

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

*Financial Statements as of and for the
Years Ended 30 June 2006 and 2005, 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 2006 and 2005, 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 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

22 September 2006

THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

STATEMENTS OF FINANCIAL POSITION

AS OF 30 JUNE 2006 AND 2005

(Thousands of dollars)

ASSETS	2006	2005
CASH	\$ 24,658	\$ 31,050
PLEDGES RECEIVABLE—Net	821	1,268
DEFERRED CHARGES, PREPAID EXPENSES, AND OTHER ASSETS	3,309	2,995
INVESTMENTS:		
Cash and short-term investments	24,210	21,896
Bonds	159,772	166,175
Stocks	396,699	400,048
Real estate and other	<u>71,879</u>	<u>30,125</u>
Total investments	<u>652,560</u>	<u>618,244</u>
DONOR ADVISED FUNDS	5,935	2,507
SPLIT-INTEREST AGREEMENTS	<u>21,887</u>	<u>18,614</u>
TOTAL	<u>\$ 709,170</u>	<u>\$ 674,678</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accrued program awards	\$ 47,317	\$ 47,371
Accounts payable and accrued expenses	10,308	12,412
Split-interest agreements payable	7,880	7,093
Donor advised funds payable	5,935	2,507
Due to Rotary International	<u>308</u>	<u>2,436</u>
Total liabilities	<u>71,748</u>	<u>71,819</u>
NET ASSETS:		
Unrestricted:		
Undesignated	404,902	373,558
Trustee-designated:		
PolioPlus	32,372	33,319
Permanent Fund	<u>52,004</u>	<u>42,312</u>
Total unrestricted net assets	489,278	449,189
Temporarily restricted	20,485	38,196
Permanently restricted	<u>127,659</u>	<u>115,474</u>
Total net assets	<u>637,422</u>	<u>602,859</u>
TOTAL	<u>\$ 709,170</u>	<u>\$ 674,678</u>

See notes to financial statements.

THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

**STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED 30 JUNE 2006 AND 2005
(Thousands of dollars)**

	2005-2006				2004-2005			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES:								
Contributions	\$ 92,408	\$ 7,297	\$ 12,185	\$ 111,890	\$ 84,538	\$ 23,483	\$ 9,885	\$ 117,906
Net investment return	50,248			50,248	42,747			42,747
Net assets released from restrictions	25,008	(25,008)			31,172	(31,172)		
Total revenues	167,664	(17,711)	12,185	162,138	158,457	(7,689)	9,885	160,653
EXPENSES:								
Program awards and expenses:								
Educational programs	28,008			28,008	27,889			27,889
Humanitarian programs	53,019			53,019	46,096			46,096
PolioPlus program	26,919			26,919	36,195			36,195
Total program awards and expenses	107,946	-	-	107,946	110,180	-	-	110,180
Development expenses	13,689			13,689	12,255			12,255
General administration	6,647			6,647	5,680			5,680
Total expenses	128,282	-	-	128,282	128,115	-	-	128,115
CHANGE IN NET ASSETS BEFORE MINIMUM PENSION LIABILITY RECOVERY (ADJUSTMENT)	39,382	(17,711)	12,185	33,856	30,342	(7,689)	9,885	32,538
MINIMUM PENSION LIABILITY RECOVERY (ADJUSTMENT)	707			707	(347)			(347)
CHANGE IN NET ASSETS	40,089	(17,711)	12,185	34,563	29,995	(7,689)	9,885	32,191
NET ASSETS—Beginning of year	449,189	38,196	115,474	602,859	419,194	45,885	105,589	570,668
NET ASSETS—End of year	\$ 489,278	\$ 20,485	\$ 127,659	\$ 637,422	\$ 449,189	\$ 38,196	\$ 115,474	\$ 602,859

See notes to financial statements.

THE ROTARY FOUNDATION OF ROTARY INTERNATIONAL

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2006 AND 2005 (Thousands of dollars)

	2005-2006	2004-2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 34,563	\$ 32,191
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Realized gain on sale of investments	(31,991)	(14,096)
Unrealized gain on investments—net	(1,427)	(16,445)
Contributed securities	(3,917)	(3,724)
Changes in assets and liabilities:		
Pledges receivable—net	447	1,437
Deferred charges, prepaid expenses, and other assets	(314)	(110)
Accrued program awards	(54)	14,314
Accounts payable and accrued expenses	(2,104)	3,100
Split-interest agreements payable	787	1,629
Due to Rotary International	<u>(2,128)</u>	<u>3,403</u>
Net cash flows from operating activities	<u>(6,138)</u>	<u>21,699</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(1,104,392)	(1,002,128)
Proceeds from sale of investments	1,106,452	973,332
Change in investment cash and short-term investments	<u>(2,314)</u>	<u>5,689</u>
Net cash flows from investing activities	<u>(254)</u>	<u>(23,107)</u>
DECREASE IN CASH	(6,392)	(1,408)
CASH—Beginning of year	<u>31,050</u>	<u>32,458</u>
CASH—End of year	<u>\$ 24,658</u>	<u>\$ 31,050</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 2006 AND 2005 (Thousands of dollars)

1. NATURE OF OPERATIONS

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

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

- *Unrestricted*—Net assets which are free of donor-imposed restrictions; all revenues, expenses, gains, and losses that are not changes in permanently or temporarily restricted net assets. The Annual Programs Fund, which receives revenue primarily from voluntary contributions from Rotary districts, clubs, Rotarians, and others, as well as certain accumulated earnings as described in Note 10, have been classified as unrestricted net assets.
- *Temporarily Restricted*—Net assets whose use by the Foundation is limited by donor-imposed restrictions that either expire by the passage of time or can be removed by fulfillment of the stipulated purpose for which the donation was restricted. Revenues received from voluntary contributions which are restricted to the PolioPlus Program, 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 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 \$4,905 and \$3,388 at 30 June 2006 and 2005, respectively, subject to certain repatriation restrictions imposed by local governments.

