

The Spencer Foundation

(An Illinois Not-for-Profit Corporation)

Financial Report

March 31, 2009 and 2008

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McGladrey & Pullen

Certified Public Accountants

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) as of March 31, 2009 and 2008, 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, 2009 and 2008 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 & Pullen, LLP

Chicago, Illinois
June 2, 2009

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

**Statements of Financial Position (In Thousands of Dollars)
March 31, 2009 and 2008**

	2009	2008
Assets		
Investments, at fair value	\$ 278,939	\$ 448,024
Cash	3,695	379
Other assets	1,081	761
	<u>\$ 283,715</u>	<u>\$ 449,164</u>
Liabilities and Unrestricted Net Assets		
Grants payable	\$ 15,186	\$ 16,608
Deferred federal excise tax	-	1,365
Accrued expenses	39	102
Accounts payable	86	85
	<u>15,311</u>	<u>18,160</u>
Unrestricted net assets	<u>268,404</u>	<u>431,004</u>
	<u>\$ 283,715</u>	<u>\$ 449,164</u>

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

**Statements of Activities (In Thousands of Dollars)
Years Ended March 31, 2009 and 2008**

	2009	2008
Investment returns		
Net realized gain on sales of investments	\$ 5,134	\$ 8,092
Net change in unrealized loss on investments	(160,096)	(30,824)
Interest income	17	42
Dividend income	13,388	14,321
	<u>(141,557)</u>	<u>(8,369)</u>
Program services		
Grants authorized, net of refunds (grant payments made were \$18,186 in 2009 and \$19,458 in 2008)	16,425	21,239
Foundation administered projects	1,216	1,317
Administrative expenses	3,777	3,727
Investment management expenses	636	786
Current federal excise tax	354	410
Deferred federal excise tax	(1,365)	(617)
	<u>21,043</u>	<u>26,862</u>
Change in net assets	(162,600)	(35,231)
Unrestricted net assets:		
Beginning of year	<u>431,004</u>	<u>466,235</u>
End of year	<u>\$ 268,404</u>	<u>\$ 431,004</u>

The Spencer Foundation
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Statements of Cash Flows (In Thousands of Dollars)
Years Ended March 31, 2009 and 2008

	2009	2008
Cash Flows from Operating Activities		
Change in net assets	\$ (162,600)	\$ (35,231)
Net realized gain on sales of investments	(5,134)	(8,092)
Net change in unrealized loss on investments	160,096	30,824
Changes in:		
Other assets	(320)	114
Grants payable	(1,422)	1,957
Deferred federal excise tax	(1,365)	(617)
Accrued expenses	(63)	65
Accounts payable	1	11
Net cash used in operating activities	<u>(10,807)</u>	<u>(10,969)</u>
Cash Flows from Investing Activities		
Purchases of investments	(8,393)	(13,238)
Proceeds from sales of investments	22,516	24,415
Net cash provided by investing activities	<u>14,123</u>	<u>11,177</u>
Net increase in cash	3,316	208
Cash:		
Beginning of year	<u>379</u>	<u>171</u>
End of year	<u>\$ 3,695</u>	<u>\$ 379</u>

**The Spencer Foundation
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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.

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 2009 and 2008 and was subject to a 2 percent federal excise tax.

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

Investments: Index funds are carried based at fair values based on quoted prices in an active market. Real estate investments are carried at approximate fair value, as determined by management based on appraisals, when available, or estimated based on current market prices for similar properties. Purchases and sales of securities are recorded on a trade date basis.

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.

Reclassifications: Certain amounts from the 2008 financial statements have been reclassified to conform to the 2009 presentation without affecting previously reported net assets.

**The Spencer Foundation
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Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies, *Continued*

New accounting pronouncements: In September 2006 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral for the implementation of SFAS No. 157 with regard to nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Foundation adopted SFAS No. 157 for the fiscal year beginning April 1, 2008, except for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis for which delayed application is permitted until its fiscal year beginning April 1, 2009. The adoption of the remaining provisions of SFAS No. 157 is not expected to have a material impact on the Foundation's financial position, results of operations or cash flows.

