

THE MCKNIGHT FOUNDATION
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2010 AND 2009

**THE MCKNIGHT FOUNDATION
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YEARS ENDED DECEMBER 31, 2010 AND 2009**

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LarsonAllen[®] LLP

CPAs, Consultants & Advisors

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INDEPENDENT AUDITORS' REPORT

Board of Directors
The McKnight Foundation
Minneapolis, Minnesota

We have audited the accompanying statements of financial position of The McKnight Foundation as of December 31, 2010 and 2009, and the related statements of activities, and cash flows 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The McKnight Foundation as of December 31, 2010 and 2009, and the results of its activities and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

LarsonAllen LLP
LarsonAllen LLP

Minneapolis, Minnesota
August 23, 2011

THE MCKNIGHT FOUNDATION
STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)

ASSETS	<u>2010</u>	<u>2009</u>
Cash	\$ 6,080	\$ 4,332
Investments:		
Marketable Securities:		
Cash and Short-Term Investments	244,915	126,158
Equity Securities	1,007,940	1,064,781
Corporate Debt Securities	125,289	118,755
Mortgage-Backed Securities	68,356	87,385
Government Securities	47,865	60,034
Government Securities Loaned to Broker	40,436	41,454
Alternate Investments:		
Private Equity	303,604	224,515
Hedge Fund	53,200	47,553
Other Alternative	47,507	41,662
Total Investments	<u>1,939,112</u>	<u>1,812,297</u>
Program-Related Investments	9,214	9,818
Investment Collateral	41,226	42,205
Accrued Interest and Dividends Receivable	2,929	2,718
Grant Receivable (Net)	13,069	17,918
Refundable Federal Excise Tax	651	465
Refundable Unrelated Business Income Tax	156	317
Other Assets	<u>2,086</u>	<u>2,683</u>
Total Assets	<u>\$ 2,014,523</u>	<u>\$ 1,892,753</u>
LIABILITIES AND NET ASSETS		
LIABILITIES		
Net due to Fiscal Agents for Securities with Settlements Pending	\$ 4,872	\$ 3,264
Accounts Payable, Accrued Expenses, and Other Liabilities	2,392	2,468
Unpaid Grants (Net)	135,182	91,460
Payable Under Investment Loan Agreement	41,226	42,205
Federal Excise Tax, Deferred	4,464	7,685
Total Liabilities	<u>188,136</u>	<u>147,082</u>
NET ASSETS		
Unrestricted	1,801,056	1,716,917
Unrestricted Board-Designated	11,102	10,066
Total Unrestricted Net Assets	<u>1,812,158</u>	<u>1,726,983</u>
Temporarily Restricted	14,229	18,688
Total Net Assets	<u>1,826,387</u>	<u>1,745,671</u>
Total Liabilities and Net Assets	<u>\$ 2,014,523</u>	<u>\$ 1,892,753</u>

See accompanying Notes to Financial Statements.

**THE MCKNIGHT FOUNDATION
STATEMENTS OF ACTIVITIES
YEARS ENDED DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

	2010	2009
CHANGES IN UNRESTRICTED NET ASSETS		
REVENUES AND GAINS		
Investment Income:		
Interest	\$ 12,462	\$ 14,221
Dividends	20,610	21,582
Gain on Investments	207,368	357,522
Miscellaneous Income	105	156
Net Assets Released from Restriction	4,620	4,488
Total Revenue and Gains	245,165	397,969
EXPENSES		
Grants Appropriated (Net) and Other Program Related Expense	140,410	82,812
Investment Management Fees	11,109	10,779
Administrative Expenses	10,828	12,192
Federal Excise Tax	(2,357)	8,081
Unrelated Business Income Tax	-	366
Total Expenses	159,990	114,230
CHANGE IN UNRESTRICTED NET ASSETS	85,175	283,739
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Grant Income	161	198
Loss on Change in Grant Contract	-	(2,500)
Release from Restriction	(4,620)	(4,488)
CHANGE IN TEMPORARILY RESTRICTED NET ASSETS	(4,459)	(6,790)
CHANGE IN NET ASSETS	80,716	276,949
Net Assets - Beginning of Year	1,745,671	1,468,722
NET ASSETS - END OF YEAR	\$ 1,826,387	\$ 1,745,671

See accompanying Notes to Financial Statements.

