

***The Rotary  
Foundation of  
Rotary International***

*Financial Statements as of and for the  
Years Ended 30 June 2005 and 2004, and  
Independent Auditors' Report*

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## TABLE OF CONTENTS

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	<b>Page</b>
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED 30 JUNE 2005 AND 2004:	
Statements of Financial Position	2
Statements of Activities	3
Statements of Cash Flows	4
Notes to Financial Statements	5-9

## INDEPENDENT AUDITORS' REPORT

To the Trustees of  
The Rotary Foundation of Rotary International:

We have audited the accompanying statements of financial position of The Rotary Foundation of Rotary International ("The Rotary Foundation") as of 30 June 2005 and 2004, and the related statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of The Rotary Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of The Rotary Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of The Rotary Foundation as of 30 June 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

16 September 2005

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF FINANCIAL POSITION

AS OF 30 JUNE 2005 AND 2004

(Thousands of dollars)

<b>ASSETS</b>	<b>2005</b>	<b>2004</b>
CASH	\$ 31,050	\$ 32,458
PLEDGES RECEIVABLE—Net	1,268	2,705
DEFERRED CHARGES, PREPAID EXPENSES, AND OTHER ASSETS	2,995	2,885
DUE FROM ROTARY INTERNATIONAL	-	967
INVESTMENTS:		
Cash and short-term investments	21,896	27,585
Bonds	166,175	160,023
Stocks	400,048	351,399
Real estate	<u>30,125</u>	<u>25,207</u>
Total investments	<u>618,244</u>	<u>564,214</u>
DONOR ADVISED FUNDS	2,507	1,779
SPLIT-INTEREST AGREEMENTS	<u>18,614</u>	<u>15,272</u>
<b>TOTAL</b>	<b><u>\$ 674,678</u></b>	<b><u>\$ 620,280</u></b>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Accrued program awards	\$ 47,371	\$ 33,057
Accounts payable and accrued expenses	12,412	9,312
Split-interest agreements payable	7,093	5,464
Donor advised funds payable	2,507	1,779
Due to Rotary International	<u>2,436</u>	<u>          </u>
Total liabilities	<u>71,819</u>	<u>49,612</u>
NET ASSETS:		
Unrestricted:		
Undesignated	373,558	348,381
Trustee-designated:		
PolioPlus	33,319	35,041
Permanent Fund	<u>42,312</u>	<u>35,772</u>
Total unrestricted net assets	449,189	419,194
Temporarily restricted	38,196	45,885
Permanently restricted	<u>115,474</u>	<u>105,589</u>
Total net assets	<u>602,859</u>	<u>570,668</u>
<b>TOTAL</b>	<b><u>\$ 674,678</u></b>	<b><u>\$ 620,280</u></b>

See notes to financial statements.

**THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL**

**STATEMENTS OF ACTIVITIES  
FOR THE YEARS ENDED 30 JUNE 2005 AND 2004  
(Thousands of dollars)**

	2004–2005				2003–2004			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:								
Contributions	\$ 84,538	\$ 23,483	\$ 9,885	\$ 117,906	\$ 70,406	\$ 26,314	\$ 9,250	\$ 105,970
Net investment return	42,747			42,747	73,642			73,642
Net assets released from restrictions	31,172	(31,172)			21,209	(21,209)		
Total revenues	<u>158,457</u>	<u>(7,689)</u>	<u>9,885</u>	<u>160,653</u>	<u>165,257</u>	<u>5,105</u>	<u>9,250</u>	<u>179,612</u>
EXPENSES:								
Program awards and expenses:								
Educational programs	27,889			27,889	27,878			27,878
Humanitarian programs	46,096			46,096	27,167			27,167
PolioPlus program	36,195			36,195	31,635			31,635
Total program awards and expenses	110,180			110,180	86,680			86,680
Development expenses	12,255			12,255	11,568			11,568
General administration	5,680			5,680	4,940			4,940
Total expenses	<u>128,115</u>	<u>-</u>	<u>-</u>	<u>128,115</u>	<u>103,188</u>	<u>-</u>	<u>-</u>	<u>103,188</u>
CHANGE IN NET ASSETS BEFORE MINIMUM PENSION LIABILITY (ADJUSTMENT) RECOVERY	30,342	(7,689)	9,885	32,538	62,069	5,105	9,250	76,424
MINIMUM PENSION LIABILITY (ADJUSTMENT) RECOVERY	(347)			(347)	659			659
CHANGE IN NET ASSETS	29,995	(7,689)	9,885	32,191	62,728	5,105	9,250	77,083
NET ASSETS—Beginning of year	419,194	45,885	105,589	570,668	356,466	40,780	96,339	493,585
NET ASSETS—End of year	<u>\$ 449,189</u>	<u>\$ 38,196</u>	<u>\$ 115,474</u>	<u>\$ 602,859</u>	<u>\$ 419,194</u>	<u>\$ 45,885</u>	<u>\$ 105,589</u>	<u>\$ 570,668</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2005 AND 2004 (Thousands of dollars)

