

# The Rotary Foundation of Rotary International

Financial Statements as of and for the  
Years Ended 30 June 2010 and 2009 (as Restated),  
and Independent Auditors' Report

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

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## INDEPENDENT AUDITORS' REPORT

To the Trustees of  
The Rotary Foundation of Rotary International:

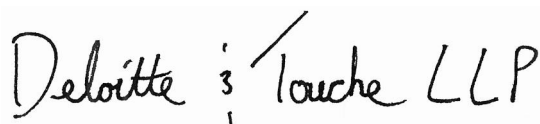
We have audited the accompanying financial statements of The Rotary Foundation of Rotary International (the "Foundation") as of 30 June 2010 and 2009, and for the years then ended, as listed in the table of contents. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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 Foundation as of 30 June 2010 and 2009, 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.

As discussed in Note 2 to the financial statements, the financial statements include investments valued at \$78,898,000 (12.0% of net assets) and \$81,034,000 (14.4% of net assets) as of 30 June 2010 and 2009, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the external investment fund managers.

As discussed in Note 9 to the financial statements, the financial statements have been restated for the correction of errors in fiscal year 2009.

A handwritten signature in black ink that reads "Deloitte Touche LLP". The signature is written in a cursive style, with "Deloitte" and "Touche" connected by a flourish, and "LLP" written separately to the right.

9 November 2010

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF FINANCIAL POSITION AS OF 30 JUNE 2010 AND 2009 (In thousands of U.S. dollars)

	2010	2009 (as Restated see Note 9)
<b>ASSETS</b>		
CASH AND CASH EQUIVALENTS	\$ 45,863	\$ 32,422
PLEDGES RECEIVABLE — Net	1,282	1,383
PREPAID EXPENSES AND OTHER ASSETS	3,646	3,204
INVESTMENTS	646,971	588,201
DONOR-ADVISED FUNDS	9,098	6,206
SPLIT-INTEREST AGREEMENTS	<u>24,429</u>	<u>22,765</u>
TOTAL	<u>\$ 731,289</u>	<u>\$ 654,181</u>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Accrued program awards	\$ 51,479	\$ 72,548
Accounts payable and accrued expenses	4,379	4,882
Split-interest agreements payable	14,659	13,462
Due to Rotary International	<u>3,302</u>	<u>1,389</u>
Total liabilities	<u>73,819</u>	<u>92,281</u>
NET ASSETS:		
Unrestricted:		
Undesignated	338,248	316,241
Trustee-designated PolioPlus	<u>31,693</u>	<u>32,152</u>
Total unrestricted net assets	369,941	348,393
Temporarily restricted:		
PolioPlus	98,258	45,241
Permanent fund	8,181	
Disaster recovery/named gifts	<u>2,059</u>	<u>325</u>
Total temporarily restricted net assets	108,498	45,566
Permanently restricted	<u>179,031</u>	<u>167,941</u>
Total net assets	<u>657,470</u>	<u>561,900</u>
TOTAL	<u>\$ 731,289</u>	<u>\$ 654,181</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED 30 JUNE 2010 AND 2009

(In thousands of U.S. dollars)

	2010				2009			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:								
Contributions	\$ 103,979	\$ 153,937	\$ 10,496	\$ 268,412	\$ 101,404	\$ 110,749	\$ 11,623	\$ 223,776
Net investment return	39,068	14,980	301	54,349	(104,550)	(50,462)	(8,868)	(163,880)
Net assets released from restrictions	105,692	(105,985)	293	-	67,611	(69,021)	1,410	-
Total revenues	<u>248,739</u>	<u>62,932</u>	<u>11,090</u>	<u>322,761</u>	<u>64,465</u>	<u>(8,734)</u>	<u>4,165</u>	<u>59,896</u>
EXPENSES:								
Program awards and expenses:								
Educational programs	29,337			29,337	28,578			28,578
Humanitarian programs	51,706			51,706	47,552			47,552
PolioPlus program	120,227			120,227	90,087			90,087
Other programs	3,629			3,629	1,416			1,416
Total program awards and expenses	204,899	-	-	204,899	167,633	-	-	167,633
Development expenses	16,461			16,461	14,495			14,495
General administration	5,227			5,227	5,698			5,698
Total expenses	<u>226,587</u>	<u>-</u>	<u>-</u>	<u>226,587</u>	<u>187,826</u>	<u>-</u>	<u>-</u>	<u>187,826</u>
CHANGE IN NET ASSETS:								
Before pension-related changes	22,152	62,932	11,090	96,174	(123,361)	(8,734)	4,165	(127,930)
Pension-related changes	(604)			(604)	(1,892)			(1,892)
CHANGE IN NET ASSETS	21,548	62,932	11,090	95,570	(125,253)	(8,734)	4,165	(129,822)
NET ASSETS — Beginning of year	348,393	45,566	167,941	561,900	525,665	10,178	155,879	691,722
NET ASSET RECLASSIFICATION				-	(52,019)	44,122	7,897	-
ADJUSTED NET ASSETS — Beginning of year	<u>348,393</u>	<u>45,566</u>	<u>167,941</u>	<u>561,900</u>	<u>473,646</u>	<u>54,300</u>	<u>163,776</u>	<u>691,722</u>
NET ASSETS — End of year	<u>\$ 369,941</u>	<u>\$ 108,498</u>	<u>\$ 179,031</u>	<u>\$ 657,470</u>	<u>\$ 348,393</u>	<u>\$ 45,566</u>	<u>\$ 167,941</u>	<u>\$ 561,900</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF FUNCTIONAL EXPENSES FOR THE YEARS ENDED 30 JUNE 2010 AND 2009 (In thousands of U.S. dollars)

