NORTHERN KENTUCKY UNIVERSITY FOUNDATION

# NORTHERN KENTUCKY UNIVERSITY FOUNDATION
# CONSOLIDATED FINANCIAL STATEMENTS

*FOR THE YEAR ENDED JUNE 30, 2016*

NORTHERN KENTUCKY UNIVERSITY
FOUNDATION

November 17, 2016

Dear NKU Foundation Board Members and Friends:

Northern Kentucky University Foundation, Inc., continued to keep pace with Northern Kentucky University in 2016, as it has since its inception.

Gifts and bequests grew to $11.7 million in 2016 from $4.7 million in 2015, due primarily to St. Elizabeth Healthcare's pledge of $8 million toward the new Health Innovation Center, currently under construction and scheduled to be completed in 2018. Total assets were $109.4 million, up from $107.2 million in 2015.

While our results in 2016 included a loss of $2.4 million on our investments, the Foundation continues to use a disciplined investment approach, diversifying for the long term, and selecting professional managers that allow us to balance current spending with future needs. The endowment pool has consistently outperformed its benchmarks, been ranked competitively against peer endowments nationally, and has bested the NSCE average (NACUBO - Commonfund Study of Endowments) in 7 of the past 10 years.

In 2016 we also engaged a consultant to review and properly assess our ability to undertake a long-term fundraising campaign to further support the University's and Foundation's programs.

I invite you to review the following Consolidated Financial Statements to understand the Northern Kentucky University Foundation's financial activity for the years ended June 30, 2016 and 2015. Our statements were audited by BKD, LLP, whose report appears on page 4.

Thank you for your continued support of Northern Kentucky University, its faculty, students and initiatives through the Northern Kentucky University Foundation. As we approach our 50 year anniversary, we can take pride in our accomplishments while maintaining our focus on the future.

Yours truly,

Barry G. Kienzle

Barry G. Kienzle
President
Northern Kentucky University Foundation, Inc.

NORTHERN KENTUCKY UNIVERSITY
FOUNDATION

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# TABLE OF CONTENTS

BKD LLP
CPAs & Advisors

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## Independent Auditor's Report

Board of Directors
Northern Kentucky University Foundation, Inc.
Highland Heights, Kentucky

We have audited the accompanying consolidated financial statements of Northern Kentucky University Foundation, Inc., which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated 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 entity's preparation and fair presentation of the consolidated 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 entity'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northern Kentucky University Foundation, Inc. as of June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The board of directors listing, letter from the president, and executive committee/officers listing are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

Cincinnati, Ohio
September 19, 2016

# *Northern Kentucky University Foundation, Inc.*
# *Consolidated Statements of Financial Position*

***As of June 30, 2016 and 2015***
**(in thousands)**

| | 2016 | 2015 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 9,313 | $ 4,929 |
| Loans and accounts receivable, net | 90 | 228 |
| Accrued interest receivable | - | 9 |
| Contributions receivable, net | 8,391 | 2,347 |
| Prepaid expenses and deferred charges | 40 | 57 |
| Investments | 91,225 | 99,334 |
| Land and land improvements | 548 | 548 |
| Accumulated depreciation | (208) | (208) |
| **TOTAL ASSETS** | **$ 109,399** | **$ 107,244** |
| **LIABILITIES AND NET ASSETS** | | |
| Accounts payable | $ 188 | $ 361 |
| Annuities payable | 140 | 148 |
| Deferred income | 27 | 26 |
| Funds held in trust for Northern Kentucky University | 11,795 | 12,692 |
| **TOTAL LIABILITIES** | **12,150** | **13,227** |
| **NET ASSETS** | | |
| Unrestricted | | |
| For current operations | 953 | 892 |
| Amounts functioning as endowment funds | 2,158 | 2,244 |
| Invested in land and land improvements | 340 | 340 |
| Total unrestricted | 3,451 | 3,476 |
| Temporarily restricted | | |
| Unexpended funds received for restricted purposes | 9,535 | 7,867 |
| Contributions receivable | 7,355 | 2,042 |
| Loan funds | 216 | 173 |
| Endowment funds | 32,638 | 37,760 |
| Total temporarily restricted | 49,744 | 47,842 |
| Permanently restricted | | |
| Contributions receivable | 1,036 | 305 |
| Endowment funds | 43,018 | 42,394 |
| Total permanently restricted | 44,054 | 42,699 |
| **TOTAL NET ASSETS** | **97,249** | **94,017** |
| **TOTAL LIABILITIES AND NET ASSETS** | **$ 109,399** | **$ 107,244** |

