Orthopaedic Research and Education Foundation

Financial Report
December 31, 2012

Contents

McGladrey

Independent Auditor's Report

To the Board of Trustees
Orthopaedic Research and Education Foundation
Rosemont, Illinois

Report on the Financial Statements

We have audited the accompanying financial statements of Orthopaedic Research and Education Foundation (Foundation) which comprise the statement of financial position as of December 31, 2012, and the related statement of activities and cash flows for the year then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Orthopaedic Research and Education Foundation as of December 31, 2012, and its changes in net assets and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

McGladrey LLP

Chicago, Illinois
April 26, 2013

Orthopaedic Research and Education Foundation

Statement of Financial Position
December 31, 2012

Assets		
Current Assets		
Cash and cash equivalents	$	6,980,994
Restricted cash		2,079,245
Pledges receivable, net		3,265,203
Other receivables		147,015
Prepaid expenses		36,692
		12,509,149
Noncurrent Assets		
Pledges receivable - long-term		662,955
Marketable securities		23,456,013
Cash surrender value of life insurance policies		1,819,378
Charitable remainder trusts receivable		2,679,138
Property and equipment, net		32,038
		28,649,522
	$	41,158,671
Liabilities and Net Assets (Deficiency)		
Current Liabilities		
Grants and awards payable - current	$	4,530,142
Accounts payable		42,471
Accrued expenses		208,309
Due to orthopaedic partners		2,079,245
		6,860,167
Noncurrent Liabilities		
Grants and awards payable - long-term		923,514
		7,783,681
Net Assets (Deficiency)		
Unrestricted		(2,870,121)
Temporarily restricted		4,453,196
Permanently restricted		31,791,915
		33,374,990
	$	41,158,671

See Notes to Financial Statements.

Orthopaedic Research and Education Foundation

Statement of Activities
Year Ended December 31, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue, gains and other support				
Contributions	$ 1,723,261	$ 2,270,316	$ 441,435	$ 4,435,012
Contributions to partner endowments	-	-	514,649	514,649
Insurance premiums for major gifts	205,314	-	-	205,314
Change in value of charitable remainder trusts	-	27,523	77,962	105,485
Change in cash surrender value of life insurance policies	-	-	(11,664)	(11,664)
Investment return	2,620,281	-	-	2,620,281
Net assets released from restrictions:				
Expiration of time restrictions	2,076,839	(2,076,839)	-	-
Grant funding	5,382,902	(5,382,902)	-	-
	12,008,597	(5,161,902)	1,022,382	7,869,077
Expenses				
Program expenses:				
Grants and awards	6,858,464	-	-	6,858,464
Grants and awards administration	601,613	-	-	601,613
	7,460,077	-	-	7,460,077
Fundraising:				
Development expenses	1,613,133	-	-	1,613,133
Special programs expenses	148,291	-	-	148,291
	1,761,424	-	-	1,761,424
General and administrative expenses	880,572			880,572
Bad debt loss	4,933	3,667	59,900	68,500
	10,107,006	3,667	59,900	10,170,573
Change in net assets	1,901,591	(5,165,569)	962,482	(2,301,496)
Net assets (deficiency):				
Beginning	(4,771,712)	9,618,765	30,829,433	35,676,486
Ending	$ (2,870,121)	$ 4,453,196	$ 31,791,915	$ 33,374,990

See Notes to Financial Statements.

Orthopaedic Research and Education Foundation

Statement of Cash Flows
Year Ended December 31, 2012

Cash Flows from Operating Activities	
Net change in net assets	$ (2,301,496)
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Net unrealized gains on investments	(228,283)
Net realized gains on investments	(1,720,227)
Donated investments	(21,530)
Change in cash surrender value of life insurance policies	11,664
Change in charitable remainder trusts receivable	(105,485)
Depreciation and amortization	12,648
Bad debt expense	68,500
Permanently restricted contributions	944,734
Changes in:	
Pledges receivable	4,968,554
Other receivables	(120,134)
Prepaid expenses	72,563
Grants and awards payable	(440,600)
Accounts payable	(16,362)
Accrued expenses	(20,584)
Due to Orthopaedic partners	351,749
Net cash provided by operating activities	1,455,711
Cash Flows from Investing Activities	
Increase in restricted cash	(351,749)
Proceeds from sales of marketable securities	2,649,846
Purchases of marketable securities	(2,085,440)
Purchases of property and equipment	(12,434)
Net cash provided by investing activities	200,223
Cash Flows from Financing Activities	
Permanently restricted contributions	(944,734)
Net cash used in financing activities	(944,734)
Increase in cash and cash equivalents	711,200
Cash and cash equivalents:	
Beginning	6,269,794
Ending	$ 6,980,994

See Notes to Financial Statements.