THE MCKNIGHT FOUNDATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	\$ 80,716	\$ 276,949
Adjustments to Reconcile Change in Net Cash Used by Operating Activities:		
Gain on Investments	(207,368)	(357,522)
Allowance on Program-Related Investments	728	880
Allowance on Grants Receivable	-	1,757
Write-off of Grants Receivable	-	743
Discount on Grants Receivable	(151)	(193)
Discount on Unpaid Grants	(575)	(7,454)
Changes in Operating Assets and Liabilities:		
Accrued Interest and Dividends Receivable	(211)	635
Grants Receivable	5,000	4,257
Refundable Federal Excise Tax	(186)	396
Refundable Unrelated Business Income Tax	161	364
Other Assets	719	362
Accounts Payable, Accrued Expenses, and Other Liabilities	(76)	698
Unpaid Grants	44,297	(9,861)
Federal Excise Tax, Deferred	(3,221)	7,685
Net Cash Used by Operating Activities	(80,167)	(80,304)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(122)	(162)
Investments Purchased	(629,984)	(639,550)
Investment Sales and Maturities	712,021	724,147
Net Cash Provided by Investing Activities	81,915	84,435
NET INCREASE IN CASH	1,748	4,131
Cash - Beginning of Year	4,332	201
CASH - END OF YEAR	\$ 6,080	\$ 4,332
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Federal Excise Taxes Paid	\$ 1,050	\$ -
Unrelated Business Income Taxes Paid (Refunded)	\$ (159)	\$ 1

See accompanying Notes to Financial Statements.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

NOTE 1 NATURE OF THE FOUNDATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Foundation

The McKnight Foundation (the Foundation), a Minnesota-based family foundation, seeks to improve the quality of life for present and future generations. Through grant-making, coalition-building, and encouragement of strategic policy reform, the Foundation uses resources to attend, unite and empower those it serves. The Foundation's grantmaking priorities include support of child and youth development, the region and communities, the arts, the environment, and scientific research on selected fields. The Foundation's primary geographic focus is the state of Minnesota.

Financial Statement Presentation

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

Unrestricted – Unrestricted net assets are not subject to donor imposed stipulations. Designated amounts represent those funds that the board of directors has set aside for a particular purpose.

Temporarily Restricted – Temporarily restricted net assets are those whose use by the Foundation has been limited by donors to a specific time period or purpose. Temporarily restricted net assets consist of grant receivable amounts from Bill and Melinda Gates Foundation as well as amounts received from this foundation that have not been used as of year-end.

Permanently Restricted – Resources subject to donor imposed restrictions that they be maintained permanently by the Foundation.

The Foundation has no permanently restricted net assets.

Tax Exempt Status

The Foundation is tax exempt under Section 501(c)(3) of the Internal Revenue Code and the applicable Minnesota statutes. The Foundation is a private foundation under Section 509(a) of the Code and pays federal excise taxes on taxable investment income and income tax on any unrelated business income as defined by the Internal Revenue Service (IRS).

The Foundation adopted the accounting standards for uncertain tax positions and files as a tax-exempt organization. No liability has been recognized by the Foundation as a result of the implementation of this standard. Should that status be challenged in the future, all years since inception could be subject to review by the IRS. Its 2007, 2008, and 2009 tax years are open for examination by the IRS.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

**NOTE 1 NATURE OF FOUNDATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions. These affect assets and liabilities as reported, the 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

For cash flow statement reporting purposes, the Foundation considers all bank demand accounts to be cash.

Concentrations and Credit Risk

The Foundation maintains its cash in bank deposit accounts, which frequently exceed federally insured limits. The Foundation has not experienced any losses in such accounts.

The Foundation invests in various securities, including U.S. government securities and domestic and foreign corporate debt and equity securities. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the value of investments.

Investments

Investments in marketable securities are stated at fair value. Fair value of actively traded fixed income and equity securities is based on quoted market prices. Fair value of inactively traded fixed income and equity securities is based on quoted market prices of identical or similar securities based on observable inputs using a market valuation approach. For securities held within a trust, partnership or other fund, fair value is the net asset value of the fund, which is based on observable inputs like quoted prices of securities in the fund. Redemption of interests in funds is at net asset value. Interest and dividend income is recorded when earned. Realized gains and losses are recorded as the difference between historical cost and fair value when an investment is sold. Unrealized gains and losses are recorded for the change in fair value of investments between reporting periods.