Expense Type	2010					2009			
	Program Awards And Expenses					Supporting Services			
	Educational Programs	Humanitarian Programs	PolioPlus Programs	Other Programs	Total Programs	Development Expenses	General Administration	Total Expenses	Total Expenses
Program awards	\$ 23,501	\$ 44,215	\$ 118,071	\$ 1,183	\$ 186,970	\$ -	\$ -	\$ 186,970	\$ 149,056
Salaries and benefits	4,100	5,426	1,087	1,496	12,109	10,016	2,292	24,417	22,307
External services	241	291	404	117	1,053	456	213	1,722	2,635
Travel	326	310	285	501	1,422	839	1,465	3,726	3,949
Assembly, convention, and meetings	42	54	23	20	139	892	99	1,130	803
Publications and printing	195	212	159	45	611	743	230	1,584	1,895
Postage, shipping, and freight	138	151	20	3	312	763	70	1,145	1,533
Recognition and promotion	16		3	1	20	976	21	1,017	1,025
Cost of sales	1	1			2	2	99	103	151
Occupancy	444	605	88	75	1,212	975	506	2,693	2,372
Other	333	441	87	188	1,049	799	232	2,080	2,100
<b>Total expenses</b>	<b>\$ 29,337</b>	<b>\$ 51,706</b>	<b>\$ 120,227</b>	<b>\$ 3,629</b>	<b>\$ 204,899</b>	<b>\$ 16,461</b>	<b>\$ 5,227</b>	<b>\$ 226,587</b>	<b>\$ 187,826</b>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2010 AND 2009 (In thousands of U.S. dollars)

	2010	2009 (as Restated see Note 9)
CASH FLOWS PROVIDED BY (USED IN)		
OPERATING ACTIVITIES:		
Change in net assets	\$ 95,570	\$ (129,822)
Adjustments to reconcile change in net assets to net cash flows provided by (used in) operating activities:		
Permanent Fund contributions	(10,204)	(11,087)
Contributed securities and split-interest agreements	(462)	(409)
Realized losses on sale of investments — net	3,761	70,628
Unrealized (gains) losses on investments — net	(51,185)	99,954
Changes in assets and liabilities:		
Pledges receivable — net	101	(455)
Prepaid expenses and other assets	(442)	(34)
Accrued program awards	(23,961)	(43,015)
Accounts payable and accrued expenses	(503)	(6,994)
Split-interest agreements payable	1,197	3,986
Due to Rotary International	<u>1,913</u>	<u>1,318</u>
Net cash flows provided by (used in) operating activities	<u>15,785</u>	<u>(15,930)</u>
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES:		
Purchase of investments	(1,120,246)	(731,778)
Proceeds from sale of investments	1,104,330	739,613
Change in short-term investments	<u>3,368</u>	<u>(3,000)</u>
Net cash flows (used in) provided by investing activities	<u>(12,548)</u>	<u>4,835</u>
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:		
Proceeds from contributions restricted for investment in the Permanent Fund	<u>10,204</u>	<u>11,087</u>
Net cash flows provided by financing activities	<u>10,204</u>	<u>11,087</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,441	(8)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>32,422</u>	<u>32,430</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 45,863</u>	<u>\$ 32,422</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 2010 AND 2009

(In thousands of U.S. dollars)

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### 1. NATURE OF OPERATIONS

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

Rotary International is the sole corporate member of the Foundation. Therefore, the Foundation is included in Rotary International’s consolidated financial statements issued under separate cover.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Use of Estimates** — The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America (GAAP), 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.

**Associate Foundations** — The 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, except Japan and Brazil, where the laws do not allow for individuals to have tax benefits. The associate foundations accept contributions and make program disbursements on behalf of the Foundation. The financial activities conducted by the associate foundations on behalf of the Foundation are included in the Statements of Financial Position and the related Statements of Activities, Functional Expenses, and Cash Flows.

**Cash and Cash Equivalents** — Cash and cash equivalents include operating cash and liquid investments with an initial maturity of three months or less, including interest-bearing accounts, money market mutual funds, and fixed-term deposits, and are stated at cost, which approximates fair value. Cash and cash equivalents include \$20,382 and \$11,771 at 30 June 2010 and 2009, respectively, subject to certain repatriation restrictions imposed by local governments.

**Pledges Receivable** — The Foundation receives multiyear unconditional pledges ranging from one to five years. Management makes assumptions regarding the outstanding pledges and ultimate collectibility of these receivables. Pledges receivable are recorded net of discounting for the present value of the expected future cash flows using the U.S. Treasury’s risk-free interest rate. As of 30 June 2010 and 2009, respectively, the present value discount is \$57 and \$90, and the allowance for uncollectible pledges is \$82 and \$117.

