated beneficiaries in accordance with the applicable donor's trust or contractual agreement. The Foundation records a split interest agreement obligation to life beneficiaries based on the present value of the estimated payments to designated life beneficiaries.

Assets held for the University and University affiliates: The Foundation invests and administers net assets owned by the University and its affiliates under a management and custodial agreement. These are reflected as liabilities on the Statement of Financial Position.

Reclassification of donor intent: At times, the Foundation receives requests by donors or their designees to change the use for which their original gift was intended. These requests are reviewed by the Foundation for approval. Approved changes, depending on the donors' requests, may result in the reclassification of net assets between unrestricted, temporarily restricted, or permanently restricted net asset classes. Reclassifications of donor intent of \$4,632 and \$409 are reflected in the Statements of Activities as net assets released from restriction for the years ended June 30, 2016 and 2015 respectively.

Contributions: Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions upon which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value.

Grants: Private research grants are received from donors to support the University's research programs. Research grants are distributed in accordance with the grant by the account manager. Grants recorded as contributions are irrevocable, voluntary nonreciprocal transfers of assets held, administered, and maintained for investment purposes at the Foundation.

Management/administrative fees: A fee is charged to accounts within each net asset class for which the Foundation manages investments and other assets. This management fee is charged based on the market value and type of investments and other assets managed. These fees are used for the administration of the Foundation's management and fundraising operations.

Other income: Unrestricted other income is comprised primarily of the following: reimbursements from the University for the cost of direct support of certain fundraising activities; receipts from various program operations, including real estate, air services, the Student Foundation, women's programs, and other miscellaneous programs; and the change in the cash surrender value of life insurance policies. Temporarily and permanently restricted other income is comprised primarily of amounts received from the University with donor related restrictions for activities and events, the change in the cash surrender value of life insurance policies, and departmental support to the IU School of Medicine from medical practice plans. These plans, which are associated with the University, operate as separate legal entities. The income received from these plans support the related University medical departments as specified.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Functional allocation of expenditures: The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited. Program expenditures include grants and aid to the University, real estate, air services, the Student Foundation, women's programs, and other miscellaneous programs.

Income taxes: The Foundation is a not-for-profit corporation and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the "Code"), except for income taxes on unrelated business income that are not significant. Contributions to the Foundation are deductible under Section 170(b)(1)(A)(iv) of the Code.

Accounting Standards Codification (ASC) 740-10, *Accounting for Uncertainty in Income Taxes*, prescribes a comprehensive model for how an organization should measure, recognize, present, and disclose in its financial statements uncertain tax positions that an organization has taken or expects to take on a tax return. The Foundation is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Foundation believes it is no longer subject to income tax examinations for years prior to 2013. As of June 30, 2016 and 2015, the Foundation has no uncertain tax positions.

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 of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Reclassification: Certain balances in the financial statements for the year ended June 30, 2015 have been reclassified with no effect on net asset classification or the change in net assets, to conform to the classification used for the year ended June 30, 2016.

Recently adopted accounting standards: In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)* removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share as a practical expedient. ASU 2015-07 also removes the requirement to make certain disclosure for all investments that are eligible to be measured at fair value using the net asset value per share as a practical expedient. For private entities, the amendments in this update are effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. During the fiscal year ended June 30, 2016, the Foundation adopted the amendment, causing certain investments valued at fair value using the net asset value per share practical expedient, formally assessed as Level 3, to be valued at fair value.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*, improving the financial reporting of repurchase agreements and other similar transactions through a change in accounting for repurchase-to-maturity transactions and repurchase financings, and added two additional disclosure requirements for (1) transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction and (2) repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings about the nature of collateral pledged and the time to maturity of those transactions. For private entities, the amendments in this update are effective for fiscal years beginning after December 15, 2014. During the fiscal year ended June 30, 2016, the Foundation adopted the amendment, providing increased transparency regarding the types of collateral pledged.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Recently issued accounting standards: In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Key elements of the ASU include a reduction in the number of net asset categories from three to two, conforming requirements on releases of capital restrictions, several new requirements related to expense presentation and disclosure (including investment expenses), and new required disclosures communicating information useful in assessing liquidity. The new standard is effective for the Foundation in the fiscal year ending June 30, 2019, early adoption is allowed. The Foundation is currently evaluating the impact of the adoption of the standard on its financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14 which defers the effective date of ASU 2014-09 one year making it effective for the Foundation's June 30, 2020 financial statements. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that period. The Foundation has not yet selected a transition method and is currently evaluating the effect that the pending adoption of the updated standard will have on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial position for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of activities. The new standard is effective for the Foundation's June 30, 2021 financial statements. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Foundation is currently evaluating the effect of the pending adoption of the new standard on the financial statements.