Note 1. Nature of Activities and Significant Accounting Policies

The Orthopaedic Research and Education Foundation (Foundation) was established in 1955 as an Illinois not-for-profit corporation. The purposes of the Foundation are to foster, promote, support, augment, develop and encourage investigative knowledge of the causes, cure and prevention of orthopaedic-related injuries, illnesses and conditions, and to encourage research in the field of orthopaedic surgery in the musculoskeletal system through the awarding of research and educational grants. This research enhances clinical care, leading to improved health, increased activity, and a better quality of life. The predominant source of revenue for the Foundation is from contributions received from orthopaedic surgeons and the orthopaedic industry. Grants are made primarily to organizations in the United States. During 2012, one donor contributed $886,100 which represents 17% percent of total contributions, and seven other donors contributed amounts in excess of $100,000 totaling $1,832,971, which represents 35% percent of total contributions.

The Foundation provides funding to several orthopaedic partners which are organizations or individuals that have been permitted by the Foundation to participate in its designated giving or endowment programs.

This summary of significant accounting policies is presented to assist in understanding the Foundation's financial statements. The financial statements and notes are representations of management who is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

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.

Basis of accounting: The accompanying financial statements have been prepared using the accrual basis of accounting, therefore, revenues are recognized when earned and expenses are recognized when incurred.

Basis of presentation: The financial statement presentation follows the requirements of the *Financial Statements of Not-for-Profit Organizations* topic of the Financial Accounting Standards Board (FASB) Codification. Under these requirements, the Foundation is required to report information regarding its financial position and activities into three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

These classes of net assets are based on the existence or absence of externally (donor) imposed restrictions. Accordingly, net assets of the Foundation and changes therein are classified and reported as follows:

> **Unrestricted net assets**: Unrestricted net assets are not subject to donor-imposed stipulations and reflect revenue earned and expenses incurred in the operation of all Foundation activities. Contributions received in support of activities and investment earnings are recorded as revenue in this category unless such amounts are restricted by the donor.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Temporarily restricted net assets: Temporarily restricted net assets are subject to donor-imposed stipulations that can be met through the passage of time (time restrictions) or actions of the Foundation (purpose restrictions). As grants are awarded, expenses are incurred or time periods are met which satisfy the requirements of the restrictions, 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: Permanently restricted net assets are subject to the restrictions imposed by donors who require that the principal be invested in perpetuity and only the investment earnings be expended.

Grants and awards: Grants and awards are expensed and a liability established when approved by either the Research Grants Committee or the Educational Grants Committee. These grants are paid over a one to three-year period, based on the submission of grantee progress reports. Grants payable in excess of one year are recorded at net present value.

Cash and cash equivalents: Cash and cash equivalents are comprised of cash in banks and money market funds. The Foundation considers highly-liquid short-term instruments with original maturities of three months or less to be cash equivalents.

Restricted cash: Amounts collected by the Foundation which are intended for orthopaedic partners are presented as restricted cash on the statement of financial position and are offset by due to orthopaedic partners' liability.

Marketable securities: Marketable securities, whether purchased or donated, are recorded at fair value based on quoted market prices. All gains and losses are included in the statement of activities. Unrealized gains or losses on such securities are based on the change in market value of the assets from the beginning to the end of the fiscal year. Realized gains or losses are based on the change in market value of the assets from the beginning of the fiscal year to the date of sale.

Investments are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the values of investments will occur in the near-term and that such changes could materially affect the Foundation and the amounts reported in the statements of activities.

