University of Illinois Foundation

Financial Audit

Fiscal Year 2007

with

Independent Auditors' Report

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

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FINANCIAL STATEMENT REPORT SUMMARY

The audit of the accompanying financial statements of the University of Illinois Foundation was performed by Clifton Gunderson, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Foundation's basic financial statements.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditors' Report

The Honorable William G. Holland
Auditor General
State of Illinois
and
The Board of Directors
University of Illinois Foundation

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of the University of Illinois Foundation (Foundation), a component unit of the University of Illinois, and a component unit of the State of Illinois, as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Foundation's 2006 financial statements and in our report dated August 3, 2006 we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the University of Illinois Foundation, as of June 30, 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 26, 2007, on our consideration of the Foundation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Clifton Gunderson LLP

Peoria, Illinois
November 26, 2007

UNIVERSITY OF ILLINOIS FOUNDATION
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2007

Introduction

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of the University of Illinois Foundation (the Foundation) for the year ended June 30, 2007. The financial statements are prepared in accordance with *Governmental Accounting Standards Board* (GASB) principles.

The Foundation is a non-profit corporation responsible for encouraging and administering private gifts made to further the University of Illinois's (University) mission. Although the Foundation is a separate legal entity from the University, the Foundation's sole reason for existence is to serve the University. The Foundation also evaluates, plans and mounts long-term special fund drives or capital campaigns over and above regular ongoing fundraising efforts.

The Foundation provides support services to assist the Chicago, Springfield and Urbana-Champaign campus development efforts. These professional services include information processing; donor research; communications; mail marketing and telemarketing; recording, receipting and acknowledging private gifts; establishing and reporting of gift funds; investing, distributing and stewarding of gift funds; and counsel on planned giving.

Financial Highlights

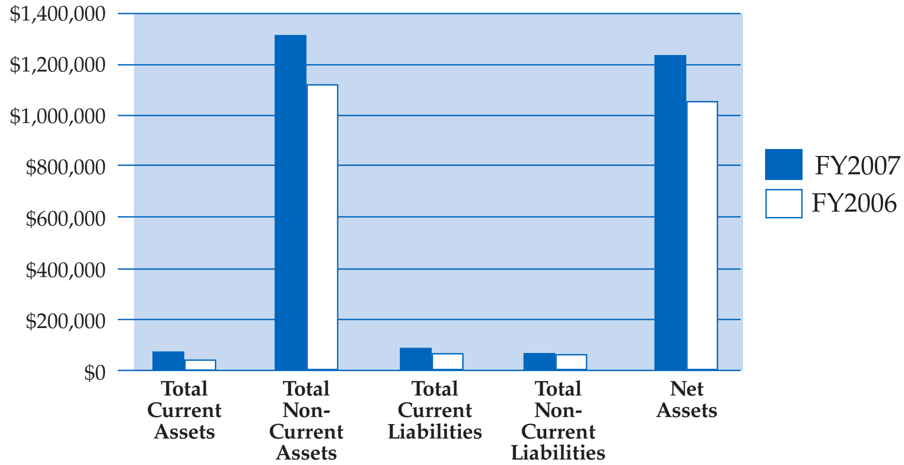
As of June 30, 2007, the Foundation's total net assets were $1.2 billion; an increase of $184.4 million from fiscal year 2006. During the fiscal year, the financial markets provided strong investment returns, resulting in a total investment return on the Foundation's endowment pool of 18%. This investment return, combined with approximately $28.4 million in new gifts to permanent endowments, had a positive impact on assets and revenues. As the need for private support to the University increases, the Foundation and campuses require additional financial resources to help meet those needs; careful planning and diligent use of these resources is required. The impact from strong investment returns, new gift activity and the public announcement of the Brilliant Futures Capital Campaign are evident in the financial reports of the Foundation.

Statement of Net Assets

The Statement of Net Assets includes all assets and liabilities of the Foundation using the accrual basis of accounting and presents the financial position of the Foundation at a specific time, following Generally Accepted Accounting Principles (GAAP). The accrual basis of accounting recognizes revenue and assets when service is provided and recognizes expenses and liabilities when others provide service, regardless of when cash is exchanged. Assets and liabilities are generally stated at current fair market value. The Foundation emphasizes a long-term risk adjusted investment strategy, cost controls, and diligent use of resources.

The comparison of current and non-current assets and liabilities and net assets is displayed below for both fiscal year 2007 and 2006 (in thousands):

	2007	2006
Current assets	$ 47,757	$ 28,630
Capital assets, net	8,022	8,183
Other non-current assets	1,302,398	1,120,517
TOTAL ASSETS	$1,358,177	$1,157,330
Current liabilities	71,404	55,743
Non-current liabilities	51,820	51,056
TOTAL LIABILITIES	123,224	106,799
TOTAL NET ASSETS	1,234,953	1,050,531
TOTAL LIABILITIES AND NET ASSETS	$1,358,177	$1,157,330



Total net assets at June 30, 2007 were $1,235.0 million, compared to $1,050.5 million from the previous year, a 17.6% increase. The breakout of net assets is shown below (in thousands):

	2007	2006
Invested in capital assets, net of related debt	$ 1,620	$ 1,526
Restricted net assets for		
Nonexpendable endowment	838,362	703,487
Expendable	377,944	328,947
Unrestricted net assets	17,027	16,571
TOTAL NET ASSETS	$1,234,953	$1,050,531

The largest component of current assets is accounts receivable, at $33.2 million in fiscal year 2007 compared to $14.8 million for fiscal year 2006. These balances consisted primarily of security sales within the Foundation's investment portfolio that are pending settlement at year-end. The accounts receivable from the University of Illinois represents services performed for direct mail and telemarketing yet to be collected from the campus units and interest on the note payable used when purchasing properties on behalf of the University of Illinois.

