

Hall Family Foundation

Accountants' Report and Financial Statements

December 31, 2008 and 2007



Hall Family Foundation
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Independent Accountants' Report

Board of Directors
Hall Family Foundation
Kansas City, Missouri

We have audited the accompanying modified cash basis statements of financial position of Hall Family Foundation (the Foundation) as of December 31, 2008 and 2007, and the related statements of activities for the years then ended. 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audits provide a reasonable basis for our opinion.

As described in Note 1, these financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hall Family Foundation as of December 31, 2008 and 2007, and the changes in its net assets for the years then ended on the basis of accounting described in Note 1.

As discussed in Note 6, in 2008 Hall Family Foundation changed its method of accounting for fair value measurements in accordance with Statement of Financial Accounting Standards No. 157.

BKD, LLP

October 26, 2009

Hall Family Foundation
Statements of Financial Position
(Modified Cash Basis)
December 31, 2008 and 2007

Assets

	2008	2007
Cash and cash equivalents	\$ 91,810,954	\$ 8,778,326
Investments, at fair value		
Fixed income securities	73,660,046	167,396,391
Equity securities	223,914,255	470,912,658
Alternative assets	219,589,759	272,152,708
Total investments	517,164,060	910,461,757
Other assets	749,104	2,182,140
Stock fund income receivable	1,464,162	1,246,935
Investment liquidation proceeds receivable	20,058,052	-
Charitable rental property, net of accumulated depreciation and amortization of \$193,241	11,804,788	-
Total assets	\$ 643,051,120	\$ 922,669,158

Liabilities and Net Assets

Liabilities	\$ -	\$ -
Unrestricted Net Assets		
Fund balance	637,155,261	681,534,175
Net unrealized gains on investments	5,895,859	241,134,983
Total unrestricted net assets	643,051,120	922,669,158
Total liabilities and net assets	\$ 643,051,120	\$ 922,669,158

Hall Family Foundation
Statements of Activities
(Modified Cash Basis)
Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Revenues		
Interest income	\$ 7,004,813	\$ 10,985,746
Dividends	12,859,265	15,475,574
Net rental income	600,237	-
Other losses	(10,076,835)	(1,768,424)
Realized gains (losses)	<u>(26,219,610)</u>	<u>80,571,988</u>
Total revenues (losses)	<u>(15,832,130)</u>	<u>105,264,884</u>
Expenditures		
Contributions	20,745,314	32,753,138
Operating expenditures		
Investment	5,150,475	6,002,820
Charitable	<u>1,064,323</u>	<u>1,083,959</u>
Total operating expenditures	6,214,798	7,086,779
Federal excise tax paid, net of refunds received	1,200,000	1,630,000
Foreign taxes paid, net of refunds received	<u>386,672</u>	<u>258,068</u>
Total expenditures	<u>28,546,784</u>	<u>41,727,985</u>
Increase (Decrease) in Net Assets Before Unrealized Gains		
(Losses) on Investments	(44,378,914)	63,536,899
Change in Unrealized Gains (Losses) on Investments	<u>(235,239,124)</u>	<u>(24,303,963)</u>
Increase (Decrease) in Unrestricted Net Assets	(279,618,038)	39,232,936
Unrestricted Net Assets, Beginning of Year	<u>922,669,158</u>	<u>883,436,222</u>
Unrestricted Net Assets, End of Year	<u>\$ 643,051,120</u>	<u>\$ 922,669,158</u>

Hall Family Foundation
Notes to Financial Statements
(Modified Cash Basis)
December 31, 2008 and 2007

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Hall Family Foundation (the Foundation) is a private foundation dedicated to purposes that are strictly charitable, educational, scientific, religious, literary, benevolent and philanthropic. The Foundation was established in 1943 by Joyce C. Hall, his wife Elizabeth Ann Hall and his brother, Rollie B. Hall. As outlined in the original bylaws, the founders intended that the Foundation should promote “the health, welfare and happiness of school-age children; the advancement and diffusion of knowledge; activities for the improvement of public health; and the advancement of social welfare.”

The Foundation’s mission statement reads: “The Hall Family Foundation is a private philanthropic organization dedicated to enhancing the quality of human life. Programs that enrich the community, help people and promote excellence are considered to be of prime importance. The Foundation views its critical function as that of a catalyst. It seeks to be responsive to programs which are innovative, yet strive to create permanent solutions to community needs in the greater Kansas City area.” In keeping with the founders’ mission, the Foundation concentrates its philanthropic efforts in five areas of interest in the greater Kansas City area: (1) Children, Youth and Families, (2) Education, (3) The Arts, (4) Community Development and (5) Additional Interests. The Foundation provides contributions to charitable organizations that qualify as tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

During 2008, two single member limited liability companies were created to facilitate the purchase of two office buildings, Fairway Office Building North, LLC (FOBN) and Fairway Office Building West, LLC (FOBW).