Subsequent events: The Foundation has evaluated subsequent events for partial recognition and/or disclosure through October 3, 2016, the date the financial statements were available to be issued.

Note 2. Promises to Give

A summary of promises to give as of June 30, 2016 and 2015 follows:

| | 2016 | 2015 |
|------------------|-------------------|-------------------|
| Promises to give | \$ 235,543 | \$ 191,241 |
| Allowance | (13,500) | (10,048) |
| Discount | (25,685) | (26,374) |
| | <u>\$ 196,358</u> | <u>\$ 154,819</u> |

Promises to give are due in the following periods:

| | 2016 | 2015 |
|---------------------------------|-------------------|-------------------|
| Promises to give, due in: | | |
| One year or less | \$ 28,023 | \$ 22,093 |
| Between one year and five years | 94,920 | 61,286 |
| More than five years | 73,415 | 71,440 |
| | <u>\$ 196,358</u> | <u>\$ 154,819</u> |

Discount rates used to present value promises to give, range between 1.0% and 8.4%.

Note 3. Fair Value Measurement and Investments

Fair value is 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. The Foundation utilizes valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs. Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. Assets and liabilities recorded at fair value are categorized within the fair value hierarchy based upon the level of judgment associated with the inputs used to measure their value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below.

- Level 1** Unadjusted quoted prices in active markets for identical assets or liabilities that the Foundation has the ability to access at the measurement date.
- Level 2** Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly, and fair value is determined through the use of models or other valuation methodologies. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.
- Level 3** Inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined by the lowest level input that is significant to the fair value measurement.

The availability of observable inputs can vary from investment to investment and is affected by a wide variety of factors, including the type of investment, whether the investment is new and not yet established in the marketplace, the liquidity of markets, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Those estimated values do not necessarily represent the amounts that may be ultimately realized due to future circumstances that cannot be reasonably determined. Because of the inherent uncertainty of valuation, those estimated values might be materially higher or lower than the values that would have been used had a readily available market for the securities existed. Accordingly, the degree of judgment exercised by the Foundation in determining fair value is greatest for securities categorized in Level 3.

The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risks associated with investing in those instruments.

The Foundation assesses the levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Foundation's accounting policies regarding the recognition of transfers between levels of the fair value hierarchy. During the fiscal years ended June 30, 2016 and 2015, no such transfers were made.

Investments in money market funds, mutual funds, exchange-traded funds, and securities traded on a national securities exchange, or reported on the NASDAQ national market, are stated at the last reported sales price on the day of valuation. These financial instruments are classified as Level 1 in the fair value hierarchy.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Preferred stock and other equities traded on inactive markets or valued by reference to similar instruments are categorized as Level 2 in the fair value hierarchy. Investments in government securities and bonds and corporate notes and debt securities which are traded on a national securities exchange or market are valued at the mean between the current "bid" and "asked" quotations on that day. If a reliable bid and asked quotation cannot be obtained from a national securities exchange, the security is priced at the mean between the bid and asked quotation of a reliable market maker. If the investments are not traded on an exchange, they are stated at cost plus accrued interest, which approximates the fair value. These financial instruments are classified as Level 2 in the fair value hierarchy.

Investments in real estate are valued by the Foundation using independent appraisals and statements provided by the management companies of the properties. These financial instruments are classified as Level 3 in the fair value hierarchy.

Net asset value (NAV): Investments in non-registered investment companies consisting of certain hedged equity funds, absolute return funds, venture capital funds, buyout funds, distressed, special situation funds, real estate funds, alternative fixed income funds, national resource funds, and public inflation funds are valued at fair value based on the applicable percentage ownership of the underlying investment entities' net assets as of the measurement date as determined by the Foundation, commonly referred to as the practical expedient. In determining fair value, the Foundation utilizes valuations provided by the underlying investment entities. The underlying investment entities value securities and other financial instruments on a fair value based upon market price, when possible, or at fair value determined by the respective entities' investment manager when no market price is determinable. Although the Foundation uses their best judgment in estimating the fair value of alternative investments, there are inherent limitations in any estimation technique. The estimated fair values of certain of the investments of the underlying investment entities, which may include derivatives, securities and other designated or side pocketed investments for which prices are not readily available, may not reflect amounts that could be realized upon immediate sale, nor amounts that may be ultimately realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments, and differences could be material.

The practical expedient allows for investments in non-registered investment companies, to be valued at the net asset value (NAV) which represents fair value. The Foundation classifies these investments using NAV within the fair value measurement table.

Charitable trusts and gift annuities: Assets received from charitable trusts and gift annuities are recorded at fair value in the unrestricted and temporarily restricted funds, respectively, until the Foundation's obligations to the annuitants have been met. The difference between the fair value of assets contributed and the split interest obligations recorded is recognized as contribution revenue. The Foundation records a split interest agreement obligation to life beneficiaries based on the present value of the estimated payments to designated life beneficiaries.