**Investments** — Investments are carried at fair value and are primarily based on quoted market prices, except for certain alternative investments totaling \$78,898 and \$81,034 at 30 June 2010 and 2009, respectively. Alternative investments include private equity, real estate, and hedge funds, for which

quoted market prices are not readily available. The estimated fair value of private equity and real estate investments is based on quarterly valuations and other data provided by external investment fund managers, updated for capital calls and distributions and other market activity for the most current fiscal quarter. Hedge funds are valued on a monthly basis. The valuations for these alternative investments involve appraisals, assumptions, and methods that are reviewed by the Foundation's management, as well as the Investment Advisory Committee.

**Donor Advised Fund** — The Donor Advised Fund (DAF) accepts irrevocable contributions and offers individuals and Rotary-affiliated groups the flexibility to recommend grants to either the Foundation or other unaffiliated IRS-approved charities. Grants are subject to approval by the Trustees. The Foundation recognizes revenue when assets are contributed to the DAF, and grants made to other organizations from the DAF are recorded as program awards.

**Split-Interest Agreements** — The Foundation is the trustee or custodian, beneficiary, and charitable remainderman of trusts and charitable annuities held for the benefit of others and the Foundation for various specified terms. These funds are held in charitable remainder unitrusts, a charitable gift annuity account, and a pooled income fund. Assets received under these agreements are recorded at fair value, and the contribution portion of these agreements is recognized as revenue 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. The Foundation policy is to perform a valuation of the split-interest agreement liabilities annually. The valuation adjustment was \$2,330 and \$4,713 as of 30 June 2010 and 2009, respectively.

**Financial Instruments** — The Foundation, from time to time, enters into foreign exchange option and forward contracts for the purpose of managing foreign exchange risk. Gains and losses resulting from changes in fair value are recognized in the statement of activities when the contracts expire. The fair value of unexpired contracts as of 30 June 2010 was negative \$46. There were no options or contracts outstanding as of 30 June 2009.

**Accrued Program Awards** — The Foundation records the full amount of program awards upon specific designation of award recipients in the year for which they are approved. Awards designated but not yet paid are included in accrued program awards in the accompanying Statements of Financial Position.

**Due to Rotary International** — Rotary International and the 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 in cash on a periodic basis.

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

*Unrestricted* — Net assets that 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 and the Donor Advised Fund, which receive revenue primarily from contributions from Rotary districts, clubs, Rotarians, and others, as well as certain accumulated earnings as described below, have been classified as unrestricted net assets.

Unrestricted net assets that are Trustee-designated represent amounts that, by Trustee policy, have been designated for specific programs of the Foundation. Accumulated investment earnings on donations to PolioPlus will be considered unrestricted and be utilized only in support of PolioPlus, except where restricted by the terms agreed on or at the time of gift acceptance.

*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 contributions that are restricted to PolioPlus, Disaster Recovery, and Named gifts are classified as temporarily restricted. Foundation policy stipulates that a portion of the Permanent Fund's net investment return will be used to support the programs of the Foundation, including reasonable administrative costs in accordance with the terms agreed on or at the time of gift acceptance and in accordance with the spending policy approved by the Foundation Trustees. The unspent portion of the net investment return will be classified as temporarily restricted. Noncurrent pledges are also classified as temporarily restricted.

*Permanently Restricted* — Net assets donated with stipulations that they be invested to provide a permanent source of income (endowment funds and split-interest agreements); such restrictions can neither expire with the passage of time nor be removed by fulfillment of a stipulated purpose. Permanent Fund contributions are classified as permanently restricted.

**Revenue Recognition** — Contributions and unconditional pledges are recognized as revenue in the period received and recorded at estimated fair value. Conditional contributions are recognized in revenue when the conditions have been met.

**Administration and General Expenses** — Administration and general expenses represent the expenses incurred to provide overall management and direction to all entities.

**Tax Status** — The 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 liability for unrelated business income at 30 June 2010 or 2009.

**Translation of Currency Other Than the U.S. Dollar** — The U.S. dollar is the reporting currency for the Foundation. The Foundation has operations in countries other than the U.S. that are translated to the Foundation's reporting currency. Translation and transaction gains or losses are reflected in the change in net assets.

**Risks and Uncertainties** — The Foundation has investments in invested cash and short-term investments, debt and equity securities, and alternative investments that are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with these investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the amounts reported in the financial statements.

**Subsequent Events** — These financial statements considered subsequent events through 9 November 2010, the date the financial statements were available to be issued.

**Recent Accounting Pronouncements Adopted** — In June 2006, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 740 (formerly FASB Interpretation (FIN) No. 48), *Accounting for Uncertainty in Income Taxes*. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with ASC 740 (formerly FASB Statement No. 109), *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and

measurement of a tax position taken or expected to be taken in a tax return. This standard was originally effective for nonpublic entities for fiscal years beginning after 15 December 2006. On 30 December 2008, the FASB issued ASC 740 (formerly FASB Staff Position (FSP) FIN No. 48-3), which defers the effective date of ASC 740 for nonpublic entities until years beginning after 15 December 2008. The Foundation's management adopted ASC 740 in the financial statements for fiscal year 2010. There were no uncertain tax positions as of 30 June 2010 and 2009.