FOBW was acquired with the intent to donate the property to The Kansas University Endowment Association. As a result, the purchase price of the property was treated for tax purposes as a qualifying distribution in 2008. The legal transfer will occur prior to year end 2009. The building will be used by the University of Kansas Medical Center for a cancer research center.

The second property, FOBN, will be operated for the foreseeable future as a multi-tenant office real estate property.

Basis of Accounting

The accompanying financial statements have been prepared on the modified cash basis of accounting. Under this method, revenue is recognized when received rather than when earned, and contributions and expenses are recognized when paid rather than when the obligation is incurred. *Notes 3 and 4* disclose the Foundation’s obligations for contributions to be paid in future years that are expected to be recognized when paid; such pledges are not recorded as liabilities on the modified cash basis of accounting used in the accompanying financial statements.

Hall Family Foundation
Notes to Financial Statements
(Modified Cash Basis)
December 31, 2008 and 2007

Use of Estimates

The preparation of financial statements in conformity with the Foundation's basis of accounting requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net assets 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. At December 31, 2008 and 2007, cash equivalents consisted primarily of money market funds.

The financial institution holding the Company's cash accounts is participating in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account.

Investments and Investment Return

All investments having a readily determinable fair value are carried at fair value. Investment return includes dividend, interest and other investment income; and realized and unrealized gains and losses on investments, and is reflected in the statement of activities as unrestricted. The stock fund income receivable represents the fourth quarter income distribution due to the Foundation from its equity partnership interests and the investment liquidation proceeds receivable represents the proceeds due on the liquidation of the Foundation's interest in the Harris Associates International Value, L.P., a non U.S. actively managed partnership.

Photography Collection

The photography collection held by the Foundation is classified as charitable-use property for tax purposes. As charitable-use property, the Foundation is considered to have made a qualifying distribution at the time of purchase. Under this classification, the collection is not required to be marked-to-market and, therefore, is reflected at cost. The value of the photography collection at December 31, 2008 and 2007 was \$157,039 and \$1,077,337, respectively, and is included in other assets in the accompanying statements of financial position.

Additions to the photography collection during 2008 and 2007 were \$1,410,130 and \$2,417,512, respectively. During 2008 and 2007, the Foundation donated a portion of the photography collection amounting to \$2,330,716 and \$1,718,626, respectively, to the Nelson-Atkins Museum of Art. These donations are reflected at cost and are classified as contributions on the statements of activities.

Hall Family Foundation
Notes to Financial Statements
(Modified Cash Basis)
December 31, 2008 and 2007

Charitable Lease Property and Revenue

Charitable rental property consists of two office buildings; one held for charitable purposes and the other for rental purposes. The buildings are depreciated on a straight-line basis over their estimated useful life. During 2008, the buildings generated rental income of \$1,347,377 and rental expenses of \$747,140.

Income Taxes

The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. As a private foundation, it is subject to federal excise tax at the rate of 2% on net investment income. Annually, the excise tax rate can be reduced to 1% if statutory distribution requirements are met. The Foundation did not meet those requirements in 2008 or 2007. The excise tax liabilities for 2008 and 2007 were \$100,434 and \$2,073,381, respectively. As of December 31, 2008, \$36,468,889 of undistributed income remains, which is required and expected to be distributed in 2009.

In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FIN 48-3, the Foundation has elected to defer the effective date of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, until its fiscal year ended December 31, 2009. The Foundation has continued to account for any uncertain tax positions in accordance with literature that was authoritative immediately prior to the effective date of FIN 48, such as FASB Statement No. 109, *Accounting for Income Taxes* and FASB Statement No. 5, *Accounting for Contingencies*.

Subsequent Events

Subsequent events have been evaluated through October 26, 2009, which is the date the financial statements were issued.

Note 2: Investments and Investment Return

Investments at December 31, 2008 and 2007 consisted of the following:

	2008		2007	
	Cost	Fair Value	Cost	Fair Value
Fixed Income Securities				
Treasury inflation - protected securities (TIPS)	\$ 37,591,484	\$ 36,329,347	\$ 38,639,045	\$ 40,057,944
Mortgage-backed debt	34,277,400	37,330,699	33,853,760	33,406,181
Partnerships	-	-	95,245,869	93,932,266
Total fixed income securities	<u>71,868,884</u>	<u>73,660,046</u>	<u>167,738,674</u>	<u>167,396,391</u>

