Consolidated Financial Statements
June 30, 2018

Northern Arizona University Foundation, Inc. and Subsidiaries

Independent Auditor's Report

To the Board of Directors
Northern Arizona University Foundation, Inc. and Subsidiaries
Flagstaff, Arizona

Report on the Consolidated Financial Statements
We have audited the accompanying consolidated financial statements of Northern Arizona University Foundation, Inc. and Subsidiaries, which comprise the consolidated statement of financial position as of June 30, 2018, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northern Arizona University Foundation, Inc. and Subsidiaries as of June 30, 2018, and the results of its changes in net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Eide Bailly LLP

Phoenix, Arizona
September 11, 2018

Assets	
Cash and cash equivalents	$ 2,064,188
Promises to give, net	9,812,827
Bequests receivable	1,524,262
Other receivables	104,667
Net investment in direct financing leases	4,649,181
Investments	183,227,568
Cash surrender value of life insurance	6,624,467
EBS licenses, net	233,322
Donated assets held-for-sale	301,942
Assets held under split-interest agreements	4,320,322
Beneficial interests in perpetual trusts	3,388,459
Other assets and prepaids	95,000
Total assets	$ 216,346,205
Liabilities and Net Assets	
Accounts payable and accrued liabilities	$ 272,614
Assets held in custody for others	34,235,324
Due to Northern Arizona University	319,355
Deferred revenue	5,341,005
Liabilities under split-interest agreements	2,770,980
Total liabilities	42,939,278
Net Assets	
Unrestricted	
Board-designated endowment	10,815,925
Undesignated	(2,002,023)
	8,813,902
Temporarily restricted	81,573,399
Permanently restricted	83,019,626
Total net assets	173,406,927
Total liabilities and net assets	$ 216,346,205

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, Support, and Gains				
Public contributions	$ 34,848	$ 9,318,280	$ 4,450,104	$ 13,803,232
EBS revenue	1,721,836	-	-	1,721,836
Net investment return	761,657	12,532,845	139,827	13,434,329
Interest income on direct financing leases	248,737	-	-	248,737
Change in beneficial interests in perpetual trusts	-	-	57,026	57,026
Change in value of split-interest agreements	(496,784)	-	-	(496,784)
Change in cash surrender value of life insurance	-	660,693	-	660,693
Other income and support	16,500	558,913	114,901	690,314
Reclassification of donor intent	(222,883)	(4,253)	227,136	-
Net assets released from restrictions	10,567,193	(10,567,193)	-	-
Total revenue, support, and gains	12,631,104	12,499,285	4,988,994	30,119,383
Expenses and Losses				
Program expenses				
Disbursements for educational purposes	3,479,142	-	-	3,479,142
Scholarships	3,603,708	-	-	3,603,708
Facilities	323,513	-	-	323,513
Other University programs	1,076,172	-	-	1,076,172
Total program expenses	8,482,535	-	-	8,482,535
Supporting services expense				
Management and general	588,478	-	-	588,478
Fundraising and development	5,037,594	-	-	5,037,594
Amortization of EBS licenses	111,581	-	-	111,581
Total supporting services expenses	5,737,653	-	-	5,737,653
Total expenses and losses	14,220,188	-	-	14,220,188
Change in Net Assets	(1,589,084)	12,499,285	4,988,994	15,899,195
Net Assets, Beginning of Year	10,402,986	69,074,114	78,030,632	157,507,732
Net Assets, End of Year	$ 8,813,902	$ 81,573,399	$ 83,019,626	$ 173,406,927