The Foundation invests in a trust fund which, as of December 31, 2010 and 2009, includes \$53,200 and \$47,553, respectively, in a limited partnership that invests in a hedge fund. The partnership's investments in this fund are stated at fair value based on the partnership's net contribution to the fund and its allocated share of undistributed profits and losses. Underlying investments in this hedge fund are primarily marketable equity securities, but may also include private equities, fixed income securities, futures, options and forward currency contracts. The hedge fund also engages in the short selling of securities and derivatives.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

**NOTE 1 NATURE OF FOUNDATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Investments (Continued)

The Foundation invests in alternative investment funds, which are not traded. The investment mix, which is very diverse, is at the direction of several fund managers and includes partnerships, venture capital, buyouts and other various strategies. Such investments are valued at amounts reported to the Foundation quarterly by the fund managers. The investments of these funds include securities of companies that may not be immediately liquid. Accordingly, their values are based upon guidelines established by the investment managers. The guidelines vary by fund and investment type. Generally, the investments will be marked to market if quotations are available, subject to appropriate liquidity discounts. If no quotations are available, the investment manager will utilize the last sale price if an arm's length sale transaction has occurred or, if not available, review the activity in the underlying securities to determine if an adjustment is appropriate, or use other valuation methods as deemed appropriate in good faith. Alternative valuation methods use comparable public market valuations and/or the income approach. Consideration is given to the financial condition of the issuer, amounts that the partnerships can reasonably expect to realize upon sale of the securities, and other factors deemed relevant. Investment interests in partnerships are valued by reference to the underlying investments as reported by general partners or managers of the portfolio partnership. Management believes these methods provide a reasonable estimate of fair value. The estimated fair value of the Foundation's interest in such funds is \$351,111 and \$266,177 as of December 31, 2010 and 2009, respectively. The Foundation's investments also include certain alternative investments that are classified based on the nature of their underlying investments.

The Foundation accounts for derivative instruments in accordance with accounting standards that require that all derivative instruments directly owned by the Foundation be recognized in the statements of financial position at fair value. The fair value adjustment is recorded directly to the invested asset and recognized as an unrealized gain or loss in the statement of activities. The Foundation uses derivative instruments principally to manage equity price risk in the Foundation's investment holdings.

Foreign Currency Translation

The assets denominated in a foreign currency are translated into U.S. dollars at the current rate of exchange on the last day of the reporting period. Revenues are translated using the actual rate on the day of the transaction. Revenues from private equity funds denominated in a foreign currency are translated using the weighted average actual rate during the quarterly reporting period.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

**NOTE 1 NATURE OF FOUNDATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Fair Value Measurements

The Foundation follows accounting standards that define fair value, establish a framework for measuring fair value in accordance with existing accounting principles generally accepted in the United States of America, and expand disclosures about fair value measurements. The framework provides a fair value hierarchy that prioritizes inputs according to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level inputs are defined as follows:

Level 1 – Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3 – Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used must maximize the use of observable inputs and minimize the use of unobservable inputs.

Net Due to Fiscal Agents for Securities with Settlements Pending

The amounts due to fiscal agents for securities with settlements pending result from the sales or purchases of securities made prior to the end of the fiscal year, but settled after the fiscal year-end.

Subsequent Events

The Foundation has evaluated events and transactions for potential recognition or disclosure in these financial statements through August 23, 2011, the date the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2009 financial statements have been reclassified to be consistent with the presentation in 2010. These reclassifications had no impact on change in net assets as previously reported.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)**

NOTE 2 INVESTMENTS

Gains (losses) on investments for the years ended December 31, 2010 and 2009 consist of the following:

	2010	2009
Marketable Securities:		
Realized Gain (Loss) on Sale of Securities	\$ 82,201	\$ (25,993)
Unrealized Gain	76,894	371,424
Alternative Investments:		
Realized Gain on Sale of Securities	11,072	1,177
Unrealized Gain	39,944	15,404
Fund Loss, Net of Fees	(2,743)	(4,490)
Total	\$ 207,368	\$ 357,522

NOTE 3 FAIR VALUE MEASUREMENTS

The Foundation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how the Foundation values all other assets and liabilities refer to Note 1 – Nature of Foundation and Significant Accounting Policies.