The increase of $2 million in current and non-current pledges receivable is the result of approximately $8 million in new pledge activity, net of $6 million received in payments during the fiscal year. The Foundation does not record pledges committed to permanent endowment funds and discounts those for current use and capital commitments.

Included in the current balance of other assets is the cash surrender value of life insurance policies donated to the Foundation as beneficiary and owner. Non-current other assets increased this past year from $14.8 million to $15.3 million as a direct result of a new $1.2 million gift and a $.7 million liquidation in a limited partnership interest.

The change in endowment investments is due to favorable markets experienced during fiscal year 2007. Endowment investments increased from $923.1 million in 2006 to $1,095.9 million in 2007 resulting from new gift activity and market performance previously mentioned. Other long-term investments increased from $128.8 million to $136.2 million. Included in this number are charitable trusts and annuities administered by the Foundation and funds held in pooled investments for current use purposes. Farms and real estate decreased due to the sale of two significant properties valued at more than one million each.

Each year in current liabilities it is typical to see fluctuating balances in accounts payable. Similar to accounts receivable within current assets, these represent securities purchased within the Foundation's endowment investment portfolio pending settlement at year-end.

Notes payable consists of a line of credit the Foundation has with J.P. Morgan. The purpose of the line of credit is to provide funds for the purchase of property on behalf of the University. Properties identified for acquisition by the University are purchased by the Foundation and leased back to the University until such time funds are available for the University to purchase the properties from the Foundation. The outstanding balance of the note at June 30, 2007 was $6.4 million, as compared to $6.7 million at June 30, 2006.

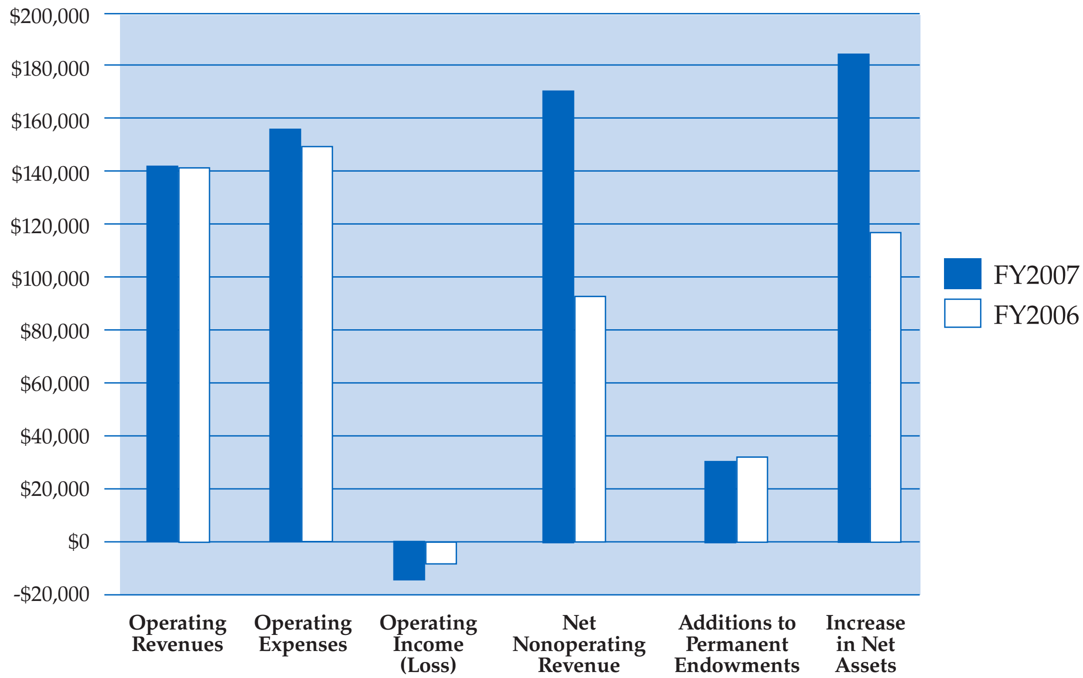
The Foundation administers several hundred charitable trusts and annuities. Financial reporting requires present value calculations of the amounts due beneficiaries for the current year classified as annuities payable. Deposits held for others represents cash and other non-gifts in transit that belong elsewhere, such as a grant received and deposited by the Foundation to be processed by University Grants and Contracts.

Within non-current liabilities, deferred distributions, annuities payable and remainder interests due to others are directly attributable to the charitable trusts and annuities administered by the Foundation. Annuities payable in non-current liabilities is the present value of the obligation to make payments over the projected lifetime of the beneficiaries. The Foundation will accept the responsibility to administer charitable trusts where a minority percentage of the remainder interest is payable to other qualified philanthropic organizations.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the Foundation, as well as nonoperating revenues and expenses. Fiscal year 2007 activity resulted in a $184.4 million increase in net assets, compared to a fiscal year 2006 net asset increase of $115.6 million. The following chart summarizes the Foundation's fiscal year 2007 and 2006 revenues, expenses, and change in net assets (in thousands):

	2007	**2006**
Operating revenues	$141,123	$140,930
Operating expenses	154,780	148,383
OPERATING LOSS	$(13,657)	$(7,453)
NET NON OPERATING REVENUE	169,726	91,714
ADDITIONS TO PERMANENT ENDOWMENTS	28,353	31,397
INCREASE IN NET ASSETS	$184,422	$115,658



Operating revenues increased for fiscal year 2007 from $140.9 million to $141.1 million. In 2006, contributions, gifts and pledges reflected several new significant major pledges and deferred gifts received, while 2007 activity increased at normal rates.

