

# The Rotary Foundation of Rotary International

Financial Statements as of and for the  
Years Ended 30 June 2007 and 2006, 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 statements of financial position of The Rotary Foundation of Rotary International ("The Rotary Foundation") as of 30 June 2007 and 2006, 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 2007 and 2006, 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 \$93,031,000 (12.6% of net assets) and \$89,787,000 (14.1% of net assets) as of 30 June 2007 and 2006, 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 fund managers.



28 September 2007  
(7 November 2007 as to Note 2)

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF FINANCIAL POSITION AS OF 30 JUNE 2007 AND 2006 (Thousands of dollars)

	2007	2006
<b>ASSETS</b>		
CASH	\$ 28,169	\$ 24,658
PLEDGES RECEIVABLE — Net	783	821
DEFERRED CHARGES, PREPAID EXPENSES, AND OTHER ASSETS	2,805	3,309
INVESTMENTS:		
Cash and short-term investments	28,818	24,210
Bonds	150,031	159,772
Stocks	477,203	396,699
Real estate and other	83,875	71,879
Total investments	<u>739,927</u>	<u>652,560</u>
DONOR ADVISED FUNDS	5,570	5,935
SPLIT-INTEREST AGREEMENTS	<u>27,201</u>	<u>21,887</u>
TOTAL	<u>\$ 804,455</u>	<u>\$ 709,170</u>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Accrued program awards	\$ 45,839	\$ 53,252
Accounts payable and accrued expenses	9,938	10,308
Split-interest agreements payable	8,559	7,880
Due to Rotary International	<u>2,152</u>	<u>308</u>
Total liabilities	<u>66,488</u>	<u>71,748</u>
NET ASSETS:		
Unrestricted:		
Undesignated	480,797	404,902
Trustee-designated:		
PolioPlus	32,520	32,372
Permanent fund	<u>78,049</u>	<u>52,004</u>
Total unrestricted net assets	591,366	489,278
Temporarily restricted	5,073	20,485
Permanently restricted	<u>141,528</u>	<u>127,659</u>
Total net assets	<u>737,967</u>	<u>637,422</u>
TOTAL	<u>\$ 804,455</u>	<u>\$ 709,170</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED 30 JUNE 2007 AND 2006 (Thousands of dollars)

	2006-2007				2005-2006			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:								
Contributions	\$ 116,312	\$ 3,367	\$ 13,263	\$ 132,942	\$ 92,408	\$ 7,297	\$ 12,185	\$ 111,890
Net investment return	105,856			105,856	50,248			50,248
Net assets released from restrictions	<u>18,173</u>	<u>(18,779)</u>	<u>606</u>	<u>-</u>	<u>25,008</u>	<u>(25,008)</u>		<u>-</u>
Total revenues	<u>240,341</u>	<u>(15,412)</u>	<u>13,869</u>	<u>238,798</u>	<u>167,664</u>	<u>(17,711)</u>	<u>12,185</u>	<u>162,138</u>
EXPENSES:								
Program awards and expenses:								
Educational programs	30,031			30,031	28,008			28,008
Humanitarian programs	54,383			54,383	53,019			53,019
PolioPlus program	25,994			25,994	26,919			26,919
Other programs	<u>8,424</u>			<u>8,424</u>				<u>-</u>
Total program awards and expenses	118,832	-	-	118,832	107,946	-	-	107,946
Development expenses	12,632			12,632	13,689			13,689
General administration	<u>6,294</u>			<u>6,294</u>	<u>6,647</u>			<u>6,647</u>
Total expenses	<u>137,758</u>	<u>-</u>	<u>-</u>	<u>137,758</u>	<u>128,282</u>	<u>-</u>	<u>-</u>	<u>128,282</u>
CHANGE IN NET ASSETS BEFORE PENSION-RELATED CHANGES	102,583	(15,412)	13,869	101,040	39,382	(17,711)	12,185	33,856
PENSION-RELATED CHANGES	<u>(495)</u>			<u>(495)</u>	<u>707</u>			<u>707</u>
CHANGE IN NET ASSETS	102,088	(15,412)	13,869	100,545	40,089	(17,711)	12,185	34,563
NET ASSETS — Beginning of year	<u>489,278</u>	<u>20,485</u>	<u>127,659</u>	<u>637,422</u>	<u>449,189</u>	<u>38,196</u>	<u>115,474</u>	<u>602,859</u>
NET ASSETS — End of year	<u>\$ 591,366</u>	<u>\$ 5,073</u>	<u>\$ 141,528</u>	<u>\$ 737,967</u>	<u>\$ 489,278</u>	<u>\$ 20,485</u>	<u>\$ 127,659</u>	<u>\$ 637,422</u>

See notes to financial statements.

# THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2007 AND 2006 (Thousands of dollars)

	2006–2007	2005–2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 100,545	\$ 34,563
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Realized gains on sale of investments — net	(37,589)	(31,991)
Unrealized gains on investments — net	(38,298)	(1,427)
Contributed securities	(4,473)	(3,917)
Changes in assets and liabilities:		
Pledges receivable — net	38	447
Deferred charges, prepaid expenses, and other assets	504	(314)
Accrued program awards	(7,048)	(54)
Accounts payable and accrued expenses	(370)	(2,104)
Split-interest agreements payable	679	787
Due to Rotary International	<u>1,844</u>	<u>(2,128)</u>
Net cash flows from operating activities	<u>15,832</u>	<u>(6,138)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of investments	(1,080,317)	(1,104,392)
Proceeds from sale of investments	1,072,604	1,106,452
Change in investment cash and short-term investments	<u>(4,608)</u>	<u>(2,314)</u>
Net cash flows from investing activities	<u>(12,321)</u>	<u>(254)</u>
INCREASE (DECREASE) IN CASH	3,511	(6,392)
CASH — Beginning of year	<u>24,658</u>	<u>31,050</u>
CASH — End of year	<u>\$ 28,169</u>	<u>\$ 24,658</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 2007 AND 2006 (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. SUMMARY OF 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.

**Recent Accounting Pronouncements** — The Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (“FIN 48”) in June 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with 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. The Rotary Foundation’s management is in the process of evaluating the effect of this new interpretation on The Rotary Foundation’s financial statements. This standard was originally effective for nonpublic entities for fiscal years beginning after 15 December 2006. On 7 November 2007, the FASB decided to issue a proposed FASB Staff Position which, if finalized, may defer the effective date of FIN 48 for nonpublic entities until years beginning after 15 December 2007.

In September 2006, the FASB issued SFAS No. 157 Statement, *Fair Value Measurements*, (“SFAS 157”). SFAS 157 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 Rotary Foundation’s management is in the process of evaluating the effect of this new interpretation, which must be adopted in fiscal year 2009, on The Rotary Foundation’s financial statements.

In February 2007, the FASB issued SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 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 Rotary Foundation’s management is in the process of evaluating the effect of this new interpretation, which must be adopted in fiscal year 2009, on The Rotary Foundation’s financial statements.

**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 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 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.

- **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, Disaster Recovery 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 corpus 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 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 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 \$6,592 and \$4,905 at 30 June 2007 and 2006, respectively, subject to certain repatriation restrictions imposed by local governments.

**Pledges Receivable** — The Foundation receives multi-year pledges. The accompanying financial statements reflect multi-year 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 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 except for certain alternative investments totaling \$93,031 and \$89,787 at 30 June 2007 and 2006, respectively, such as private equity, real estate, and hedge fund of funds, for which quoted market prices may not be available. The estimated fair value of alternative investments is based on quarterly valuations provided by the external investment fund managers. The valuations for these alternative investments involve estimates, appraisals, assumptions, and methods which are reviewed by The Rotary Foundation management as well as the Finance committee. Cash and short-term investments are primarily money market investments held by the Foundation's custodian bank during the process of settling investment transactions.

**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. There were no options or contracts outstanding as of 30 June 2007 and 2006.

**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 awards 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.

**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 unrecorded liability for unrelated business income at 30 June 2007 or 2006.

**Translation of Currency Other Than the U.S. Dollar** — The U.S. dollar is the reporting currency for The Rotary 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 Rotary Foundation has investments in cash and short-term investments, 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 Statements of Financial Position and the Statements of Activities.

**Reclassifications** — Certain prior-year balances have been reclassified to conform to the current-year presentation.

### 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 2007 and 2006, is as follows:

	<b>2006–2007</b>	<b>2005–2006</b>
Due within one year	\$ 567	\$ 822
Due within one to five years	385	161
Due after five years	<u>-</u>	<u>5</u>
	952	988
Present value discount	(78)	(120)
Allowance for uncollectible pledges	<u>(91)</u>	<u>(47)</u>
Pledges receivable — net	<u>\$ 783</u>	<u>\$ 821</u>
Present value discount rates	8.0%–8.25%	8.0%–8.25%

### 4. INVESTMENTS

At 30 June 2007, the Foundation had investments in bonds in the amount of \$2,449 denominated in currencies other than the U.S. dollar and, at 30 June 2006, the Foundation did not have any investments in bonds denominated in currencies other than the U.S. dollar. In addition, the Foundation held investments in certain AAA-rated sub-prime mortgage backed securities totaling \$11,000 (or 1.5% of the Foundation's total investments) at 30 June 2007. Accrued interest and dividends are included in total investments. At 30 June 2007, real estate and other consists of real estate funds of \$74,235 and hedge fund of funds of \$9,640; and stocks include \$9,156 of private equity funds. At 30 June 2006, real estate and other consists of real estate funds of \$62,239 and hedge fund of funds of \$9,640; and stocks include \$17,908 of private equity funds.

