

# AUDIT REPORT

Tennessee Board of Regents  
Endowment for Educational Excellence  
Tennessee State University Foundation

For the Year Ended  
June 30, 2013



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY

Department of Audit  
Division of State Audit



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COMPTROLLER OF THE TREASURY  
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February 13, 2014

The Honorable Bill Haslam, Governor  
Members of the General Assembly  
The Honorable John G. Morgan, Chancellor  
Dr. Glenda Baskin Glover, President

Ladies and Gentlemen:

Transmitted herewith is the report on the Endowment for Educational Excellence at Tennessee State University Foundation, for the year ended June 30, 2013. You will note from the independent auditor's report that an unmodified opinion was given on the fairness of the presentation of the financial statements.

Consideration of the internal control over financial reporting and tests of compliance disclosed no audit findings.

Sincerely,

Deborah V. Loveless, CPA  
Director

14/036

**Audit Report**  
**Tennessee Board of Regents**  
**Endowment for Educational Excellence**  
**Tennessee State University Foundation**  
**For the Year Ended June 30, 2013**

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State of Tennessee

# **A u d i t   H i g h l i g h t s**

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

## **Endowment for Educational Excellence**

**Tennessee State University Foundation**

For the Year Ended June 30, 2013

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### **Opinion on the Financial Statements**

The opinion on the financial statements is unmodified.

### **Audit Findings**

The audit report contains no findings.



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
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**Independent Auditor's Report**

The Honorable Bill Haslam, Governor  
Members of the General Assembly  
The Honorable John G. Morgan, Chancellor  
Dr. Glenda Baskin Glover, President

We have audited the accompanying financial statements of the Endowment for Educational Excellence at the Tennessee State University Foundation as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

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

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

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements, based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Endowment for Educational Excellence of the Tennessee State University Foundation, as of June 30, 2013, as well as the changes in financial position and cash flows thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matters***

As discussed in Note 1, the financial statements of the Endowment for Educational Excellence are intended to present the financial position, the changes in financial position, and the cash flows of only that portion of the Tennessee State University Foundation's activity that is attributable to the transactions of the Endowment for Educational Excellence. They do not purport to, and do not, present fairly the financial position of the Tennessee State University Foundation, as of June 30, 2013, and the changes in financial position and cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 3, the financial statements of the Endowment for Educational Excellence of the Tennessee State University Foundation include investments valued at \$1,861,566.82 (4.76% of net position of the foundation), 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 or the general partners. Our opinion is not modified with respect to this matter.

### ***Other Matters - Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Deborah V. Loveless, CPA  
Director  
January 13, 2014

**Tennessee Board of Regents**  
**ENDOWMENT FOR EDUCATIONAL EXCELLENCE**  
**Tennessee State University Foundation**  
**Management's Discussion and Analysis**

**Introduction**

This section of the Tennessee State University Foundation Endowment for Educational Excellence trust's annual financial report presents a discussion and analysis of the financial performance of the trust during the fiscal year ended June 30, 2013, with comparative information presented for the fiscal year ended June 30, 2012. This discussion, along with the financial statements and related note disclosures, has been prepared by management and should be read in conjunction with the independent auditor's report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

**Overview of the Financial Statements**

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the trust as a whole. The full scope of the trust's activities is considered to be a single business-type activity and, accordingly, is reported within a single column in the basic financial statements.

The trust's financial report includes the statement of net position; the statement of revenues, expenses, and changes in net position; and the statement of cash flows. Notes to the financial statements are also presented to provide additional information that is essential to a full understanding of the financial statements.

**The Statement of Net Position**

The statement of net position is a point-in-time financial statement. The statement of net position presents the financial position of the trust at the end of the fiscal year. To aid the reader in determining the trust's ability to meet immediate and future obligations, the statement includes all assets, liabilities, deferred outflows/inflows, and net position of the trust and segregates the assets and liabilities into current and noncurrent components. Current assets are those that are available to satisfy current liabilities, inclusive of assets that will be converted to cash within one year. Current liabilities are those that will be paid within one year. The statement of net position is prepared under the accrual basis of accounting; assets and liabilities are recognized when goods or services are provided or received, despite when cash is actually exchanged.

From the data presented, readers of the statement are able to determine the assets available to continue the operations of the trust. They are also able to determine how much the trust owes vendors, lenders, and others. Net position represents the difference between the trust's assets

and liabilities, along with the difference between deferred outflows and deferred inflows of resources, and is one indicator of the trust's current financial condition.

The statement of net position also indicates the availability of net position for expenditure by the trust. Net position is reported as restricted net position, which is sub-divided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowments and similar resources whose use is limited by donors or other outside sources and, as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net position is available for expenditure by the trust but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the resources.