Concentration of credit risk: The Foundation maintains cash and cash equivalents in certain financial institutions. At times during the year, balances at these institutions may exceed federally insured limits. The Foundation has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Contributions: Contributions are recognized when received or when the donor makes an unconditional promise to give to the Foundation. Promises to give payable over more than one year are recorded at net present value. Contributions of cash and other assets are recorded as 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 a purpose restriction is fulfilled, 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 contributions must be invested in perpetuity, the earnings from which are available to support the activities of the Foundation. Gifts of marketable securities are recorded as contributions at their fair value at the date of the gift.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

As part of its fundraising activities, the Foundation solicits annual campaign donations on behalf of the orthopaedic partners. Contributions on the statement of activities do not include such funds as the Foundation is only an intermediary. Contributions received on behalf of orthopaedic partners totaled $1,848,728 in 2012. A total of $2,079,245 was not paid and is included on the statement of financial position as of December 31, 2012.

In addition, the Foundation solicits contributions to its endowment that are to benefit the orthopaedic partners and other organizations. These contributions are recorded as permanently restricted contributions of the Foundation, and the earnings are distributed to the beneficiary organization annually.

Pledges receivable: Unconditional promises to give are recognized as revenues in the period the promise is given. Pledges receivable are reported net of a present value discount and an allowance for doubtful pledges based on management's estimate of the collectibility of identified receivables.

Property and equipment: Property and equipment purchases of $500 or more are recorded at cost and depreciated over their estimated useful lives on a straight-line basis. Office furniture and equipment, and computer equipment and software are depreciated over five years. Leasehold improvements are amortized over the lesser of the useful life or the term of the lease.

Major renewals and betterments, which extend the useful life of an asset, are capitalized while routine maintenance and repairs are expensed as incurred. Gains or losses on dispositions of property and equipment are included in the statement of activities.

Functional allocation of expenses: The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of activities. Expenses that are directly associated with a particular program or supporting service are charged directly to that functional area. Certain other costs have been allocated among the programs and supporting services benefited based on estimates of staff time devoted to the functional areas and other appropriate allocation methods determined by management.

Donated services: A significant amount of donated services are contributed to the Foundation by various individuals to support the Foundation's program and supporting services. These volunteer activities include participation on the Board of Trustees and numerous other committees. The value of these services is not reflected in these financial statements since they do not meet the criteria for recognition under the FASB Codification Topic *Accounting for Contributions Received and Contributions Made*.

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Tax status: The Foundation, an Illinois nonprofit corporation, is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state law, except for taxes pertaining to unrelated business income, if any.

The Foundation follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under the guidance, the Foundation may recognize the tax benefits from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Foundation and various positions related to potential sources of unrelated business taxable income. As of December 31, 2012, there were no unrecognized tax benefits identified or recorded as liabilities.

The Foundation files Form 990 in the U.S. federal jurisdiction and the State of Illinois. The Foundation is no longer subject to examination by the Internal Revenue Service for years before 2009.

Note 2. Marketable Securities and Investment Return

At December 31, 2012, the aggregate amounts of marketable securities by major type (current and long-term) recorded at fair value were as follows:

	Fair Value	Cost
Fixed income mutual funds	$ 6,631,419	$ 6,690,417
Domestic equity mutual funds	5,546,113	4,929,440
International equity mutual funds	4,879,087	4,439,605
Commodity mutual funds and other	4,983,439	5,184,555
U.S. government and agency securities	1,415,955	1,365,263
	$ 23,456,013	$ 22,609,280

The following schedule summarizes the investment return for 2012 and its classification in the statement of activities:

	Unrestricted
Interest and dividends	$ 720,388
Net realized gains	1,720,227
Net unrealized gains	228,283
Fees - investment manager	(48,617)
	$ 2,620,281

Note 3. Pledges Receivable

Pledges receivable as of December 31, 2012, represent unconditional promises to give and are due as follows:

Less than one year	$ 3,465,203
One to five years	681,000
More than five years	3,500
	4,149,703
Less: discount to net present value	(21,545)
Less: allowance for uncollectible pledges	(200,000)
Net pledges receivable	3,928,158
Less: current portion	(3,265,203)
Noncurrent pledges receivable, net	$ 662,955

The discount rate used in determining the net present value of pledges receivable ranged from 3.25 to 7.25 percent at December 31, 2012.

In 2012, contributions of $153,385, including pledges of $9,800, were received from Board members. Pledges from Board members totaling $18,630 were outstanding at December 31, 2012.