In September 2006, the FASB issued ASC 820 (formerly FASB Statement No. 157), *Fair Value Measurements*. ASC 820 clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value measurements. The Foundation's management adopted ASC 820 in the financial statements for fiscal year 2009.

In February 2007, the FASB issued ASC 825 (formerly FASB Statement No. 159), *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of ASC 320 (formerly FASB Statement No. 115)*. ASC 825 permits entities to choose to measure many financial instruments and certain other items at fair value that were not previously required to be measured at fair value. ASC 825 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The Foundation's management adopted ASC 825 in the financial statements for fiscal year 2009. This adoption did not have a material impact to the financial statements.

In August 2008, the FASB issued ASC 958-205-05-5 (formerly FSP FAS 117-1), *Endowments of Not-for-Profits Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*. ASC 958-205-05-5 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This ASC also requires enhanced disclosures about the Foundation's endowment funds. The Foundation's management adopted this new standard in fiscal year 2009. As a result of this adoption, the Foundation reclassified investment earnings of \$44,122 from unrestricted net assets to temporarily restricted net assets and \$7,897 of split interest agreements from unrestricted net assets to permanently restricted net assets during fiscal year 2009.

In March 2008, the FASB issued ASC 815-10-15-2 (formerly FASB Statement No. 161), *Disclosures about Derivative Instruments and Hedging Activities — an amendment of ASC 815 (formerly FASB Statement No. 133)*. ASC 815-10-15-2 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves transparency of financial reporting. The Foundation's management adopted ASC 815-10-15-2 in the financial statements for fiscal year 2010. This adoption did not have a material impact to the financial statements.

In June 2009, the FASB issued ASC 105 (formerly FASB Statement No. 168), *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles — a replacement of ASC 105 (formerly FASB Statement No. 162)*. The Accounting Standards Codification (the "Codification") will become the exclusive source of authoritative GAAP for all nongovernmental entities. All content in the Codification will carry the same level of authority, essentially modifying the GAAP hierarchy to include only two levels of GAAP: authoritative and nonauthoritative. The Foundation's management adopted ASC 105 in the financial statements for fiscal year 2010.

In September 2009, the FASB issued Accounting Standards Update (ASU) 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), an amendment of Fair Value Measurements and Disclosure (ASC 820) or (ASU 2009-12)*. This amendment provides

additional guidance on using the net asset value per share, provided by an investee, when estimating the fair value on an alternative investment that does not have a readily determinable fair value and enhances the disclosures concerning these investments. Examples of alternative investments, within the scope of this amendment, include investments in hedge funds, private equity funds, real estate funds, and venture capital partnerships. The Foundation's management adopted ASU 2009-12 in the financial statements for fiscal year 2010. The adoption of ASU 2009-12 had no impact on the net assets of the Foundation, and the adoption did not impact the classification of the Foundation's investments in the fair value hierarchy.

**Recent Accounting Pronouncements Pending Adoption** — In April 2009, the FASB issued ASC 958-805 (formerly FASB Statement No. 164), *Not-for-Profit Entities: Mergers and Acquisitions — Including an amendment of ASC 350 (formerly FASB Statement No. 142)*. ASC 958-805 establishes principles and requirements for how a not-for-profit entity (a) determines whether a combination is a merger or an acquisition; (b) applies the carryover method in accounting for a merger; (c) applies the acquisition method in accounting for an acquisition, including determining which of the combining entities is the acquirer; and, (d) determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of a merger or an acquisition. The Foundation's management is in the process of evaluating the effect of this new standard which must be adopted in fiscal year 2011.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (ASU 2010-06), *Improving Disclosures about Fair Value Measurements*, which, among other things, amends ASC 820 to require entities to separately present purchases, sales, issuances, and settlements in their reconciliation of Level 3 fair value measurements (i.e., to present such items on a gross basis rather than on a net basis), and which clarifies existing disclosure requirements provided by ASC 820 regarding the level of disaggregation and the inputs and valuation techniques used to measure fair value for measurements that fall within either Level 2 or Level 3 of the fair value hierarchy. ASU 2010-06 is effective for interim and annual periods beginning after 15 December 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements (which are effective for fiscal years beginning after 15 December 2010, and for interim periods within those fiscal years). The Foundation's management is currently assessing the impact that the adoption of ASU 2010-06 will have on the financial statement disclosures.

### 3. INVESTMENTS

At 30 June 2010, alternative investments comprised of real estate funds of \$39,273, hedge funds of \$25,353, and private equity funds of \$14,272. At 30 June 2009, alternative investments consisted of real estate funds of \$43,051, hedge funds of \$26,826, and private equity funds of \$11,157. The Foundation had investments in bonds in the amount of \$8,381 and \$2,889 denominated in currencies other than the U.S. dollar at 30 June 2010 and 2009, respectively. Accrued interest and dividends are included in total investments.