Liabilities for charitable gift annuities are recorded in an amount equal to the present value of the estimated future obligations based on mortality rates derived from ordinary life annuity tables. In computing the liability, management considers the estimated return on the invested assets and the contractual payment obligation during the expected term of each respective annuity agreement. Fair value estimates are classified as Level 3.

Indiana University Foundation

Notes to Financial Statements (In thousands)

The following table presents the Foundation's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of June 30, 2016:

| | Quoted Prices for Identical Assets in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 | Valued Using Net Asset Value ** | Total |
|---------------------------------|-----------------------------------------------------------------------------|---------------------------------------------------------|--------------------------------------------------|---------------------------------------|---------------------|
| Assets | | | | | |
| Investments | | | | | |
| Domestic equities | \$ 376,586 | \$ 12,018 | \$ - | \$ 122,813 | \$ 511,417 |
| International equities | 255,311 | - | - | 57,266 | 312,577 |
| Domestic fixed income | 73,780 | 144,047 | - | 78,988 | 296,815 |
| International fixed income | 1,774 | 13,285 | - | 10,780 | 25,839 |
| Real estate | - | - | 25,452 | - | 25,452 |
| Cash equivalents | 28,017 | 1,490 | - | - | 29,507 |
| Alternative investments | | | | | |
| Hedged equity funds | - | - | - | 98,493 | 98,493 |
| Absolute return funds | - | - | - | 253,399 | 253,399 |
| Venture capital | - | - | - | 141,908 | 141,908 |
| Buyouts | - | - | - | 112,539 | 112,539 |
| Distressed / special situations | - | - | - | 39,457 | 39,457 |
| Real estate | - | - | - | 75,914 | 75,914 |
| Alternative fixed income | - | - | - | 44,811 | 44,811 |
| Natural resources | - | - | - | 102,245 | 102,245 |
| Public inflation hedge | - | - | - | 29,622 | 29,622 |
| | <u>\$ 735,468</u> | <u>\$ 170,840</u> | <u>\$ 25,452</u> | <u>\$ 1,168,235</u> | <u>\$ 2,099,995</u> |
| Liabilities | | | | | |
| Split interest | | | | | |
| agreement obligations | \$ - | \$ - | \$ 33,172 | \$ - | \$ 33,172 |

Indiana University Foundation

Notes to Financial Statements (In thousands)

The following table presents the Foundation's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of June 30, 2015:

| | Quoted Prices for Identical Assets in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 | Valued Using Net Asset Value ** | Total |
|---------------------------------|-----------------------------------------------------------------------------|---------------------------------------------------------|--------------------------------------------------|---------------------------------------|---------------------|
| Assets | | | | | |
| Investments | | | | | |
| Domestic equities | \$ 391,789 | \$ 13,442 | \$ - | \$ 141,273 | \$ 546,504 |
| International equities | 279,049 | - | - | - | 279,049 |
| Domestic fixed income | 16,640 | 167,108 | - | 88,447 | 272,195 |
| International fixed income | 2,825 | 36,858 | - | 10,321 | 50,004 |
| Real estate | - | - | 21,842 | - | 21,842 |
| Cash equivalents | 22,828 | - | - | - | 22,828 |
| Alternative investments | | | | | |
| Hedged equity funds | - | - | - | 135,109 | 135,109 |
| Absolute return funds | - | - | - | 291,201 | 291,201 |
| Venture capital | - | - | - | 170,977 | 170,977 |
| Buyouts | - | - | - | 126,997 | 126,997 |
| Distressed / special situations | - | - | - | 35,462 | 35,462 |
| Real estate | - | - | - | 76,376 | 76,376 |
| Alternative fixed income | - | - | - | 39,354 | 39,354 |
| Natural resources | - | - | - | 90,861 | 90,861 |
| Public inflation hedge | - | - | - | 31,786 | 31,786 |
| | <u>\$ 713,131</u> | <u>\$ 217,408</u> | <u>\$ 21,842</u> | <u>\$ 1,238,164</u> | <u>\$ 2,190,545</u> |
| Liabilities | | | | | |
| Split interest | | | | | |
| agreement obligations | \$ - | \$ - | \$ 35,384 | \$ - | \$ 35,384 |

** Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in the tables above are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of financial position.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Financial instruments classified as Level 3 in the fair value hierarchy represent the Foundation's investments in financial instruments in which at least one significant unobservable input is used in the valuation model. The following table presents a reconciliation of activity for the Level 3 financial instruments as of June 30, 2016 and 2015:

| | 2016 | 2015 |
|----------------------------------------|------------------|------------------|
| Beginning balance (real estate) | \$ 21,842 | \$ 19,047 |
| Realized and unrealized gains (losses) | 774 | 1,493 |
| Purchases | 4,295 | 2,588 |
| Sales and settlements | (1,459) | (1,286) |
| Ending balance | <u>\$ 25,452</u> | <u>\$ 21,842</u> |