A large portion of the Foundation's revenue for operating expenses is collected from an administrative fee charged on the fair market value of the endowment pool; as a result, positive stock market returns within the endowment are evident in current revenues. The administrative fee approved by the Board of Directors for fiscal year 2007 remained unchanged at 1.10%.

The Foundation's other major revenue source is the allocation from the University of Illinois as payment on the contract with the Foundation for fundraising, gift and trust administration services. Other operating revenue primarily represents non-gift fundraising proceeds. The Foundation continues to record growth in this category as the campus' accelerate events, auctions and athletic contributions.

A significant operating expense for the Foundation continues to be the investment in human resources. Salaries and benefits increased from $13.2 million to $14.6 million. The investment in highly trained professionals serving all campuses of the University, along with an approved salary program for existing employees, increased salaries and benefits for the year. The impact of the capital campaign is reflected in operating expenses as staff is added, new printing materials are produced, travel is increased, and additional events are held. In fiscal year 2007 an investment was made in marketing/communications design, materials and production for the campaign leadership forums and public announcement. This investment is reflected as professional services in the supplies and in marketing/communication categories.

As an operating expense, "Distributions on behalf of the University" is the line item most telling of the results of private giving. Included in this category are cash gifts transferred to the University upon receipt, non-gift fundraising proceeds, construction gifts received in current or prior years transferred upon completion of construction phases, endowment income budgets, and gifts-in-kind. The breakdown is as follows (in millions):

	FY07	FY06
Cash gifts/non-gift transfers	$ 85.1	$ 81.3
Construction gifts	2.3	6.1
Endowment budgets	32.0	29.7
Gifts-in-kind	9.3	10.2
Total distributions to the University	$128.7	$127.3

Reporting standards require an annual actuarial adjustment calculation for the charitable trusts and annuities, which will produce either a revenue or expense. Included in this category are payments to beneficiaries, net of any income received and annual adjustments. The annual adjustment to annuities payable increased, resulting in a net actuarial adjustment of $3.6 million.

Following GASB requirements, the Foundation does not include additions to permanent endowments in operating income, but rather, presents these gifts as nonoperating revenues. This exclusion does, and will likely continue to, cause a net operating loss to be reported. The effort and emphasis with private giving continues to build the University's endowment; gifts to permanent endowments in fiscal year 2007 were $28.4 million. The permanent endowment additions, combined with the net increase in fair value of investments of $160.0 million, increased the Foundation's net assets by $184.4 million from $1,050.5 million to $1,235.0 million.

Statement of Cash Flows

The Statement of Cash Flows provides information about the Foundation's sources and uses of cash. The following summarizes the Foundation's fiscal year 2007 and 2006 cash flows (in thousands):

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Total sources	$ 127,690	$ 122,376
Total uses	(148,346)	(142,815)
Net cash flows used by operating activities	(20,656)	(20,439)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	28,353	31,397
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets for University of Illinois	0	3,084
Purchase of capital assets	(251)	(461)
Payment on notes payable	(255)	(3,218)
Interest on indebtedness	(325)	(396)
Net cash used by capital and related financing activities	(831)	(991)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	1,246,601	1,003,153
Investment income	12,792	9,401
Purchase of investments	(1,264,250)	(1,022,923)
Net cash used by investing activities	(4,857)	(10,369)
Net increase (decrease) in cash and cash equivalents	2,009	(402)
Cash and cash equivalents - beginning of year	2,904	3,306
Cash and cash equivalents, end of year	$ 4,913	$ 2,904

Factors Influencing the Future

On June 1, 2007 the "Brilliant Futures" fundraising campaign was officially launched. The largest and most ambitious campaign in the history of the University of Illinois, Brilliant Futures aims to raise $2.25 billion for students, faculty, research and the campus environment. Momentum is strong moving into the public phase of the campaign with total gift commitments (gifts, grants, and pledges) for campaign purposes exceeding $365 million for the fiscal year end June 30, 2007. Continued momentum is critical to bring the campaign to a successful conclusion scheduled for the end of 2011.

Growth of the endowment is among the campaign's priorities. With endowment investments now exceeding $1 billion the combination of new gift flow and investment return can have material impact on the Foundation's balance sheet. The asset allocation of the endowment pool is broadly diversified across major asset classes in order to minimize investment risk and enhance investment performance over the long-term. The asset allocation policies are currently under review and recommendations will likely be presented to the Board of Directors during the course of Fiscal Year 2008.

During Fiscal Year 2007 and continuing into Fiscal Year 2008 the Foundation is participating in the Advancement Technology Project, a University-wide collaboration focused on enhancing constituency relationship management. The initial stage of this project, the Discovery Phase, is to conduct a needs analysis and solutions/feasibility analysis to support operational and strategic constituency relationship management. At the conclusion of the Discovery Phase there is an expectation that a decision will be made on how to proceed with an implementation plan in the most cost effective manner. The overall approach of the implementation may impact the financial and human resources of the Foundation and the advancement community at the University of Illinois as a whole.

Strong leadership within the University and Foundation along with guidance and support from the Board of Trustees of the University and the Board of Directors of the Foundation are committed to a successful campaign aimed at enhancing the preeminence of the University and its campuses.