The components of net investment return are as follows:

	<b>2010</b>	<b>2009</b>
Interest and dividends	\$ 13,076	\$ 18,334
Realized losses — net	(3,761)	(70,628)
Unrealized gains (losses) — net	51,185	(99,954)
Investment and banking fees	(2,140)	(2,462)
Change in value of split-interest agreements	(2,330)	(4,713)
Miscellaneous gains (losses) — net	957	(165)
Currency losses — net	<u>(2,638)</u>	<u>(4,292)</u>
 Total	 <u>\$ 54,349</u>	 <u>\$ (163,880)</u>

#### 4. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. The fair values of the Foundation's financial assets and liabilities that are measured on a recurring basis are as follows as of 30 June 2010:

	Fair Value as of 30 June 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Invested cash and short-term investments	\$ 16,329	\$ 16,329	\$ -	\$ -
Bonds	268,582	142,138	126,444	
Stocks	283,162	94,358	188,804	
Alternative investments:				
Private equity	14,272	793		13,479
Real estate	39,273	12		39,261
Hedge funds	<u>25,353</u>			<u>25,353</u>
Subtotal	<u>646,971</u>	<u>253,630</u>	<u>315,248</u>	<u>78,093</u>
Donor-advised funds:				
Invested cash and short-term investments	4,594	4,594		
Bonds	2,159	2,159		
Stocks	<u>2,345</u>	<u>2,345</u>		
Subtotal	<u>9,098</u>	<u>9,098</u>	<u>-</u>	<u>-</u>
Split-interest agreements:				
Invested cash and short-term investments	2,222	2,222		
Bonds	6,174		6,174	
Stocks	<u>16,033</u>	<u>16,033</u>		
Subtotal	<u>24,429</u>	<u>18,255</u>	<u>6,174</u>	<u>-</u>
Total assets	<u>\$ 680,498</u>	<u>\$ 280,983</u>	<u>\$ 321,422</u>	<u>\$ 78,093</u>
Liabilities				
Split-interest agreements payable	<u>\$ 14,659</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,659</u>
Total liabilities	<u>\$ 14,659</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,659</u>

The fair values of the Foundation's financial assets and liabilities that are measured on a recurring basis are as follows as of 30 June 2009:

	Fair Value as of 30 June 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Invested cash and short-term investments	\$ 19,697	\$ 19,697	\$ -	\$ -
Bonds	226,297	103,425	122,872	
Stocks	261,173	106,746	154,427	
Alternative investments:				
Private equity	11,157	884		10,273
Real estate	43,051	12		43,039
Hedge funds	<u>26,826</u>	<u>          </u>	<u>          </u>	<u>26,826</u>
Subtotal	<u>588,201</u>	<u>230,764</u>	<u>277,299</u>	<u>80,138</u>
Donor-advised funds:				
Invested cash and short-term investments	<u>6,206</u>	<u>6,206</u>	<u>          </u>	<u>          </u>
Subtotal	6,206	6,206	-	-
Split-interest agreements:				
Invested cash and short-term investments	1,927	1,927		
Bonds	5,395		5,395	
Stocks	<u>15,443</u>	<u>15,443</u>	<u>          </u>	<u>          </u>
Subtotal	<u>22,765</u>	<u>17,370</u>	<u>5,395</u>	<u>-</u>
Total assets	<u>\$617,172</u>	<u>\$254,340</u>	<u>\$282,694</u>	<u>\$ 80,138</u>
<b>Liabilities</b>				
Split-interest agreements payable	<u>\$ 13,462</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,462</u>
Total liabilities	<u>\$ 13,462</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,462</u>

*Level 1* — Inputs are quoted prices in active markets for identified assets or liabilities that the Foundation has access to on the measurement date. The quoted prices provide the most reliable evidence, except when a significant event occurs that may affect the fair value measurement.

Foundation investments categorized as Level 1 include: money market and fixed-term deposits with maturities of less than one year, U.S. government obligations, U.S. and non-U.S. equity securities and exchange-traded funds, valued primarily based on quoted prices from an exchange.

*Level 2* — Inputs other than quoted prices included in Level 1 that are observable for assets or liabilities, either directly or indirectly. Level 2 inputs include quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield; and inputs that are derived principally using observable market data by correlation or other means (market-corroborated inputs).

Foundation investments categorized as Level 2 include fixed-income instruments, primarily corporate bonds, international bonds, asset-backed securities, non-exchange traded funds, mutual funds, U.S. agency bonds, and commingled funds valued primarily using market-corroborated pricing.

*Level 3* — One or more unobservable inputs, which are deemed significant to the determination of the fair value, for which there is little or no market data available. Unobservable inputs reflect the Foundation’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk) and are developed based on the best information available.

Foundation investments categorized as Level 3 include hedge fund of funds, private equity fund of funds, and real estate funds (valued primarily based on net asset value per share).