Valuation Inputs

The following table sets forth the Foundation’s assets that are measured and recognized at fair value on a recurring basis as of December 31, 2010 and 2009, under the appropriate level of the fair value hierarchy. Investments are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Cash and Short-Term Investments are recorded at cost and have been included to facilitate the reconciliation of the footnote to the Statement of Financial Position.

THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009
(IN THOUSANDS)

NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)

Valuation Inputs (Continued)

<u>December 31, 2010</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Marketable Securities, at Fair Value:				
Equity Securities:				
Domestic	\$ 315,929	\$ 286,261	\$ -	\$ 602,190
International	67,965	337,785	-	405,750
Corporate Debt Securities	115,316	9,973	-	125,289
Mortgage-Backed Securities	68,356	-	-	68,356
Government Securities	47,865	-	-	47,865
Government Securities Loaned to Brokers	-	40,436	-	40,436
Alternative Investments:				
Private Equity	-	-	303,604	303,604
Hedge Fund	-	53,200	-	53,200
Other Alternative	-	-	47,507	47,507
Cash and Short-Term Investments	-	-	-	244,915
Investment Subtotal	<u>615,431</u>	<u>727,655</u>	<u>351,111</u>	<u>1,939,112</u>
Investment Collateral	<u>-</u>	<u>41,226</u>	<u>-</u>	<u>41,226</u>
Total	<u>\$ 615,431</u>	<u>\$ 768,881</u>	<u>\$ 351,111</u>	<u>\$ 1,980,338</u>
<u>December 31, 2009</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Marketable Securities, at Fair Value:				
Equity Securities				
Domestic	\$ 294,248	\$ 770,533	\$ -	\$ 1,064,781
International	73,815	44,940	-	118,755
Corporate Debt Securities	86,038	1,347	-	87,385
Mortgage-Backed Securities	53,406	6,628	-	60,034
Government Securities	-	41,454	-	41,454
Government Securities Loaned to Brokers	-	-	-	-
Alternative Investments:				
Private Equity	-	-	224,515	224,515
Hedge Fund	-	47,553	-	47,553
Other Alternative	-	-	41,662	41,662
Cash and Short-Term Investments	-	-	-	126,158
Investment Subtotal	<u>507,507</u>	<u>912,455</u>	<u>266,177</u>	<u>1,812,297</u>
Investment Collateral	<u>-</u>	<u>42,205</u>	<u>-</u>	<u>42,205</u>
Total	<u>\$ 507,507</u>	<u>\$ 954,660</u>	<u>\$ 266,177</u>	<u>\$ 1,854,502</u>

THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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(IN THOUSANDS)

NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using Level 3 inputs for the years ended December 31, 2010 and 2009 is as follows:

	Private Equity	Other Alternative	Total
Beginning Balance at January 1, 2010	\$ 224,515	\$ 41,662	\$ 266,177
Total Gains Included in Change in Net Assets	42,083	1,482	43,565
Purchases, Sales, Capital Calls	37,006	4,363	41,369
Ending Balance at December 31, 2010	<u>\$ 303,604</u>	<u>\$ 47,507</u>	<u>\$ 351,111</u>
Change in Unrealized Losses included in Change in Net Assets Related to Assets Still Held at December 31, 2010	<u>\$ 39,443</u>	<u>\$ 2,694</u>	<u>\$ 42,137</u>
Beginning Balance at January 1, 2009	\$ 163,783	\$ 187,573	\$ 351,356
Transfers from Level 3 to Level 2	-	(140,895)	(140,895)
Total Gains Included in Change in Net Assets	14,557	(7,249)	7,308
Purchases, Sales, Capital Calls	46,175	2,233	48,408
Ending Balance at December 31, 2009	<u>\$ 224,515</u>	<u>\$ 41,662</u>	<u>\$ 266,177</u>
Change in Unrealized Losses included in Change in Net Assets Related to Assets Still Held at December 31, 2009	<u>\$ 19,341</u>	<u>\$ (6,674)</u>	<u>\$ 12,667</u>

