

The Spencer Foundation

Financial Report
March 31, 2016

Contents

Independent auditor's report	1
<hr/>	
Financial statements	
Statements of financial position	2
Statements of activities	3
Statements of cash flows	4
Notes to financial statements	5-11



Independent Auditor's Report

RSM US LLP

To the Board of Directors
The Spencer Foundation

Report on the Financial Statements

We have audited the accompanying financial statements of The Spencer Foundation (the Foundation) which comprise the statement of financial position as of March 31, 2016 and 2015, 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, 2016 and 2015, 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.

RSM US LLP

Chicago, Illinois
June 22, 2016

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The Spencer Foundation

**Statements of Financial Position (In Thousands of Dollars)
March 31, 2016 and 2015**

	2016	2015
Assets		
Investments, at fair value	\$ 493,670	\$ 520,907
Cash	6,805	15,788
Other assets	808	792
	<u>\$ 501,283</u>	<u>\$ 537,487</u>
Liabilities and Unrestricted Net Assets		
Grants payable	\$ 26,896	\$ 19,355
Deferred federal excise tax	3,350	3,741
Postretirement benefits liability	1,897	2,004
Accounts payable	187	226
	<u>32,330</u>	<u>25,326</u>
Unrestricted net assets	<u>468,953</u>	<u>512,161</u>
	<u>\$ 501,283</u>	<u>\$ 537,487</u>

See notes to financial statements.

The Spencer Foundation

Statements of Activities (In Thousands of Dollars) Years Ended March 31, 2016 and 2015

	2016	2015
Revenue:		
Net realized gain on sales of investments	\$ 4,410	\$ 14,837
Net change in unrealized (loss) gain on investments	(24,763)	13,694
Interest and other income	10	132
Dividend income	12,141	14,356
	<u>(8,202)</u>	<u>43,019</u>
Program services:		
Grants authorized, net of refunds (grant payments made were \$20,959 in 2016 and \$28,384 in 2015)	28,500	35,555
Administrative expenses	5,893	6,136
Investment management expenses	974	1,209
Current federal excise tax, net of tax refund	30	566
Deferred federal excise (credit) tax	(391)	322
	<u>35,006</u>	<u>43,788</u>
Decrease in net assets	(43,208)	(769)
Unrestricted net assets:		
Beginning of year	<u>512,161</u>	<u>512,930</u>
End of year	<u>\$ 468,953</u>	<u>\$ 512,161</u>

See notes to financial statements.

The Spencer Foundation

**Statements of Cash Flows (In Thousands of Dollars)
Years Ended March 31, 2016 and 2015**

	2016	2015
Cash flows from operating activities:		
Decrease in net assets	\$ (43,208)	\$ (769)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Net realized gain on sales of investments	(4,410)	(14,837)
Net change in unrealized loss (gain) on investments	24,763	(13,694)
Changes in:		
Other assets	(16)	(241)
Grants payable	7,541	7,137
Deferred federal excise tax	(391)	322
Postretirement benefits liability	(107)	157
Accounts payable	(39)	121
Net cash used in operating activities	(15,867)	(21,804)
Cash flows from investing activities:		
Adjustments to reconcile change in net assets to net cash used in investing activities:		
Purchases of investments	(1,255)	(3,590)
Proceeds from sales of investments	8,139	31,026
Net cash provided by investing activities	6,884	27,436
Net (decrease) increase in cash	(8,983)	5,632
Cash:		
Beginning of year	15,788	10,156
End of year	\$ 6,805	\$ 15,788

See notes to financial statements.

The Spencer Foundation

Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: The Spencer Foundation (an Illinois not-for-profit corporation) (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. Activities are conducted from offices in Chicago, Illinois.

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 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 the applicable tax rate.

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 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. There were no unrecognized tax positions identified or recorded as liabilities for the periods presented in these financial statements.

The Spencer Foundation

Notes to Financial Statements

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

The Foundation files forms 990-PF in the U.S. federal jurisdiction and the State of Illinois. The Foundation is generally no longer subject to examination by the Internal Revenue Service for tax years before 2013.

Recent accounting pronouncements: In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Foundation for the year ending March 31, 2020. The Foundation is currently evaluating the impact of the adoption of this standard on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial position for all leases with terms longer than twelve months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for the Foundation for the year ending March 31, 2021. The Foundation is currently evaluating the impact of the adoption of the standard on its financial statements.

Reclassifications: Certain 2015 amounts have been reclassified to conform to the current year presentation without affecting previously reported net assets or changes in net assets.

Subsequent events: The Foundation has evaluated subsequent events for potential recognition and/or disclosure through June 22, 2016, the date the financial statements were available to be issued.

Note 2. Investments

Investments at March 31, 2016 and 2015 are summarized as follows:

	2016		2015	
	Cost	Market or Fair Value	Cost	Market or Fair Value
Marketable securities:				
Equity funds - domestic	\$ 202,042,000	\$ 360,806,000	\$ 205,088,000	\$ 376,448,000
Equity funds - international	70,952,000	69,408,000	70,952,000	77,515,000
Bond funds - domestic	66,698,000	62,705,000	65,845,000	65,912,000
Real estate investments	641,000	751,000	977,000	1,032,000
	<u>\$ 340,333,000</u>	<u>\$ 493,670,000</u>	<u>\$ 342,862,000</u>	<u>\$ 520,907,000</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.