Operating Activities	
Change in net assets	$ 15,899,195
Adjustments to reconcile change in net assets to net cash used for operating activities	
Amortization of EBS license	111,581
Amortization of interest income on direct financing lease	(248,737)
Realized and unrealized gain on investments	(11,118,642)
Donated investments	(699,372)
Donated real estate	(260,000)
Realized and unrealized gain on custodial investments	(1,339,916)
Change in present value of discount on promises to give	(22,845)
Change in allowance for uncollectible promises to give	(2,599)
Change in discount on bequests receivable	(11,650)
Change in value of assets held under split-interest agreements	(290,940)
Change in beneficial interests in perpetual trust	(57,026)
Contributions restricted to endowment	(4,450,104)
Change in value of liabilities under split-interest agreements	489,443
Changes in operating assets and liabilities	
Promises to give	(1,014,218)
Bequests receivable	(1,394,758)
Other receivables	(3,148)
Accounts payable and accrued liabilities	85,975
Deferred revenue	(195,508)
Net Cash used for Operating Activities	(4,523,269)
Investing Activities	
Purchases of investments	(4,903,872)
Proceeds from sales of investments	2,576,992
Change in cash surrender value of life insurance	(660,693)
Change in assets held in custody for others	2,519,547
Purchase of EBS license	(250,000)
Collections on net investment in direct financing lease	488,225
Earnest deposit for real estate purchase	(50,000)
Proceeds of assets held under split-interest agreements	449,494
Net Cash from Investing Activities	169,693
Financing Activities	
Collections of contributions restricted to endowment	4,450,104
Payments to Northern Arizona University	(334,236)
Payments to beneficiaries of split-interest agreements	(89,191)
Net Cash from Financing Activities	4,026,677
Net Change in Cash and Cash Equivalents	(326,899)
Cash and Cash Equivalents, Beginning of Year	2,391,087
Cash and Cash Equivalents, End of Year	$ 2,064,188

Note 1 - Principal Activity and Significant Accounting Policies

Organization

The Northern Arizona University Foundation, Inc. (NAU Foundation) is an Arizona nonprofit organization operating exclusively for the benefit of Northern Arizona University (the University). The NAU Foundation receives gifts and bequests, administers and invests securities and property, and disburses payments to and on behalf of the University for the advancement of its mission.

Northern Arizona Real Estate Holdings, LLC, (NAREH) is a wholly owned subsidiary of NAU Foundation. NAREH was established to construct, develop, equip, operate, maintain, lease, and hold real estate investments on behalf of NAU Foundation.

NAU Ventures, LLC (NAUV) is a wholly owned subsidiary of NAU Foundation. NAUV was established to license or otherwise commercialize the intellectual property owned or controlled by the Arizona Board of Regents, the University, or NAU Foundation, to perform other technology transfer and intellectual property management services for the University, and to perform other services from time to time.

Based on the type of organization of NAREH and NAUV, and as otherwise provided in the operating agreement executed by the member of the respective companies, no member is personally liable for any acts, debts, or liabilities beyond the member’s capital contributions. The LLCs have no defined finite lives.

Principles of Consolidation

The consolidated financial statements include the accounts of NAU Foundation, NAREH, and NAUV because the NAU Foundation has both control and an economic interest in NAREH and NAUV. All significant intercompany accounts and transactions have been eliminated in consolidation. Unless otherwise noted, these consolidated entities are hereinafter referred to as “the Foundation.”

Cash and Cash Equivalents

The Foundation considers all cash and highly liquid financial instruments with original maturities of three months or less, and which are neither held for nor restricted by donors for long-term purposes, to be cash and cash equivalents. Cash and highly liquid financial instruments restricted to capital expenditures, permanent endowment, or other long-term purposes of the Foundation are excluded from this definition.

Bequests Receivable

Bequests receivable are recognized as contribution revenue in the period the Foundation receives notification the court has found the will of the donor’s estate to be valid and all conditions have been substantially met. Bequests receivable are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible bequests receivable based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible bequests receivable and a credit to bequests receivable. At June 30, 2018, bequests receivable are considered by management to be fully collectible and, accordingly, an allowance for uncollectible bequests receivable has not been provided.

Promises to Give

Unconditional promises to give expected to be collected within one year are recorded at net realizable value. Unconditional promises to give expected to be collected in future years are initially recorded at fair value using present value techniques incorporating risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the asset. In subsequent years, amortization of the discounts is included in contribution revenue in the statement of activities. Management determines the allowance for uncollectable promises to give based on historical experience, an assessment of economic conditions, and a review of subsequent collections. Promises to give are written off when deemed uncollectable. At June 30, 2018, the allowance was $235,047.

In October 2011, the Foundation received a conditional promise to give that matches funds raised and deposited for a specific endowment fund at a ratio of 3:1, with a maximum matching annual contribution totaling $133,333 per year for a period of five years. The agreement is based upon fiscal years ending on October 31. The agreement was amended in April 2016 to change the maximum matching annual contribution total to $97,910 per year for a period of three years, extending the original promise to give by two years ending October 31, 2018. For the year ended June 30, 2018, the Foundation had raised approximately $54,000 towards the match and as such, has recorded contribution revenue of approximately $18,000. Any remaining matching contribution will be recognized if and when the Foundation raises the necessary amount to meet the conditions of this promise.