The Foundation invests primarily in investment funds, limited partnerships, or non-U.S. corporations referred to collectively for this purpose as investment funds. Investment funds are presented in the accompanying financial statements at fair value as determined under FASB Accounting Standards Codification ASC 820: *Fair Value Measurements and Disclosures*. In situations where the investment fund does not have a readily determinable fair value and meets other eligibility criteria, the Foundation measures fair value based on net asset value per share or its equivalent. The adoption of authoritative guidance on fair value measurements and disclosure did not have a material impact on the accompanying financial statements. The Foundation previously classified its investments that calculate net asset value per share as a Level 3 fair value measurement. It reclassified these investments as a Level 2 fair value measurement during 2009, resulting in a transfer of \$140,895.

The following table lists investments in investment funds by major category as of December 31, 2010 and 2009:

December 31, 2010	Net Asset Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Equity Securities	\$ 624,046	\$ -	Ranges from weekly to quarterly	2 days prior to opening date
Corporate Debt Securities	9,973	-	Ranges from weekly to quarterly	2 days prior to opening date
Private Equity	303,604	204,758	N/A	N/A
Hedge Fund	53,200	-	Quarterly	2 days prior to opening date
Other Alternatives	47,507	21,458	N/A	N/A

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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(IN THOUSANDS)**

NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)

<u>December 31, 2009</u>	<u>Net Asset Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (If Currently Eligible)</u>	<u>Redemption Notice Period</u>
Equity Securities	\$ 770,533	\$ -	Ranges from weekly to quarterly	2 days prior to opening date
Corporate Debt Securities	44,940	-	Ranges from weekly to quarterly	2 days prior to opening date
Mortgage-Backed Securities	1,347	-	Ranges from weekly to quarterly	2 days prior to opening date
Government Securities	6,628	-	Ranges from weekly to quarterly	2 days prior to opening date
Private Equity	224,515	258,487	N/A	N/A
Hedge Fund	47,553	-	Quarterly	2 days prior to opening date
Other Alternatives	41,662	26,362	N/A	N/A

Equity securities include commingled funds containing investments in domestic or foreign stocks that value their investments daily but impose certain liquidity restrictions on investors through periodic fund openings ranging from weekly to quarterly. Investing in equity securities provides diversification, dividend income, and growth potential to the overall portfolio.

Corporate debt securities include commingled funds containing investments in corporate bonds that value their investments daily but impose certain liquidity restrictions on investors through periodic fund openings ranging from weekly to quarterly. Investing in corporate debt securities provides diversification, interest income, and growth potential to the overall portfolio.

Mortgage-backed securities include commingled funds containing investments in mortgage-backed securities that value their investments daily but impose certain liquidity restrictions on investors through periodic fund openings ranging from weekly to quarterly. Investing in mortgage-backed securities provides diversification, interest income, and growth potential to the overall portfolio.

Government securities include commingled funds containing investments in government bonds that value their underlying investments daily but impose certain liquidity restrictions on investors that have periodic fund openings ranging from weekly to quarterly. Investing in government debt securities provides diversification, interest income, low risk and stability to the overall portfolio.

Private equity includes investments in funds of funds holding underlying positions in funds owning private assets. Underlying investments are valued quarterly and have restrictive liquidity provisions. Investing in private equity provides diversification, growth potential, and wider market access to the overall portfolio.

Hedge funds include the position held by a trust in which the Foundation invests as part of an overall tactical asset allocation strategy. Underlying assets are valued by the manager at a maximum quarterly. Liquidity restrictions are imposed on investors through quarterly fund openings. Investing in this hedge fund strategy provides diversification, growth potential, and risk reduction to the overall portfolio.

THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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(IN THOUSANDS)

NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)

Other alternative investments include limited partnerships in natural resources and distressed debt, and an investment in a real estate investment trust (REIT). In this category units are priced daily but the fund managers impose certain liquidity restrictions on participants. Investments in such alternative assets provide diversification and growth potential to the overall portfolio.

