The Spencer Foundation

(An Illinois Not-for-Profit Corporation)

Financial Report
March 31, 2014 and 2013

Contents

McGladrey

Independent Auditor's Report

To the Board of Directors
The Spencer Foundation

Report on the Financial Statements

We have audited the accompanying financial statements of The Spencer Foundation (an Illinois not-for-profit corporation) (the Foundation) which comprise the statement of financial position as of March 31, 2014 and 2013, 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.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Spencer Foundation as of March 31, 2014 and 2013, 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.

McGladrey LLP

Chicago, Illinois
June 4, 2014

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

Statements of Financial Position (In Thousands of Dollars)
March 31, 2014 and 2013

		2014		2013
Assets				
Investments, at fair value	**$**	**519,812**	$	471,526
Cash		**10,156**		368
Other assets		**551**		506
	$	**530,519**	$	472,400
Liabilities and Unrestricted Net Assets				
Grants payable	**$**	**12,218**	$	11,175
Deferred federal excise tax		**3,419**		2,197
Postretirement benefits liability		**1,847**		1,716
Accounts payable		**105**		110
		17,589		15,198
Unrestricted net assets		**512,930**		457,202
	$	**530,519**	$	472,400

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, 2014 and 2013

	2014	2013
Investment returns:		
Net realized gain on sales of investments	**$ 9,910**	$ 11,587
Net change in unrealized gain on investments	**58,186**	30,828
Interest and other income	**16**	17
Dividend income	**11,322**	12,025
	79,434	54,457
Program services:		
Grants authorized, net of refunds (grant payments made were $13,954 in 2014 and $11,221 in 2013)	**14,881**	8,238
Foundation administered projects	**716**	667
Administrative expenses	**5,394**	5,210
Investment management expenses	**1,040**	825
Current federal excise tax (net of tax refund)	**453**	397
Deferred federal excise tax	**1,222**	593
	23,706	15,930
Change in net assets	**55,728**	38,527
Unrestricted net assets:		
Beginning of year	**457,202**	418,675
End of year	**$ 512,930**	$ 457,202

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, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities		
Change in net assets	**$ 55,728**	$ 38,527
Net realized gain on sales of investments	**(9,910)**	(11,587)
Net change in unrealized gain on investments	**(58,186)**	(30,828)
Changes in:		
Other assets	**(45)**	123
Grants payable	**1,043**	(2,706)
Deferred federal excise tax	**1,222**	593
Postretirement benefits liability	**131**	144
Accounts payable	**(5)**	69
Net cash used in operating activities	**(10,022)**	(5,665)
Cash Flows from Investing Activities		
Purchases of investments	**(4,714)**	(33,829)
Proceeds from sales of investments	**24,524**	38,781
Net cash provided by investing activities	**19,810**	4,952
Net increase (decrease) in cash	**9,788**	(713)
Cash:		
Beginning of year	**368**	1,081
End of year	**$ 10,156**	$ 368

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 (the 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 2014 and 2013 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, 2014 and 2013, 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 2011.

Subsequent events: The Foundation has evaluated subsequent events for potential recognition and/or disclosure through June 4, 2014 the date the financial statements were available to be issued.

Note 2. Investments

Investments at March 31, 2014 and 2013 are summarized as follows:

	2014		2013	
	Cost	Market or Fair Value	Cost	Market or Fair Value
Marketable securities:				
Equity funds - domestic	$ 220,721,000	$ 373,083,000	$ 232,588,000	$ 329,692,000
Equity funds - international	70,952,000	82,441,000	70,952,000	77,263,000
Bond funds - domestic	62,818,000	63,263,000	60,851,000	63,546,000
Real estate investments	970,000	1,025,000	970,000	1,025,000
	$ 355,461,000	$ 519,812,000	$ 365,361,000	$ 471,526,000

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.

Note 3. Fair Value Measurements (Continued)

Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

> 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, 2014 and 2013, there were no such transfers.

