The Spencer Foundation

(An Illinois Not-for-Profit Corporation)

Financial Report
March 31, 2012 and 2011

Contents

McGladrey

Independent Auditor's Report

To the Board of Directors
The Spencer Foundation

We have audited the accompanying statements of financial position of The Spencer Foundation (an Illinois not-for-profit corporation) (the Foundation) as of March 31, 2012 and 2011, 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 Spencer Foundation as of March 31, 2012 and 2011 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey LLP

Chicago, Illinois
June 14, 2012

The Spencer Foundation
(An Illinois Not-for-Profit Corporation)

Statements of Financial Position (In Thousands of Dollars)
March 31, 2012 and 2011

		2012		2011
Assets				
Investments, at fair value	**$**	**434,063**	$	430,842
Cash		**1,081**		231
Other assets		**629**		542
	$	**435,773**	$	431,615
Liabilities and Unrestricted Net Assets				
Grants payable	**$**	**13,881**	$	10,852
Deferred federal excise tax		**1,604**		1,430
Postretirement benefits liability		**1,572**		1,386
Accounts payable		**41**		150
		17,098		13,818
Unrestricted net assets		**418,675**		417,797
	$	**435,773**	$	431,615

See Notes to Financial Statements.

The Spencer Foundation
(An Illinois Not-for-Profit Corporation)

Statements of Activities (In Thousands of Dollars)
Years Ended March 31, 2012 and 2011

	2012	2011
Investment returns:		
Net realized gain on sales of investments	**$ 4,773**	$ 2,611
Net change in unrealized gain on investments	**6,085**	44,717
Interest and other income	**19**	10
Dividend income	**10,460**	11,222
	21,337	58,560
Program services:		
Grants authorized, net of refunds (grant payments made were $10,885 in 2012 and $12,928 in 2011)	**13,581**	13,904
Foundation administered projects	**749**	778
Administrative expenses	**4,971**	5,553
Investment management expenses	**713**	642
Current federal excise tax (net of tax refund)	**271**	167
Deferred federal excise tax	**174**	850
	20,459	21,894
Change in net assets	**878**	36,666
Unrestricted net assets:		
Beginning of year	**417,797**	381,131
End of year	**$ 418,675**	$ 417,797

See Notes to Financial Statements.

The Spencer Foundation
(An Illinois Not-for-Profit Corporation)

Statements of Cash Flows (In Thousands of Dollars)
Years Ended March 31, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities		
Change in net assets	$ 878	$ 36,666
Net realized gain on sales of investments	(4,773)	(2,611)
Net change in unrealized gain on investments	(6,085)	(44,717)
Changes in:		
Other assets	(87)	253
Grants payable	3,029	1,045
Deferred federal excise tax	174	850
Postretirement benefits liability	186	1,386
Accrued expenses	-	(67)
Accounts payable	(109)	53
Net cash used in operating activities	(6,787)	(7,142)
Cash Flows from Investing Activities		
Purchases of investments	(12,439)	(9,482)
Proceeds from sales of investments	20,076	16,719
Net cash provided by investing activities	7,637	7,237
Net increase in cash	850	95
Cash:		
Beginning of year	231	136
End of year	$ 1,081	$ 231

See Notes to Financial Statements.

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: The Spencer Foundation (the Foundation), organized in 1962, is the residuary legatee under the will of Lyle M. Spencer, deceased. The Foundation was established to support research aimed at the improvement of education. Support is derived primarily from returns on the Foundation's investments.

Financial statement presentation: The financial statements have been prepared following accounting principles applicable to nonprofit organizations.

Investments: Investments are carried at fair values. Purchases and sales of securities are recorded on a trade date basis. Investment income, realized gains (losses) and change in unrealized gains (losses) are reflected in the statements of activities.

Deferred federal excise tax: Deferred federal excise tax represents taxes provided on the net unrealized appreciation on investments, using a rate of 2 percent.

Awards and grants: Awards and grants, including multiyear grants, are considered obligations when approved by the Foundation's Board of Directors.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions affecting the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Fair value of financial instruments: Substantially all of the Foundation's assets and liabilities are considered financial instruments and are either already reflected at fair value or are short-term or replaceable on demand. Therefore, their carrying amounts approximate fair value.