Property and Equipment

Property and equipment additions over $5,000 are recorded at cost, or if donated, at fair value on the date of donation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets ranging from five to ten years, or in the case of capitalized leased assets or leasehold improvements, the lesser of the useful life of the asset or the lease term. When assets are sold or otherwise disposed of, the cost and related depreciation or amortization are removed from the accounts, and any remaining gain or loss is included in the statement of activities. Costs of maintenance and repairs that do not improve or extend the useful lives of the respective assets are expensed currently.

The Foundation reviews the carrying values of property and equipment for impairment whenever events or circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. When considered impaired, an impairment loss is recognized to the extent carrying value exceeds the fair value of the asset. There were no indicators of asset impairment during the year ended June 30, 2018.

Educational Broadband Services License and Deferred Revenue

The Foundation has been granted several educational broadband services (EBS) licenses from the Federal Communications Commission (FCC), which have been fully amortized since the date of donation. Additionally, the Foundation has entered into an agreement to purchase EBS licenses with initial funding of $15,000,000 from an outside corporation. Under the agreement, the Foundation purchases EBS licenses and then subsequently leases the licenses to the outside corporation. The Foundation recognizes revenue at the time of purchase of an EBS license and recognizes rent revenue for the duration of the lease agreement. Any unspent proceeds from the initial funding are reflected as deferred revenue in the accompanying consolidated statements of financial position.

The cost of the purchased licenses is amortized using the straight-line method over estimated useful lives of ten years or the remaining life of the license, whichever is shorter at time of acquisition.

Assets Held and Liabilities under Split-Interest Agreements

Charitable Trusts

The Foundation acts as trustee for various revocable and irrevocable trusts. These trusts are governed by the respective trust agreements, which generally provide for either an income stream or a future distribution of cash or other assets to the Foundation, in whole or in part, for a specified period or upon the occurrence of a specific event, respectively. If a trust is revocable, or if the maker of the trust reserves the right to replace the Foundation as the beneficiary of the trust, the Foundation records the assets placed in trust at fair value, with an equal and offsetting liability until such time the Foundation receives distributions from the trust in accordance with its terms. If the trust is irrevocable, the trust assets are recorded at fair value, and a related liability for future payments to be made to the specified beneficiaries is recorded at fair value using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the liability. The excess of contributed assets over the trust liability is recorded as a temporarily or permanently restricted contribution until such amount is received via trust distribution and/or is expended in satisfaction of the restricted purpose stipulated by the trust agreement, if any, at which time temporarily restricted net assets are released to unrestricted net assets and permanently restricted net assets are transferred to the endowment. In subsequent years, the liability for future trust payments to the donor is reduced by payments made to the donor and is adjusted to reflect changes in the fair value of the liability at the end of the year. Upon termination of the trust, the remaining liability, if any, is removed and recognized as income.

Charitable Gift Annuities

Under charitable gift annuity contracts, the Foundation receives immediate and unrestricted title to contributed assets and agrees to make fixed recurring payments over the stipulated period. Contributed assets are recorded at fair value on the date of receipt. The related liability for future payments to be made to the specified beneficiaries is recorded at fair value using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the liability. The excess of contributed assets over the annuity liability is recorded as an unrestricted contribution. In subsequent years, the liability for future payments to the donor is reduced by payments made to the donor and is adjusted to reflect changes in the fair value of the liability at the end of the year. Upon termination of the annuity contract, the remaining liability is removed and recognized as income.

Beneficial Interests in Perpetual Trusts

The Foundation has been named as an irrevocable beneficiary of several perpetual trusts held and administered by independent trustees. Perpetual trusts provide for the distribution of the net income of the trusts to the Foundation; however, the Foundation will never receive the assets of the trusts. At the date the Foundation receives notice of a beneficial interest, a permanently restricted contribution is recorded in the statement of activities, and a beneficial interest in perpetual trust is recorded in the statement of financial position at the fair value of the underlying trust assets. Thereafter, beneficial interests in the trusts are reported at the fair value of the trusts’ assets in the statement of financial position, with trust distributions and changes in fair value recognized in the statement of activities.

Investment in Direct Financing Lease

The Foundation has two leases which are classified as direct financing leases. The components of the net investment in direct financing leases include the minimum lease payments receivable, unguaranteed residual values, and unearned income. Interest income is recognized over the life of the lease.