<b>Alternative Investments Level 3 Assets</b>	<b>Fair Value</b>	<b>Unfunded Commitments</b>	<b>Redemption Frequency (if currently eligible)</b>	<b>Redemption Notice Period</b>
Private equity fund of funds (a)	\$ 13,479	\$ 23,341		
Real estate funds (b)	39,261		quarterly	60–90 days
Hedge fund of funds (c)	<u>25,353</u>	<u>                    </u>	quarterly	30–90 days
Total	<u>\$ 78,093</u>	<u>\$ 23,341</u>		

- (a) Private equity fund of funds includes several private equity funds of funds that invest globally. Capital is committed to these investments and called as investments are made. Distributions are made only when the underlying investments of the funds undergo a significant market event, such as acquisition by another company or an initial public offering. The time horizon of a typical private equity fund of funds is approximately 10 to 15 years. The fair values of the investments in this category have been estimated based on the Foundation’s ownership interest in partners’ capital.
- (b) Real estate funds include open-ended real estate funds that invest in U.S. real estate. The holdings in the real estate composite comprise a mix of apartments, offices, industrial, retail, and hotel properties. The fair values of the investments in this category have been estimated using the net asset value per share of the investments based on an annual valuation by an independent third-party appraiser.
- (c) Hedge fund of funds includes various hedge funds of funds that pursue multiple global strategies to diversify risks and reduce volatility. The fair values of the investments in this category have been estimated using the net asset value per share of the investments. A full redemption has been requested from one of the fund of funds managers, and proceeds have been distributed as the underlying managers have been able to provide liquidity. As of 30 June 2010, 65% of the proceeds have been paid to the Foundation. Another one of the fund of funds is in liquidation, with all assets in cash pending distribution to creditors and investors. The Foundation previously recorded a valuation reserve of \$16,000 and has not received any distributions from this fund of funds as of 30 June 2010.

For fair value measurements using significant unobservable inputs (Level 3), the changes are as follows:

	<b>Private Equity</b>	<b>Real Estate</b>	<b>Hedge Funds</b>	<b>Total</b>
Beginning balance 1 July 2008	\$ 6,676	\$ 32,468	\$ 21,640	\$ 60,784
Realized and unrealized gains (losses) — net	1,758	(22,536)	(2,435)	(23,213)
Purchases (sales) — net	<u>1,839</u>	<u>33,107</u>	<u>7,621</u>	<u>42,567</u>
Ending balance 30 June 2009	10,273	43,039	26,826	80,138
Realized and unrealized gains (losses) — net	1,257	(3,197)	1,202	(738)
(Sales) purchases — net	<u>1,949</u>	<u>(581)</u>	<u>(2,675)</u>	<u>(1,307)</u>
Ending balance 30 June 2010	<u>\$ 13,479</u>	<u>\$ 39,261</u>	<u>\$ 25,353</u>	<u>\$ 78,093</u>

## 5. ENDOWMENTS

The Foundation's Permanent Fund is comprised of donor-restricted endowment funds. The primary objective of the Permanent Fund is to support the programs of the Foundation in perpetuity. The portion of a permanent endowment that must be maintained permanently — not expended or otherwise exhausted — is classified as permanently restricted net assets. The portion of the fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until it has been appropriated for expenditure by the Foundation and has met any purpose restrictions. A portion of the Permanent Fund's investment earnings are used to finance the programs of the Foundation based on the terms of the gift and the spending policy. The Permanent Fund may make an annual distribution to the Annual Programs Fund and the Disaster Recovery/Named Gifts Fund for program awards and expenses. All spending is approved by the Trustees. At 30 June 2010 and 2009, the balance of temporarily restricted net assets from Permanent Fund earnings is \$8,181 and \$0, respectively.

The Foundation Trustees have responsibility for formulating the Permanent Fund investment policy. Funds are included in a consolidated endowment pool and invested in accordance with the investment policy approved by the Trustees and monitored by the Investment Advisory Committee. Assets of the Permanent Fund are invested to ensure that capital is preserved and enhanced over time, both in real and nominal terms. The Permanent Fund investment policy is to invest in a diversified asset portfolio that is expected to produce an average annual total return that at least equals inflation, plus endowment spending, without assuming undue risk.

In fiscal year 2010, the Permanent Fund's spending policy stipulated spending 5.0% of the average market value over the previous 12-quarter period. Since the aggregate market value of the fund was below the accumulated gift value when the spending calculation was made, no spending was approved, except when specifically required by the terms of the gift. In June 2010, the Trustees approved a new spending policy beginning fiscal year 2011 in which annual spending will occur each year from endowed gifts whose market values exceed their accumulated gift values. The Trustees approved a spending rate for fiscal year 2011 of 4.5%.

Split-interest agreements and related activity are part of permanently restricted net assets but are managed separately from Permanent Fund endowments. Therefore, split-interest agreements are not included in the spending calculations for the Permanent Fund or in the endowment net assets reported.