**See accompanying notes to the consolidated financial statements**

# Consolidated Statement of Activities

*For the year ended June 30, 2016*
**(in thousands)**

| | Unrestricted Net Assets | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | Total |
|---|---|---|---|---|
| **REVENUES, GAINS AND OTHER SUPPORT** | | | | |
| Gifts and bequests | $ 3 | $ 10,298 | $ 1,375 | $ 11,676 |
| Rental income | 126 | | | 126 |
| Investment return | (42) | (2,393) | | (2,435) |
| Other revenue | 106 | 281 | | 387 |
| **Total revenues and gains** | **193** | **8,186** | **1,375** | **9,754** |
| **Net assets released from restrictions** | 6,135 | (6,135) | | - |
| **Total revenues, gains and other support** | **6,328** | **2,051** | **1,375** | **9,754** |
| | | | | |
| **EXPENSES AND LOSSES** | | | | |
| **Program expenses** | | | | |
| Instruction | 1,011 | | | 1,011 |
| Research | 24 | | | 24 |
| Public service | 475 | | | 475 |
| Libraries | 11 | | | 11 |
| Academic support | 598 | | | 598 |
| Student services | 514 | | | 514 |
| Institutional support | 821 | | | 821 |
| University facilities and equipment acquisition | 167 | | | 167 |
| Student financial aid | 2,011 | | | 2,011 |
| Other program expenses and losses | | 149 | 20 | 169 |
| **Total program expenses** | **5,632** | **149** | **20** | **5,801** |
| **Support expenses** | | | | |
| Management and general | 591 | | | 591 |
| Fund raising support | 129 | | | 129 |
| Rental property | 1 | | | 1 |
| **Total support expenses** | **721** | **-** | **-** | **721** |
| **TOTAL EXPENSES AND LOSSES** | **6,353** | **149** | **20** | **6,522** |
| **INCREASE (DECREASE) IN NET ASSETS** | **(25)** | **1,902** | **1,355** | **3,232** |
| **NET ASSETS - BEGINNING OF YEAR** | 3,476 | 47,842 | 42,699 | 94,017 |
| **NET ASSETS - END OF YEAR** | **$ 3,451** | **$ 49,744** | **$ 44,054** | **$ 97,249** |

**See accompanying notes to the consolidated financial statements**

# Northern Kentucky University Foundation, Inc.
## Consolidated Statement of Activities

*For the year ended June 30, 2015*
**(in thousands)**

| | Unrestricted Net Assets | Temporarily Restricted Net Assets | Permanently Restricted Net Assets | Total |
|---|---|---|---|---|
| **REVENUES, GAINS AND OTHER SUPPORT** | | | | |
| Gifts and bequests | $ 8 | $ 3,374 | $ 1,361 | $ 4,743 |
| Rental income | 119 | | | 119 |
| Investment return | 61 | 1,450 | | 1,511 |
| Other revenue | 62 | 286 | | 348 |
| **Total revenues and gains** | **250** | **5,110** | **1,361** | **6,721** |
| **Net assets released from restrictions** | 6,897 | (6,897) | | - |
| **Reclassifications of net assets** | | (28) | 28 | - |
| **Total revenues, gains and other support** | **7,147** | **(1,815)** | **1,389** | **6,721** |
| | | | | |
| **EXPENSES AND LOSSES** | | | | |
| **Program expenses** | | | | |
| Instruction | 1,089 | | | 1,089 |
| Research | 35 | | | 35 |
| Public service | 601 | | | 601 |
| Libraries | 28 | | | 28 |
| Academic support | 606 | | | 606 |
| Student services | 321 | | | 321 |
| Institutional support | 781 | | | 781 |
| University facilities and equipment acquisition | 44 | | | 44 |
| Student financial aid | 2,889 | | | 2,889 |
| Other program expenses and losses | | 135 | | 135 |
| **Total program expenses** | **6,394** | **135** | **-** | **6,529** |
| **Support expenses** | | | | |
| Management and general | 631 | | | 631 |
| Fund raising support | 92 | | | 92 |
| **Total support expenses** | **723** | **-** | **-** | **723** |
| **TOTAL EXPENSES AND LOSSES** | **7,117** | **135** | **-** | **7,252** |
| **INCREASE (DECREASE) IN NET ASSETS** | **30** | **(1,950)** | **1,389** | **(531)** |
| **NET ASSETS - BEGINNING OF YEAR** | 3,446 | 49,792 | 41,310 | 94,548 |
| **NET ASSETS - END OF YEAR** | **$ 3,476** | **$ 47,842** | **$ 42,699** | **$ 94,017** |