	2004–2005	2003–2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 32,191	\$ 77,083
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Realized gain on sale of investments	(14,096)	(1,701)
Unrealized gain on investments	(16,445)	(62,421)
Contributed securities	(3,724)	(2,131)
Changes in assets and liabilities:		
Pledges receivable—net	1,437	1,136
Deferred charges, prepaid expenses, and other assets	(110)	(938)
Accrued program awards	14,314	(20,668)
Accounts payable and accrued expenses	3,100	(1,348)
Split-interest agreements payable	1,629	140
Due to/from Rotary International	<u>3,403</u>	<u>2,457</u>
Net cash flows from operating activities	<u>21,699</u>	<u>(8,391)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(1,002,128)	(770,232)
Proceeds from sale of investments	973,332	750,070
Change in investment cash and short-term investments	<u>5,689</u>	<u>25,122</u>
Net cash flows from investing activities	<u>(23,107)</u>	<u>4,960</u>
DECREASE IN CASH	(1,408)	(3,431)
CASH—Beginning of year	<u>32,458</u>	<u>35,889</u>
CASH—End of year	<u>\$ 31,050</u>	<u>\$ 32,458</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED 30 JUNE 2005 AND 2004

(Thousands of dollars)

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### 1. NATURE OF OPERATIONS

The Rotary Foundation of Rotary International (“The Rotary Foundation” or the “Foundation”) is a corporation organized under the Illinois Not-for-Profit Corporation Act. The Rotary Foundation supports the efforts of Rotary International to achieve world understanding and peace through international humanitarian, educational, and cultural exchange programs. The Rotary Foundation’s fiscal operations include educational, cultural exchange, and humanitarian programs; fund development and donor services; and investment of funds. Operating revenue is derived primarily from donor contributions and investment income.

### 2. SIGNIFICANT ACCOUNTING POLICIES

*Use of Estimates*—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Net Assets*—The Rotary Foundation classifies resources into three classes of net assets as follows:

- *Unrestricted*—Net assets which are free of donor-imposed restrictions; all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets. The Annual Programs Fund, which receives revenue primarily from voluntary contributions from Rotary districts, clubs, Rotarians, and others, as well as certain accumulated earnings as described in Note 10, have been classified as unrestricted net assets.
- *Temporarily Restricted*—Net assets whose use by the Foundation is limited by donor-imposed restrictions that either expire by the passage of time or can be removed by fulfillment of the stipulated purpose for which the donation was restricted. Revenues received from voluntary contributions which are restricted to the PolioPlus Program and Solidarity in South Asia (tsunami relief) are classified as temporarily restricted. Noncurrent pledges are classified as temporarily restricted.
- *Permanently Restricted*—Net assets donated with stipulations that they be invested to provide a permanent source of income (e.g., endowment funds); such restrictions can neither expire with the passage of time nor be removed by fulfillment of a stipulated purpose. The Permanent Fund has been classified as permanently restricted. This fund is the recipient of contributions which specify that only the earnings of the fund may be spent in support of the programs of The Rotary Foundation.

**Associate Foundations**—The Rotary Foundation has established associate foundations in Australia, Brazil, Canada, Germany, India, Japan, and the United Kingdom. The associate foundations provide local Rotarians and other donors with tax benefits under the laws in each country. The associate foundations accept contributions and make program disbursements on behalf of The Rotary Foundation. The financial activities conducted by the associate foundations on behalf of The Rotary Foundation are included in the statements of financial position and the related statements of activities and of cash flows.

**Cash**—Cash includes \$3,388 and \$2,882 at 30 June 2005 and 2004, respectively, subject to certain withdrawal restrictions imposed by local governments.

**Pledges Receivable**—The Foundation receives multiyear pledges. The accompanying financial statements reflect multiyear pledges (ranging from one to six years) discounted by the Foundation's expected long-term rate of return for the applicable number of years. Management makes assumptions regarding the outstanding pledges and ultimate collectibility of these receivables (Note 3).