The carrying amount of the net investment in direct financing leases is reduced by a valuation allowance for uncollectible lease payments. The allowance for uncollectible lease payments is established as losses are estimated to have occurred through a provision for lease losses charged to earnings. Lease losses are charged against the allowance when management believes the uncollectability of a lease balance is confirmed. Subsequent recoveries, if any are credited to the allowance. As of June 30, 2018, the allowance for uncollectible lease payments was $0.

Investments

Investment purchases are recorded at cost, or if donated, at fair value on the date of donation. Thereafter, investments are reported at their fair values in the statement of financial position. Net investment gain/(loss) is reported in the statement of activities and consists of interest and dividend income, realized and unrealized gains and losses, less investment management and custodial fees.

For management efficiency, investments of the unrestricted and restricted net assets are pooled, except for certain assets that the board of directors or the donors have designated to be segregated and maintained separately.

Cash Surrender Value of Life Insurance

The Foundation is the owner and beneficiary of ten life insurance policies covering the lives of certain donors to the Foundation. The policies are recorded at their cash surrender value at the policy's anniversary date. Policy earnings and expenses are included in the accompanying consolidated statement of activities.

Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Unrestricted Net Assets – Net assets available for use in general operations. Unrestricted board-designated net assets consist of net assets designated by the board of directors for operating reserve and quasi-endowment.

Temporarily Restricted Net Assets – Net assets subject to donor restrictions that may or will be met by expenditures or actions of the Foundation and/or the passage of time, and certain income earned on permanently restricted net assets that has not yet been appropriated for expenditure by the Foundation's board of directors.

The Foundation reports contributions as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently Restricted Net Assets – Net assets whose use is limited by donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by action of the Foundation. The restrictions stipulate that resources be maintained permanently but permit the Foundation to expend the income generated in accordance with the provisions of the agreements.

Reclassification of Donor Intent

At times, the Foundation receives requests by donors or their designees to change the use for which the donor's original gift was intended. These donor requests are reviewed by the Foundation for approval, and if approved, may result in the reclassification of net assets between unrestricted, temporarily restricted, or permanently restricted net assets. These reclassifications are reflected in the consolidated statement of activities for the year ended June 30, 2018 as reclassification of donor intent.

Revenue and Revenue Recognition

Revenue from exchange transactions, investment activities, management fees, other fees and charges, and non-contribution related revenue is recognized when earned. Revenue received in advance is recorded as deferred revenue in the accompanying consolidated statements of financial position. Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a beneficial interest is received. Contributions received with temporary restrictions that are met in the same reporting period are reported as unrestricted support and increase unrestricted net assets. Conditional promises to give are not recognized until the conditions on which they depend have been substantially met.

Donated Services and In-Kind Contributions

Contributed goods are recorded at fair value at the date of donation. The Foundation records donated professional services at the respective fair values of the services received. The consolidated financial statements do not reflect the value of any donated services as they do not meet the recognition criteria prescribed by generally accepted accounting principles.

Functional Allocation of Expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income Taxes

NAU Foundation is organized as an Arizona nonprofit corporation and has been recognized by the Internal Revenue Service (IRS) as exempt from federal income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3), and has been determined not to be a private foundation under Sections 509(a)(1). Contributions to it qualify for the charitable contribution deduction under Section 170(b)(1)(A). NAU Foundation is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. In addition, NAU Foundation is subject to income tax on net income that is derived from business activities that are unrelated to its exempt purposes. NAU Foundation has determined it is not subject to unrelated business income tax and has not filed an Exempt Organization Business Income Tax Return (Form 990-T) with the IRS, or its Arizona equivalent (Form 99-T) with the Arizona Department of Revenue.

NAUV and NAREH are organized as single-member, limited liability corporations and are disregarded as entities separate from NAU Foundation for income tax purposes.

NAU Foundation believes that it has appropriate support for any income tax positions taken by the combined entity, and as such, does not have any uncertain tax positions that are material to the financial statements. NAU Foundation would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred.

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 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 and those differences could be material.

Financial Instruments and Credit Risk

The Foundation manages deposit concentration risk by placing cash and investments with financial institutions and investment brokerage firms believed by management to be creditworthy. At times, amounts on deposit may exceed insured limits or include uninsured investments in money market mutual funds held at financial institutions. To date, the Foundation has not experienced losses in any of these accounts. Credit risk associated with accounts receivable and promises to give is considered to be limited due to high historical collection rates.