UNIVERSITY OF ILLINOIS FOUNDATION

Statement of Net Assets

June 30, 2007 with Comparative Totals for 2006 (in thousands)

ASSETS

Current Assets	**2007**	**2006**
Cash and cash equivalents	$ 1,120	$ 1,156
Restricted cash and cash equivalents	2,346	1,157
Accrued investment income	2,033	1,800
Accounts receivable - University of Illinois	257	326
Accounts receivable	33,200	14,762
Pledges receivable	4,500	5,364
Prepaid expenses	118	169
Other assets	4,183	3,896
Total current assets	47,757	28,630
Noncurrent Assets		
Restricted cash and cash equivalents	1,447	591
Endowment investments	1,095,925	923,111
Other long-term investments	136,214	128,819
Pledges receivable	20,500	17,636
Farms and real estate	24,406	26,021
Capital assets, net	8,022	8,183
Irrevocable trust held by other trustees	8,617	9,562
Other assets	15,289	14,777
Total noncurrent assets	1,310,420	1,128,700
Total assets	$1,358,177	$1,157,330

LIABILITIES

Current liabilities		
Accounts payable	57,229	40,833
Notes payable	6,402	6,657
Annuities payable	6,700	7,331
Accrued vacation and sick pay	984	922
Deposits held for others - University of Illinois	89	-0-
Total current liabilities	71,404	55,743
Noncurrent liabilities		
Deferred distributions	52	37
Annuities payable	44,408	44,359
Remainder interest due to others	7,360	6,660
Total noncurrent liabilities	51,820	51,056
Total liabilities	123,224	106,799

NET ASSETS

Invested in capital assets, net of related debt	1,620	1,526
Restricted for		
Nonexpendable endowment	838,362	703,487
Expendable	377,944	328,947
Unrestricted	17,027	16,571
Total net assets	1,234,953	1,050,531
Total liabilities and net assets	$1,358,177	$1,157,330

See notes to financial statements.

UNIVERSITY OF ILLINOIS FOUNDATION

Statement of Revenues, Expenses, and Changes in Net Assets

Year Ended June 30, 2007 with Comparative Totals for 2006 (in thousands)

	2007	2006
OPERATING REVENUES		
Contributions, gifts and pledges	$ 111,119	$ 114,954
Service fee revenue	11,343	9,943
Allocation from the University of Illinois	8,959	8,642
Endowment property operations	511	590
Annual funds revenue	401	440
Other operating revenue	8,790	6,361
Total operating revenues	141,123	140,930
OPERATING EXPENSES		
Salaries and benefits	14,580	13,154
Marketing and communications	1,518	742
Travel	989	939
Meetings, conferences, and special events	1,456	945
Equipment	534	373
Supplies and other	3,150	2,124
Distributions on behalf of the University of Illinois	128,731	127,279
Depreciation	244	106
Actuarial adjustments	3,578	2,721
Total operating expenses	154,780	148,383
OPERATING LOSS	(13,657)	(7,453)
NONOPERATING REVENUES (EXPENSES)		
Investment income-net of investment expense	10,101	7,294
Net increase in fair value of investments	159,950	84,816
Interest on indebtedness	(325)	(396)
Net nonoperating revenues	169,726	91,714
Income before other revenues, expenses, gains, or losses	156,069	84,261
Additions to permanent endowments	28,353	31,397
INCREASE IN NET ASSETS	184,422	115,658
NET ASSETS, BEGINNING OF YEAR	1,050,531	934,873
NET ASSETS, END OF YEAR	$1,234,953	$1,050,531

See notes to financial statements.

UNIVERSITY OF ILLINOIS FOUNDATION
Statement of Cash Flows
Year Ended June 30, 2007 with Comparative Totals for 2006 (in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2007	2006
Contributions, gifts and pledges	$ 98,304	$ 96,816
Service fee revenue	11,343	9,943
Allocation from the University of Illinois	8,272	8,226
Endowment property operations	511	590
Annual funds revenue	470	440
Other operating revenue	8,790	6,361
Payments for salaries and benefits	(13,919)	(12,377)
Payments for marketing and communications	(1,518)	(753)
Payments for travel	(984)	(941)
Payments for meetings, conferences and special events	(1,419)	(997)
Payments for equipment	(535)	(472)
Payments for supplies and other	(2,766)	(2,132)
Distribution on behalf of the University of Illinois	(119,352)	(117,055)
Payments to annuitants	(7,853)	(8,088)
Net cash used by operations	(20,656)	(20,439)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Gifts and grants received for other than capital purposes:		
Private gifts for endowment purposes	28,353	31,397
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets for University of Illinois	-0-	3,084
Purchase of capital assets	(251)	(461)
Payment on notes payable	(255)	(3,218)
Interest on indebtedness	(325)	(396)
Net cash used by capital and related financing activities	(831)	(991)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	1,246,601	1,003,153
Investment income	12,792	9,401
Purchase of investments	(1,264,250)	(1,022,923)
Net cash used by investing activities	(4,857)	(10,369)
Net increase (decrease) in cash and cash equivalents	2,009	(402)
Cash and cash equivalents - beginning of year	2,904	3,306
Cash and cash equivalents - end of year	$ 4,913	$ 2,904

See notes to financial statements.