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	2008		2007	
	Cost	Fair Value	Cost	Fair Value
Equity Securities				
U.S. passive (tied to the Wilshire 5000)				
Partnership interest	\$ 23,295,033	\$ 116,920,428	\$ 27,533,276	\$ 194,638,495
U.S. actively managed				
Partnership interests	-	-	36,059,840	39,744,912
Non-U.S. passive				
Partnership interests	53,304,858	30,434,002	54,882,161	57,430,480
Non-U.S. actively managed				
Common stocks	24,770,496	23,954,590	21,718,808	37,006,370
Mutual funds	62,022,748	35,441,475	59,820,644	70,843,923
Preferred stock	-	-	209,065	421,231
Partnership and trust interests	20,695,488	17,163,760	57,732,947	70,827,247
Total non-U.S. actively managed	107,488,732	76,559,825	139,481,464	179,098,771
Total equity securities	184,088,623	223,914,255	257,956,741	470,912,658
Alternative Assets				
Marketable				
Absolute return partnerships	110,905,691	119,674,548	107,941,256	138,463,831
Non-marketable				
Partnership and trust interests	76,346,298	63,727,145	80,252,960	84,534,649
Real estate and trust interests	68,058,704	36,188,066	53,190,840	49,136,563
Other	-	-	2,246,303	17,665
Total alternative assets	255,310,693	219,589,759	243,631,359	272,152,708
Total investments	\$ 511,268,200	\$ 517,164,060	\$ 669,326,774	\$ 910,461,757

The Foundation's investments include those described above as "Alternative Assets." This asset class employs a number of investment strategies that utilize a variety of securities and financial instruments in sophisticated trading and portfolio management techniques. These assets include, but are not necessarily limited to, the following types of investment strategies: marketable investments, non-marketable investments and real estate.

Marketable investments consist of absolute return (diversified arbitrage, distressed investment and convertible arbitrage) and equity hedge fund (U.S. long/short, global long/short and sector-specific investments) investment strategies.

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Non-marketable investments consist primarily of investments in various venture capital, hard assets, distressed and private equity partnerships. Outstanding capital commitments to these partnerships as of December 31, 2008 approximated \$62,881,000.

The fair value of these investments is estimated based on the estimated fair values of the underlying securities. These estimates could change materially in the near term.

Note 3: Contribution Commitments

As of December 31, 2008, the Foundation's Board of Directors has authorized contributions to be paid in future years, excluding commitments discussed in *Note 4*, in the total amount of \$64,935,543, which is due in varying amounts and at various dates through 2014. This amount also excludes the purchase price of the Fairway Office Building West, which, as discussed in Note 1, was treated for tax purposes as a qualifying distribution in 2008.

Note 4: Donation Agreement with the Nelson Gallery Foundation

In April 2004, the Hall Family Foundation entered into a Donation Agreement with The Nelson Gallery Foundation (donee). Under the agreement, the Foundation is responsible for the payment of principal and interest on the \$60,000,000 Missouri Development Finance Board Cultural Facilities Revenue, Series 2004A Bonds, through periodic charitable donations to the donee's agent. The primary use of the proceeds of the Bonds is to finance the costs of the Campus Enhancement Project. The Bonds are the third series of bonds issued by the Missouri Development Finance Board for purposes of financing the project. The 2004A series is the only series under which the Foundation has any direct or indirect obligation for payment.

The bonds bear interest at a variable rate that is based on the BMA Daily Index, payable monthly. The Foundation's obligation to pay donations to fund principal on the bonds is subject to a mandatory sinking fund redemption and payment schedule as follows:

	Principal Amount
2029	\$ 11,200,000
2030	11,600,000
2031	12,000,000
2032	12,400,000
2033 final maturity	12,800,000
	\$ 60,000,000

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Any amendment (including termination) of the Bonds, the Loan Agreement or the Bank Agreement is subject to prior written consent of the Foundation. The Nelson Gallery Foundation shall not cause or permit any of the bonds to be called for redemption (other than a scheduled, mandatory sinking fund redemption or a special mandatory redemption, if any) without the prior written consent of the Foundation. In addition, the Nelson Gallery Foundation must obtain prior written consent of the Foundation prior to changing the interest rate mode or replacing the Remarketing Agent on the Bonds.

In connection with the Donation Agreement, the Foundation entered into a 10-year interest rate swap agreement in April 2004 which, in effect, fixed the interest on \$25,000,000 of the \$60,000,000 obligation at the rate of 3.88% per annum. The semi-annual payments under the swap agreement are due June 1 and December 1 of each year. The swap agreement expires in 2013. As of December 31, 2008, the fair value of the swap contract due J. P. Morgan was \$(2,273,627).

All payments by the Foundation that are required under the donation and interest rate swap agreements will be reported for tax purposes as qualifying distributions. In the event the interest rate swap agreement causes payments to be received by the Foundation, these payments will result in adjustments to qualifying distributions for tax reporting purposes.