The following presents a reconciliation for the changes in the Foundation's liability for charitable remainder and annuity trusts, which is deemed a Level 3 liability:

| | 2016 | 2015 |
|-----------------------------------------------------------|------------------|------------------|
| Beginning balance | \$ 35,384 | \$ 36,441 |
| Liability portion of charitable gifts received | 1,984 | 784 |
| Payments to annuitants | (3,950) | (4,308) |
| Change in the present value of split interest obligations | (246) | 2,467 |
| | <u>\$ 33,172</u> | <u>\$ 35,384</u> |

The table below presents the Foundation's ability to redeem investments valued at net asset value or its equivalent as of June 30, 2016 and 2015, and includes the underlying investment entities' redemption frequency and redemption notice period. The tables also include a summary of the significant categories of such investments measured at net asset value, their attributes and investment strategies as of June 30, 2016 and 2015:

| Investment Category and Strategy | 2016 Fair Value | 2016 Unfunded Commitments | 2015 Fair Value | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|---------------------------------------------------|---------------------|---------------------------|---------------------|----------------------------------------------|--------------------------|
| Domestic equities ^(a) | \$ 122,813 | \$ - | \$ 141,273 | monthly, quarterly | 30-60 days |
| International equities ^(b) | 57,266 | - | - | monthly | 30 days |
| Domestic fixed income ^(c) | 78,988 | - | 88,447 | monthly, bimonthly, quarterly | 30-45 days |
| International fixed income ^(d) | 10,780 | - | 10,321 | monthly, bimonthly, quarterly | 30-45 days |
| Hedge equity funds ^(e) | 98,493 | - | 135,109 | monthly, quarterly, semi-annually, annually | 30-90 days |
| Absolute return funds ^(f) | 253,399 | - | 291,201 | monthly, quarterly, semi-annually, annually | 33-95 days |
| Venture capital funds ^(g) | 141,908 | 88,314 | 170,977 | Long-term commitment *** | none |
| Buyout funds ^(h) | 112,539 | 110,043 | 126,997 | Long-term commitment *** | none |
| Distressed/special situation funds ⁽ⁱ⁾ | 39,457 | 30,429 | 35,462 | Long-term commitment *** | none |
| Real estate funds ^(j) | 75,914 | 77,121 | 76,376 | Long-term commitment *** | none |
| Alternative fixed income ^(k) | 44,811 | 18,698 | 39,354 | Long-term commitment *** | none |
| Natural resources funds ^(l) | 102,245 | 84,360 | 90,861 | Long-term commitment *** | none |
| Public inflation hedge ^(m) | 29,622 | - | 31,786 | monthly | 10 days |
| | <u>\$ 1,168,235</u> | <u>\$ 408,965</u> | <u>\$ 1,238,164</u> | | |

Indiana University Foundation

Notes to Financial Statements (In thousands)

*** The nature of this investment class is that distributions are received through liquidations of the underlying assets of the underlying investment fund. These underlying funds generally hold long term liquid investments, therefore, distributions are at the discretion of the underlying fund manager.