UNIVERSITY OF ILLINOIS FOUNDATION

Statement of Cash Flows

Year Ended June 30, 2007 with Comparative Totals for 2006 (in thousands)

	2007	2006
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (13,657)	$ (7,453)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	244	106
Actuarial adjustment	(3,117)	(980)
Change in assets and liabilities:		
Accounts receivable - University of Illinois	69	461
Prepaid expenses	50	(97)
Other assets	(2,691)	(7,309)
Pledge receivable	(2,000)	(5,000)
Accounts payable	295	(277)
Accrued vacation and sick leave	62	110
Deposits held for others	89	-0-
Net cash used by operating activities	$ (20,656)	$ (20,439)
Noncash noncapital financing activities:		
On-behalf payments of fringe benefits	687	877
Gifts in kind	12,291	19,406
Noncash capital and related financing activities:		
Farmland acquired in exchange for land, farmland, and buildings	2,497	-0-

See notes to financial statements.

1. Summary of Significant Accounting Policies

Nature of Institution

The University of Illinois Foundation (Foundation) is a non-profit corporation responsible for encouraging and administering private gifts made to further the mission of the University of Illinois (University). Although the Foundation is a separate legal entity from the University the Foundation's sole reason for existence is to serve the University.

Measurement Focus and Basis of Accounting

The financial statements of the Foundation have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Internal activity and balances are eliminated in preparation of the financial statements unless they relate to services provided and used internally. Operating revenues and expenses include exchange transactions. Investment income and interest on capital asset-related debt are included in nonoperating revenues and expenses. The Foundation first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the Foundation follows all applicable GASB pronouncements. In addition, the Foundation applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Foundation has elected not to apply FASB pronouncements issued after November 30, 1989.

The Foundation is a component unit of the University for financial reporting purposes. The financial balances and activities included in these financial statements are, therefore, also included in the University's annual financial report.

The basic financial statements include prior year comparative information, which has been derived from the Foundation's 2006 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2006.

Rather than issuing fund-type financial statements, GASB Statement No. 35 requires a Management's Discussion and Analysis, notes to the financial statements, and basic financial statements including a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Cash Equivalents

The Foundation considers all liquid investments with original maturities of three months or less to be cash equivalents, except for money market mutual funds held in the endowment.

At June 30, 2007, cash equivalents consisted primarily of money market savings accounts and similar funds.

Receivables

The accounts receivable from the University of Illinois represents payments for services performed for direct mail and telemarketing yet to be collected from the campus units. Accounts receivable consists primarily of security sales within the Foundation's investment portfolio that are pending settlement at year end. Pledges receivable that are expected to be collected in future years are recorded at the present value of their estimated cash flows. It is estimated that ninety percent of the gross pledges are collectible. The collectible pledges are expected to be collected over a period of five years and are discounted at a rate of 6.4%.

Investments

Investments are recorded at fair value, as determined by quoted market prices. Investments in real estate trusts and partnerships are recorded at their estimated market value as determined by the investment managers. Substantially all of the investments are managed by external professional investment managers. Many of these investments are made through commingled investment vehicles such as common trust funds and mutual funds. A number of the investment managers have been delegated the authority to utilize derivatives in the execution of their investment strategies. In general, managers utilize derivatives to reduce or eliminate undesirable risks, to increase portfolio liquidity and flexibility or to increase investment return within the level of risk defined in the manager's investment guidelines. Examples of authorized derivative transactions would be the hedging of foreign currency exposure through the use of currency forwards, owning mortgage securities with embedded prepayment options or utilizing treasury futures to change the duration of a fixed income portfolio. At June 30, 2007 the Foundation had a foreign currency contract with a notional value of $405,000 and a fair value of zero.

The Foundation increases its investment income by lending the Foundation's securities, through its custodian, to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. Government securities in an amount approximating 102% of the fair value of the securities loaned. The collateral cannot be pledged or sold unless the borrower defaults. As of June 30, 2007, $141,381,000 of the Foundation's investments were on loan. At year-end, The Foundation has no credit risk exposure to borrowers because the amounts the Foundation owes the borrowers exceed the amounts the borrowers owe the Foundation.

The Foundation invests in "To Be Announced" (TBA) GNMA and FNMA mortgage rolls. The Foundation does not intend to finance all of its TBA mortgage rolls. The Foundation reports its pending trades as accounts receivable and accounts payable on the gross basis in the accompanying financial statements.

Board policy authorizes the Foundation to invest in obligations of the U. S. Treasury, agencies, and instrumentalities (U. S. Government securities); bank and savings and loan time deposits; corporate bonds, stock and commercial paper; repurchase agreements; and mutual funds. At June 30, 2007, the Foundation had no repurchase agreements.

Farms and Real Estate

Real estate and farms received as gifts and to be held for investment purposes are recorded at fair market value at the date of gift. The Foundation does not record depreciation on these assets. Farms and Real Estate are recorded at carrying value, which is the fair market value of the asset at the time of gift.

Capital Assets

Capital assets are recorded at cost on the date of acquisition or fair value if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The Foundation utilizes an estimated useful life of five years on most furniture and equipment. Buildings and site improvements are depreciated using an estimated useful life of 20-50 years.

Accrued Compensated Absences

Accrued compensated absences for the Foundation personnel are charged as an operating expense, using the vesting method for sick leave, based on earned but unused vacation and sick leave days including the Foundation's share of social security and medicare taxes.

Federal Income Tax Status

The U.S. Treasury Department issued a determination letter dated September 9, 1983 holding that the Foundation is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

2. Transactions with the University of Illinois, State of Illinois and Related Parties

The Foundation was formed for the purpose of providing fundraising services and other assistance to the University in order to attract private gifts to support the University's instructional, research and public services activities. In this capacity the Foundation solicits, receives, holds and administers gifts for the benefit of the University.

The Foundation enters into annual contracts with the University which require the Foundation to perform the above described functions and supervise University employees who maintain University donor records and perform support functions for Foundation fundraising activities.