The following table summarizes the trust's assets, liabilities, deferred outflows/inflows, and net position at June 30, 2013, and June 30, 2012.

**Summary of Net Position  
(in thousands of dollars)**

	<u>2013</u>	<u>2012</u>
Assets:		
Current assets	\$ 1,360	\$ 966
Noncurrent assets	37,771	34,156
Total Assets	39,131	35,122
Net Position:		
Restricted – nonexpendable	33,806	32,085
Restricted – expendable	5,325	3,037
Total Net Position	\$39,131	\$35,122

Comparison of FY 2013 to FY 2012

- The increase in noncurrent assets and restricted – expendable net position is due to unrealized gains from market changes in fiscal year 2013.

**The Statement of Revenues, Expenses, and Changes in Net Position**

The statement of revenues, expenses, and changes in net position presents the results of operations for the fiscal year. Revenues and expenses are recognized when earned or incurred, regardless of when cash is received. The statement indicates whether the trust's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the trust, both operating and nonoperating; the expenses paid by the trust, both operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the trust.

Generally speaking, operating expenses are those expenses paid to acquire or produce the goods and services to carry out the mission of the trust. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although the trust is

dependent upon gifts to fund educational and general operations, under GASB standards these funding sources are reported as nonoperating revenues, as is investment income. As a result, the trust has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the “increase in net position” is more indicative of overall financial results for the year.

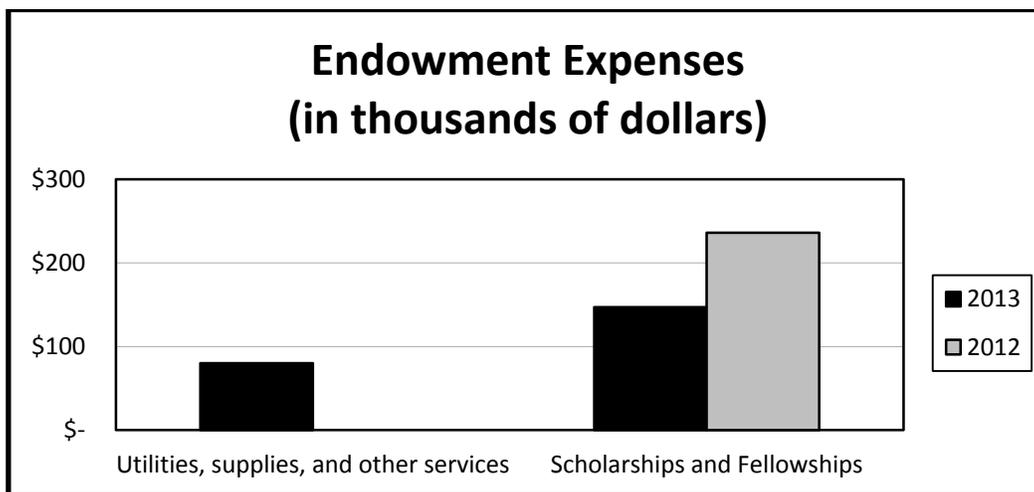
A summary of the trust’s revenues, expenses, and changes in net position for the years ended June 30, 2013, and June 30, 2012, follows.

**Summary of Revenues, Expenses, and Changes in Net Position**  
(in thousands of dollars)

	<u>2013</u>	<u>2012</u>
Operating expenses	\$ 227	\$ 236
Operating loss	(227)	(236)
Nonoperating revenues and expenses	4,235	932
Income before other revenues	4,008	696
Other revenues, expenses, gains, or losses	1	1
Increase in net position	4,009	697
Net position at beginning of year	35,122	34,425
Net position at end of year	\$39,131	\$35,122

Operating Expenses

Operating expenses may be reported by nature or function. The trust has chosen to report the expenses in their natural classification on the statement of revenues, expenses, and changes in net position. The following summarizes the operating expenses by natural classifications for the last two fiscal years:



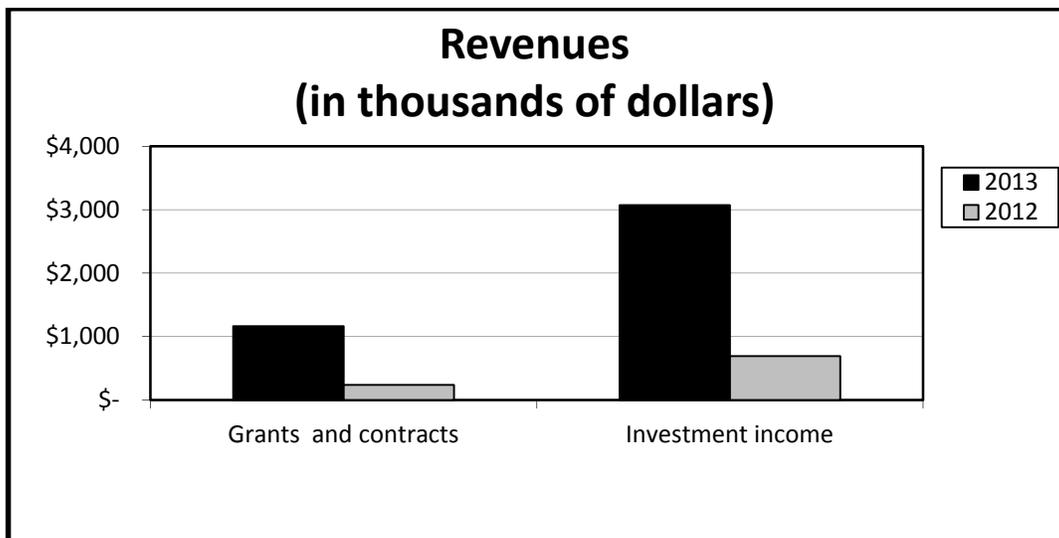
Comparison of FY 2013 to FY 2012

- Utilities, supplies, and other services increased due to amounts paid to other departments for use for endowment-appropriate expenses.

- Scholarships and fellowships decreased in fiscal year 2013 due to the additional operating expenses not part of the prior year.

Nonoperating Revenues and Expenses

Certain revenue sources that the trust relies on to provide funding for operations, including certain gifts, grants, and investment income, are defined by the GASB as nonoperating. Nonoperating expenses include capital financing costs and other costs related to capital assets. The trust had no nonoperating expenses in the last two fiscal years. The following summarizes the trust’s nonoperating revenues for the last two fiscal years:

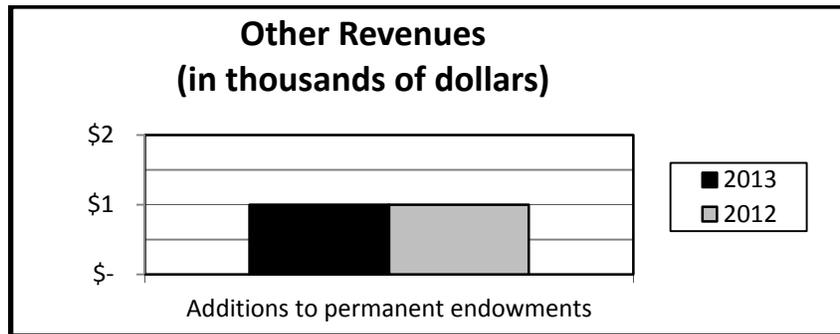


Comparison of FY 2013 to FY 2012

- Grants and contracts increased in fiscal year 2013 due to the Title III matching funds that were not available in fiscal year 2012.
- Investment income increased due to market changes that caused almost \$2 million in unrealized gains in fiscal year 2013 alone.

Other Revenues

This category is composed of state appropriations for capital purposes; capital grants and gifts; and additions to permanent endowments. These amounts were as follows for the last two fiscal years:



## **Economic Factors That Will Affect the Future**

The trust is not aware of any factors that will have a significant effect on the financial position or results of operations.

## **Requests for Information**

This financial report is designed to provide a general overview of the endowment’s finances for all those with an interest in the university’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to:

Ms. Cynthia B. Brooks  
Vice President for Business and Finance  
Tennessee State University  
3500 John Merritt Boulevard  
Nashville, TN 37209

**Tennessee Board of Regents**  
**ENDOWMENT FOR EDUCATIONAL EXCELLENCE**  
**Tennessee State University Foundation**  
**Statement of Net Position**  
**June 30, 2013**

**ASSETS**

Current assets:

Cash and cash equivalents (Note 2)	\$ 1,360,113.16
Total current assets	1,360,113.16

Noncurrent assets:

Cash and cash equivalents (Note 2)	2,398,296.09
Investments (Note 3)	35,373,078.60
Total noncurrent assets	37,771,374.69
Total assets	39,131,487.85

**NET POSITION**

Restricted for

Nonexpendable	33,806,713.58
Expendable (Note 4)	5,324,774.27
Total net position	\$39,131,487.85

The notes to the financial statements are an integral part of this statement.