**See accompanying notes to the consolidated financial statements**

# *Consolidated Statements of Cash Flows*

*For the years ended June 30, 2016 and 2015*
**(in thousands)**

| | 2016 | 2015 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Interest and dividends received | $ 1,649 | $ 1,068 |
| Contributions received | 2,534 | 2,861 |
| Other receipts | 648 | 508 |
| Payments to vendors for goods and services | (2,220) | (1,916) |
| Subgrants to the University | (2,692) | (2,244) |
| Disbursements to students for financial aid | (2,011) | (2,911) |
| Interest paid | - | (35) |
| **Net cash provided by (used for) operating activities** | **(2,092)** | **(2,669)** |
| **Cash flows from investing activities:** | | |
| Proceeds from sales and maturities of investments | 19,297 | 17,313 |
| Purchases of investments | (15,565) | (17,331) |
| **Net cash provided by (used for) investing activities** | **3,732** | **(18)** |
| **Cash flows from financing activities:** | | |
| Endowment and other capital gifts | 2,783 | 2,220 |
| Reduction of notes payable | - | (822) |
| Payments to annuitants | (39) | (40) |
| **Net cash provided by (used for) financing activities** | **2,744** | **1,358** |
| **Net change in cash and cash equivalents** | 4,384 | (1,329) |
| **Cash and cash equivalents at beginning of year** | 4,929 | 6,258 |
| **Cash and cash equivalents at end of year** | **$ 9,313** | **$ 4,929** |
| **Reconciliation of change in net assets to net cash provided by (used for) operating activities:** | | |
| **Change in net assets** | **$ 3,232** | **$ (531)** |
| Bad debt expense adjustment | 4 | 2 |
| Provision for uncollectible pledges | 24 | 54 |
| Adjustment of annuities payable | 31 | 32 |
| Adjustment of life estate remainder interest | (49) | (7) |
| Contributions restricted for long-term investment | (2,783) | (2,220) |
| Net losses (gains) on investments | 3,862 | (437) |
| Endowment return attributable to NKU | (184) | - |
| Contribution of real estate | (138) | - |
| **Changes in assets and liabilities:** | | |
| Accounts receivable | 134 | (111) |
| Interest receivable | 9 | (6) |
| Contributions receivable | (6,068) | 423 |
| Prepaid expenses and deferred charges | 17 | (7) |
| Accounts payable | (173) | 184 |
| Accrued interest payable | - | (32) |
| Deferred revenue | 1 | - |
| Cash surrender value of life insurance | (11) | (13) |
| **Net cash provided by (used for) operating activities** | **$ (2,092)** | **$ (2,669)** |

**See accompanying notes to the consolidated financial statements**

# *Notes to Consolidated Financial Statements*

## *June 30, 2016 and 2015*

## NOTE A – HISTORY AND PURPOSE

**Northern Kentucky University Foundation, Inc.**

Northern Kentucky University Foundation, Inc. (the Foundation) was incorporated November 23, 1970, as a Kentucky non-stock, not-for-profit corporation. The purpose of the foundation, as stated by the articles of incorporation, is to provide general and specific services and material things necessary or desirable for the growth and development of Northern Kentucky University (the University), and encompasses prospective students, students, alumni, faculty, and staff, as well as research and civic services and cooperative educational programs. Any and all things and acts in and incidental to the conduct of such activities deemed useful, necessary, proper and lawful, are also declared purposes.

Kentucky Revised Statutes define affiliation status for corporations supporting public education institutions. The Foundation is an unaffiliated corporation as defined by the statutes.

The Internal Revenue Service has determined that the Foundation is a tax-exempt organization under Section 501(c)(3) of the code and has determined that it is not a private foundation within Section 509(a) of the code. Contributions, bequests, legacies, devices, transfers and gifts made to the Foundation are deductible by donors, as provided in Section 170 of the code.

**Scope of Statements**

The consolidated financial statements of the Foundation include the operations of the Foundation as well as the following single member limited liability companies: NKUF Properties 1, LLC, NKUF Properties 2, LLC, NKUF Properties 3, LLC, NKUF Properties 4, LLC, NKUF Properties 5, LLC, NKUF Properties 6, LLC, and NKUF Properties 7, LLC. These entities hold title to real estate and other assets formerly held by the Foundation. All material intercompany transactions and balances have been eliminated.

## NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Foundation in preparation of its consolidated financial statements.

These statements are presented on the accrual basis of accounting, and have been prepared to focus on the Foundation as a whole and to present transactions according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of balances and transactions into three classes of net assets - permanently restricted, temporarily restricted and unrestricted net assets.