The Foundation is required to recognize as revenue and expense those on-behalf payments for fringe benefits made by the State of Illinois for University employees who are supervised by the Foundation. These payments (estimated at $687,000 in 2007) are included in the amounts shown as allocation from the University of Illinois and salaries and benefits.

Pursuant to the contracts, the Foundation is required to comply with Section VI of "University Guidelines 1982," as adopted by the University Board of Trustees on November 12, 1982 and amended in 1997 by the State of Illinois Legislative Audit Commission. The contracts require the University to make payments to the Foundation for the cost of services provided up to specified limits and to provide other support as described below:

- On October 6, 1989, the Foundation Board of Directors agreed to renovate the University Facility now known as the "Karnes Center in Historic Harker Hall at Swanlund Plaza" at a cost of approximately $5.5 million in exchange for the University President's pledge to provide the facility to the Foundation rent free through fiscal year 2023.
- The University provided the Foundation with certain administrative services in the areas of purchasing, accounting, cashiering, internal auditing, benefits and investment management, and electronic data processing systems at no cost. Such costs (estimated at $374,000 in 2007) are not reflected in the accompanying financial statements.

Gifts received by the Foundation include some donations attributable to solicitations by development personnel of the University. Amounts received directly by the Foundation through these fundraising efforts are generally not quantifiable. Conversely, private gifts and grants received by the University (approximately $53 million in 2007) include some gifts attributable to direct and indirect solicitations by Foundation personnel. Amounts received directly by the University through these fundraising efforts are not quantifiable.

Gifts received from Board Members were $5,560,000 in 2007.

Gifts received from the University of Illinois Alumni Association were approximately $387,000 in 2007. Conversely, disbursements to the Alumni Association from the Foundation were $40,000 in 2007.

The Foundation transferred $722,900 directly to the University of Illinois on behalf of the Alumni Association. The funds were received from pledges collected that were restricted to the construction of the Alumni Center.

Gifts and gift related income transferred from the Foundation to the University of $128,731,000 in 2007 are reflected in the statement of revenues, expenses, and changes in net assets. Other transactions between the Foundation and the University include the following:

- The University leases from the Foundation various properties with a carrying value of $5,407,000 at June 30, 2007. Payments by the University to the Foundation, which approximate the Foundation's cost of carrying the properties, were $325,000 in 2007. The Foundation also holds $1,836,000 of properties for the University's future use that is not covered by the lease agreement.
- The Foundation obtained certain goods and services (supplies, telephone, printing, etc.) during 2007 through the University for which the Foundation reimbursed the University at cost.

3. Cash and Cash Equivalents (in thousands)

The Foundation implemented GASB Statement No. 40, Deposit and Investment Risk Disclosure (an amendment of GASB Statement No. 3) for fiscal year ending June 30, 2005. Cash and cash equivalents consist of the following at June 30, 2007:

		2007	
	Unrestricted	Restricted	Total
Demand deposits at banks	$ 1,120	$ 374	$1,494
Money market and similar deposits at banks	-0-	3,237	3,237
Other	-0-	182	182
Total cash and cash equivalents	$ 1,120	$ 3,793	$4,913

Custodial Credit Risk-Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Foundation's deposits may not be returned to it. The Foundation has a deposit policy in which collateral security is obtained from any financial institution that balances exceed the $100,000 federally insured threshold.

As of June 30, 2007, the Foundation's unadjusted bank balances and carrying values, of which $2,620,000 and $3,595,000, respectively, was covered by federal depository insurance or by collateral held by an agent in the entity's name. Uninsured and uncollateralized balances as of June 30, 2007, was $1,318,000.

4. Investments

During 2007, the Foundation realized net gains of $86,102,000 from the sale of investments. The calculation of realized gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net change in the fair value of investments during 2007 was $159,950,000. The unrealized gain on investments held at year-end was $186,909,000 at June 30, 2007. The carrying value of the investment portfolio of the Foundation at June 30, 2007 is as follows, in thousands:

	2007
Treasury bonds and bills	$ 20,303
U.S. government agencies	45,369
Corporate bonds and notes	61,949
Preferred stock	3
International preferred stock	954
Common stock	306,777
International common stock	193,321
Real estate trust and partnerships	238,431
Mutual funds	
Bonds	123,241
Stocks	204,782
Blended	899
Money market	32,245
Other	3,865
Total investments	$1,232,139

The Board of Directors has established an investment policy that embraces the total-return concept. The focus is to preserve the real value or purchasing power of endowment pool assets and the annual support the assets provide over the long term. The Foundation's total portfolio is broadly diversified across major asset classes in order to minimize investment risk and enhance investment performance. For fiscal year 2007, 4.75% of the seven year moving average market value will be distributed for the educational purposes specified in the individual fund agreements between the Foundation and the donors. The net appreciation on investments of donor-restricted endowments available for authorization for expenditure approximates $195,648,000 at June 30, 2007.

Nearly all of the Foundation's investments are managed by external investment managers, who have full discretion to manage their portfolios subject to investment policy and manager guidelines established by the Foundation, and in the case of mutual funds and other commingled vehicles, in accordance with the applicable prospectus.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to a debt investment will not fulfill its obligations. The Foundation's investment policy requires that short-term funds be invested in obligations of the U.S. government and other fixed income securities and money market instruments rated investment grade by a recognized rating agency. Manager guidelines for long-term fixed income investments require that at least 70 percent of each manager's portfolio be investment grade and that the weighted average of each portfolio not fall below Standard & Poor's AA- or equivalent. Managers of long-term funds have discretion to invest in unrated securities if such securities in their judgment are of comparable credit quality. The Foundation also invests in bond mutual funds with average credit quality of Moody's B to Aaa.