Note 2. Investments

Investments at March 31, 2009 and 2008 are summarized as follows:

	2009		2008	
	Cost	Market or Fair Value	Cost	Market or Fair Value
Marketable securities				
Equity funds	\$ 301,420,000	\$ 213,405,000	\$ 312,004,000	\$ 379,348,000
Bond funds	68,224,000	64,415,000	67,032,000	67,951,000
Real estate investments	914,000	1,119,000	510,000	725,000
	<u>\$ 370,558,000</u>	<u>\$ 278,939,000</u>	<u>\$ 379,546,000</u>	<u>\$ 448,024,000</u>

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.

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Notes to Financial Statements

Note 3. Fair Value Measurements

Effective April 1, 2008, the Foundation adopted SFAS No. 157, which provides a framework for measuring fair value under generally accepted accounting principles. SFAS No. 157 applies to all financial instruments that are being measured and reported on a fair value basis.

As defined in SFAS No. 157, fair value is 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:

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.

For the fiscal year ended March 31, 2009, 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. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to the limited market activity of the instrument.

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.

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Notes to Financial Statements

Note 3. Fair Value Measurements, Continued

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to SFAS No. 157. 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.

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, 2009			
	Level 1	Level 2	Level 3	Total
Equity funds	\$ 213,405,000	\$ -	\$ -	\$ 213,405,000
Bond funds	64,415,000	-	-	64,415,000
Real estate investments	-	1,119,000	-	1,119,000
	<u>\$ 277,820,000</u>	<u>\$ 1,119,000</u>	<u>\$ -</u>	<u>\$ 278,939,000</u>

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:

2010	\$ 9,945,000
2011	4,202,000
2012	750,000
Thereafter	<u>289,000</u>
	<u>\$ 15,186,000</u>

Grants authorized are shown net of rescissions and refunds of \$339,000 in 2009 and \$177,000 in 2008. Payments on authorized but unpaid grants may be accelerated upon mutual agreement between the Foundation and the grantees.

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Notes to Financial Statements

Note 5. Unrestricted Net Assets

Unrestricted net assets are comprised of the following amounts:

	<u>2009</u>	<u>2008</u>
Principal	\$ 82,203,000	\$ 82,203,000
Cumulative excess of grants and other expenses over revenue (cumulative grants authorized of \$410,476,000 at March 31, 2009)	(244,439,000)	(236,800,000)
Cumulative net realized gains on sales of investments	523,617,000	518,482,000
Unrealized gains in investment portfolio	<u>(92,977,000)</u>	<u>67,119,000</u>
	<u>\$ 268,404,000</u>	<u>\$ 431,004,000</u>

Note 6. Retirement Plans

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 \$260,000 for fiscal year 2009 (\$249,000 - 2008).

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.

Note 7. Commitments

The Foundation currently occupies office space in Chicago, under the terms of an operating lease which expires in 2015. The lease requires the Foundation to pay monthly base rents ranging from \$16,000 to \$21,000, plus a proportionate share of operating and real estate taxes. At March 31, 2009, the Foundation had the following commitments for base rentals under these leases:

2010	\$ 218,000
2011	225,000
2012	231,000
2013	238,000
2014	244,000
Thereafter	<u>421,000</u>
	<u>\$ 1,577,000</u>

Rent expense was \$359,000 for fiscal year 2009 (\$355,000 - 2008).

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Notes to Financial Statements

Note 8. Pending Adoptions of New Accounting Principles

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return including positions that the organization is exempt from income taxes or not subject to income taxes on unrelated business income. If there are changes in net assets as a result of application of FIN 48, these will be accounted for as an adjustment to the opening balance of net assets. Additional disclosures about the amounts of such liabilities will be required also. The Foundation presently discloses or recognizes income tax positions based on management's estimate of whether it is reasonably possible or probable, respectively, that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. The Foundation has elected defer the application of FIN 48 in accordance with FASB Staff Position (FSP) FIN 48-3. This FSP defers the elective date of FIN 48 for nonpublic enterprises, such as the Foundation, included within its scope, to the annual financial statements for fiscal years beginning after December 15, 2008. The Foundation will be required to adopt FIN 48 in its 2010 annual financial statements. Management is currently assessing the impact of FIN 48 on its financial position and results of operations and has not determined if the adoption of FIN 48 will have a material effect on its financial statements.