NOTE 4 DERIVATIVES

The Foundation uses derivative instruments principally to manage risk in the Foundation's investment holdings. The following is a summary of the Foundation's risk management strategy and the effect on the financial statements:

The Foundation manages an investment portfolio. As part of the Foundation's strategy to manage the risk inherent in the portfolio, the Foundation may enter into hedging transactions, using derivatives, to protect the fair value of investments in the portfolio or the anticipated future cash flows associated with the forecasted purchases or sales of certain investments. Derivative instruments owned are recorded at fair value in the accompanying statements of financial position, and the related gains and losses are immediately recognized in the statements of activities. Net realized and unrealized losses of approximately \$811 and net realized and unrealized gain of approximately \$1,844 were recognized for the years ended December 31, 2010 and 2009, respectively.

The Foundation manages its interest rate risk on a cash collateral pool included in the investment portfolio through the use of U.S. Treasury note futures. Possible risk arises from movement of securities' values and interest rates and the resultant inability of counterparties to meet the terms of the contracts. At December 31, 2010 and 2009, the Foundation held 90-day U.S. Treasury note futures to manage the risk. The Foundation had 1,324 and 422 contracts outstanding as of December 31, 2010 and 2009, at a gross contract value of \$96,840 and \$32,486, respectively. The net exposure amount is included in the Foundation's investment portfolio.

NOTE 5 SECURITIES LENDING

Under a securities lending agreement, the Foundation has authorized the lending agent to manage and administer a securities lending program. The lending agent has the responsibility for negotiating the terms of each loan and for collecting the required collateral, which must be in the amount of 102% in the case of securities of U.S. issuers and 105% in the case of non-U.S. issuers of the market value of any securities loaned, including any accrued interest. Collateral was invested in a short-term investment trust and was due to the investment borrower in accordance with the terms of the collateral agreement.

**THE MCKNIGHT FOUNDATION
NOTES TO FINANCIAL STATEMENTS
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(IN THOUSANDS)**

NOTE 5 SECURITIES LENDING (CONTINUED)

The fair market value of securities on loan was \$40,436 and \$41,454 as of December 31, 2010 and 2009, respectively. The Foundation reflects the collateral received for securities on loan as an asset on its statement of financial position and its obligation to return the collateral as a liability on its statement of financial position. An asset of approximately \$41,226 and \$42,205, and the related liability representing the obligation to return collateral received of \$41,226 and \$42,205 are reflected on the statement of financial position as of December 31, 2010 and 2009, respectively. Net investment earnings for the securities lending activity was \$100 and \$193 for the years ended December 31, 2010 and 2009, respectively.

NOTE 6 PROGRAM-RELATED INVESTMENTS

The Foundation made loans to various local nonprofit organizations to fund projects that fulfill the charitable purposes of the Foundation. Interest rates on the loans range from 2%-5%. The Foundation discounted loans that were made at below-market-rate interest rates. In the event that a program investment loan is determined to be uncollectible or the value is permanently impaired, the Foundation may record the uncollectible amount as an allowance. An allowance of \$152 and \$880 was recorded at December 31, 2010 and 2009, respectively. Total loans outstanding at December 31, 2010 and 2009 were \$9,214 and \$9,818, respectively. Principal payments on the program-related investments are expected to be collected as follows:

	2010	2009
Less than One Year	\$ -	\$ 300
One Year to Five Years	-	-
Greater than Five Years	10,303	11,461
Present Value Discount	(937)	(1,063)
Allowance	(152)	(880)
	\$ 9,214	\$ 9,818

NOTE 7 GRANT RECEIVABLE

In October 2008, the Foundation was awarded a project support grant from the Bill and Melinda Gates Foundation totaling \$26,749. This grant is intended to assist the Foundation's Collaborative Crop Research Program in identifying, supporting and facilitating the success of crop research projects designed to overcome constraints to food and nutritional security in sub-Saharan Africa. The grant receivable has been discounted using a rate of .88% in 2010 and 2009 which is based on what the Foundation would expect to earn on investments with a similar term.

THE MCKNIGHT FOUNDATION
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NOTE 7 GRANTS RECEIVABLE (CONTINUED)

The original terms of the agreement allowed the Foundation to receive funds in semi-annual installments of up to \$2,500 for five years after the initial disbursement of \$1,749. In 2009 the agreement was amended in which the total grant award will be reduced by the difference between the \$5,000 expected to be received each year per the payment schedule below and the amount actually disbursed. As a result of the change in terms, the amount of the change in the total grant award was (\$743) in 2009. The grant award did not change in 2010. An allowance of \$1,757 was recorded as of December 31, 2010 and 2009 for an estimated total loss on the change in contract of \$2,500 in 2009 which is recorded on the statement of activities as a loss on change in grant contract.