Tax status: The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income taxes. However, in accordance with Section 4940(e) of the Code, the Foundation is subject to a federal excise tax of 2 percent of net investment income and net realized taxable gains on security transactions or 1 percent if the Foundation meets certain specified distribution requirements. The Foundation did not meet the specified requirements for fiscal years 2012 and 2011 and was subject to a 2 percent federal excise tax.

The Foundation follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Foundation may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the Foundation, and various positions related to the potential sources of unrelated business taxable income. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods. As of March 31, 2012 and 2011, there were no unrecognized tax positions identified or recorded as liabilities.

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

The Foundation files forms 990PF in the U.S. federal jurisdiction and the State of Illinois. With few exceptions, the Foundation is no longer subject to examination by the Internal Revenue Service for fiscal years before 2008.

Subsequent events: The Foundation has evaluated subsequent events for potential recognition and/or disclosure through June 14, 2012, the date the financial statements were available to be issued.

Note 2. Investments

Investments at March 31, 2012 and 2011 are summarized as follows:

	2012		2011	
	Cost	Market or Fair Value	Cost	Market or Fair Value
Marketable securities:				
Equity funds - domestic	$ 232,085,000	$ 304,747,000	$ 244,511,000	$ 305,320,000
Equity funds - international	63,620,000	64,550,000	62,165,000	69,293,000
Bond funds - domestic	62,046,000	63,737,000	53,942,000	55,200,000
Real estate investments	970,000	1,029,000	970,000	1,029,000
	$ 358,721,000	$ 434,063,000	$ 361,588,000	$ 430,842,000

The Foundation's investments 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 will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

Note 3. Fair Value Measurements

The Foundation follows the accounting guidance related to fair value measurements, which provides a framework for measuring fair value under generally accepted accounting principles. This guidance applies to all financial instruments that are being measured and reported on a fair value basis.

Fair value is defined 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. In determining fair value, the Foundation uses various methods including market, income and cost approaches. Based on these approaches, the Foundation often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Foundation utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used on the valuation techniques, the Foundation is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Note 3. Fair Value Measurements (Continued)

Level 1. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.

Level 3. Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Foundation's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

The Foundation assesses the levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Foundation's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. For the years ended March 31, 2012 and 2011, there were no such transfers.

For the fiscal years ended March 31, 2012 and 2011, the application of valuation techniques applied to similar assets and liabilities has been consistent. The following is a description of the valuation methodologies used for instruments at fair value:

Marketable securities: The fair value of investment securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers.

Real estate investments: The fair value of real estate investments is based on independent appraisals, when available, or estimated based on current market prices for similar properties.

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to fair value measurement. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs would be classified as Level 3.

Note 3. Fair Value Measurements (Continued)

Fair value on a recurring basis: The table below presents the balances of assets and liabilities measured at fair value on a recurring basis:

	March 31, 2012			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	$ 304,747,000	$ -	$ -	$ 304,747,000
Equity funds - international	64,550,000	-	-	64,550,000
Bond funds - domestic	63,737,000	-	-	63,737,000
Real estate investments	-	1,029,000	-	1,029,000
	$ 433,034,000	$ 1,029,000	$ -	$ 434,063,000

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	$ 305,320,000	$ -	$ -	$ 305,320,000
Equity funds - international	69,293,000	-	-	69,293,000
Bond funds - domestic	55,200,000	-	-	55,200,000
Real estate investments	-	1,029,000	-	1,029,000
	$ 429,813,000	$ 1,029,000	$ -	$ 430,842,000

Note 4. Grants Payable

Grants payable consist primarily of multiyear unconditional grants that are generally payable over one to five years. Management estimates these grants will be paid as follows:

2013	$ 7,159,000
2014	4,095,000
2015	1,971,000
2016	656,000
	$ 13,881,000

Grants authorized are shown net of rescissions and refunds of $336,000 in 2012 and $74,000 in 2011. Payments on authorized but unpaid grants may be accelerated upon mutual agreement between the Foundation and the grantees.