- (a) This category includes investments held in mutual funds, exchange-traded funds, partnerships, and limited liability companies located in the U.S. Redemptions range from daily to annually.
- (b) This category includes investments held in mutual funds, exchange-traded funds, partnerships, and limited liability companies located in economies outside of the U.S. Redemptions range from daily to annually.
- (c) This category includes investments that are primarily in both long and short term fixed income securities located in the U.S. Management of the investments has the ability to shift investments from a net long position to a net short position. There were no restricted investments as of June 30, 2016.
- (d) This category includes investments that are primarily in both long and short term fixed income securities located in economies outside of the U.S. Management of the investments has the ability to shift investments from a net long position to a net short position. There were no restricted investments as of June 30, 2016.
- (e) This category includes investments in hedge funds that invest globally in both long and short common stocks across all market capitalizations. Management of the hedge funds may opportunistically shift investments across sectors, geographies, and net market exposures.
- (f) This category includes investments in hedge funds that invest opportunistically across various strategies including long/short equity, fixed income, distressed credit, merger arbitrage, convertible arbitrage, etc. As of June 30, 2016, 56% of the total Marketable Alternative Investments (Hedged equity funds and Absolute return funds) could be redeemed in 0-6 months, an additional 21% could be redeemed between 7-12 months, another 17% could be redeemed between 13- 24 months, and 2% could be redeemed between 25- 36 months. The remaining 4% is designated as illiquid investments.
- (g) This category includes investments that are primarily in early-stage companies in the technology and life science sectors. The nature of investments in this category is that money is distributed as underlying companies are exited via acquisition or Initial Public Offering (IPO). The typical life of a partnership is 10 years but is subject to extensions.
- (h) This category includes private equity funds that invest across sectors primarily in the United States, but also internationally. The nature of investments in this category is that money is distributed as underlying companies are recapitalized or exited via acquisition or IPO. The typical life of a partnership is 10 years but is subject to extensions.
- (i) This category includes investments that are focused on distressed or secondary investments. The typical life of a partnership is 10 years but is subject to extensions.
- (j) This category includes investments that are primarily in U.S. commercial real estate, but also includes real estate funds focused on Europe and Asia. The real estate exposure can include both publicly traded Real Estate Investment Trust funds and private partnerships. The typical life of a partnership is 10 years but is subject to extensions.
- (k) This category includes investments that are focused primarily on direct lending across the corporate and real estate sectors. The investments are structured to provide a steady stream of income to the Foundation based on floating interest rate loans. The typical life of a partnership is 5 years but is subject to extensions.
- (l) This category includes investments that are focused on direct energy, mining and minerals, and timber. The typical life of a partnership is 10 years but is subject to extensions. Certain funds in this category will provide an income stream as the underlying commodity is harvested/sold.
- (m) This category includes investments that are in equity and equity-related securities, commodity derivatives, fixed income obligations, and derivatives related to equity, fixed income, and commodity securities.

Indiana University Foundation

Notes to Financial Statements (In thousands)

The following table summarizes the qualitative information about certain of the Foundation's Level 3 inputs as of June 30, 2016 and 2015:

| | Fair Value | Valuation Techniques | Unobservable Inputs | Ranges |
|-------------------------------|------------|----------------------|-------------------------|--------|
| Real estate investments, 2016 | \$ 25,452 | Market approach | Comparable transactions | N/A |
| Real estate investments, 2015 | \$ 21,842 | Market approach | Comparable transactions | N/A |

A summary of total investment income (loss) for the years ended June 30, 2016 and 2015 is as follows:

| | 2016 | 2015 |
|-----------------------------------------------------------|--------------------|------------------|
| Dividend, interest, and other investment income | \$ 14,098 | \$ 6,632 |
| Net realized and unrealized gains (losses) on investments | (92,480) | 51,287 |
| Outside investment management fees | (4,375) | (4,877) |
| | <u>\$ (82,757)</u> | <u>\$ 53,042</u> |

Note 4. Securities Lending

The Foundation has a securities lending agreement and guaranty agreement with The Bank of New York Mellon Corporation (BNY). BNY may lend, up to \$110,000 of the stocks and bonds for which it holds as custodian, to borrowers under terms of participation in a securities lending program and acts as agent and administrator for the program. The securities lending agreement requires that loans are collateralized at all times in an amount equal to at least 102% of the market value of any loaned securities at the time of the loan, plus accrued interest.

The Foundation receives compensation in the form of fees and earns interest on the cash collateral. The amount of fees depends on a number of factors including the type of security and length of the loan. The Foundation continues to receive interest payments or dividends on the securities loaned during the borrowing period. The Foundation has the right under the terms of the securities lending agreement to recall the securities from the borrower on demand.

As of June 30, 2016 and 2015, the Foundation had loaned securities that were collateralized by cash equivalents and short duration fixed income instruments. The cash collateral is invested by BNY in accordance with approved investment guidelines. Those guidelines require the cash collateral to be invested in readily marketable, high quality, short-term obligations; however, such investments are subject to risk of payment delays or default on the part of the issuer or counterparty or otherwise may not generate sufficient interest to support the costs associated with securities lending. The Foundation could also experience delays in recovering its securities and possible loss of income or value if the borrower fails to return the borrowed securities, although the Foundation is indemnified from this risk by contract with the securities lending agent. As of June 30, 2016, the market value of the securities on loan and payable on collateral due to broker totaled \$99,083.

The Foundation receives cash as collateral in return for securities lent as part of the securities lending program. The collateral is invested in the Collateral Portfolio (a securities lending trust subject to Rule 2a-7 under the 1940 Act). The schedules of investments for the Foundation include the particular cash collateral holdings as of June 30, 2016. The interest income earned by the Foundation on investments of cash collateral received from borrowers for the securities loaned to them ("securities lending income") is reflected in the Foundation's statement of activities. Interest income earned on collateral investments and recognized by the Foundation during the year ended June 30, 2016 was \$287.