**Due to/from Rotary International**—Rotary International and The Rotary Foundation handle certain fiscal matters on behalf of each other, including transfers of funds within countries, payment of general and administrative expenses, and payment of employee salaries and benefits. The balances resulting from these transactions are settled on a periodic basis.

**Investments**—Investments are carried at fair value based on quoted market prices (Note 4).

**Financial Instruments**—The Foundation, from time to time, enters into futures, option, forward, swap, and foreign exchange options and forward contracts. All financial instruments are recorded at fair value with gains and losses resulting from changes in fair value recognized in net assets in the period of change.

**Accrued Program Awards**—The Rotary Foundation records the full amount of program awards upon specific designation of award recipients. Awards designated but not yet paid are included in accrued program expenses in the accompanying statements of financial position.

**Revenue Recognition**—Contributions and unconditional pledges are recognized as revenue in the period received and recorded at estimated fair value. Conditional promises received are recognized when they become unconditional.

**Donated Materials**—The value of donated materials is not recorded in the financial statements because The Rotary Foundation acts only as an agent for the donors in distribution of the goods.

**Tax Status**—The Rotary Foundation is a qualified not-for-profit organization exempt from income tax under Section 501(c)(3) of the Internal Revenue Code, but is subject to U.S. tax on any unrelated business income. There was no such taxable income in 2005 or 2004.

**Translation of Currency Other Than the U.S. Dollar**—The U.S. dollar is the functional currency for The Rotary Foundation. The Foundation has operations in countries other than the U.S. Translation gains or losses are reflected in the change in net assets.

**Risks and Uncertainties**—The Rotary Foundation has investments in cash equivalents, debt, and equity securities. Investment securities are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the amounts reported in the statement of financial position and the statement of activities.

### 3. PLEDGES RECEIVABLE

Pledges receivable are recorded after discounting to the present value of the expected future cash flows. Aging and valuation at 30 June is as follows:

	2004–2005	2003–2004
Due within one year	\$ 1,048	\$ 2,298
Due within one to five years	495	751
Due after five years	<u>10</u>	<u>20</u>
	1,553	3,069
Present value discount	(232)	(255)
Allowance for uncollectible pledges	<u>(53)</u>	<u>(109)</u>
Pledges receivable	<u>\$ 1,268</u>	<u>\$ 2,705</u>
Present value discount rates	1.2%–8.7%	1.2%–8.7%

### 4. INVESTMENTS

Investments in bonds include \$2,179 and \$5,529 at 30 June 2005 and 2004, respectively, denominated in currencies other than the U.S. dollar. Accrued interest and dividends are included in total investments.

The components of net investment return are as follows:

	2004–2005	2003–2004
Interest and dividends	\$ 14,139	\$ 11,152
Realized gain	14,096	1,701
Unrealized gain	16,445	62,421
Currency exchange gains	155	189
Investment and banking fees	(2,191)	(2,205)
Miscellaneous gain	<u>103</u>	<u>384</u>
Total	<u>\$ 42,747</u>	<u>\$ 73,642</u>

### 5. FINANCIAL INSTRUMENTS

The Foundation utilizes forward and option contracts in an effort to mitigate the risk associated with the volatility of fluctuations in foreign currency exchange rates in regular transactions with International Offices. These transactions are entered into to hedge other positions or transactions and, therefore, are subject to varying degrees of market and credit risks. The Foundation also utilizes futures, options, forward, and swap contracts in connection with their investments in certain fixed income securities. These instruments are used to manage portfolio risk and may be used as a substitute for direct investment in the underlying security. All financial instruments are recorded at fair value with gains and losses resulting from changes in fair value recognized in net assets in the period of change.

### 6. ROTARY INTERNATIONAL REIMBURSEMENTS

Rotary International charges The Rotary Foundation for expenses incurred on its behalf based on time and usage studies. The Boards of Rotary and The Rotary Foundation approved new allocation

percentages effective 1 July 2001. The new allocations resulted in increased charges to The Rotary Foundation and are being phased in over four years. These expense allocations flow through intercompany accounts of the two entities and are as follows:

	<b>2004–2005</b>	<b>2003–2004</b>
World headquarters general administration	\$ 6,844	\$ 5,796
Information Services	5,458	5,762
International Offices	2,972	2,223
One Rotary Center net occupancy costs	525	603
International Assembly	1,081	700
Other	<u>5</u>	<u>25</u>
Total	<u>\$ 16,885</u>	<u>\$ 15,109</u>

## 7. BENEFIT PLANS

**Pension Benefits**—The Rotary Foundation is allocated its proportionate share of the pension expense for the Rotary International Retirement Plan. Employees of Rotary International participate in the Rotary International Retirement Plan, which is a defined benefit pension plan. This plan covers substantially all employees of Rotary International. The benefits are determined by application of a benefit ratio to the employees’ highest average of annual earnings for five consecutive plan years. The pension plan assets are invested in certain fixed income and equity funds.