Net assets and changes therein are classified as follows:

> *Permanently restricted net assets* - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Foundation. Generally, the donors of these assets permit the Foundation to use the returns on the related investments over time for general or specific purposes.
>
> *Temporarily restricted net assets* - Net assets subject to donor-imposed stipulations that may or will be met by actions of the Foundation and/or the passage of time. Temporarily restricted net assets are generally established in support of colleges or departments of the University, often for specific purposes such as faculty support, scholarships and fellowships, library acquisitions, equipment or building projects and other specific purposes.
>
> *Unrestricted net assets* - Net assets not subject to donor-imposed stipulations.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Restricted contributions and net investment returns earned are reported as temporarily restricted support and reclassified as unrestricted when any donor-imposed restrictions are satisfied. Expirations of temporary restrictions on net assets are met when a donor stipulated time restriction ends or purpose restriction is accomplished and reclassified to unrestricted net assets and reported in the consolidated statement of activities as net assets released from restriction.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions receivable are discounted at an appropriate rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions on the contributions. An allowance for uncollectible contributions receivable is provided based upon management's judgment of such factors as prior collection history, type of contribution and nature of the fund-raising activity.

Income and realized net gains on long-term investments are reported as follows:

- As increases in permanently restricted net assets – if the terms of the gift require that they be added to the principal of a permanent endowment fund.

- As increases in temporarily restricted net assets – if the terms of the gift impose restrictions on the use of the income.

- As increases in unrestricted net assets – in all other cases.

**Cash and Cash Equivalents**

Cash and cash equivalents includes all readily available sources of cash such as petty cash, demand deposits and temporary investments in marketable securities with maturities of less than three months. Cash and cash equivalents representing investments purchased with endowment net assets are reported as investments.

At various times throughout the year, the Foundation has cash in certain financial institutions in excess of insured limits. Additionally, at June 30, 2016 and 2015, $696,000 and $277,000, respectively, was collateralized with securities held by the financial institution's trust department or agent, but not in the Foundation's name. At June 30, 2016 and 2015, balances of $7,618,000 and $3,621,000, respectively, were neither insured nor collateralized.

**Loans and Accounts Receivable**

Loans receivable consists primarily of loans made to students under privately funded loan programs. The advances are evidenced by signed promissory notes, bearing interest at varying stated interest rates, with varying due dates. Loans, accounts and other receivables are stated at the amount management expects to collect from outstanding balances. Management provides for a probable uncollectible allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. The allowance for doubtful accounts as of June 30, 2016 and 2015 was approximately $127,000 and $124,000, respectively.

**Investments**

Investments in equity securities with readily determinable fair values and all debt securities are reported at their fair value. The estimated fair value of investments is based on quoted market prices, except for investments for which quoted market prices are not available. The alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers. The estimated fair value of certain alternative investments, such as private equity interests, is based on valuations provided by the external investment managers adjusted for cash receipts, cash disbursements and distributions. The Foundation believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

The Foundation invests its endowment investment portfolio and allocates the related earnings for expenditure in accordance with the total return concept. A distribution of endowment return that is independent of the cash yield and appreciation (depreciation) of investments earned during the year is provided for program support.

The Foundation has significant exposure to a number of risks including interest rate, market and credit risks for both marketable and non-marketable securities. Due to the level of risk exposure, it is possible that near-term valuation changes for investment securities may occur to an extent that could materially affect the amounts reported in the Foundation's consolidated financial statements.

All true endowment investments and long-term net assets functioning as endowments are managed in a pool, unless special considerations or donor stipulations require that they be held separately.

**Land and Land Improvements**

At June 30, 2016 and 2015, land and land improvements (in thousands) consisted of:

| | 2016 | 2015 |
|---|---|---|
| **Type of asset:** | | |
| Land | $ 178 | $ 178 |
| Land held for future use by the University | 162 | 162 |
| Land improvements | 208 | 208 |
| **Total land and land improvements** | **$ 548** | **$ 548** |

Assets acquired for Foundation use with a useful life greater than one year and a value of $5,000 or more are capitalized. Annual depreciation for land improvements is calculated on a straight-line basis, beginning in the month of acquisition based on a useful life of 30 years. At June 30, 2016 and 2015 all land improvements were fully depreciated.

Assets purchased or constructed through the Foundation for immediate use by the University are recorded by the Foundation as a program expense.

**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 actual transfer date.

**Reclassifications**

Certain items have been reclassified for the year ended June 30, 2015 in order to conform to classifications used for the year ended June 30, 2016. These reclassifications had no effect on total net assets or the change in net assets.