Indiana University Foundation

Notes to Financial Statements (In thousands)

The table below outlines the gross obligations for secured borrowings by the type of collateral pledged at June 30, 2016.

| | | |
|----------------------|----|---------------|
| Cash collateral: | | |
| U.S. equities | \$ | 82,819 |
| U.S. corporate | | 11,105 |
| Non U.S. equities | | 2,576 |
| Non-cash collateral: | | |
| U.S. equities | | 2,038 |
| U.S. corporate | | 545 |
| | \$ | <u>99,083</u> |

Note 5. Split Interest Agreements

A summary of assets held and the obligations related to split interest agreements as of June 30, 2016 and 2015 follows:

| | 2016 | 2015 |
|----------------------------------------------------|------------------|------------------|
| Assets (included in investments): | | |
| Charitable remainder trusts and other | \$ 34,239 | \$ 38,851 |
| Charitable gift annuities | 30,021 | 32,032 |
| | <u>\$ 64,260</u> | <u>\$ 70,883</u> |
| Liabilities - split interest agreement obligations | <u>\$ 33,172</u> | <u>\$ 35,384</u> |

Charitable gift annuity assets are separate and distinct funds, managed as independent accounts of the Foundation. The Foundation maintains reserves and a surplus of such reserves in an amount at least equal to the designated beneficiary payments on all the outstanding gift annuity contracts. These reserves shall not be applied for the payment of debts and obligations of the Foundation or for any purpose other than payment of the annuity benefits.

Note 6. Property, Plant, and Equipment

A summary of property, plant, and equipment as of June 30, 2016 and 2015 follows:

| | 2016 | 2015 |
|--------------------------------------|------------------|------------------|
| Land and buildings | \$ 63,569 | \$ 61,678 |
| Information and technology equipment | 2,953 | 2,598 |
| Other | 2,797 | 3,135 |
| | <u>69,319</u> | <u>67,411</u> |
| Less accumulated depreciation | (25,419) | (22,959) |
| | <u>\$ 43,900</u> | <u>\$ 44,452</u> |

Indiana University Foundation

Notes to Financial Statements (In thousands)

Note 7. Endowments

The Foundation's endowment consists of both donor-restricted endowment funds and funds designated by the Board to function as endowments and consists of 5,556 and 5,334 individual funds as of June 30, 2016 and 2015 respectively. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board has interpreted the state of Indiana's "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) as requiring the preservation of the fair value providing for intergenerational equity. The fair value of a donor's permanent endowment classified as permanently restricted net assets is its market value. Market value includes the original gift value of the assets held in perpetuity, the original value of subsequent gifts to the permanent endowment, and net realized and unrealized gains absent explicit donor stipulations to the contrary. 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 appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purpose of the Foundation and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Foundation
- The investment policies of the Foundation

The following tables present the Foundation's endowment composition, changes, and net asset classifications as of and for the years ended June 30, 2016 and 2015:

| | 2016 | | | Total |
|----------------------------------|------------------|------------------------|------------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Donor-restricted endowment funds | \$ - | \$ 608,003 | \$ 1,128,786 | \$ 1,736,789 |
| Board-designated endowment | 27,715 | - | - | 27,715 |
| | <u>\$ 27,715</u> | <u>\$ 608,003</u> | <u>\$ 1,128,786</u> | <u>\$ 1,764,504</u> |

| | 2015 | | | Total |
|----------------------------------|------------------|------------------------|------------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Donor-restricted endowment funds | \$ - | \$ 628,597 | \$ 1,204,381 | \$ 1,832,978 |
| Board-designated endowment | 29,212 | - | - | 29,212 |
| | <u>\$ 29,212</u> | <u>\$ 628,597</u> | <u>\$ 1,204,381</u> | <u>\$ 1,862,190</u> |

Indiana University Foundation

Notes to Financial Statements
(In thousands)

| | 2016 | | | Total |
|---------------------------------------------------|------------------|------------------------|------------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Beginning of the year | \$ 29,212 | \$ 628,597 | \$ 1,204,381 | \$ 1,862,190 |
| Investment income (loss) | (616) | 28,975 | (126,834) | (98,475) |
| Contributions and other revenue | 337 | 38,143 | 51,239 | 89,719 |
| Appropriation of endowment assets for expenditure | (1,218) | (87,712) | - | (88,930) |
| | <u>\$ 27,715</u> | <u>\$ 608,003</u> | <u>\$ 1,128,786</u> | <u>\$ 1,764,504</u> |

| | 2015 | | | Total |
|---------------------------------------------------|------------------|------------------------|------------------------|---------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Beginning of the year | \$ 29,090 | \$ 615,387 | \$ 1,179,007 | \$ 1,823,484 |
| Investment income (loss) | 1,589 | 58,298 | (26,847) | 33,040 |
| Contributions and other revenue | 96 | 36,657 | 52,221 | 88,974 |
| Appropriation of endowment assets for expenditure | (1,563) | (81,745) | - | (83,308) |
| | <u>\$ 29,212</u> | <u>\$ 628,597</u> | <u>\$ 1,204,381</u> | <u>\$ 1,862,190</u> |

Net assets include nonexpendable and expendable assets related to donor gifts and assets held in perpetuity or held in trust with explicit time or purpose restrictions. These can be held either for the benefit of the Foundation or for the benefit of the University.