Investments are made by an investment manager whose performance is monitored by management and the board of directors. Although the fair values of investments are subject to fluctuation on a year-to-year basis, management and the board of directors believe that the investment policies and guidelines are prudent for the long-term welfare of the Foundation.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-02 to improve financial reporting about leasing transactions (Topic 842). The ASU affects all lease transactions. Lessors will classify leases as either a sales-type, direct financing, or operating lease. In a sales-type lease, the lessor transfers control of the underlying asset to the lessee. At lease commencement, the lessor should derecognize the leased asset and record its net investment in the lease. The net investment in the lease consists of a lease receivable and the unguaranteed residual asset. In a direct financing lease, the lessor should derecognize the leased asset underlying the lease and record a net investment in the lease at lease commencement. The net investment in the lease should be measured in the same manner as a sales-type lease adjusted for selling profit and initial direct costs. An operating lease is neither a sale nor financing of an asset. The lessor should keep the asset underlying the lease on its balance sheet and continue to depreciate the asset based on its useful life. Rental revenue should be recognized on a straight-line basis. The Foundation has several leasing transactions. The amendments in this update are effective for years beginning after December 15, 2019. The Foundation is currently evaluating the impact of adopting ASU 2016-02 and has not determined the effect to the consolidated financial statements.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of ASU 2014-09 is that revenue should be recognized in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 defines a five-step process in order to achieve this core principle which may require the use of judgment and estimates. The entity may adopt ASU 2014-09 either by using a full retrospective approach for all periods presented or a modified retrospective approach. Additionally, in April 2016, FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. The amendments in this standard clarify the process of identifying performance obligations and the licensing implementation guidance. These standards are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016. The Foundation has not yet selected a transition method and is currently evaluating the impact of these standards on its consolidated financial statements.

In August 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-14 to improve presentation of financial statements for nonprofit entities. The ASU affects all nonprofit entities. The main provisions of this Update that will impact the Foundation include:

- Present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. The nonprofits will report amounts for net assets with donor restrictions and net assets without donor restrictions. They will also be required to present on the face of the statement of activities the amount of the change in each of the two classes of net assets rather than that of the currently required three classes.
- All nonprofits will now be required to disclose an analysis of expenses by both functional and natural classifications.
- All nonprofits will have to add disclosures regarding how they manage liquidity and information that communicates the availability of financial assets to meet cash needs for general expenditures.
- Changes in reporting underwater endowments.

This new standard will be effective for years beginning after December 15, 2017, or July 1, 2018 for the Foundation. The standard requires retrospective application.

Subsequent Events

The Foundation has evaluated subsequent events through September 11, 2018, the date the consolidated financial statements were available to be issued.

Note 2 - Fair Value of Assets and Liabilities

Certain assets and liabilities are reported at fair value in the consolidated financial statements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal, or most advantageous, market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Inputs used to determine fair value refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available. A three-tier hierarchy categorizes the inputs as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Foundation can access at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, 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, and market-corroborated inputs.

Level 3 – Unobservable inputs for the asset or liability. In these situations, the Foundation develops inputs using the best information available in the circumstances.

In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to entire measurement requires judgment, taking into account factors specific to the asset or liability. The categorization of an asset within the hierarchy is based upon the pricing transparency of the asset and does not necessarily correspond to our assessment of the quality, risk or liquidity profile of the asset or liability.

A significant portion of the Foundation's investment assets are classified within Level 1 because they are comprised of common stock, money market funds, and open-end mutual funds with readily determinable fair values based on daily market prices or redemption values. Corporate bonds are valued by the custodians of the securities using pricing models based on credit quality, time to maturity, stated interest rates and market-rate assumptions; life insurance policies are valued at cash surrender value; fair values of beneficial interests in charitable trusts held by others and other investments are valued using market-price data for similar assets. These are classified within Level 2. The Foundation's investment in real estate is based upon the expected liquidation value of the property based on comparable property in a similar market. Because these inputs are unobservable, these investments are classified within Level 3.

The fair values of obligations under split-interest agreements are determined using present value techniques, actuarial tables, the fair values of trust investments as reported by the trustees or held by the Foundation, and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the underlying assets and liabilities. The fair values of beneficial interests in charitable and perpetual trusts are determined by management using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the underlying assets and are based on the fair values of trust investments as reported by the trustees. These are considered to be Level 3 measurements.

The Foundation measures the fair value of assets held in custody for others based on a pooling of investments based on a net asset value per share of the pool. Since the fair value of the majority of the liability balance is based primarily upon the observable inputs used during the valuation of the assets but not based upon identical inputs for identical agency liabilities, a Level 2 classification has been assigned for the inputs used to determine the fair value of the majority of assets held in custody for others liability.

