

**THE MCKNIGHT FOUNDATION**  
**FINANCIAL STATEMENTS**  
**YEARS ENDED DECEMBER 31, 2017 AND 2016**

**THE MCKNIGHT FOUNDATION  
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YEARS ENDED DECEMBER 31, 2017 AND 2016**

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## INDEPENDENT AUDITORS' REPORT

Board of Directors  
The McKnight Foundation  
Minneapolis, Minnesota

We have audited the accompanying financial statements of The McKnight Foundation, which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of activities and cash flows for the years 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.

### ***Auditors' Responsibility***

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 from 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 auditors' 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.

Board of Directors  
The McKnight Foundation

***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, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*CliftonLarsonAllen LLP*

**CliftonLarsonAllen LLP**

Minneapolis, Minnesota  
August 22, 2018

**THE MCKNIGHT FOUNDATION**  
**STATEMENTS OF FINANCIAL POSITION**  
**DECEMBER 31, 2017 AND 2016**  
(IN THOUSANDS)

|  | 2017         | 2016         |
|--|--------------|--------------|
| <b>ASSETS</b>  |              |              |
| Cash   | \$ 6,095     | \$ 6,228     |
| Investments:   |              |              |
| Marketable Securities:   |              |              |
| Cash and Short-Term Investments                                    | 251,104      | 281,911      |
| Equity Securities  | 1,263,538    | 993,094      |
| Corporate Debt Securities  | 102,938      | 82,586       |
| Asset-Backed Securities  | 57,392       | 48,126       |
| Government Securities  | 75,012       | 73,381       |
| Absolute Return  | 61,347       | -            |
| Securities Loaned to Broker  | 4,942        | 6,731        |
| Alternate Investments:   |              |              |
| Private Equity   | 360,394      | 358,200      |
| Hedge Fund   | 116,803      | 222,912      |
| Other Alternative  | 59,333       | 61,963       |
| Total Investments  | 2,352,803    | 2,128,904    |
| Program-Related Investments  | 21,943       | 21,026       |
| Investment Collateral  | 5,108        | 6,891        |
| Net Due from Fiscal Agents for Securities with Settlements Pending | 12,979       | -            |
| Accrued Interest and Dividends Receivable                          | 1,777        | 1,766        |
| Grant Receivable (Net)   | 4,779        | 9,418        |
| Refundable Federal Excise Tax                                      | -            | 100          |
| Refundable Unrelated Business Income Tax                           | 309          | 359          |
| Other Assets   | 1,649        | 1,725        |
| Total Assets   | \$ 2,407,442 | \$ 2,176,417 |
| <b>LIABILITIES AND NET ASSETS</b>                                  |              |              |
| <b>LIABILITIES</b>   |              |              |
| Net Due to Fiscal Agents for Securities with Settlements Pending   | \$ -         | \$ 11,276    |
| Accounts Payable, Accrued Expenses, and Other Liabilities          | 2,107        | 2,444        |
| Unpaid Grants (Net)  | 63,876       | 95,992       |
| Payable Under Investment Loan Agreement                            | 5,108        | 6,891        |
| Federal Excise Tax   | 8,531        | 5,184        |
| Total Liabilities  | 79,622       | 121,787      |
| <b>NET ASSETS</b>  |              |              |
| Unrestricted   | 2,306,656    | 2,029,856    |
| Unrestricted Board-Designated                                      | 15,401       | 14,303       |
| Total Unrestricted Net Assets                                      | 2,322,057    | 2,044,159    |
| Temporarily Restricted   | 5,763        | 10,471       |
| Total Net Assets   | 2,327,820    | 2,054,630    |
| Total Liabilities and Net Assets                                   | \$ 2,407,442 | \$ 2,176,417 |

See accompanying Notes to Financial Statements.

**THE MCKNIGHT FOUNDATION**  
**STATEMENTS OF ACTIVITIES**  
**YEARS ENDED DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