## NOTE C – PROPERTY LEASES

At June 30, 2016, the Foundation owned properties subject to lease agreements with unrelated parties, as follows:

One property is subject to a lease covering approximately 23 acres of Foundation land. The lease is for 48 years ending on July 31, 2040, with four additional lease option terms of ten years each. All lease payments were current as of June 30, 2016 and 2015. As a condition of the lease, the Foundation has executed fee title mortgages to institutional lenders which subordinates its title in the real estate leased as security for construction financing of permanent improvements thereon. Any improvements constructed on the leased property of the Foundation shall become the property of the Foundation only upon termination of the lease or termination of the last such renewal term as may be exercised.

A second property is subject to a property lease and easements covering approximately .2 (two tenths) acre of Foundation land. The initial lease term was 5 years, beginning January 1, 1997, with nine additional 5-year automatic renewals at the option of the lessee. All lease payments were current as of June 30, 2015 and 2016.

The following is a schedule by years of the future rentals receivable (in thousands) on property leases as of June 30, 2016:

| Year ending June 30 | |
|---|---|
| 2017 | $ 122 |
| 2018 | 115 |
| 2019 | 115 |
| 2020 | 115 |
| 2021 | 125 |
| 2022 and thereafter | 2,815 |
| **Total future rentals** | **$ 3,407** |

## NOTE D – UNCONDITIONAL AND CONDITIONAL PROMISES TO GIVE

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts are computed using a risk free interest rate and amortization of the discount is included in gifts and bequests revenue.

At June 30, 2016 and 2015, the Foundation recognized contributions based on the following unconditional promises to give (in thousands):

| | 2016 | 2015 |
|---|---|---|
| **Purpose:** | | |
| Endowment giving | $ 1,094 | $ 317 |
| Capital purposes | 6,025 | 155 |
| Operating programs | 1,679 | 2,045 |
| **Gross unconditional promises** | **8,798** | **2,517** |
| Less: Discount and allowance for uncollectible accounts | (407) | (170) |
| **Net unconditional promises to give** | **$ 8,391** | **$ 2,347** |
| **Amounts due in:** | | |
| Less than one year | 3,097 | 1,069 |
| One to five years | 5,601 | 1,248 |
| More than five years | 100 | 200 |
| **Total** | **$ 8,798** | **$ 2,517** |

The discount rates used to calculate the present value of contributions receivable at June 30, 2016 and 2015 vary from 1.2% to 2.2%, depending on when the promise was made.

Conditional promises to give are not included as support until such time as the conditions are substantially met. At June 30, 2016 and 2015, the Foundation had received conditional promises to give of approximately $1.1 million, consisting of the face value of life insurance policies, net of accumulated cash surrender value.

Approximately 69% of all contributions were received from one donor in fiscal year 2016. In addition, 69% of total pledges receivable were due from one donor at June 30, 2016.

## NOTE E – FAIR VALUE MEASUREMENTS

The three levels of the fair value hierarchy under generally accepted accounting principles are described as follows:

**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 for identical or similar assets or liabilities in inactive markets;
- Other inputs that are observable for the asset or liability;
- Other inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

**Level 3** – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value:

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 investments include short term money market funds, cash surrender value, fixed income funds and equity funds.

Level 2 investments are based on quoted prices of securities or other property with similar characteristics and include hedge funds of funds, low volatility, fixed income and a remainder interest in real property subject to a life estate.

Level 3 investments include those in which there is no active market, such as private equity, private debt, natural resources, private real estate and low volatility alternative investments. For such investments, the fair values are based on valuations determined by the investment managers using Net Asset Values (NAV) as of their most recent statements, adjusted for cash receipts and cash disbursements through June 30.

Level 3 investments also include those for which the determination of fair value requires significant management judgment or estimation. Pursuant to GAAP, management has considered redemption restrictions to assess classification of fair value inputs. Accordingly, the Foundation has classified alternative investments that are redeemable in greater than 90 days or that are considered an illiquid asset, as Level 3 investments.

There have been no changes in the methodologies used at June 30, 2016.

**Level 3 Valuation Process**

Fair value determinations for Level 3 measurements of securities are the responsibility of the Comptroller's office. The Comptroller's office contracts with a pricing specialist to generate fair value estimates on a monthly or quarterly basis. The Comptroller's office challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States.