Note 4. Charitable Remainder Trusts

The Foundation is named as a beneficiary of various irrevocable charitable remainder trusts. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, a specified portion of the remaining assets are available for the Foundation's use or for investment in perpetuity. The fair value of the trust attributable to the present value of the future benefits to be received by the Foundation is recorded in the statement of activities as temporarily restricted or permanently restricted contributions in the period the trust was established and in the statement of financial position as a charitable remainder trust receivable. The estimated present value of all charitable remainder trusts totaled $2,679,138 at December 31, 2012.

The Foundation has not been designated as the trustee of any of the trusts and, therefore, does not hold any of the trust assets, nor is it liable for payment of distributions to the donors. The present value of the estimated future payments was calculated using a discount rate based on the U.S. Treasury yield rate plus a 0.5 percent risk premium for maturities that correspond to the discount period. The discount period is based on the designated beneficiary's expected life based on the applicable mortality tables.

In addition, a donor challenged two orthopaedic partner organizations to raise $250,000 each for the Foundation by the end of 1998, at which time the donor would match each contribution up to $250,000. Each challenge was met, and the donor has stipulated that the Foundation will receive $500,000 from his charitable remainder trust, which is a revocable trust. The matching funds will not be recorded until the contribution becomes irrevocable.

Note 5. Life Insurance Policies

In 1995, the Foundation began a fundraising program encouraging donors to make charitable gifts in the form of life insurance policies. Donors make charitable, tax-deductible contributions to the Foundation annually in the amount of the insurance premiums. The Foundation purchases the life insurance policies on these donors and is the owner and beneficiary of the policies. The cash surrender value of the policies was $1,819,378 at December 31, 2012, and is recorded as a noncurrent asset on the statement of financial position. The face value of these policies was $18,152,747 at December 31, 2012. Insurance premium contribution revenue is recognized in the year it is received. Insurance expense is recognized in the year the premiums are due.

Note 6. Property and Equipment

Property and equipment at December 31, 2012, consists of:

Office furniture and equipment	$ 122,858
Computer equipment and software	131,551
Leasehold improvements	22,201
	276,610
Accumulated depreciation and amortization	(244,572)
	$ 32,038
Depreciation and amortization expense	$ 12,648

Note 7. Grants and Awards Payable

Grants and awards payable	$ 5,493,283
Discount to net present value	(39,627)
	5,453,656
Current portion	(4,530,142)
Noncurrent grants and awards payable	$ 923,514

The discount rate used in determining the net present value of grants and awards payable was 3.25 percent at December 31, 2012.

Note 8. Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at December 31, 2012:

Clinician development program grants	$ 1,570,000
Spine Study Group Program	743,540
Research grants	728,500
Discretionary uses of the foundation	745,969
Raymond public sector project	532,980
For periods after December 31, 2012	132,207
	$ 4,453,196

Note 9. Permanently Restricted Net Assets

At December 31, 2012, the income from permanently restricted net assets is expendable to support the following:

Orthopaedic Partner grants and awards	$ 19,414,767
Foundation grants and awards	5,114,459
Discretionary uses of the foundation	7,262,689
	$ 31,791,915

Note 10. Retirement Plan

The Foundation sponsors a defined contribution retirement plan covering all full-time employees. Employees are eligible to enter into the plan on the first day of the plan year after which the employee has completed two years of service as defined in the plan document. Upon entrance into the plan, employees are fully vested. Contributions are 15 percent of qualified employee compensation plus an additional 4.3 percent of qualified compensation over $25,000. The plan may be amended or terminated at any time. Retirement plan expense was $160,569 for 2012.

Note 11. Commitments

Effective October 1, 2007, the Foundation entered into a five-year lease for its existing office space with the American Academy of Orthopaedic Surgeons. The lease expired in September 2012. In 2012 the Foundation extended the lease through September 2014 with the same terms. The lease terms call for initial monthly rents of $6,294, plus a 3.75 percent increase each lease year. In November 2010, the Foundation entered into a three-year lease for a copier with a minimum monthly lease payment of $666.

The future minimum rental commitments under these leases through September 2014 are as follows:

2013	$ 95,495
2014	73,285
	$ 168,780

Total expense under the above leases was $91,237 in 2012.

Note 12. Fair Value Measurements

The *Fair Value Measurements and Disclosures* topic of the FASB Codification establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This topic applies to all financial instruments that are being measured and reported on a fair value basis.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined under this topic as assumptions market participants would use in pricing an asset or liability.