For the fiscal years ended March 31, 2014 and 2013, the application of valuation techniques applied to similar assets and liabilities has been consistent. The following are descriptions 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 tables below present the balances of assets and liabilities measured at fair value on a recurring basis:

	March 31, 2014			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	$ 373,083,000	$ -	$ -	$ 373,083,000
Equity funds - international	82,441,000	-	-	82,441,000
Bond funds - domestic	63,263,000	-	-	63,263,000
Real estate investments	-	1,025,000	-	1,025,000
	$ 518,787,000	$ 1,025,000	$ -	$ 519,812,000

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	$ 329,692,000	$ -	$ -	$ 329,692,000
Equity funds - international	77,263,000	-	-	77,263,000
Bond funds - domestic	63,546,000	-	-	63,546,000
Real estate investments	-	1,025,000	-	1,025,000
	$ 470,501,000	$ 1,025,000	$ -	$ 471,526,000

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:

2015	$ 8,450,000
2016	3,071,000
2017	697,000
	$ 12,218,000

Grants authorized are shown net of rescissions and refunds of $117,000 in 2014 and $320,000 in 2013. 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:

	2014	2013
Principal	$ 82,203,000	$ 82,203,000
Cumulative excess of grants and other expenses over revenue (cumulative grants authorized of $472,504,000 at March 31, 2014)	(286,425,000)	(274,057,000)
Cumulative net realized gains on sales of investments	552,797,000	542,887,000
Unrealized gains in investment portfolio	164,355,000	106,169,000
	$ 512,930,000	$ 457,202,000

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 $330,000 for fiscal year 2014 ($346,000 - 2013).

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

The Foundation maintains a postretirement medical benefits plan and records a liability 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.

	2014	2013
Obligations and funded status:		
Fair value of plan assets	$ -	$ -
Accumulated postretirement benefit obligation	(1,847,000)	(1,716,000)
Funded status	$ (1,847,000)	$ (1,716,000)
Amounts recognized on the statements of financial position:		
Postretirement benefits liability	$ 1,847,000	$ 1,716,000

Note 6. Employee Benefits (Continued)

The table below summarizes changes in the Foundation's postretirement benefit obligation for the years ended March 31, 2014 and 2013:

	2014	2013
Postretirement benefit obligation, beginning of year	$ 1,716,000	$ 1,572,000
Initial recognition of postretirement benefit liability	-	-
Service cost	124,000	118,000
Interest cost	84,000	77,000
Actuarial (gain)/loss	(33,000)	-
Plan amendments	-	-
Benefits paid	(44,000)	(51,000)
Postretirement benefit obligation, end of year	$ 1,847,000	$ 1,716,000

Changes in the postretirement benefit obligation are reflected on the statement of activities in administrative expense for the years ended March 31, 2014 and 2013 as follows:

	2014	2013
Net periodic postretirement benefit cost	$ 200,000	$ 187,000
Change in postretirement benefit obligation not included in net periodic postretirement benefit cost	$ (24,000)	$ 8,000

There were no contributions made by participants to the medical plan for the years ended March 31, 2014 and 2013.

The weighted-average actuarial assumptions used to determine benefit obligation and benefit cost for the years ended March 31, 2014 and 2013 were as follows:

	2014	2013
Discount rate for obligations	5.00%	5.00%
Discount rate of costs	5.00%	5.00%

Note 6. Employee Benefits (Continued)

The assumed health care cost trend rates used to determine benefit obligation for the years ended March 31, 2014 and 2013 were as follows:

	2014	2013
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	5.23%	6.24%
Current post-65 health care trend rate	5.23%	6.24%
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 $55,000 to its postretirement benefit plan in 2015..

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

Years ending March 31:	
2015	$ 55,000
2016	56,000
2017	63,000
2018	68,000
2019	69,000
Fiscal 2020 - 2023	385,000
	$ 696,000

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, 2014, the Foundation had the following commitments for base rentals under this lease:

2015	$ 231,000
2016	238,000
2017	245,000
2018	251,000
2019	257,000
Thereafter	718,000
	$ 1,940,000

Rent expense, including operating expense and real estate taxes, was $308,000 for fiscal year 2014 ($384,000 - 2013).