The following assets were measured at fair value on a recurring basis as of June 30, 2016 and 2015 (in thousands):

| | 2016 | 2015 |
|---|---|---|
| **Type of Investment:** | | |
| Short-term money market funds | $ 7 | $ 7 |
| Cash surrender value | 381 | 370 |
| Fixed income funds: | | |
| Core | 1,554 | 1,489 |
| Core Plus | 4,184 | 5,163 |
| Global | 1,852 | 2,153 |
| Treasury Inflation Protected Securities | 1,572 | 1,503 |
| Equity funds: | | |
| Large/Mid Cap – Broad | 19,697 | 14,280 |
| Large/Mid Cap – Growth | - | 4,655 |
| Large/Mid Cap – Value | 5,580 | 10,298 |
| Small Cap – Growth | 1,312 | 1,411 |
| Small Cap – Value | 1,556 | 1,675 |
| International – Core | 6,251 | 8,492 |
| International - Value | 2,964 | - |
| International Small Cap – Value | 2,198 | 2,423 |
| Emerging Markets – Value | 3,553 | 4,026 |
| Emerging Markets – Small Cap | 3,476 | 3,684 |
| Real Estate Investment Trust | 15 | 12 |
| Exchange Traded Funds | 39 | 32 |
| **Quoted Prices in Active Market for Identical Assets (Level 1)** | **$ 56,191** | **$ 61,673** |

| | | |
|---|---|---|
| Hedge funds: | | |
| Public Natural Resources-Master Limited Partnerships | 3,059 | 2,605 |
| Fixed Income High Yield | 1,611 | 2,133 |
| Low-Volatility Diversifying Strategies | - | 2,749 |
| Remainder interest in real property and other | 535 | 348 |
| **Significant Other Observable Inputs: (Level 2)** | **$ 5,205** | **$ 7,835** |
| Private equity: | | |
| Buyout | 1,699 | 1,749 |
| Diversified | 2,015 | 1,987 |
| Venture Capital | 972 | 868 |
| Secondary | 2,079 | 1,966 |
| Private Debt: | | |
| Distressed | 1,776 | 1,453 |
| Mezzanine | 192 | 360 |
| Natural resources: | | |
| Diversified | 3,965 | 3,819 |
| Energy | 3,836 | 2,972 |
| Commodities | 1,790 | 751 |
| Private real estate: | | |
| Value Added | 1,375 | 1,754 |
| Low-Volatility: | | |
| Diversifying Strategies | 10,037 | 9,143 |
| **Significant Unobservable Inputs: (Level 3)** | **$ 29,736** | **$ 26,822** |

The tables below present information about the changes in the fair value of assets based on significant unobservable inputs (Level 3) (in thousands):

| **Investments:** | **Private Equity/Debt** | **Natural Resources** | **Private Real Estate** | **Low-Volatility** |
|---|---|---|---|---|
| **Beginning Balance, July 1, 2014** | **$ 7,038** | **$ 7,160** | **$ 1,980** | **$ 10,100** |
| Additional investments | 2,603 | 1,711 | 255 | 4,000 |
| Capital distributions | (1,775) | (916) | (646) | (5,330) |
| Fees | (78) | (86) | (18) | (61) |
| Realized gains (losses) | 187 | 309 | 259 | - |
| Unrealized gains (losses) | 408 | (636) | (76) | 434 |
| **Balance, June 30, 2015** | **$ 8,383** | **$ 7,542** | **$ 1,754** | **$ 9,143** |
| Additional investments | 1,615 | 2,844 | 26 | 1,800 |
| Capital distributions | (1,670) | (496) | (514) | (20) |
| Dividends | 59 | 46 | 29 | - |
| Fees | (102) | (158) | (26) | (72) |
| Realized gains (losses) | 210 | 44 | 189 | (232) |
| Unrealized gains (losses) | 238 | (231) | (83) | (582) |
| **Balance, June 30, 2016** | **$ 8,733** | **$ 9,591** | **$ 1,375** | **$ 10,037** |

## NOTE F – INVESTMENTS

The market values (in thousands) of the Foundation's investments as of June 30, 2016 and 2015 are categorized by type below:

| | 2016 | 2015 |
|---|---|---|
| **Type of Investment:** | | |
| Short-term money market funds | $ 7 | $ 7 |
| Cash and cash surrender value | 474 | 522 |
| Certificates of deposit | - | 2,852 |
| Fixed income funds: | | |
| Core | 1,554 | 1,489 |
| Core Plus | 4,184 | 5,163 |
| Global | 1,852 | 2,153 |
| High Yield | 1,611 | 2,133 |
| Treasury Inflation Protected Securities | 1,572 | 1,503 |
| Equity funds: | | |
| Large/Mid Cap - Broad | 19,697 | 14,280 |
| Large/Mid Cap - Growth | - | 4,655 |
| Large/Mid Cap - Value | 5,580 | 10,298 |
| Small Cap - Growth | 1,312 | 1,411 |
| Small Cap - Value | 1,556 | 1,675 |
| International - Core | 6,251 | 8,492 |
| International - Value | 2,964 | - |
| International Small Cap - Value | 2,198 | 2,423 |
| Emerging Markets - Value | 3,553 | 4,026 |
| Emerging Markets - Small Cap | 3,476 | 3,684 |
| Real Estate Investment Trust | 15 | 12 |
| Exchange Traded Funds | 39 | 32 |
| Hedge funds: | | |
| Public Natural Resources - Master Limited Partnerships | 3,059 | 2,605 |
| Remainder interest in real property and other | 535 | 348 |
| Private equity: | | |
| Buyout | 1,699 | 1,749 |
| Diversified | 2,015 | 1,987 |
| Venture Capital | 972 | 868 |
| Secondary | 2,079 | 1,966 |
| Private debt: | | |
| Distressed | 1,776 | 1,453 |
| Mezzanine | 192 | 360 |
| Natural Resources: | | |
| Diversified | 3,965 | 3,819 |
| Energy | 3,836 | 2,972 |
| Commodities | 1,790 | 751 |
| Private real estate: | | |
| Value Added | 1,375 | 1,754 |
| Low-Volatility: | | |
| Diversifying Strategies | 10,037 | 11,892 |
| **Total Investments** | **$ 91,225** | **$ 99,334** |