**Tennessee Board of Regents**  
**ENDOWMENT FOR EDUCATIONAL EXCELLENCE**  
**Tennessee State University Foundation**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**For the Year Ended June 30, 2013**

<b>EXPENSES</b>	
Utilities, supplies, and other services	\$ 80,167.29
Scholarships and fellowships	147,162.50
<b>Total operating expenses</b>	<b>227,329.79</b>
<b>Operating loss</b>	<b>(227,329.79)</b>
<b>NONOPERATING REVENUES</b>	
Grants and contracts	1,164,503.78
Investment income	3,071,702.51
<b>Net nonoperating revenues</b>	<b>4,236,206.29</b>
<b>Income before other revenues, expenses, gains, or losses</b>	<b>4,008,876.50</b>
<b>Additions to permanent endowments</b>	<b>750.00</b>
<b>Total other revenues</b>	<b>750.00</b>
<b>Increase in net position</b>	<b>4,009,626.50</b>
<b>NET POSITION</b>	
Net position - beginning of year	35,121,861.35
<b>Net position - end of year</b>	<b>\$ 39,131,487.85</b>

The notes to the financial statements are an integral part of this statement.

**Tennessee Board of Regents**  
**ENDOWMENT FOR EDUCATIONAL EXCELLENCE**  
**Tennessee State University Foundation**  
**Statement of Cash Flows**  
**For the Year Ended June 30, 2013**

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<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Payments to suppliers and vendors	\$ (80,167.29)
Payments for scholarships and fellowships	(147,162.50)
<b>Net cash used by operating activities</b>	<b>(227,329.79)</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>	
Gifts and grants received for other than capital or endowment purposes	1,164,503.78
Private gifts for endowment purposes	750.00
<b>Net cash provided by noncapital financing activities</b>	<b>1,165,253.78</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Proceeds from sales and maturities of investments	7,291,538.31
Income on investments	890,164.23
Purchase of investments	(7,733,033.00)
Other investing receipts (payments)	56.67
<b>Net cash provided by investing activities</b>	<b>448,726.21</b>
Net increase in cash	1,386,650.20
Cash and cash equivalents - beginning of year	2,371,759.05
<b>Cash and cash equivalents - end of year</b>	<b>\$ 3,758,409.25</b>
<b>Reconciliation of operating loss to net cash used by operating activities:</b>	
Operating loss	\$ (227,329.79)
<b>Net cash used by operating activities</b>	<b>\$ (227,329.79)</b>
<b>Noncash investing, capital, and financing activities</b>	
Unrealized gains/losses on investments	\$ 1,887,084.74

The notes to the financial statements are an integral part of this statement.

**Tennessee Board of Regents**  
**ENDOWMENT FOR EDUCATIONAL EXCELLENCE**  
**Tennessee State University Foundation**  
**Notes to the Financial Statements**  
**June 30, 2013**

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**Note 1. Summary of Significant Accounting Policies**

**Reporting Entity**

Pursuant to the consent decree entered into on January 5, 2001, in settlement of the *Geier v. Sundquist* lawsuit, the Tennessee State University Foundation Endowment for Educational Excellence trust was established. This trust was created by the Tennessee Board of Regents and is operated exclusively for the educational purposes of Tennessee State University. The Tennessee State University Foundation is the trustee of these funds and, in accordance with the trust agreement, delegates the actual management of the endowment assets to professional investment managers.

The Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 18-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority votes of its members; any vacancy in its membership shall be filled in the same way. The entire membership of the board of trustees shall not exceed 25 in number and shall have a minimum of 8. All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources or income thereon that the foundation holds and invests is restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

These financial statements present only that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the Endowment for Educational Excellence.

**Basis of Presentation**

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

## Notes to the Financial Statements (Continued)

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### **Basis of Accounting**

The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all of the provider's eligibility requirements have been met.

The trust has classified its revenues and expenses as either operating or nonoperating according to the following criteria: Operating revenues and expenses are those that have the characteristics of exchange transactions. Operating expenses for the endowment include (1) utilities, supplies, and other services and (2) scholarships and fellowships.

All other activity is nonoperating in nature and includes (1) federal grant funds from the U.S. Department of Education under the Title III Strengthening Historically Black Colleges and Universities Program; (2) investment income; and (3) gifts.

### **Cash Equivalents**

This classification includes instruments that are readily convertible to known amounts of cash and have original maturities of three months or less.

### **Net Position**

The Endowment for Educational Excellence's net position is classified as follows:

Nonexpendable restricted net position - Nonexpendable restricted net position consists of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

Expendable restricted net position - Expendable restricted net position includes resources that the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. The trust agreement does provide for spending a portion of the income, as discussed in Note 4. Spending decisions are to be made by the budget committee established in the trust agreement through the preparation of an annual budget.