Note 5: Related Party Transactions

Historically, a department of Hallmark Cards, Inc. (Hallmark) provided personnel and rent-free space for the Foundation's operations. The administrative expenses associated with the personnel provided included salaries, benefits, and other personnel costs. These expenses were reimbursed by the Foundation directly to Hallmark. During 1999, this department of Hallmark was incorporated as Chinquapin Trust Company (Chinquapin). Since the incorporation of Chinquapin, it has provided the rent-free space and personnel needed to carry out the Foundation's charitable purposes. The administrative expenses are reimbursed quarterly by the Foundation to Chinquapin, which in turn reimburses Hallmark. Expenses related to administrative services paid to Chinquapin for the period ending December 31, 2008 and 2007 were \$1,026,686 and \$1,074,844, respectively.

Note 6: Disclosures About Fair Value of Assets and Liabilities

Effective January 1, 2008, the Foundation adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the year.

Hall Family Foundation
Notes to Financial Statements
(Modified Cash Basis)
December 31, 2008 and 2007

FAS 157 defines fair value as 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. FAS 157 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying statements of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Equity Interests

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include mutual funds, publicly traded real estate investment trusts and stocks. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include common trust funds and the Wilshire 5000 equity fund.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and consist of various partnership interests. Partnership investments include interests in equity security investment portfolios as well as alternative asset partnerships which are described in Note 2. Partnership interests are valued based on the Foundation's proportionate interest in the fair value of the underlying investment assets held by the partnerships. These nonpublic investments are included in Level 3 of the fair value hierarchy because they trade infrequently, and therefore, the fair value is dependent on significant unobservable inputs.

Debt Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include treasury inflation protected securities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include mortgage backed debt.

Hall Family Foundation
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(Modified Cash Basis)
December 31, 2008 and 2007

Cash Equivalents – Money Market Funds

Money market funds are liquid investments that have quoted market prices in an active market and are therefore categorized in Level 1 of the fair value hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying statement of financial position measured at fair value on a recurring basis and level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity interests				
Mutual funds	\$ 44,258,925	\$ 44,258,925	\$ -	\$ -
Common trust funds	46,788,047	-	46,788,047	-
Real estate investment trusts	11,017,211	11,017,211	-	-
Stocks	23,954,590	23,954,590	-	-
Limited partnerships and limited liability companies				
Wilshire 5000 equity fund	116,920,428	-	116,920,428	-
Non-U.S. actively managed funds	17,163,760	-	-	17,163,760
Absolute return partnerships	119,674,548	-	-	119,674,548
Private equity	63,726,505	-	-	63,726,505
Total equity interests	443,504,014	79,230,726	163,708,475	200,564,813
Debt securities				
Treasury inflation protection securities	36,329,347	36,329,347	-	-
Mortgage-backed debt	37,330,699	-	37,330,699	-
Total debt securities	73,660,046	36,329,347	37,330,699	-
Total investments	517,164,060	115,560,073	201,039,174	200,564,813
Cash equivalents - money market funds	91,079,143	91,079,143	-	-
	<u>\$ 608,243,203</u>	<u>\$ 206,639,216</u>	<u>\$ 201,039,174</u>	<u>\$ 200,564,813</u>

Hall Family Foundation
Notes to Financial Statements
(Modified Cash Basis)
December 31, 2008 and 2007

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying statement of financial position using significant unobservable (Level 3) inputs:

	Non-U.S. Actively Managed Funds	Absolute Return Funds	Private Equity Funds	Total
Balance, January 1, 2008	\$ 30,947,266	\$ 138,463,831	\$ 197,729,621	\$ 367,140,718
Total realized and unrealized gains and losses included in change in net assets held at the reporting date	(13,783,506)	(21,514,283)	(16,368,968)	(51,666,757)
Total realized and unrealized gains and losses included in change in net assets liquidated during 2008			(26,083,407)	(26,083,407)
Purchases, issuances and settlements	-	2,725,000	(91,550,741)	(88,825,741)
Balance, December 31, 2008	<u>\$ 17,163,760</u>	<u>\$ 119,674,548</u>	<u>\$ 63,726,505</u>	<u>\$ 200,564,813</u>

The following methods were used to estimate fair value of all other financial instruments recognized in the accompanying statements of financial position and amounts other than fair value.

Cash and Cash Equivalents

The carrying amount approximates fair value.

Note 7: Current Economic Conditions

The current economic environment has created unprecedented circumstances and challenges for not-for-profit organizations. As a result, not-for-profit organizations are facing declines in the fair values of investments and other assets. The values of the assets recorded in the financial statements could change rapidly, resulting in material future adjustments to investment values. The financial statements have been prepared using values and information currently available to the Foundation.

In addition, given the volatility of current economic conditions, the values of assets recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values that could negatively impact the Foundation. The Foundation's management intends to vigilantly monitor and aggressively manage these matters, including challenging the quality and values of investments, especially hard-to-value investments.