Investment return (in thousands) for the years ended June 30, 2016 and 2015 consists of:

| | 2016 | 2015 |
|---|---|---|
| Interest and dividend income (net of investment fees: 2016 - $470, 2015 - $451) | $ 1,427 | $ 1,074 |
| Net realized gains (losses) | 2,968 | 1,434 |
| Net unrealized gains (losses) | (6,830) | (997) |
| | **$ (2,435)** | **$ 1,511** |

The Foundation records the cost of managing its endowment portfolio as a decrease in investment income within the appropriate net asset class in the consolidated statement of activities. Some of the Foundation's investment managers report investment transactions net of fees. The fees noted above are only those fees separately stated by the managers.

The investments of the Foundation are commingled with certain investments which the Foundation holds in trust for the University. The market value of funds held in trust for the University at June 30, 2016 and 2015 was approximately $11,795,000 and $12,692,000 respectively. (See Note I)

At June 30, 2016 and 2015, the Foundation had committed approximately $35.9 and $34.4 million, respectively, of its endowment investment resources to alternative investments, of which approximately $8.2 and $10.4 million, respectively, had not yet been called by the investment managers. Alternative investments for which commitments have been made consist of private equity/debt, natural resources, private real estate and low-volatility.

Alternative investments of the Foundation have limited marketability and the related investment agreements generally contain restrictive redemption provisions to the extent that the underlying investments should be considered illiquid for the duration of the investment through normal maturity. Early redemption of such investments would likely result in recovery of significantly less than the original investment amount. Foundation management believes the investment portfolio contains sufficient liquidity among other asset classes to make early redemption of alternative investments unlikely for reasons of meeting current spending needs.

## NOTE G – ENDOWMENTS

The Foundation's endowment consists of 293 individual funds established for a variety of purposes. Its endowment includes both donor-restricted funds and funds designated by the Board of Directors to function as endowments (quasi-endowments). Net assets associated with endowment funds, including quasi-endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The board, at their discretion, can at any time permit spending from the principal of any quasi-endowed fund, provided the expenditure complies with any donor-imposed restrictions related to the fund.

Kentucky enacted the Kentucky Uniform Prudent Management of Institutional Funds Act (KUPMIFA), the provisions of which apply to endowment funds existing on or established after enactment, with an effective date of July 15, 2010.

An interpretation of KUPMIFA provisions by the Foundation Board of Directors requires that the historical dollar amount of a donor-restricted endowment fund be preserved. As a result of this requirement, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment. In the absence of donor restrictions, the net appreciation on a donor-restricted endowment fund is spendable. The net appreciation of donor-restricted endowment funds is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation.

Under KUPMIFA, the Foundation endowment spending policy allows for prudent spending of future endowment earnings for accounts without accumulated earnings based upon consideration of the following factors, if applicable:

Duration and preservation of the endowment fund
Purpose of the institution and the endowment fund
General economic conditions
Possible effect of inflation or deflation
Expected total return on investments
Other resources of the institution
Investment policy

The approved annual endowment spending rate is reduced by a proportion of 5% for each 1% the affected endowment is below the value of original and subsequent gifts to the permanent endowment (i.e. principal).

*Return Objectives and Risk Parameters.* The Foundation has adopted investment and spending policies, approved by the Board of Directors, for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of these endowment assets over the long-term. The Foundation's spending and investment policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes. The current long-term return objective is to return a rate equal to the Consumer Price Index +5%, net of investment fees. Actual returns in any given year may vary from this amount.

*Strategies Employed for Achieving Objectives.* To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that includes fixed income investments as well as publicly traded equity-based investments and various alternative investment strategies to achieve its long-term return objectives within prudent risk parameters.