|   | 2017         | 2016         |
|---|--------------|--------------|
| <b>CHANGE IN UNRESTRICTED NET ASSETS</b>                    |              |              |
| <b>REVENUES AND GAINS</b>                                   |              |              |
| Investment Income:  |              |              |
| Interest  | \$ 9,251     | \$ 8,046     |
| Dividends   | 21,955       | 21,157       |
| Gain on Investments   | 337,562      | 111,448      |
| Miscellaneous Income  | 233          | 171          |
| Net Assets Released from Restriction                        | 4,951        | 4,730        |
| Total Revenue and Gains                                     | 373,952      | 145,552      |
| <b>EXPENSES</b>   |              |              |
| Grants Appropriated (Net) and Other Program Related Expense | 59,182       | 100,332      |
| Investment Management Fees                                  | 15,452       | 13,381       |
| Administrative Expenses                                     | 14,628       | 14,228       |
| Federal Tax   | 6,792        | 589          |
| Total Expenses  | 96,054       | 128,530      |
| <b>CHANGE IN UNRESTRICTED NET ASSETS</b>                    | 277,898      | 17,022       |
| <b>CHANGE IN TEMPORARILY RESTRICTED NET ASSETS</b>          |              |              |
| Grant Income  | 2            | 2            |
| Change in Discount and Allowance                            | 240          | 357          |
| Release from Restriction                                    | (4,950)      | (4,730)      |
| <b>CHANGE IN TEMPORARILY RESTRICTED NET ASSETS</b>          | (4,708)      | (4,371)      |
| <b>CHANGE IN NET ASSETS</b>                                 | 273,190      | 12,651       |
| Net Assets - Beginning of Year                              | 2,054,630    | 2,041,979    |
| <b>NET ASSETS - END OF YEAR</b>                             | \$ 2,327,820 | \$ 2,054,630 |

See accompanying Notes to Financial Statements.

**THE MCKNIGHT FOUNDATION**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

|   | 2017       | 2016      |
|---|------------|-----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |            |           |
| Change in Net Assets  | \$ 273,190 | \$ 12,651 |
| Adjustments to Reconcile Change in Net Assets to Net Cash Used by Operating Activities: |            |           |
| Gain on Investments   | (337,562)  | (111,448) |
| Discount on Program-Related Investments   | 132        | (205)     |
| Discount on Grants Receivable   | (240)      | (357)     |
| Discount on Unpaid Grants   | 1,678      | (68)      |
| Changes in Operating Assets and Liabilities:  |            |           |
| Accrued Interest and Dividends Receivable   | (11)       | (65)      |
| Program-Related Investments Receivable  | (1,049)    | (1,000)   |
| Grants Receivable   | 4,879      | 5,057     |
| Refundable Federal Excise Tax   | 100        | (100)     |
| Refundable Unrelated Business Income Tax  | 50         | 365       |
| Other Assets  | 119        | 105       |
| Accounts Payable, Accrued Expenses, and Other Liabilities                               | (337)      | (328)     |
| Unpaid Grants   | (33,794)   | 12,436    |
| Federal Excise Tax, Deferred  | 3,347      | (1,566)   |
| Net Cash Used by Operating Activities   | (89,498)   | (84,523)  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |            |           |
| Purchase of Property and Equipment  | (43)       | (186)     |
| Investments Purchased   | (459,297)  | (534,136) |
| Investment Sales and Maturities   | 548,705    | 619,696   |
| Net Cash Provided by Investing Activities   | 89,365     | 85,374    |
| <b>NET INCREASE (DECREASE) IN CASH</b>  | (133)      | 851       |
| Cash - Beginning of Year  | 6,228      | 5,377     |
| <b>CASH - END OF YEAR</b>   | \$ 6,095   | \$ 6,228  |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>                                |            |           |
| Federal Excise Taxes Paid   | \$ 3,150   | \$ 1,700  |
| Unrelated Business Income Taxes Paid  | \$ 7       | \$ 154    |

See accompanying Notes to Financial Statements.

**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

**NOTE 1 NATURE OF 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. The Foundation uses all its resources to attend, unite, and empower those it serves. The Foundation's grant making priorities include regional economic and community development, Minnesota's arts and artists, education equity, youth engagement, Midwest climate and energy, Mississippi River water quality, neuroscience research, international crop research, and rural livelihoods. The Foundation's primary geographic focus is the state of Minnesota, with significant support also directed to strategies throughout the U.S. and in Africa, Southeast Asia, and Latin America.

**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 (IRC) 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.



**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(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 are stated at fair value. The fair value of publicly traded securities is based upon quoted market prices and net asset values. For other securities, for which no such quotations or valuations are readily available, fair value is estimated using values provided by external investment managers. These can consist of private equity investments, limited partnerships, mutual funds, fund of funds and hedge funds, and are recorded at approximate fair value as determined and approved by the managers or valuation committees of the alternative investments based upon judgments, which include, among other factors, restrictions affecting marketability and operating results.

The Foundation may also be invested in fixed income securities that are not actively traded and as such quoted market prices may not be available. These investments are priced using the estimates provided by investment managers. The Foundation believes that these valuations are a reasonable estimate of fair value as of December 31, 2017 and 2016, but are subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed.

Receivables and payables with settlements pending arise out of the ordinary course of buys and sells within the Foundation's investment portfolio. These items are short-term in nature and are settled in the next year.