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

Due to 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 where available (Note 4). 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.

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

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

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

Tax Status—The Rotary Foundation is a qualified not-for-profit organization exempt from income tax under Section 501(c)(3) of the Internal Revenue Code, but is subject to U.S. tax on any unrelated business income. There was no such taxable income in 2006 or 2005.

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 generally 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 investment, 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.

3. PLEDGES RECEIVABLE

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

	2005–2006	2004–2005
Due within one year	\$ 822	\$ 1,048
Due within one to five years	161	495
Due after five years	<u>5</u>	<u>10</u>
	988	1,553
Present value discount	(120)	(232)
Allowance for uncollectible pledges	<u>(47)</u>	<u>(53)</u>
Pledges receivable	<u>\$ 821</u>	<u>\$ 1,268</u>
Present value discount rates	8.0%–8.25%	1.2%–8.7%

4. INVESTMENTS

At 30 June 2006, the Foundation did not have any investments in bonds denominated in currencies other than the U.S. dollar. The Foundation did have \$2,179 of investment in bonds denominated in currencies other than the U.S. dollar at 30 June 2005. Accrued interest and dividends are included in total investments. The net unrealized gain for 2005-2006 includes a provision for an unrealized contingency loss on investments of \$16 million.

The components of net investment return are as follows:

	2005–2006	2004–2005
Interest and dividends	\$ 17,451	\$ 14,139
Realized gain	31,991	14,096
Unrealized gain—net	1,427	16,445
Currency exchange gains	420	155
Investment and banking fees	(2,511)	(2,191)
Miscellaneous gain	<u>1,470</u>	<u>103</u>
Total	<u>\$ 50,248</u>	<u>\$ 42,747</u>

5. FINANCIAL INSTRUMENTS

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

security. All financial instruments are recorded at fair value with gains and losses resulting from changes in fair value recognized in net assets in the period of change.

6. ROTARY INTERNATIONAL REIMBURSEMENTS

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:

	2005–2006	2004–2005
World headquarters general administration	\$ 9,034	\$ 6,844
Information Services	7,071	5,458
International Offices	3,217	2,972
One Rotary Center net occupancy costs	639	525
International Assembly	<u>1,063</u>	<u>1,086</u>
Total	<u>\$ 21,024</u>	<u>\$ 16,885</u>

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

	2005–2006	2004–2005
Educational programs	\$ 3,881	\$ 3,132
Humanitarian Programs	6,037	4,760
PolioPlus programs	798	834
Development expenses	8,036	6,484
General administration	<u>2,272</u>	<u>1,675</u>
Total	<u>\$ 21,024</u>	<u>\$ 16,885</u>

7. BENEFIT PLANS

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

Rotary'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 uses a 30 June measurement date for its plan.

Rotary International applies the Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* ("SFAS 87"), in reporting retirement plan activities. As of 30 June 2006, the retirement plan's accumulated benefit obligation, \$27,955, was less than the fair value of retirement plan

assets, \$29,492. The minimum pension liability recovery allocated to The Rotary Foundation, was \$707 at 30 June 2006, based upon its proportionate share of payroll expense for 2005–2006.

The net periodic pension expense allocated to The Rotary Foundation based upon its proportionate share of payroll expense for 2005–2006 and 2004–2005 was \$506 and \$409, respectively.

401(k) Plan—The Rotary Foundation is allocated its proportionate share of 401(k) expense for the Rotary International 401(k) Plan. Employees of Rotary International participate in the Rotary International 401(k) Plan, which is a defined contribution plan. Employees voluntarily make contributions to the Plan in amounts based upon a percentage of their total compensation, up to a maximum of 15%, subject to limitations imposed by the Internal Revenue Service. Rotary International matches 50% of the first 6% contributed of the participant’s annual compensation. The expense allocated to The Rotary Foundation for the years ended 30 June 2006 and 2005 was \$177 and \$150, respectively. The Plan’s assets are invested in certain fixed income, money market, and equity funds.

8. SPLIT-INTEREST AGREEMENTS

The Rotary Foundation is the 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.

9. PROGRAM AWARDS AND EXPENSES

Program awards and expenses comprise:

	2005–2006			2004–2005		
	Awards	Expenses	Total	Awards	Expenses	Total
Educational Programs	\$ 21,919	\$ 6,089	\$ 28,008	\$ 22,890	\$ 4,999	\$ 27,889
Humanitarian Programs	44,281	8,738	53,019	38,509	7,587	46,096
PolioPlus Program	24,865	2,054	26,919	33,133	3,062	36,195
Total	<u>\$91,065</u>	<u>\$ 16,881</u>	<u>\$ 107,946</u>	<u>\$ 94,532</u>	<u>\$ 15,648</u>	<u>\$ 110,180</u>

10. UNRESTRICTED NET ASSETS

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

11. DONOR ADVISED FUND PROGRAM

During 2002, The Rotary Foundation established a Donor Advised Fund (the "Fund"). The Fund accepts contributions and offers individuals and Rotary-affiliated groups the flexibility to make grant recommendations to either The Rotary Foundation or other unaffiliated IRS approved charities. Donors may recommend grants at any time which are subject to approval by the Trustees. At 30 June 2006 and 2005, assets and equal offsetting liabilities of \$5,935 and \$2,507, respectively, have been recorded in the Statements of Financial Position.

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