The timing of grant receivable payments is as follows as of December 31:

	2010	2009
Less than One Year	\$ 5,000	\$ 5,000
One Year to Five Years	10,000	15,000
Present Value Discount Allowance	(174)	(325)
	(1,757)	(1,757)
Total	<u>\$ 13,069</u>	<u>\$ 17,918</u>

NOTE 8 FEDERAL TAXES AND DISTRIBUTION REQUIREMENTS

Federal Excise Taxes

The Foundation is subject to a 2% excise tax on its taxable investment income, which includes income from investments plus net realized capital gains (net capital losses, however, are not deductible). Tax on net investment income is reduced from 2% to 1% for any taxable year in which the Foundation's qualifying distributions meet certain requirements prescribed by Internal Revenue Code Section 4940(e)(1).

Deferred federal excise taxes based on the 2% rate are computed on the differences between the carrying value and tax basis of the Foundation's investments, as well as temporary differences in income recognition.

The composition of federal excise tax is as follows for the years ended December 31:

	2010	2009
Provision:		
Current	\$ 864	\$ 396
Deferred	(3,221)	7,685
	<u>\$ (2,357)</u>	<u>\$ 8,081</u>
Receivable (Liability):		
Current	\$ 651	\$ 465
Deferred	(4,464)	(7,685)
	<u>\$ (3,813)</u>	<u>\$ (7,220)</u>

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NOTE 8 FEDERAL TAXES AND DISTRIBUTION REQUIREMENTS (CONTINUED)

Distribution Requirements

The Foundation is subject to distribution requirements of the Internal Revenue Code. Accordingly, it must distribute, within one year after the end of each fiscal year, 5% of the fair market value of its investment assets, as defined. The investments includable for the 5% distribution requirement are exclusive of those investments deemed to be held for charitable activities (representing 1.5% of the investments) or other program related investments. Qualifying distributions are determined on a cash basis and include grant payments and certain other expenses incurred by the Foundation.

Unrelated Business Income Taxes

In accordance with Section 511(a)(1) of the Code, the Foundation is subject to corporate tax rates on net income earned from unrelated business activities. The Foundation's investments produce minimal amounts of unrelated business income. The provision for income taxes relating to unrelated business income was \$-0- and \$366 in 2010 and 2009, respectively.

NOTE 9 GRANTS – PAID AND PAYABLE

Grant commitments are recognized in the year authorized by the Foundation's Board of Directors. Unpaid grants at December 31, 2010 and 2009, represent the present value of multiyear grants that are payable from 2011 to 2023. Present value is determined using discount rates ranging from 0.9% to 3.25%. Total amount of grant funding was \$96,686 and \$98,939 in 2010 and 2009, respectively.

The timing of unpaid grants is as follows as of December 31:

	2010	2009
Less than One Year	\$ 62,338	\$ 41,819
One Year to Five Years	60,727	33,074
Greater than Five Years	22,225	26,100
Present Value Discount	(10,108)	(9,533)
	\$ 135,182	\$ 91,460

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NOTE 10 RELATED PARTIES

The Foundation has agreed to provide grants to The McKnight Endowment Fund for Neuroscience (the Fund) annually through 2023, for the purpose of funding and administering neuroscience awards. During 2010 and 2009, \$3,992 and \$4,578 of grants were paid to the Fund, respectively. Grants to be paid to the Fund are included in Note 9 and are as follows as of December 31:

	2010	2009
Less than One Year	\$ 7,355	\$ 4,000
One Year to Five Years	19,375	22,847
Greater than Five Years	22,225	26,100
Present Value Discount	(7,527)	(9,129)
	\$ 41,428	\$ 43,818

Pursuant to an administrative agreement, the Fund reimbursed the Foundation \$100 for each of the years ended December 31, 2010 and 2009, for administrative services provided by the Foundation.

During the year, grants have been approved and disbursed to organizations in which some of the board members may be involved. It is the Foundation's policy to have each board member disclose any potential conflict of interest. These board members are prohibited from voting on grants to these organizations in those instances.

During the year, payments have been made to board members for their services as board members.