The Spencer Foundation

Notes to 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:

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, 2016 and 2015, there were no such transfers.

The Spencer Foundation

Notes to Financial Statements

Note 3. Fair Value Measurements (Continued)

For the fiscal years ended March 31, 2016 and 2015, 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.

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, 2016			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	\$ 360,806,000	\$ -	\$ -	\$ 360,806,000
Equity funds - international	69,408,000	-	-	69,408,000
Bond funds - domestic	62,705,000	-	-	62,705,000
Real estate investments	-	751,000	-	751,000
	<u>\$ 492,919,000</u>	<u>\$ 751,000</u>	<u>\$ -</u>	<u>\$ 493,670,000</u>

	March 31, 2015			
	Level 1	Level 2	Level 3	Total
Equity funds - domestic	\$ 376,448,000	\$ -	\$ -	\$ 376,448,000
Equity funds - international	77,515,000	-	-	77,515,000
Bond funds - domestic	65,912,000	-	-	65,912,000
Real estate investments	-	1,032,000	-	1,032,000
	<u>\$ 519,875,000</u>	<u>\$ 1,032,000</u>	<u>\$ -</u>	<u>\$ 520,907,000</u>

The Spencer Foundation

Notes to Financial Statements

Note 4. Grants Payable

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

2017	\$ 17,048,000
2018	7,690,000
2019	2,158,000
	<u>\$ 26,896,000</u>

Grants authorized are shown net of rescissions and refunds of \$120,000 and \$246,000 in fiscal years 2016 and 2015, respectively. Payments on authorized but unpaid grants may be accelerated upon mutual agreement between the Foundation and the grantees.

Note 5. 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 \$316,000 and \$357,000 for fiscal years 2016 and 2015, respectively.

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 healthcare 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.

	2016	2015
Obligations and funded status:		
Fair value of plan assets	\$ -	\$ -
Accumulated postretirement benefit obligation	(1,897,000)	(2,004,000)
Funded status	<u>\$ (1,897,000)</u>	<u>\$ (2,004,000)</u>
Amounts recognized on the statements of financial position:		
Postretirement benefits liability	<u>\$ 1,897,000</u>	<u>\$ 2,004,000</u>

The Spencer Foundation

Notes to Financial Statements

Note 5. Employee Benefits (Continued)

The table below summarizes changes in the Foundation's postretirement benefit obligation for the years ended March 31, 2016 and 2015:

	2016	2015
Postretirement benefit obligation, beginning of year	\$ 2,004,000	\$ 1,847,000
Service cost	127,000	121,000
Interest cost	99,000	91,000
Actuarial gain	(281,000)	-
Benefits paid	(52,000)	(55,000)
Postretirement benefit obligation, end of year	<u>\$ 1,897,000</u>	<u>\$ 2,004,000</u>

Changes in the postretirement benefit obligation are included in the statement of activities in administrative expense for the years ended March 31, 2016 and 2015 as follows:

	2016	2015
Net periodic postretirement benefit cost	<u>\$ 218,000</u>	<u>\$ 204,000</u>
Change in postretirement benefit obligation not included in net periodic postretirement benefit cost	<u>\$ (273,000)</u>	<u>\$ 8,000</u>

There were no contributions made by participants to the medical plan for the years ended March 31, 2016 and 2015.

The weighted-average actuarial assumptions used to determine benefit obligation and benefit cost for the years ended March 31, 2016 and 2015 were as follows:

	2016	2015
Discount rate for obligations	4.50%	5.00%
Discount rate of costs	5.00%	5.00%

The Spencer Foundation

Notes to Financial Statements

Note 5. Employee Benefits (Continued)

The assumed healthcare cost trend rates used to determine benefit obligation for the years ended March 31, 2016 and 2015 were as follows:

	2016	2015
Assumed healthcare cost trend rates as of March 31:		
Healthcare cost trend Medicare rate assumed for the next year:		
Current pre-65 healthcare trend rate	5.00%	5.00%
Current post-65 healthcare trend rate	5.00%	5.00%
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 \$50,000 to its postretirement benefit plan during the year ended March 31, 2017.

Annual benefit payments, which reflect expected future service, as appropriate, are expected to be as follows:

Years ending March 31:		
2017	\$	50,000
2018		54,000
2019		52,000
2020		50,000
2021		49,000
Fiscal 2022 - 2026		348,000
		<u>\$ 603,000</u>

Note 6. Commitments

The Foundation currently occupies office space in Chicago, Illinois under the terms of an operating lease which expires in fiscal year 2022. 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, 2016, the Foundation had the following commitments for base rentals under this lease:

2017	\$	245,000
2018		251,000
2019		257,000
2020		264,000
2021		271,000
2022		183,000
		<u>\$ 1,471,000</u>

Rent expense, including operating expense and real estate taxes, was \$428,000 and \$277,000 for fiscal years 2016 and 2015, respectively.