**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

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

**Investments (Continued)**

Changes in fair value are recorded as unrealized gains or losses in the period of change. Realized gains and losses on sales of securities are generally determined using the specific identification method.

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.

**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 MCKNIGHT FOUNDATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2017 AND 2016  
(IN THOUSANDS)**

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

**Fair Value Measurements (Continued)**

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.

**Board-Designated Net Assets**

Board-designated net assets consist of amounts designated for board-directed grant-making and are presented as unrestricted net assets on the statements of financial position.

**Functional Allocation of Expense**

Expenses not directly related to specific grants are considered management and general expenses. Grants are considered program expenses.

**Subsequent Events**

The Foundation has evaluated events and transactions for potential recognition or disclosure in these financial statements through August 22, 2018, the date the financial statements were available to be issued.

**NOTE 2 INVESTMENTS**

Gains on investments for the years ended December 31 consist of the following:

|                                     | <u>2017</u>       | <u>2016</u>       |
|-------------------------------------|-------------------|-------------------|
| Marketable Securities:              |                   |                   |
| Realized Gain on Sale of Securities | \$ 96,507         | \$ 18,881         |
| Unrealized Gain                     | 161,411           | 63,240            |
| Alternative Investments:            |                   |                   |
| Realized Gain on Sale of Securities | 80,139            | 44,947            |
| Unrealized Loss                     | (2,199)           | (16,746)          |
| Fund Gain, Net of Fees              | 1,704             | 1,126             |
| Total                               | <u>\$ 337,562</u> | <u>\$ 111,448</u> |

**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

**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 tables set forth the Foundation's assets that are measured and recognized at fair value on a recurring basis as of December 31, 2017 and 2016, 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 statements of financial position.

| <u>December 31, 2017</u>                                  | <u>Level 1</u>    | <u>Level 2</u>    | <u>Level 3</u> | <u>Total</u>        |
|---|-------------------|-------------------|----------------|---------------------|
| Marketable Securities:                                    |                   |                   |                |                     |
| Equity Securities:  |                   |                   |                |                     |
| Domestic  | \$ 447,709        | \$ -              | \$ -           | \$ 447,709          |
| Global  | 92,581            | -                 | -              | 92,581              |
| Corporate Debt Securities                                 | -                 | 90,632            | -              | 90,632              |
| Asset-Backed Securities                                   | -                 | 57,392            | -              | 57,392              |
| Government Securities                                     | -                 | 60,856            | -              | 60,856              |
| Securities Loaned to Brokers                              | -                 | 4,942             | -              | 4,942               |
| Absolute Return   | 61,347            | -                 | -              | 61,347              |
| Cash and Short-Term Investments                           | -                 | -                 | -              | 251,104             |
| Investment Subtotal                                       | <u>601,637</u>    | <u>213,822</u>    | <u>-</u>       | <u>1,066,563</u>    |
| Investment Collateral                                     | -                 | 5,108             | -              | 5,108               |
| Total Investments at Fair Value                           | <u>601,637</u>    | <u>218,930</u>    | <u>-</u>       | <u>1,071,671</u>    |
| Investments Measured at Net Asset Value or its Equivalent | -                 | -                 | -              | 1,271,067           |
| Direct Investments Held at Cost                           | -                 | -                 | -              | 15,173              |
| Total Investments   | <u>\$ 601,637</u> | <u>\$ 218,930</u> | <u>\$ -</u>    | <u>\$ 2,357,911</u> |
| <br>  |                   |                   |                |                     |
| <u>December 31, 2016</u>                                  | <u>Level 1</u>    | <u>Level 2</u>    | <u>Level 3</u> | <u>Total</u>        |
| Marketable Securities:                                    |                   |                   |                |                     |
| Equity Securities:  |                   |                   |                |                     |
| Domestic  | \$ 382,400        | \$ -              | \$ -           | \$ 382,400          |
| Global  | 51,109            | -                 | -              | 51,109              |
| Corporate Debt Securities                                 | -                 | 78,394            | -              | 78,394              |
| Asset-Backed Securities                                   | -                 | 48,126            | -              | 48,126              |
| Government Securities                                     | -                 | 59,664            | -              | 59,664              |
| Securities Loaned to Brokers                              | -                 | 6,731             | -              | 6,731               |
| Cash and Short-Term Investments                           | -                 | -                 | -              | 281,911             |
| Investment Subtotal                                       | <u>433,509</u>    | <u>192,915</u>    | <u>-</u>       | <u>908,335</u>      |
| Investment Collateral                                     | -                 | 6,891             | -              | 6,891               |
| Total Investments at Fair Value                           | <u>433,509</u>    | <u>199,806</u>    | <u>-</u>       | <u>915,226</u>      |
| Investments Measured at Net Asset Value or its Equivalent | -                 | -                 | -              | 1,213,069           |
| Direct Investments Held at Cost                           | -                 | -                 | -              | 7,500               |
| Total Investments   | <u>\$ 433,509</u> | <u>\$ 199,806</u> | <u>\$ -</u>    | <u>\$ 2,135,795</u> |