Footnote 4 — Credit Risk
June 30, 2007

		QUALITY RATING									
	Carrying Amount (in thousands)	**A1/P1**	**AAA**	**AA**	**A**	**BAA**	**BA**	**BBB**	**BB**	**B**	**UNRATED**
U.S. treasury bonds and bills	$ 20,032		$ 19,650					$ 382			
U.S. government agencies	45,369		45,264		$ 105						
Municipal bonds	271		148	21							102
Corporate bonds and notes	61,949		23,820	4,090	2,945			8,000	5,528	3,057	14,509
Bond mutual funds	120,973	8,225	79,978	12,351	8,017	395	6,176	2,796	842	2,171	22
Municipal bond mutual funds	2,268		1,622	441	97			105			3
Blended bond mutual funds	899		250	281	263	83					22
Money Market mutual funds	32,245		32,245								
Total by Risk Category	284,006	$8,225	$202,977	$17,184	$11,427	$478	$6,176	$11,283	$6,370	$5,228	$14,658

Preferred stock	3
International preferred stock	954
Common stock	306,777
International common stock	193,321
Real estate trusts & partnerships	238,431
Mutual Funds	
Stocks	204,782
Other	3,865
Total Investments	$1,232,139

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Foundation will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Foundation investment policy does not limit the value of investments that may be held by an outside party.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Foundation's investment policy provides that short-term funds shall be broadly diversified. The Foundation's manager guidelines for long-term fixed income investments provide that non-U.S. government obligations may not exceed 10% per issuer, private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit-independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer), and obligations of other issuers (other than the U.S. government, U.S. agencies, or U.S. government-sponsored corporations and agencies) may not exceed 5%.

As of June 30, 2007 not more than 5 percent of the Foundation's total investments were invested in securities of any one issuer, excluding securities issued or guaranteed by the U.S. government, mutual funds, and external investment pools or other pooled investments.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. To manage its exposure to fair value losses arising from increasing interest rates, the Foundation invests its short-term investments in money market funds and other commingled vehicles with average maturities of up to approximately two years. The Foundation's manager guidelines for long-term fixed income investments provide that the average weighted duration of the portfolio (including options positions) not vary from that of the Lehman Brothers Aggregate Bond Index by more than +/- 20 percent.

		Investment Maturities (in years)			
	Carrying Amount (in thousands)	**Less than 1**	**1-5**	**6-10**	**More than 10**
U.S treasury bonds and bills	$ 20,032	$ 1,498		$ 225	$ 18,309
U.S. government agencies	45,369				45,369
Municipal bonds	271			271	
Corporate bonds and notes	61,949	-0-	2,533	1,985	57,431
Bond mutual funds	120,973	3,051	84,950	32,725	247
Municipal bond mutual funds	2,268	186	742	1,043	297
Blended bond mutual funds	899			899	
Money Market mutual funds	32,245	32,223	22		
Total by Risk category	$ 284,006	$ 36,958	$ 88,247	$ 37,148	$ 121,653
Preferred stock	3				
International preferred stock	954				
Common stock	306,777				
International common stock	193,321				
Real estate trusts & partnerships	238,431				
Mutual Funds					
Stocks	204,782				
Other	3,865				
Total investments	$ 1,232,139				

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Foundation's short-term investments generally are not exposed to foreign currency risk.

The Foundation's investment policy provides that long-term investments may be exposed to foreign currency risk as follows: fixed income managers may invest up to 30% of their portfolios in non-U.S. dollar denominated securities; non-U.S. equity managers invest at least 90% of their portfolios in non-U.S. securities.

The U.S. dollar balances of the Foundation's investment exposed to foreign currency risk as of June 30, 2007 are listed below. Amounts listed for U.S. dollar are primarily ADR's (American Depository Receipts) with exposure to various foreign currencies.

	Cash equivalents (U.S. dollars)	International common stock	International preferred stock	International equity mutual funds	International bond mutual funds	Total (in thousands)
Australian dollar	$ 9	$ 7,406	$ –	$ 519	$ 17	$ 7,951
Brazilian real	–	–	–	644	37	681
British pound sterling	331	52,230	–	4,763	10	57,334
Canadian dollar	9	10,552	–	304	4	10,869
Danish krone	10	2,270	–	286	–	2,566
Euro	576	45,093	411	8,452	164	54,696
Hong Kong dollar	25	4,586	–	662	–	5,273
Hungarian forint	10	319	–	–	–	329
Indian rupee	–	–	–	322	–	322
Indonesian rupiah	34	258	–	36	–	328
Israel shekel	–	–	–	89	–	89
Japanese yen	343	33,140	–	2,629	26	36,138
Malaysian ringgit	104	753	–	–	–	857
Mexican peso	7	–	–	215	35	257
New Taiwan dollar	348	1,713	–	197	–	2,258
Norwegian krone	84	2,018	–	–	–	2,102
Polish zloty	–	–	–	–	15	15
Russian ruble	–	–	–	107	–	107
Singapore dollar	9	1,386	–	107	–	1,502
South African rand	17	750	–	–	26	793
South Korean won	49	2,500	–	483	1	3,033
Swedish krona	(227)	7,104	–	715	–	7,592
Swiss franc	9	15,319	–	1,305	–	16,633
Thai baht	–	673	–	–	–	673
Turkish lira	–	438	–	–	–	438
United States dollar	15,677	4,813	543	6,262	898	28,193
Uraguayan peso	–	–	–	–	1	1
Total Foreign Currency	$ 17,424	$ 193,321	$ 954	$ 28,097	$ 1,234	$241,030