Return objectives and risk parameters: The primary investment objective of the Foundation's asset management program is to achieve an annualized total return equal to or greater than the rate of inflation, net of fees and expenses, in order to maintain the purchasing power of those assets. The assets are managed in a manner that will not only meet the primary investment objective, but also seek growth above the objective and attempt to limit volatility for year-to-year spending.

The Foundation has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy endowment assets are invested in a manner that is intended to yield a long-term rate of return that exceeds the distribution rate, inflation, and administrative fees of the endowment, while assuming a prudent level of investment risk. Actual results may not be sufficient to achieve this over some shorter time frames.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Strategies employed for achieving investment objectives: To achieve 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 gains) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints. Endowment assets will be invested in the Foundation's Pooled Long-Term Fund. Operating funds will typically be invested in the Pooled Short-Term Fund. An additional option is the Pooled Intermediate-Term Fund, which will fill a need for those operating funds that are due to be spent 6 months to 2 years from the time the cash is received. The Foundation's Investment Committee understands the long-term nature of the endowment assets and believes that investing in assets with higher return expectations outweighs their short-term volatility risk. As a result, the majority of assets will be invested in equity or equity-like securities, including real assets (real estate and natural resources). Real assets provide the added benefit of inflation protection. Fixed income and absolute return strategies will be used to lower short-term volatility and provide stability, especially during periods of deflation and negative equity markets. Cash is not a strategic asset of the Pooled Long-Term Fund, but is a residual to the investment process and used to meet the short-term liquidity needs.

Relationship of spending policy to investment objectives: The Foundation determines the method to be used to make endowment distributions to the University. In establishing a method, the Foundation considers the expected long-term rate of return on the investment of the Foundation's endowment funds. Over the long-term, the Foundation expects the spending policy to allow the endowment to grow at a sufficient rate to maintain the purchasing power of the endowment assets over time, sometimes referred to as intergenerational equity, as well as to provide additional real growth through new gifts. Effective July 1, 2011 the Foundation determined that distributions will continue to be based upon a 12-quarter rolling average of the market value of the Pooled Long-Term Fund, but constrained by inflation bands that will limit the distributions to fall within 2 times inflation on the growth side and 1 times inflation on the down side, based on what was distributed in the previous year. The inflation factor is calculated as a rolling 5 year average of the Consumer Price Index. Additionally, the distribution rate is reduced 8.3 basis points per year over 6 years resulting in a 4.5% distribution rate in fiscal year 2016–2017. The expectation is that these inflation bands will prevent distributions from fluctuating widely. Depending upon market conditions and the needs and available resources of the Foundation, appropriations for expenditure from individual endowments may be temporarily suspended to facilitate preservation of the endowment.

Indiana University Foundation

**Notes to Financial Statements
(In thousands)**

Note 8. Restricted Net Assets

The income generated from restricted net assets is used in accordance with the donors' time and/or purpose restrictions. Foundation operations and University programs permanently restricted assets are held in perpetuity. A summary of restricted net assets and the related donor imposed restrictions as of June 30, 2016 and 2015 are as follows:

| | 2016 | | 2015 | |
|----------------------------------|------------------------|------------------------|------------------------|------------------------|
| | Temporarily Restricted | Permanently Restricted | Temporarily Restricted | Permanently Restricted |
| Foundation operations | \$ 8,478 | \$ 23,085 | \$ 9,434 | \$ 25,164 |
| University programs: | | | | |
| Awards | 5,721 | 16,005 | 5,806 | 9,601 |
| Capital and capital improvements | 135,923 | 2,320 | 110,701 | 2,565 |
| Fellowships / lectureships | 24,366 | 90,084 | 23,075 | 97,946 |
| General endowments | 261,362 | 273,892 | 280,401 | 288,851 |
| Medical practice plans | 32,532 | - | 35,002 | - |
| Operations | 75,218 | 4,992 | 75,497 | 4,392 |
| Professorships / chairs | 100,710 | 331,979 | 120,439 | 335,316 |
| Research | 41,931 | 52,777 | 37,225 | 66,773 |
| Scholarships | 145,495 | 447,616 | 141,611 | 461,563 |
| | <u>\$ 831,736</u> | <u>\$ 1,242,750</u> | <u>\$ 839,191</u> | <u>\$ 1,292,171</u> |

Note 9. Retirement Plan

The Foundation maintains the Indiana University Foundation Section 403(b) Annuity Plan (Plan), a defined contribution retirement plan available to all eligible employees. The Foundation Investment Retirement Committee administers the operation of the Plan. Benefits to retired participants are based on the value of the individual retirement account at the date of retirement. The total contribution is 10% of the participant's annual salary up to the social security wage base and 15% on annual salary in excess of the social security wage base. The Foundation's policy is to fund retirement costs related to this plan as incurred. Retirement expense related to this plan amounted to \$1,987 and \$1,939 for the years ended June 30, 2016 and 2015 respectively.