The following table presents assets and liabilities measured at fair value on a recurring basis at June 30, 2018:

		Fair Value Measurements at Report Date Using		
Assets	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Operating investments				
Mutual Fund				
U.S. Governmental Bond Municipal Fund	$ 13,925,631	$ -	$ 13,925,631	$ -
Corporate Bond Mutual Fund	13,663,553	13,663,553	-	-
Exchange Traded Funds	357,212	357,212	-	-
Equity Mutual Funds	69,544,262	69,544,262	-	-
International Bond Mutual Funds	6,837,116	6,837,116	-	-
International Equity Mutual Funds	69,737,587	69,737,587	-	-
Common Stock	3,419,494	3,419,494	-	-
Money Market Funds	1,946,664	1,946,664	-	-
Corporate Bonds	3,796,049	-	3,796,049	-
	$ 183,227,568	$ 165,505,888	$ 17,721,680	$ -
Assets held under split-interest agreements				
Mutual Fund				
Corporate Bond Mutual Funds	$ 1,113,632	$ -	$ 1,113,632	$ -
Equity Mutual Funds	2,387,445	2,387,445	-	-
Alternative Investment Mutual Funds	398,437	398,437	-	-
Money Market Funds	82,346	82,346	-	-
Real Estate	338,462	-	-	338,462
	$ 4,320,322	$ 2,868,228	$ 1,113,632	$ 338,462
Beneficial interests in perpetual trusts	$ 3,388,459	$ -	$ -	$ 3,388,459
Liabilities				
Assets held in custody for others	$ 34,235,324	$ -	$ 34,235,324	$ -
Liabilities under split-interest agreements	$ 2,770,980	$ -	$ -	$ 2,770,980

The following is a reconciliation of the beginning and ending balance of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2018:

	Fair Value Measurements at Report Date Using Significant Unobservable Inputs (Level 3)		
Year Ended June 30, 2018	Real Estate Investment Under Split-Interest Agreement	Beneficial Interest in Perpetual Trusts	Liabilities Under Split-Interest Agreements
Balance at June 30, 2017	$ 338,462	$ 3,327,839	$ 2,370,728
Change in value of assets held by third party	-	60,620	-
Purchases/contributions of investments	-	-	-
Distributions	-	-	(89,191)
Change in actuarial valuation	-	-	489,443
Balance at June 30, 2018	$ 338,462	$ 3,388,459	$ 2,770,980
The amount of the total gains for the period or included in changes in net assets attributable to the change in unrealized gains or losses related to assets still held at the reporting date	$ -	$ 60,620	$ -

Fair Value of Financial Instruments Not Required to Be Reported at Fair Value

The carrying amounts of cash and cash equivalents, bequests receivable, other receivables, net investment in direct financing leases, accounts payable, accrued expenses and other liabilities, and deferred revenue approximate fair value due to the short-term nature of the items. The carrying amount of promises to give due in more than one year is based on the discounted net present value of the expected future cash receipts and approximates fair value.

Note 3 - Net Investment Return

Net investment return consists of the following for the year ended June 30, 2018:

Interest and dividends	$ 2,395,403
Net realized and unrealized gain (loss)	11,118,642
Less investment management and custodial fees	(79,716)
	$ 13,434,329

Note 4 - Promises to Give

Unconditional promises to give are estimated to be collected as follows at June 30, 2018:

Within one year	$ 3,294,890
In one to five years	6,704,696
Over five years	172,142
	10,171,728
Less discount to present value at rates ranging from 0.1% - 2.42%	(123,854)
Less allowance for uncollectible promises to give	(235,047)
	$ 9,812,827

At June 30, 2018, two donors accounted for approximately 47% of gross promises to give.

Note 5 - EBS Licenses and Leases

Prior to 2002, the Foundation was the recipient of several donated EBS licenses, which were subsequently fully amortized. In fiscal year 2008, the Foundation received approximately $15,000,000 from an outside corporation to purchase additional licenses in exchange for exclusive rights to leasing the purchased licenses. The following is a summary of activity relating to the original $15,000,000 and the resulting deferred revenue as of June 30, 2018:

Original advanced funds	$ 15,000,000
Licenses purchased in previous years	(8,900,045)
Cash transfers out of investments	(363,427)
One-time bonus in previous year	(1,300,000)
Interest earned in previous years on advanced funds	820,714
Interest earned in current year on advanced funds	83,763
	$ 5,341,005

The licenses are granted for ten-year terms, which are due to expire at various dates through 2027. The licenses are renewable indefinitely in ten-year increments, and the Foundation intends on renewing all licenses currently held. The following is a summary of EBS licenses held as of June 30, 2018:

EBS licenses	$ 9,150,045
Accumulated amortization	(8,916,723)
Net EBS licenses	$ 233,322

Annual amortization expense for the year ended June 30, 2018 was $111,581.