**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

**NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)**

**Valuation Inputs (Continued)**

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 standards for 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 following tables list investments in investment funds by major category as of December 31, 2017 and 2016:

| <u>December 31, 2017</u>  | <u>Net Asset<br/>Value</u> | <u>Unfunded<br/>Commitments</u> | <u>Redemption Frequency<br/>(if Currently Eligible)</u> | <u>Redemption<br/>Notice Period</u> |
|---------------------------|----------------------------|---------------------------------|---|-------------------------------------|
| Equity Securities         | \$ 723,248                 | \$ -                            | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Corporate Debt Securities | 4,633                      | 327                             | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Government Securities     | 14,156                     | -                               | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Private Equity            | 352,894                    | 216,371                         | N/A   | N/A                                 |
| Hedge Fund                | 116,803                    | -                               | Quarterly   | 45-95 Days Prior to<br>Opening Date |
| Other Alternatives        | 59,333                     | 4,526                           | N/A   | N/A                                 |
| <br>                      |                            |                                 |   |                                     |
| <u>December 31, 2016</u>  | <u>Net Asset<br/>Value</u> | <u>Unfunded<br/>Commitments</u> | <u>Redemption Frequency<br/>(if Currently Eligible)</u> | <u>Redemption<br/>Notice Period</u> |
| Equity Securities         | \$ 559,585                 | \$ -                            | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Corporate Debt Securities | 4,192                      | -                               | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Government Securities     | 13,717                     | -                               | Ranges from Weekly to Quarterly                         | Two Days Prior to Opening Date      |
| Private Equity            | 350,700                    | 196,737                         | N/A   | N/A                                 |
| Hedge Fund                | 222,912                    | -                               | Quarterly   | 45-95 Days Prior to<br>Opening Date |
| Other Alternatives        | 61,963                     | 18,676                          | N/A   | N/A                                 |

In addition to the unfunded commitments noted above, the Foundation has entered into investment commitments of \$109 million since December 31, 2017. Approximately \$4 million has been called on these funds since December 31, 2017.

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.

**THE MCKNIGHT FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**  
**(IN THOUSANDS)**

**NOTE 3 FAIR VALUE MEASUREMENTS (CONTINUED)**

**Valuation Inputs (Continued)**

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.

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. The unobservable inputs used to determine the fair value of the private equity investments have been estimated based on the capital account balances reported by underlying partnerships subject to the funds' management review and judgment. 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. Hedge funds also include funds held as a strategy to reduce portfolio volatility. The unobservable inputs used to determine the fair value of the hedge fund investments have been estimated based on the capital account balances reported by underlying funds subject to the funds' management review and judgment. 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.

Other alternative investments include limited partnerships in natural resources and distressed debt, and an investment in a real estate investment trust (REIT). The unobservable inputs used to determine the fair value of the other alternative investments have been estimated based on the capital account balances reported by underlying funds subject to the funds' management review and judgment. 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.

**THE MCKNIGHT FOUNDATION**  
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**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 gains of approximately \$7,490 and \$6,608 were recognized for the years ended December 31, 2017 and 2016, respectively.

The Foundation manages its risk on a cash collateral pool included in the investment portfolio through the use of 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. The Foundation had 364 and 1,055 contracts outstanding and contract exposure amounts of \$46,432 and \$118,367 as of December 31, 2017 and 2016, respectively. The net fair value of the contract position 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, including any accrued interest. Loans of domestic securities are initially collateralized at 102% of the fair value of securities lent. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of securities lent.

The fair market value of securities on loan was \$4,942 and \$6,731 as of December 31, 2017 and 2016, 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 \$5,108 and \$6,891, and the related liability representing the obligation to return collateral received of \$5,108 and \$6,891 are reflected on the statement of financial position as of December 31, 2017 and 2016, respectively. Net investment earnings for the securities lending activity was \$46 and \$139 for the years ended December 31, 2017 and 2016, respectively.