Changes in endowment net assets for the fiscal years ended 30 June 2009 and 2010, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets 1 July 2008	\$ -	\$ 44,122	\$ 145,971	\$ 190,093
Contributions			11,088	11,088
Transfer of funds		(48)	1,575	1,527
Investment return				
Interest, dividends, and investment fees — net		3,089		3,089
Realized and unrealized losses — net	<u>          </u>	<u>(53,551)</u>	<u>          </u>	<u>(53,551)</u>
Total investment return	<u>-</u>	<u>(50,462)</u>	<u>-</u>	<u>(50,462)</u>
Appropriation of endowment assets for expenditure		(244)		(244)
Other changes:				
Transfer of unrestricted net assets to temporarily restricted net assets	<u>(6,632)</u>	<u>6,632</u>	<u>          </u>	<u>-</u>
Endowment net assets 30 June 2009	(6,632)	-	158,634	152,002
Contributions			10,204	10,204
Transfer of funds — net		27	431	458
Investment return				
Interest, dividends, and investment fees — net		2,412		2,412
Realized and unrealized gains — net	<u>          </u>	<u>12,568</u>	<u>          </u>	<u>12,568</u>
Total investment return	<u>-</u>	<u>14,980</u>	<u>-</u>	<u>14,980</u>
Appropriation of endowment assets for expenditure		(194)		(194)
Other changes:				
Transfer of unrestricted net assets to temporarily restricted net assets	<u>6,632</u>	<u>(6,632)</u>	<u>          </u>	<u>-</u>
Endowment net assets 30 June 2010	<u>\$ -</u>	<u>\$ 8,181</u>	<u>\$ 169,269</u>	<u>\$ 177,450</u>

### Funds with Deficiencies

From time to time, the fair value of assets associated with the donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the organization to retain as a fund of perpetual duration. The Foundation is required to transfer funds from prior investment earned income and/or unrestricted net assets to temporarily restricted net assets when the deficiencies resulted from unfavorable market fluctuations for which the aggregate amount of the fair value of the assets at fiscal

year-end is less than the level required by donor stipulations in order to retain as a fund of perpetual duration. There was no deficiency as of 30 June 2010. As of 30 June 2009, these deficiencies totaled \$6,632.

## 6. ROTARY INTERNATIONAL REIMBURSEMENTS

In accordance with an administrative services agreement dated 14 April 2009, Rotary International charges the Foundation for expenses incurred on its behalf. Both boards meet annually to adjust the agreement as needed. These expense allocations flow through intercompany accounts of the two entities and are as follows:

	<b>2010</b>	<b>2009</b>
General administration	\$ 10,955	\$ 10,570
Information services	4,173	4,107
International assembly	1,283	1,397
International offices	4,344	4,088
One Rotary Center net occupancy costs	<u>596</u>	<u>483</u>
Total	<u>\$ 21,351</u>	<u>\$ 20,645</u>

The Foundation allocates these costs based upon staff resources required to support each functional area. These amounts are allocated as follows:

	<b>2010</b>	<b>2009</b>
Educational programs	\$ 4,021	\$ 4,041
Humanitarian programs	5,451	6,467
PolioPlus program	865	910
Other programs	575	
Development expenses	8,810	7,686
General administration	<u>1,629</u>	<u>1,541</u>
Total	<u>\$ 21,351</u>	<u>\$ 20,645</u>

## 7. BENEFIT PLANS

**Pension Benefits** — The Foundation is allocated its proportionate share of the pension expense for the Rotary International Retirement Plan. The retirement plan is a defined benefit pension plan, covering substantially all Rotary International employees with a hire date before 1 January 2008. The plan was closed to employees hired on or after this date. The benefits are determined by application of a benefit ratio to the employee's highest average 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 determined on an actuarial basis to provide the assets sufficient to meet the benefit obligations. Rotary International uses a 30 June measurement date for its plan.

As of 30 June 2010, the retirement plan's projected benefit obligation, \$49,276, was greater than the fair value of retirement plan assets, \$36,314. As of 30 June 2009, the retirement plan's projected benefit obligation, \$41,119, was greater than the fair value of retirement plan assets, \$30,478. The net actuarial loss recognized by the Foundation based upon its proportionate share of payroll expense was \$604 and \$1,892 in fiscal years 2010 and 2009, respectively. These amounts are reflected in pension-related changes in the Statements of Activities.

The net periodic pension expense allocated to the Foundation based upon its proportionate share of payroll expense was \$675 and \$418 for fiscal years 2010 and 2009, respectively.

**Pension Plan Assets** — There are two main investment goals of the pension plan. One is to provide a total return that, over the long term, increases the ratio of plan assets to liabilities subject to an acceptable level of risk. The other is to mitigate the volatility in funded status by investing in assets that hedge against the liability of the pension plan. This is accomplished through diversification of assets in accordance with the investment policy. Periodic rebalancing occurs after the end of each calendar quarter, as required by the policy. The target allocations for plan assets are 50 percent bonds and U.S. Treasury or Agency securities and 50 percent stocks.

Fair value hierarchy table presents information about the Rotary International pension plan investments measured at fair value as of 30 June 2010, is as follows.

Description	Fair Value as of 30 June 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Invested cash and short-term investments	\$ 515	\$515	\$ -	\$ -
Bonds	20,013		20,013	
Stocks	<u>15,786</u>	_____	<u>15,786</u>	_____
Total	<u>\$36,314</u>	<u>\$515</u>	<u>\$35,799</u>	<u>\$ -</u>

Pension plan assets categorized as Level 1 include money market and fixed-term deposits with maturities of less than one year, valued at book value, which approximates market value.