The components of net investment return are as follows:

	<b>2006–2007</b>	<b>2005–2006</b>
Interest and dividends	\$ 32,190	\$ 17,451
Realized gains — net	37,796	31,991
Unrealized gains — net	38,319	1,427
Currency exchange gains	626	420
Investment and banking fees	(2,618)	(2,511)
Miscellaneous (losses) gains	<u>(457)</u>	<u>1,470</u>
Total	<u>\$ 105,856</u>	<u>\$ 50,248</u>

## 5. ROTARY INTERNATIONAL REIMBURSEMENTS

In accordance with an administrative services agreement dated 28 June 2006, Rotary International charges The Rotary 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:

	2006–2007	2005–2006
General administration	\$ 10,104	\$ 9,034
Information services	5,056	7,071
International assembly	1,146	1,063
International offices	3,640	3,217
One Rotary Center net occupancy costs	<u>701</u>	<u>639</u>
Total	<u>\$ 20,647</u>	<u>\$ 21,024</u>

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

	2006–2007	2005–2006
Educational programs	\$ 4,105	\$ 3,881
Humanitarian programs	6,826	6,037
PolioPlus program	850	798
Development expenses	6,825	8,036
General administration	<u>2,041</u>	<u>2,272</u>
Total	<u>\$ 20,647</u>	<u>\$ 21,024</u>

## 6. 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 uses a 30 June measurement date for its plan.

Effective 30 June 2007, Rotary International implemented Statement of Financial Accounting Standard No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plan — an amendment of FASB Statements No. 87, 88, 106 and 132 (R)* (“SFAS 158”). As of 30 June 2007, the retirement plan’s projected benefit obligation, \$36,050, was greater than the fair value of retirement plan assets, \$34,070. Rotary International allocated the effect of implementing SFAS 158 to The Rotary Foundation in the amount of \$495 at 30 June 2007, based upon its proportionate share of payroll expense for 2006–2007. The accumulated benefit obligation at the end of 2007 and 2006 was \$ 29,292 and \$27,955, respectively. A minimum pension liability recovery was allocated to The Rotary Foundation at the end of 2005–2006 of \$707. These expenses/recoveries are reflected in pension-related changes in the statements of activities.

The net periodic pension expense allocated to The Rotary Foundation based upon its proportionate share of payroll expense for 2006–2007 and 2005–2006 was \$381 and \$506, respectively.

In fiscal year 2007, the Board of Directors of Rotary International approved terminating admission into the Rotary International Retirement Plan for employees with a hire date after 31 December 2007. Current plan participants will not be affected by the decision.

**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 2007 and 2006, was \$173 and \$177, respectively. The plan’s assets are invested in certain fixed income, money market, and equity funds.

## 7. SPLIT-INTEREST AGREEMENTS

The Rotary Foundation is the trustee or custodian and charitable remainderman of trusts and charitable annuities held for the benefit of others 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 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 the cash is received.

## 8. PROGRAM AWARDS AND EXPENSES

Program awards and expenses comprise:

	2006–2007			2005–2006		
	Awards	Expenses	Total	Awards	Expenses	Total
Educational programs	\$ 23,293	\$ 6,738	\$ 30,031	\$ 21,919	\$ 6,089	\$ 28,008
Humanitarian programs	44,759	9,624	54,383	44,281	8,738	53,019
PolioPlus program	23,744	2,250	25,994	24,865	2,054	26,919
Other programs	8,424		8,424			-
Total	<u>\$ 100,220</u>	<u>\$ 18,612</u>	<u>\$ 118,832</u>	<u>\$ 91,065</u>	<u>\$ 16,881</u>	<u>\$ 107,946</u>

## **9. DONOR ADVISED FUND PROGRAM**

During 2002, The Rotary Foundation established a Donor Advised Fund (DAF). The DAF accepts irrevocable contributions and offers individuals and Rotary-affiliated groups the flexibility to recommend grants to either The Rotary 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. Grants made to other organizations from the DAF are recorded as program awards. For the year ending, 30 June 2007, revenues and program awards were \$13,492 and \$8,424, respectively.

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