Indiana University Foundation

Notes to Financial Statements (In thousands)

Note 10. Grants and Aid to the University

Program expenditures include support for Foundation and University programs. For the years ended June 30, 2016 and 2015, a summary of these expenditures is as follows:

| | 2016 | 2015 |
|------------------------------------------------------------------------------|-------------------|-------------------|
| Program expenditures | | |
| Foundation programs | | |
| Real estate | \$ 1,885 | \$ 3,265 |
| Student foundation | 485 | 471 |
| Air services | 908 | 1,249 |
| Woman's programs | 21 | 129 |
| Miscellaneous | 18 | 17 |
| Total foundation programs | <u>3,317</u> | <u>5,131</u> |
| University grants and aid | | |
| Grants and aid - operating support | | |
| University support | 32,437 | 29,270 |
| Student scholarship and financial aid | 44,247 | 45,746 |
| Faculty support | 27,407 | 23,475 |
| Faculty research | 8,859 | 8,232 |
| | <u>112,950</u> | <u>106,723</u> |
| Grants - endowment and capital and land, building and equipment purchases | 23,906 | 44,901 |
| Total University grants and aid | <u>136,856</u> | <u>151,624</u> |
| | <u>\$ 140,173</u> | <u>\$ 156,755</u> |

Note 11. Related Party Transactions

In addition to amounts and transactions disclosed in the preceding notes and financial statements, the following is a summary of related party transactions. These transactions have been summarized below by financial statement classification as reported in the Statements of Activities. Related parties include affiliates, board of directors, management, and members of their immediate families.

Support and other revenue:

Fees and other income: Included in unrestricted other income is direct support from the University for certain fundraising efforts as well as income from its program operations. For the years ended June 30, 2016 and 2015 the University provided development services support to the Foundation in the amount of \$4,923 for 2016 and 2015 and reimbursed the Foundation for its direct support of campaign fundraising efforts in the amount of \$1,200 and \$595 respectively. As a part of the Foundation program operations, the Foundation received support from the University for each of the years ended June 30, 2016 and 2015 respectively, as follows: \$3,805 and \$5,017 of rental income for the lease of certain real estate; \$375 and \$673 for Telefund service fees related to its telephone fundraising operations; \$907 and \$1,228 for charter services; and \$18,860 and \$17,330 in management/administrative fees of which, \$2,562 and \$2,387 were received on custodial assets held for the University or University affiliates.

Contributions and promises to give: The Foundation includes related party contributions in the Statements of Activities and outstanding related party promises to give in the Statements of Financial Position.

Indiana University Foundation

Notes to Financial Statements (In thousands)

A summary of related party Contributions and Promises to Give as of and for the years ended June 30, 2016 and 2015 follows:

| | 2016 | 2015 |
|------------------|-----------|----------|
| Contributions | \$ 11,140 | \$ 6,687 |
| Promises to give | 103,290 | 88,292 |

Expenditures:

Investment management fees and investments: As of June 30, 2016 and 2015, the Foundation owns partnership interests of \$1,475 and \$2,155 respectively, where a related party is a general partner. Management fees are outlined in individual partnership agreements and range from 1% to 2.5% of the annual capital commitments.

Program expenditures: The Foundation operates a program to acquire on behalf of, lease to, and/or grant real estate to the University. Included in University support are the net book values of properties granted to the University totaling none and \$789 for the years ended June 30, 2016 and 2015 respectively. In addition, program costs include maintenance and repair, utilities, insurance and taxes. Income received by the Foundation related to these operations is recorded in other income.

Note 12. Cash Flows Information

Supplemental information relative to the statement of cash flows for the years ended June 30, 2016 and 2015 is as follows:

| | 2016 | 2015 |
|-----------------------------------------------------------------------------------------------------------|-----------|-----------|
| Supplemental Disclosure of Cash Flow Information | | |
| Cash payments for interest | \$ 362 | \$ 262 |
| Non cash investing and financing activities: | | |
| Gifts of securities, life insurance, consulting services, and real and personal property at fair value | \$ 12,113 | \$ 14,669 |
| Promissory note issued on real estate | \$ 500 | \$ - |
| Real estate granted to the University | \$ - | \$ 789 |