Pension plan assets categorized as Level 2 include fixed-income instruments, primarily mutual funds, and commingled funds. Mutual funds are valued primarily using market corroborated pricing. Commingled funds are valued based on net asset values per share, derived from the quoted market prices in active markets of the underlying equity securities.

**401(k) Plan** — The Foundation is allocated its proportionate share of 401(k) expense for the Rotary International 401(k) Plan. Employees of Rotary International participate in the 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 50%, subject to limitations imposed by the Internal Revenue Service. Rotary International matches 100% of the first 1% and 50% of the next 5% contributed of the participant's annual compensation. The expense allocated to the Foundation was \$334 and \$294 for the years ended 30 June 2010 and 2009, respectively. For employees hired on or after 1 January 2008, Rotary International may also make further contributions to the plan via Rotary's Points Based Contribution.

## 8. BILL & MELINDA GATES FOUNDATION GRANT

The Foundation entered into a grant agreement with the Bill & Melinda Gates Foundation (BMGF) for a total of \$355,000 to support the global polio eradication initiative. The intent of the grant agreement is to join with other organizations, such as the United Nations Children's Fund (UNICEF), the Center for Disease Control (CDC), and the World Health Organization (WHO), in pursuit of the eradication of polio throughout the world. In accordance with the grant agreement, the Foundation recognizes revenue when funds from BMGF are received and committed or spent.

Through the three year period ended 30 June 2010, the Foundation received a total of \$290,000 from BMGF recorded as temporarily restricted revenue. In September 2010, the Foundation received an additional \$30,000 from BMGF. The agreements have provisions whereby the Foundation is responsible for separately raising \$200,000 by 30 June 2012, which it is doing through Rotary's *\$200 Million Challenge*. Through 30 June 2010, the Challenge has reported \$135,000 toward this goal.

## 9. RESTATEMENT

Subsequent to the issuance of the Foundation's fiscal year 2009 financial statements, management determined that the \$172,805 of future conditional contributions to be received from the BMGF should not have been recorded as pledges receivable and deferred revenue. As a result, pledges receivable and deferred revenue were overstated in fiscal year 2009 by \$172,805 in the Statement of Financial Position as well as correlating errors in the Statement of Cash Flows. These balances have been restated from the amounts previously reported. There were no effects of this correction on the net assets, revenues or expenses in fiscal year 2009.

The following table presents the effects of the restatement adjustment for the year ended 30 June 2009:

	As Previously Reported	Restatement Adjustment	As restated
<b>Statement of Financial Position</b>			
Assets:			
Pledges receivable — net	\$ 174,188	\$(172,805)	\$ 1,383
Total	826,986	(172,805)	654,181
Liabilities:			
Deferred revenues	172,805	(172,805)	
Total liabilities	265,086	(172,805)	92,281
<b>Statement of Cash Flows</b>			
Cash flows provided by (used in) operating activities:			
Pledges receivable — net	\$(173,260)	\$ 172,805	\$ (455)
Deferred revenue	172,805	(172,805)	

Subsequent to the issuance of the Foundation's fiscal year 2009 financial statements, management determined that \$11,087 of contributions received to establish permanent endowments should have been classified in the Statement of Cash Flows as financing activities, rather than operating activities. These balances have been restated from the amounts previously reported. There were no effects of this correction on the net assets, revenues or expenses in fiscal year 2009.

The following table presents the effects of the restatement adjustment for the year ended 30 June 2009:

	<b>As Previously Reported</b>	<b>Restatement Adjustment</b>	<b>As restated</b>
<b>Statement of Cash Flows</b>			
Cash flows provided by (used in) operating activities:			
Permanent Fund contributions	\$ -	\$ (11,087)	\$ (11,087)
Net cash flows provided by (used in) operating activities	(4,843)	(11,087)	(15,930)
Cash flows provided by financing activities:			
Proceeds from contributions restricted for investment in the Permanent Fund		11,087	11,087
Net cash flows provided by financing activities		11,087	11,087

Subsequent to the issuance of the Foundation's fiscal year 2009 financial statements, management determined that certain, bonds, stocks, split-interest agreements and split-interest liabilities were categorized in the incorrect Levels within the Fair Value Hierarchy, as disclosed in Note 4. There were no effects of this correction on the net assets, revenues or expenses in fiscal year 2009.

The following table presents the effects of the restatement adjustments for the year ended 30 June 2009:

	<b>As Previously Reported</b>	<b>Restatement Adjustment</b>	<b>As restated</b>
<b>Fair Value Measurements Footnote Disclosure</b>			
Quoted prices in active markets for identical assets (Level 1):			
Bonds	\$ 226,297	\$ (122,872)	\$ 103,425
Stocks	261,173	(154,427)	106,746
Split-interest agreements	22,765	(5,395)	17,370
Split-interest agreements payable	13,462	(13,462)	
Significant other observable inputs (Level 2):			
Bonds		122,872	122,872
Stocks		154,427	154,427
Split-interest agreements		5,395	5,395
Significant other observable inputs (Level 3):			
Split-interest agreements payable		13,462	13,462

\* \* \* \* \*