*Spending Policy and How the Objectives Relate to Spending Policy.* The spending policy calculates the amount of money annually distributed from the Foundation's various endowed funds, for grant making and administration. The current spending policy is to distribute an amount at least equal to 3-5% of a moving sixteen quarter average of the fair value of the endowment funds. Accordingly, over the long term, the Foundation expects its current spending policy to allow the Foundation to meet its objective to maintain the historical dollar amount of endowment assets as well as to provide additional real growth through investment return.

Endowment net asset composition by type of endowment (in thousands) as of June 30, 2016 is as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total Net Endowment Assets |
|---|---|---|---|---|
| Donor restricted endowment funds | $ - | $ 26,575 | $ 43,018 | $ 69,593 |
| Quasi-endowment funds | 2,158 | 6,063 | - | $ 8,221 |
| Total endowment funds | **$ 2,158** | **$ 32,638** | **$ 43,018** | **$ 77,814** |

Changes in endowment net assets (in thousands) for the year ended June 30, 2016 are as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total Net Endowment Assets |
|---|---|---|---|---|
| Endowment net assets, beginning of year | $ 2,244 | $ 37,760 | $ 42,394 | $ 82,398 |
| Contributions collected | - | 28 | 624 | 652 |
| Investment income | 38 | 1,345 | - | 1,383 |
| Net investment gain (loss) | (106) | (3,787) | - | (3,893) |
| Amounts appropriated for expenditure | (18) | (2,708) | - | (2,726) |
| Endowment net assets, end of year | **$ 2,158** | **$ 32,638** | **$ 43,018** | **$ 77,814** |

Endowment net asset composition by type of endowment (in thousands) as of June 30, 2015 is as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total Net Endowment Assets |
|---|---|---|---|---|
| Donor restricted endowment funds | $ - | $ 31,795 | $ 42,394 | $ 74,189 |
| Quasi-endowment funds | 2,244 | 5,965 | - | 8,209 |
| Total endowment funds | **$ 2,244** | **$ 37,760** | **$ 42,394** | **$ 82,398** |

Changes in endowment net assets (in thousands) for the year ended June 30, 2015 are as follows:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total Net Endowment Assets |
|---|---|---|---|---|
| Endowment net assets, beginning of year | $ 2,212 | $ 38,905 | $ 41,105 | $ 82,222 |
| Contributions collected | - | 20 | 1,261 | 1,281 |
| Investment income | 30 | 1,081 | - | 1,111 |
| Net investment gain (loss) | 10 | 371 | - | 381 |
| Amounts appropriated for expenditure | (8) | (2,617) | - | (2,625) |
| Transfer to permanently restricted | - | - | 28 | 28 |
| Endowment net assets, end of year | **$ 2,244** | **$ 37,760** | **$ 42,394** | **$ 82,398** |

*Funds with Deficiencies.* From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or KUPMIFA requires the Foundation to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were approximately $33,000 at June 30, 2016. The deficiencies resulted from unfavorable market conditions that occurred after the investment of permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Directors. There were no such deficiencies at June 30, 2015.

## NOTE H - CONTINGENT LIABILITIES

Legal counsel for the Foundation have advised that they know of no pending or threatened litigation, claims or assessments involving the Foundation that could have a material adverse financial effect on the Foundation.

## NOTE I – REGIONAL UNIVERSITY EXCELLENCE TRUST FUND

The Foundation holds certain funds, consisting of endowment matching funds received by the University from the Commonwealth of Kentucky's Regional University Excellence Trust Fund, which were subsequently transferred to the Foundation for management and investment.

The Foundation reports these funds and accumulated earnings as assets held in trust for the University. Investment earnings, gains and losses and expenditures from these funds are reported as changes in the balance held in trust rather than as revenue and expenses of the Foundation. (See Note F)

## NOTE J – SUBSEQUENT EVENTS

Events occurring after June 30, 2016 have been evaluated for possible adjustment to the financial statements or disclosure through September 19, 2016, the date on which the consolidated financial statements were available to be issued.

## NOTE K – RELATED PARTY TRANSACTIONS

During the years ended June 30, 2016 and 2015, the Foundation made payments on behalf of the University of $434,000 and $496,000, respectively, for salaries, benefits, and other administrative costs for University staff that directly support the Foundation's operations. These payments are made by agreement between the Foundation and University. As of June 30, 2016 and 2015, there were no amounts owed to the University for such costs.

In support of University programs for the years ended June 30, 2016 and 2015, the Foundation made payments on behalf of the University of $3,908,000 and $5,045,000, respectively. In addition, the Foundation transferred to the University $1,893,000 in 2016 and $1,622,000 in 2015 for restricted purposes.

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