The future amortization of the existing EBS licenses is as follows:

Years Ending June 30,	
2019	$ 41,258
2020	41,258
2021	41,258
2022	41,258
2023	41,258
Thereafter	27,032
	$ 233,322

The Foundation leases the licenses after purchase. The leases are granted for ten-year terms, in accordance with the license terms, which are due to expire at various dates through June 2027. The FCC has certain educational programming requirements. As part of the lease agreements, the lessees are responsible for ensuring that the educational requirements are met. After the educational requirements are met, there is excess frequency capacity that can be used. The Foundation receives monthly lease payments for the use of the excess capacity. In addition to the monthly payment terms, several leases required the lessee to pay an initial fee.

The terms of the related lease agreements correspond with the terms of the licenses. Most leases have renewal clauses, which provide for a maximum lease term of 30 years. Total revenue received from these agreements was $1,721,836 for the year ended June 30, 2018.

Minimum future lease receipts under the existing EBS licenses are as follows:

Years Ending June 30,	
2019	$ 1,324,968
2020	1,338,312
2021	1,352,496
2022	1,350,452
2023	708,274
Thereafter	469,552
	$ 6,544,054

Note 6 - Direct Financing Leases

During fiscal 2013, NAREH constructed a building on certain property owned by the Arizona Board of Regents with a total initial direct cost of $9,780,185, which is also the initial net investment in direct financing lease. NAREH then leased the building to Northern Arizona University under a direct financing lease. The lease with Northern Arizona University originated in fiscal 2013 and has a 20-year term.

Net investment in direct financing leases consists of the following at June 30, 2018:

Net minimum lease payments receivable	$ 6,367,835
Unearned income	(1,718,654)
Net investment in direct financing leases	$ 4,649,181

Minimum future lease receipts under these direct financing leases are as follows as of June 30, 2018:

Years Ending June 30,	
2019	$ 490,575
2020	487,100
2021	491,075
2022	490,060
2023	487,275
Thereafter	3,921,750
Direct financing lease	$ 6,367,835

Note 7 - Assets Held in Custody for Others

The Foundation maintains certain assets on behalf of others. The balances of assets held in custody for others consist of the following at June 30, 2018:

Cash	$ 1,779,868
Pledges receivable	100
Investments	31,779,875
Beneficial interest in perpetual trust	675,481
	$ 34,235,324

Assets held on behalf of:	
Northern Arizona University	$ 33,896,468
NAU Parents' Association	338,856
	$ 34,235,324

Note 8 - Endowments

The Foundation’s endowment (the Endowment) consists of approximately 800 individual funds established by donors to provide annual funding for specific activities and general operations. The Endowment also includes certain unrestricted net assets designated for quasi-endowment by the board of directors, and quasi-endowments set up by donors that are working to the level of required investment to qualify as an Endowment under the Foundation’s donor guidelines. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's board of directors has interpreted the Arizona Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, unless there are explicit donor stipulations to the contrary. At June 30, 2018, there were no such donor stipulations. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the Endowment, (b) the original value of subsequent gifts donated to the Endowment (including promises to give net of discount and allowance for doubtful accounts), and (c) accumulations to the endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added. The remaining portion of the donor-restricted endowment is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. The Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the organization
- The investment policies of the organization

The Foundation had the following endowment net asset composition by type of fund as of June 30, 2018:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Board-designated quasi-endowment	$ 10,815,925	$ -	$ -	$ 10,815,925
Donor-restricted quasi-endowment	-	5,951,442	-	5,951,442
Donor-restricted for permanent endowment	(27,262)	29,633,332	76,680,017	106,286,087
	$ 10,788,663	$ 35,584,774	$ 76,680,017	$ 123,053,454

At June 30, 2018, certain donor-restricted endowment funds had fair values less than the amount of the original gifts (the permanently restricted portion of the funds). Deficiencies of $27,262 are reported in unrestricted net assets.