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**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 1%-2%. 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 for program related investments is established based on annual review by the Foundation's Investment Committee of the status of all program related investments. If the Investment Committee determines that a specific program related investment should have an allowance established the Investment Committee recommends to the board of directors who approves the allowance. No allowances were recorded at December 31, 2017 and 2016. Total loans outstanding at December 31, 2017 and 2016 were \$21,943 and \$21,026, respectively, none of which were past due.

Principal payments on the program-related investments are expected to be collected as follows:

|                         | 2017      | 2016      |
|-------------------------|-----------|-----------|
| Less than One Year      | \$ 1,500  | \$ 1,000  |
| One Year to Five Years  | 18,700    | 20,200    |
| Greater than Five Years | 3,049     | 1,000     |
| Present Value Discount  | (1,306)   | (1,174)   |
| Total                   | \$ 21,943 | \$ 21,026 |

At December 31, the program related investments consisted of the following:

|  | 2017      | 2016      |
|--|-----------|-----------|
| Program Related Investments            | \$ 23,249 | \$ 22,200 |
| Less Discounts:                        |           |           |
| Beginning of Year                      | (1,174)   | (1,379)   |
| (Increases) Decreases                  | (132)     | 205       |
| End of Year                            | (1,306)   | (1,174)   |
| Total Program Related Investments, Net | \$ 21,943 | \$ 21,026 |

At December 31, 2017 and 2016, there were \$4.3 million in approved program-related investments that were not yet drawn upon.



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**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 3.25% in 2017 and 2016, which is based on what the Foundation would expect to earn on investments with a similar term.

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 remaining balance was received in 2013, leaving no ending balance of the original grant at December 31, 2013.

In October 2013, the Foundation was awarded a renewal grant from the Bill and Melinda Gates Foundation totaling \$24,961, payable over five years. This grant is intended to assist the Foundation's Collaborative Crop Research Program in continuing the work identified in the original grant. The grant receivable has been discounted using a rate of 3.25% in 2017 and 2016, which is based on what the Foundation would expect to earn on investments with a similar term. No allowance was recorded as of December 31, 2017 and 2016.

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

|                        | 2017     | 2016     |
|------------------------|----------|----------|
| Less than One Year     | \$ 4,779 | \$ 4,880 |
| One Year to Five Years | -        | 4,778    |
| Present Value Discount | -        | (240)    |
| Total                  | \$ 4,779 | \$ 9,418 |

**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.

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**NOTE 8 FEDERAL TAXES AND DISTRIBUTION REQUIREMENTS (CONTINUED)**

**Federal Excise Taxes (Continued)**

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

|                         | <u>2017</u>       | <u>2016</u>       |
|-------------------------|-------------------|-------------------|
| Provision:              |                   |                   |
| Current                 | \$ 3,862          | \$ 1,514          |
| Deferred                | 2,745             | (1,480)           |
| Total                   | <u>\$ 6,607</u>   | <u>\$ 34</u>      |
| Receivable (Liability): |                   |                   |
| Current                 | \$ (601)          | \$ 100            |
| Deferred                | (7,930)           | (5,184)           |
| Total                   | <u>\$ (8,531)</u> | <u>\$ (5,084)</u> |

**Distribution Requirements**

The Foundation is subject to distribution requirements of the IRC. 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 payments made for income taxes relating to unrelated business income was \$7 and \$154 in 2017 and 2016, 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, 2017 and 2016, represent the present value of multiyear grants that are payable from 2018 to 2023. Present value is determined using a discount rate of 4.13% in 2017 and 3.51% in 2016. Total amount of grant funding was \$90,858 and \$87,876 in 2017 and 2016, respectively.

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**NOTE 9 GRANTS – PAID AND PAYABLE (CONTINUED)**

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

|                        | 2017             | 2016             |
|------------------------|------------------|------------------|
| Less than One Year     | \$ 40,712        | \$ 53,166        |
| One Year to Five Years | 25,117           | 46,457           |
| Present Value Discount | (1,953)          | (3,631)          |
| Total                  | <u>\$ 63,876</u> | <u>\$ 95,992</u> |

**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. The Foundation, which the Fund relies upon for grant funding, has the ability to appoint two of the ten members of the Fund's board of directors. During 2017 and 2016, \$3,718 and \$3,762 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:

|                        | 2017             | 2016             |
|------------------------|------------------|------------------|
| Less than One Year     | \$ 3,875         | \$ 3,875         |
| One Year to Five Years | 15,855           | 19,573           |
| Present Value Discount | (1,457)          | (2,066)          |
| Total                  | <u>\$ 18,273</u> | <u>\$ 21,382</u> |

Pursuant to an administrative agreement, the Fund reimbursed the Foundation \$100 for each of the years ended December 31, 2017 and 2016, 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.