Note 12. Fair Value Measurements (Continued)

The three levels of the fair value hierarchy under this topic are described below:

Level 1. Quoted market prices in active markets for identical assets or liabilities.

Level 2. Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3. Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to Accounting Standards Codification (ASC) Topic, *Fair Value Measurements and Disclosure*.

The Foundation assesses the levels of investments at each measurement date, and transfers between levels are recognized on the actual date of the event of change in circumstances that caused the transfer in accordance with the Foundation's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. For the year ended December 31, 2012, there were no such transfers.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used for the year ended December 31, 2012.

Marketable securities:

The Foundation's marketable securities include government bonds, and various mutual funds. government bonds are traded on a national securities exchange and are stated at the last reported sales price on the date of valuation. Investments in mutual funds are stated at their reported net asset value as of the valuation date. The investments are entirely Level 1 assets as defined by ASC Topic*, Fair Value Measurements and Disclosure* at December 31, 2012.

Charitable remainder trusts:

Fair value of the assets held in charitable remainder trusts is determined by calculating the present value of the future expected cash flows. Future cash flows are estimated based on the lesser of the total assets of the trust or the amount pledged to the Foundation, and management's estimate of the year of receipt. Discount rates used are based on the U.S. treasury rate plus a risk premium. Discount rates used for the year ended December 31, 2012, range from 2.28% to 3.04%.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation believes that the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 12. Fair Value Measurements (Continued)

Fair values of assets measured on a recurring basis at December 31, 2012, are as follows:

	Fair Value	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)
Fixed income mutual funds	$ 6,631,419	$ 6,631,419	$ -
Domestic equity mutual funds	5,546,113	5,546,113	-
International equity mutual funds	4,879,087	4,879,087	-
Commodity mutual funds and other	4,983,439	4,983,439	-
U.S. government bonds	1,415,955	1,415,955	-
Charitable remainder trusts	2,679,138	-	2,679,138
	$ 26,135,151	$ 23,456,013	$ 2,679,138

Fair value measurements using significant unobservable inputs (Level 3):

	Charitable Remainder Trusts
Balance, January 1, 2012	$ 2,573,653
Change in value, net of discount	105,485
Balance, December 31, 2012	$ 2,679,138

The change in values of assets held in remainder trusts is included in revenues in the statement of activities and is related to assets still held at the statement of financial position date.

Note 13. Endowment

The Foundation's endowment consists of over forty donor-restricted funds established for programs of the Foundation and its orthopaedic partners. As required by accounting standards generally accepted in the United States, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the purchasing power (real value) of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. The Foundation's spending and investment policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes. The current long-term investment return objective is to provide a nominal return of 8 percent or greater, net of investment fees. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk parameters.

The Foundation's endowment spending policy determines the distribution of the investment earnings of these funds absent any donor specifications to the contrary. This spending policy calculates the amount annually distributed from the Foundation's various endowment funds for grantmaking and administration. Under the current endowment spending policy, 5 percent of the average of the fair value of donor-restricted marketable securities at the end of the previous twelve quarters is appropriated to support current operations, representing an appropriation of current year total investment return.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment Funds	$ (1,404,324)	$ -	$ 26,967,447	$ 25,563,123

Note 13. Endowment (Continued)

Endowment net asset composition by type of funds as of December 31, 2012:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ (5,206,410)	$ -	$ 26,022,713	$ 20,816,303
Contributions	-	-	944,734	944,734
Investment income	2,312,820	-	-	2,312,820
Net appreciation	226,920	-	-	226,920
Amounts appropriated for expenditure	1,262,346	-	-	1,262,346
Endowment net assets, end of year	$ (1,404,324)	$ -	$ 26,967,447	$ 25,563,123

In 2008, the endowment suffered losses in excess of $6.7 million which were classified in the unrestricted net asset category. Therefore, when applicable, excess endowment earnings are reclassified from temporarily restricted to unrestricted in order to replenish the unrestricted fund. There were no such reclassifications in 2012.

Note 14. Subsequent Events

Management has evaluated subsequent events through April 26, 2013, the date which the financial statements were available for issue. Subsequent to year-end, the Board approved $1,707,066 for research grants and awards to be paid out over a one to three-year period beginning in 2013. In addition, the Board approved $2,894,010 for educational grants to be paid out in 2013.