Investment and Spending Policies

The Foundation has adopted investment and spending policies for the Endowment that attempt to provide a predictable stream of funding for operations while seeking to maintain the purchasing power of the endowment assets. Over time, long-term rates of return should be equal to an amount sufficient to maintain the purchasing power of the Endowment assets, to provide the necessary capital to fund the spending policy, and to cover the costs of managing the Endowment investments. The target minimum rate of return is the Consumer Price Index plus 5% on an annual basis. Actual returns in any given year may vary from this amount. To satisfy this long-term rate-of-return objective, the investment portfolio is structured on a total-return approach through which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). A significant portion of the funds are invested to seek growth of principal over time.

The Foundation uses an endowment spending-rate formula to determine the amount to spend from the Endowment each year. The rate, determined and adjusted from time to time by the Board of Directors, is applied to the average fair value of the Endowment investments for the prior 12 quarters at December 31 of each year to determine the spending amount for the upcoming year. During 2018, the spending rate maximum was 4.5%. In establishing this policy, the Foundation considered the long-term expected return on the Endowment and set the rate with the objective of maintaining the purchasing power of the Endowment over time.

With the exception of certain permanently restricted contributions that the donor requires to be separately invested, all permanently restricted contributions are consolidated in an investment pool. Appreciation, depreciation, income, and expense relative to the pooled endowment investments are allocated to each Endowment based upon the ratio of that Endowment's investment balance to the total investment pool and are shown as a change in temporarily restricted net assets.

Changes in Endowment net assets for the year ended June 30, 2018 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 10,321,763	$ 30,484,136	$ 72,395,223	$ 113,201,122
Investment return				
Investment income, net of fees	99,913	896,597	-	996,510
Net realized and unrealized gain (loss)	458,874	6,944,220	139,827	7,542,921
	558,787	7,840,817	139,827	8,539,431
Contributions	-	64,905	3,254,014	3,318,919
Reclassification of donor intent	2,176	363,906	890,953	1,257,035
Recovery of deficiency in original gift value of permanently restricted funds below fair value	46,413	-	-	46,413
Appropriation of endowment assets pursuant to spending-rate policy	(140,476)	(3,168,990)	-	(3,309,466)
Endowment net assets, end of year	$ 10,788,663	$ 35,584,774	$ 76,680,017	$ 123,053,454

Note 9 - Restricted Net Assets

Temporarily Restricted

Temporarily restricted net assets at June 30, 2018 consist of:

Restricted by donors for:	
Other restricted	$ 37,737,740
Student aid	14,431,891
Academic divisions	9,487,233
Research	7,591,055
Public service	4,040,930
Faculty staff	2,366,541
Physical plant	3,612,218
Athletics	1,623,905
Library	681,886
	$ 81,573,399

Net assets were released from restrictions as follows during the year ended June 30, 2018:

Satisfaction of purpose restrictions	
Student aid	$ 3,853,457
Other restricted	1,523,839
Research	1,304,747
Public service	1,465,039
Academic divisions	1,281,470
Physical plant	333,561
Faculty staff	383,610
Athletics	400,131
Library	21,339
	$ 10,567,193

Permanently Restricted

Permanently restricted net assets consist of charitable remainder trusts, charitable gift annuities, beneficial interests in perpetual trusts and endowment funds restricted by donors for investment in perpetuity. Distributions from perpetual trusts and earnings on endowment funds are available for the purposes specified by the donors, or in certain cases, for the unrestricted use of the Foundation. The permanently restricted net asset balances, classified by restriction on the use of earnings, are as follows at June 30, 2018:

Restricted by donors for:	
Student aid	$ 60,682,769
Other restricted	6,520,491
Faculty staff	7,689,681
Academic divisions	5,912,188
Public service	1,351,670
Library	519,707
Research	295,586
Athletics	8,128
Physical plant	39,406
	$ 83,019,626

Note 10 - Related Party Transactions

Members of the Foundation's board of directors have made contributions and pledges to the Foundation in the current and prior years. At June 30, 2018, gross unconditional pledges receivable from these members totaled $258,633. During the year ended June 30, 2018, the Foundation recognized contribution revenue from these donors of $720,916. During the year ended June 30, 2018, the Foundation recognized expenses for scholarships to Northern Arizona University of $3,603,708. Additionally, as of June 30, 2018, the Foundation has a liability to Northern Arizona University for $319,355 in connection with a management services agreement whereby the Foundation would owe 95% of any realized value of certain stock to the University.