Note 5. Unrestricted Net Assets

Unrestricted net assets are comprised of the following amounts:

	2012	2011
Principal	$ 82,203,000	$ 82,203,000
Cumulative excess of grants and other expenses over revenue (cumulative grants authorized of $448,001,000 at March 31, 2012)	(270,167,000)	(260,187,000)
Cumulative net realized gains on sales of investments	531,300,000	526,527,000
Unrealized gains in investment portfolio	75,339,000	69,254,000
	$ 418,675,000	$ 417,797,000

Note 6. Employee Benefits

The Foundation maintains a defined contribution retirement plan covering all active full-time employees. Under the terms of the plan, the Foundation must contribute specified percentages of an employee's salary. The plan is currently invested in employee-designated individual annuity contracts and various approved mutual funds. The Foundation's contribution to the plan was $318,000 for fiscal year 2012 ($258,000 - 2011).

In addition, the Foundation maintains a supplemental retirement plan that allows employees to defer a portion of their pretax salaries. No contributions are made to this plan by the Foundation.

In fiscal year 2011, the Foundation recorded a liability for a postretirement medical benefits plan in accordance with the accounting guidance on employer's accounting for defined benefit pension and other postretirement plans. The plan provides health care benefits to retired employees and their spouses and beneficiaries. Generally, qualified employees may become eligible for these benefits if they retire in accordance with the provisions of the Foundation's medical plan and are participating in the Foundation's medical plan at the time of their retirement. The Foundation's postretirement benefit plan is not funded. The Foundation has the right to modify or terminate the plan. The Foundation uses a March 31 measurement date for its plan.

	2012	2011
Obligations and funded status:		
Fair value of plan assets	$ -	$ -
Accumulated postretirement benefit obligation	(1,572,000)	(1,386,000)
Funded status	$ (1,572,000)	$ (1,386,000)
Amounts recognized on the statements of financial position:		
Postretirement benefits liability	$ 1,572,000	$ 1,386,000

Note 6. Employee Benefits (Continued)

The table below summarizes changes in the Foundation's postretirement benefit obligation for the years ended March 31, 2012 and 2011:

	2012	2011
Postretirement benefit obligation, beginning of year	$ 1,386,000	$ -
Initial recognition of postretirement benefit liability	-	1,283,000
Service cost	102,000	96,000
Interest cost	82,000	76,000
Actuarial (gain)/loss	171,000	(24,000)
Plan amendments	(123,000)	-
Benefits paid	(46,000)	(45,000)
Postretirement benefit obligation, end of year	$ 1,572,000	$ 1,386,000

In October 2011, the plan was amended so that the Foundation will no longer reimburse Medicare premiums for future retirees who are under the age of 60 as of October 2011.

Changes in the postretirement benefit obligation are reflected on the statement of activities in administrative expense for the years ended March 31, 2012 and 2011 as follows:

	2012	2011
Net periodic postretirement benefit cost	$ 184,000	$ 1,455,000
Change in postretirement benefit obligation not included in net periodic postretirement benefit cost	$ 47,000	$ (69,000)

There were no contributions made by participants to the medical plan for the year ended March 31, 2012.

The weighted-average actuarial assumptions used to determine benefit obligation and benefit cost for the years ended March 31, 2012 and 2011 were as follows:

	2012	2011
Discount rate for obligations	5.00%	6.00%
Discount rate of costs	5.00%	6.00%

Note 6. Employee Benefits (Continued)

The assumed health care cost trend rates used to determine benefit obligation for the years ended March 31, 2012 and 2011 were as follows:

	2012	2011
Assumed health care cost trend rates as of March 31		
Health care cost trend Medicare rate assumed for the next year		
Current pre-65 health care trend rate	7.24%	8.24%
Current post-65 health care trend rate	7.24%	8.24%
Rate to which the cost trend rate is assumed to decline		
(the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2017

The Foundation expects to contribute approximately $51,000 to its postretirement benefit plan in 2013.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years ending March 31:	
2013	$ 51,000
2014	52,000
2015	59,000
2016	61,000
2017	68,000
Fiscal 2018 - 2022	383,000
	$ 674,000

Note 7. Commitments

The Foundation currently occupies office space in Chicago, under the terms of an operating lease which expires in calendar year 2021. The lease requires the Foundation to pay monthly base rents ranging from $18,000 to $23,000, plus a proportionate share of operating expense and real estate taxes. At March 31, 2012, the Foundation had the following commitments for base rentals under this lease:

2013	$ 218,000
2014	168,000
2015	231,000
2016	238,000
2017	245,000
Thereafter	1,226,000
	$ 2,326,000

Rent expense, including operating expense and real estate taxes, was $461,000 for fiscal year 2012 ($408,000 - 2011).