Rotary International’s funding policy, subject to the minimum funding requirements under the Employee Retirement Income Security Act of 1974, is to contribute such amounts as are determined on an actuarial basis to provide the assets sufficient to meet the benefit obligations.

Rotary International applies the Statement of Financial Accounting Standards No. 87, *Employers’ Accounting for Pensions* (“SFAS 87”), in reporting retirement plan activities. As of 30 June 2005, the retirement plan’s accumulated benefit obligation, \$29,190, was greater than the fair value of retirement plan assets, \$26,458. Rotary International recorded an accrued benefit liability of \$2,732, as required by SFAS 87. The minimum pension liability adjustment allocated to The Rotary Foundation, was (\$347) at 30 June 2005, based upon its proportionate share of payroll expense for 2004–2005.

The net periodic pension expense allocated to The Rotary Foundation based upon its proportionate share of payroll expense for 2004–2005 and 2003–2004 was \$409 and \$429, respectively.

**401(k) Plan**—The Rotary Foundation is allocated its proportionate share of 401(k) expense for the Rotary International 401(k) Plan. Employees of Rotary International participate in the Rotary International 401(k) Plan, which is a defined contribution plan. Employees voluntarily make contributions to the Plan in amounts based upon a percentage of their total compensation, up to a maximum of 15%, subject to limitations imposed by the Internal Revenue Service. Rotary International matches 50% of the first 6% contributed of the participant’s annual compensation. The expense allocated to The Rotary Foundation for the years ended 30 June 2005 and 2004 was \$150 and \$154, respectively. The Plan’s assets are invested in certain fixed income, money market, and equity funds.

## 8. SPLIT-INTEREST AGREEMENTS

The Rotary Foundation is the charitable remainderman of trusts held for the benefit of others for various specified terms. These funds are held in charitable remainder unitrusts, irrevocable testamentary and

inter-vivos trusts, and pooled income funds. Assets received under these agreements are recorded at fair value, and the contribution portion of these agreements is recognized as revenue or gain, when received. Liabilities incurred as a result of these agreements are measured based on the present value of the expected future payments to be made to the named beneficiaries using various discount rates and actuarial assumptions reflecting the terms of the agreements and the estimated time of receipt.

From time to time, the Foundation is named as a beneficiary of revocable estates. It is the Foundation's policy to recognize revenue on such estates when either the cash is received or the commitment from the estate becomes irrevocable.

## 9. PROGRAM AWARDS AND EXPENSES

Program awards and expenses comprise:

	2004-2005			2003-2004		
	Awards	Expenses	Total	Awards	Expenses	Total
Educational Programs	\$ 22,890	\$ 4,999	\$ 27,889	\$ 23,731	\$ 4,147	\$ 27,878
Humanitarian Programs	38,509	7,587	46,096	21,117	6,050	27,167
PolioPlus Program	<u>33,133</u>	<u>3,062</u>	<u>36,195</u>	<u>29,327</u>	<u>2,308</u>	<u>31,635</u>
Total	<u>\$ 94,532</u>	<u>\$ 15,648</u>	<u>\$ 110,180</u>	<u>\$ 74,175</u>	<u>\$ 12,505</u>	<u>\$ 86,680</u>

## 10. UNRESTRICTED NET ASSETS

Unrestricted net assets that are Trustee-designated represent amounts that, by Trustee policy, have been designated for specific programs of The Rotary Foundation. Trustee policy stipulates that accumulated investment earnings on donations that are restricted by donors to the PolioPlus Program be utilized only in support of PolioPlus. Trustee policy also stipulates that the excess of investment earnings from donations that are permanently restricted by donors over the amounts spent for programs be designated as the Permanent Fund in order to maintain the purchasing power of donor-stipulated permanent gifts.

## 11. DONOR ADVISED FUND PROGRAM

During 2002, The Rotary Foundation established a Donor Advised Fund (the "Fund"). The Fund accepts contributions and offers individuals and Rotary-affiliated groups the flexibility to make grant recommendations to either The Rotary Foundation or other unaffiliated charities. Donors may recommend grants at any time which are subject to approval by the Trustees. At 30 June 2005 and 2004, assets and equal offsetting liabilities of \$2,507 and \$1,779, respectively, have been recorded in the Statements of Financial Position.

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