### **Accounting Change**

The university implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the university was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

## Notes to the Financial Statements (Continued)

### Note 2. Cash

At June 30, 2013, cash consisted of \$1,851,222.06 in bank accounts and \$1,907,187.19 in money market accounts.

### Note 3. Investments

The endowment is authorized to invest funds in accordance with its board of directors' policies. All investments permitted to be reported at fair value under GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, as amended, are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 20, 2013, the endowment had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (In Years)					No Maturity Date
		Less than 1	1 to 5	6 to 10	More than 10		
U.S. Treasury	\$ 3,081,641.41	\$ -	\$ 109,592.76	\$ 2,972,048.65	\$ -	\$ -	
U.S. agencies	853,239.94	-	853,239.94	-	-	-	
Corporate stocks	15,173,400.60	-	-	-	-	15,173,400.60	
Corporate bonds	6,295,939.02	1,576,767.08	3,345,122.19	1,374,049.75	-	-	
Mutual equity funds	2,022,405.00	-	-	-	-	2,022,405.00	
Foreign stock	1,958,477.22	-	-	-	-	1,958,477.22	
Foreign mutual funds	2,625,702.52	-	-	-	-	2,625,702.52	
Government mortgage backed securities	688,636.00	-	-	83,147.70	605,488.30	-	
Collateralized mortgage obligations	812,070.07	-	83,058.40	398,544.56	330,467.11	-	
Real estate investment trusts	1,861,566.82	-	-	-	-	1,861,566.82	
<b>Total</b>	<b>\$35,373,078.60</b>	<b>\$1,576,767.08</b>	<b>\$ 4,391,013.29</b>	<b>\$ 4,827,790.66</b>	<b>\$ 935,955.41</b>	<b>\$ 23,641,552.16</b>	

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. The endowment does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

## Notes to the Financial Statements (Continued)

### Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The foundation is authorized to invest funds in accordance with the trust agreement. Under the trust agreement, the foundation is authorized to invest and reinvest the property of the trust in any kind of investment specifically including, but not limited to, domestic or foreign government obligations of any kind; domestic or foreign securities of any kind including, but not limited to, preferred or common stocks, bonds, mortgage participants and shares of investment trusts, investment companies, money market funds, and mutual funds (including market or index funds); options to purchase or sell domestic or foreign securities or domestic or foreign government obligations of any kind; and interest in partnerships, so long as such investments are made with the care of a fiduciary. Securities are rated by Standard and Poor's, Moody's Investors Service, and/or Fitch ratings and are presented below using the Standard and Poor's rating scale. The endowment investment policy states that fixed income securities must be rated BBB or higher at the time of purchase, with an average portfolio rating of an A. Asset-backed securities, mortgage-backed securities, and collateralized mortgage obligations should have an AA rating or higher at the time of purchase. Unrated bonds may be purchased but shall not exceed 20% of the portfolio. At June 30, 2013, the endowment's investments were rated as follows:

Investment Type	Fair Value	Credit Quality Rating			
		AAA	AA	A	BBB
U.S. agencies	\$ 853,239.94	\$ -	\$ 853,239.94	\$ -	\$ -
Corporate bonds	6,295,939.02	214,093.15	689,328.91	4,634,157.61	758,359.35
Government mortgage-backed securities	688,636.00	-	688,636.00	-	-
Collateralized mortgage obligations	812,070.07	481,602.96	330,467.11	-	-
<b>Total</b>	<b>\$8,649,885.03</b>	<b>\$695,696.11</b>	<b>\$2,561,671.96</b>	<b>\$4,634,157.61</b>	<b>\$758,359.35</b>

### Alternative Investments

The endowment has investments in Real Estate Investment Trusts. The estimated fair value of these assets is \$1,861,566.82 at June 30, 2013.

The endowment believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2013. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the foundation's investment policy. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques.

## **Notes to the Financial Statements (Continued)**

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The value of shares for Inland America is estimated to be the offering of \$6.93 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value for these shares on any given date.

The value of shares for Behringer Harvard is estimated to be the offering of \$4.01 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value for these shares on any given date.

### **Note 4. Endowments**

Under the established spending plans, the budget committee may appropriate for distribution each year from Consent Decree Endowment funds, an amount up to 75% of the interest and dividend income. The budget committee may also appropriate an amount up to 50% of the interest and dividend income of Title III funds. The remaining funds are to be reinvested in the corpus of the fund. At June 30, 2013, net appreciation of \$1,360,113.16 is available to be spent, all of which is included in restricted expendable net position. Of this amount, \$662,920.29 is available from Consent Decree funds, and \$697,192.87 is available from Title III funds.