5. Farms and Real Estate

The carrying value and approximate fair value of farms and non-farm real estate owned by the Foundation at June 30, 2007 are as follows, in thousands:

	2007	
	Carrying Value	Fair Value
Farms	$ 14,429	$ 23,946
Non-farm real estate	9,977	10,048
Total farms and real estate	$ 24,406	$ 33,994

6. Capital Assets (in thousands)

A summary of the changes in capital assets is as follows:

2007	Cost				
	Balance June 30, 2006	Additions	Transfers	Retirements	Balance June 30, 2007
Land held for the University's future use	$ 934	$ -0-	$ -0-	$ (295)	$ 639
Farmland held for the University's future use	647	2,497	-0-	(647)	2,497
Buildings held for the University's future use	5,880	-0-	-0-	(1,709)	4,171
Furniture, fixtures, and equipment	1,123	251	-0-	(100)	1,274
	$ 8,584	$ 2,748	$ -0-	$ (2,751)	$ 8,581

	Accumulated Depreciation				
	Balance June 30, 2006	Additions	Transfers	Retirements	Balance June 30, 2007
Buildings held for the University's use	$ -0-	$ 64	$ -0-	$ -0-	$ 64
Furniture, fixtures, and equipment	401	180	-0-	(86)	495
	$ 401	$ 244	$ -0-	$ (86)	$ 559
					$ 8,022

7. Note Payable

Note payable includes the following, in thousands:

	2007
$28,000 line of credit to bank, due on January 31, 2008, interest rate negotiated in irregular intervals (5.82% at June 30, 2007), unsecured	$ 6,402

The note payable is to provide funds to purchase property that is to be held for the University of Illinois. The changes in the note payable balance consists of the following, in thousands:

Balance at June 30, 2006	$ 6,657
Proceeds	-0-
Payments	(255)
Balance at June 30, 2007	$ 6,402

8. Annuities Payable

Several donors have entered into split-interest agreements with the Foundation. These agreements are in the form of charitable gift annuities, charitable remainder annuity trusts, charitable remainder unitrusts and deferred gift annuities. The annuities payable to beneficiaries resulting from these agreements are reported as a liability at the present value of the estimated future payments to be distributed over the beneficiaries lives. The Foundation recalculates the present value of these payments through the use of IRS discount rates and IRS life expectancy tables. The Foundation utilized discount rates based upon the applicable month and year in which the split interest agreements were initiated within these calculations.

9. Retirement Plan and Post-Employment Benefits

The Foundation contributes to the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined-benefit pension plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents, and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois' financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by accessing the website at www.SURS.org or by calling 1-800-275-7877.

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 10.61% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The Foundation's contributions to SURS for the years ending June 30, 2007, 2006, and 2005 were approximately $658,000, $521,000, and $475,000, respectively, equal to the required contributions for each year.

Participation in SURS does not exempt an employee or the Foundation from contributing to Social Security, under which all employees are covered.

In addition to providing pension benefits, the State of Illinois provides certain health, dental, and life insurance benefits to annuitants. This includes annuitants of the Foundation. Substantially all State employees, including the Foundation's employees, may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits for annuitants under age sixty are equal to their annual salary at the time of retirement; life insurance benefits for annuitants age 60 or older are limited to five thousand dollars per annuitant. Currently, the State does not segregate payments made to annuitants from those made to current employees for health, dental, and life insurance benefits. These costs are funded by the State and are not an obligation of the Foundation.

Employees of the Foundation may also elect to participate in several tax deferred annuity plans. These are single employer plans under which benefits are provided to participating employees through contracts issued to each individual. Participation and the level of employee contributions are voluntary. The Foundation is not required to make contributions.

10. Operating Leases

The Foundation is obligated under certain leases accounted for as operating leases.

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of June 30, 2007, in thousands:

	Year Ending June 30	Amount
	2008	203
	2009	123
Total minimum payments required		$326

The following schedule shows the composition of total rental expense for all operating leases except those with terms of a month or less that were not renewed, in thousands:

	Year Ending June 30 2007
Minimum rentals	$271

11. Funds Held by Others

Beneficial Interests - The Foundation is an income beneficiary of several irrevocable trusts, the assets of which are held and administered by others in perpetuity; thus, the principal is not reported in the accompanying financial statements. Income received from these assets was $945,000 in 2007. The aggregate fair value of these assets was approximately $28,431,000 at June 30, 2007.

Supporting Organizations - The Foundation and/or the University is the supported organization of three independent foundations that were established under Internal Revenue Code Section 509(a). The Foundation actively participates in establishing such supporting organizations upon donor requests. The Foundation is represented on each governing board and, when appropriate, provides accounting and investment services. During fiscal year 2007, the Foundation received contributions of $40,000 from these supporting organizations.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Honorable William G. Holland
Auditor General
State of Illinois and
The Board of Directors
University of Illinois Foundation

As Special Assistant Auditors for the Auditor General, we have audited the basic financial statements of the University of Illinois Foundation (Foundation), as of and for the year ended June 30, 2007, and have issued our report thereon dated November 26, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Foundation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Foundation's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Foundation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted a certain matter which we have reported to management of the University of Illinois Foundation in a separate letter dated November 26, 2007.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Audit Committee, the Board of Directors of the Foundation, and Foundation management, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Peoria, Illinois
November 26, 2007

University of Illinois Foundation

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