# John S. and James L. Knight Foundation

Financial Statements
For the Years Ended December 31, 2012 and 2011
With the Independent Auditor's Report

McGladrey

Assurance ▪ Tax ▪ Consulting

John S. and James L. Knight Foundation

Financial Statements

Years Ended Dec. 31, 2012 and 2011

## Contents

McGladrey

**Independent Auditor's Report**

The Board of Trustees
John S. and James L. Knight Foundation

We have audited the accompanying financial statements of the John S. and James L. Knight Foundation (the "Foundation") which comprise the statements of financial position as of December 31, 2012 and 2011, 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 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 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 Foundation'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 Foundation as of December 31, 2012 and 2011, 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

Miami, Florida
May 17, 2013

John S. and James L. Knight Foundation

Statements of Financial Position

| | Dec. 31 2012 | Dec. 31 2011 |
|---|---|---|
| **Assets** | | |
| Investments: | | |
| Investment assets: | | |
| Cash and cash equivalents | **$ 22,377,470** | **$ 38,310,147** |
| Interest, dividends and other investments receivables | **38,978,797** | **22,915,207** |
| Fair value of derivative instruments | **544,111** | **1,856,258** |
| U.S. government and agency obligations | **26,254,028** | **83,829,152** |
| Government-sponsored enterprises obligations | **26,607,424** | **20,765,913** |
| International government bonds | **8,914,453** | **3,467,737** |
| Corporate bonds and other obligations | **157,852,516** | **88,840,883** |
| Equity securities | **716,997,506** | **633,961,262** |
| Hedge fund investments | **454,724,983** | **488,636,129** |
| Alternative equity investments | **528,635,511** | **538,768,213** |
| Real estate investments | **113,934,856** | **113,723,732** |
| Total investments | **2,095,821,655** | **2,035,074,633** |
| Securities pledged to creditors | **38,339,587** | **112,596,776** |
| Program-related investments, net | **1,581,250** | **1,375,000** |
| Beneficial interest in remainder trusts | **40,664,667** | **41,518,045** |
| Other assets | **3,227,321** | **2,272,302** |
| Total assets | **$2,179,634,480** | **$2,192,836,756** |
| **Liabilities and net assets** | | |
| Liabilities: | | |
| Payable under securities loan agreement | **$ 39,378,844** | **$ 115,165,198** |
| Grants payable | **132,973,472** | **139,253,825** |
| Pension benefits liability | **2,051,137** | **1,696,065** |
| Deferred taxes payable | **1,909,631** | **747,710** |
| Other liabilities | **3,815,757** | **4,567,845** |
| Total liabilities | **180,128,841** | **261,430,643** |
| Net assets: | | |
| Temporarily restricted | **40,664,667** | **41,518,045** |
| Unrestricted | **1,958,840,972** | **1,889,888,068** |
| Total net assets | **1,999,505,639** | **1,931,406,113** |
| Total liabilities and net assets | **$2,179,634,480** | **$2,192,836,756** |

*See accompanying notes.*

John S. and James L. Knight Foundation

## Statements of Activities

| | Year Ended Dec. 31 | |
|---|---|---|
| | **2012** | **2011** |
| Changes in unrestricted net assets: | | |
| Investment activity: | | |
| Interest | **$ 8,267,654** | **$ 10,748,980** |
| Dividends | **11,573,921** | **20,161,034** |
| Net realized gain on sale of investments | **82,438,170** | **87,641,139** |
| Other income | **6,064,885** | **2,583,799** |
| Net change in fair value of investments | **85,638,214** | **(87,017,353)** |
| Less: investment expenses | **(8,860,073)** | **(7,971,682)** |
| Total investment activity | **185,122,771** | **26,145,917** |
| Release from restrictions - remainder trust assets received | **5,225,536** | **-** |
| Total investment activity and other support | **190,348,307** | **26,145,917** |
| Grants approved and expenses: | | |
| Transformation grants | **17,676,078** | **12,045,696** |
| Impact grants | **5,562,500** | **11,320,000** |
| Communities grants | **18,927,450** | **14,301,178** |
| Journalism Initiative grants | **14,139,017** | **18,558,399** |
| National Fund grants | **9,451,490** | **8,886,069** |
| Arts | **25,169,692** | **11,996,100** |
| Other grants | **1,426,458** | **892,520** |
| Grant forfeitures and other | **(1,245,587)** | **(2,220,339)** |
| Change in grant payable discount | **1,386,006** | **3,090,811** |
| Direct charitable activities | **11,110,406** | **10,294,790** |
| General and administrative expenses | **13,374,735** | **15,181,694** |
| Federal excise and other taxes, net | **4,567,439** | **4,134,609** |
| Total grants and expenses | **121,545,684** | **108,481,527** |
| Increase(decrease) in unrestricted net assets from operating activities | **68,802,623** | **(82,335,610)** |
| Pension and postretirement changes other than net periodic pension and postretirement costs | **150,281** | **(1,683,365)** |
| Increase(decrease) in unrestricted net assets | **68,952,904** | **(84,018,975)** |
| Changes in temporarily restricted net assets: | | |
| Change in value of beneficial interest in remainder trusts | **4,372,158** | **(41,287,780)** |
| Assets released from restrictions | **(5,225,536)** | **-** |
| Decrease in temporarily restricted net assets | **(853,378)** | **(41,287,780)** |
| Net increase(decrease) in net assets | **68,099,526** | **(125,306,755)** |
| Net assets at beginning of year | **1,931,406,113** | **2,056,712,868** |
| Net assets at end of year | **$ 1,999,505,639** | **$ 1,931,406,113** |

*See accompanying notes.*

# John S. and James L. Knight Foundation

## Statements of Cash Flows

| | Year Ended Dec. 31 | |
|---|---|---|
| | **2012** | **2011** |
| **Operating activities** | | |
| Change in net assets | **$ 68,099,526** | **$ (125,306,755)** |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Net realized (gain) on sale of investments | **(82,438,170)** | **(87,641,139)** |
| Other Income | **(6,064,885)** | **(2,583,799)** |
| Net change in fair value of investments | **(85,638,214)** | **87,017,353** |
| Change in value of beneficial interest in remainder trusts | **853,378** | **41,287,780** |
| Changes in operating assets and liabilities: | | |
| Interest, dividends and other investment receivables | **(53,229,239)** | **11,083,531** |
| Disbursements for program-related investments | **(2,222,900)** | **(664,000)** |
| PRI Recoveries | **45,000** | **100,000** |
| Valuation allowance – program-related investments | **1,971,650** | **564,000** |
| Grants payable | **(6,280,353)** | **(20,066,533)** |
| Deferred taxes | **1,161,921** | **(607,958)** |
| Pension and postretirement liability | **355,069** | **2,151,473** |
| Other liabilities | **(752,085)** | **(2,614,995)** |
| Net cash used in operating activities | **(164,139,302)** | **(97,281,042)** |
| **Investing activities** | | |
| Proceeds from sale of investments | **622,037,437** | **610,406,511** |
| Purchases of investments | **(473,830,812)** | **(551,030,659)** |
| Net cash provided by investing activities | **148,206,625** | **59,375,852** |
| Net change in cash and cash equivalents | **(15,932,677)** | **(37,905,190)** |
| Cash and cash equivalents at beginning of year | **38,310,147** | **76,215,337** |
| Cash and cash equivalents at end of year | **$ 22,377,470** | **$ 38,310,147** |
| **Supplemental data** | | |
| Federal and state taxes paid | **$ 4,222,823** | **$ 3,437,000** |

*See accompanying notes.*

## 1. The Organization

The John S. and James L. Knight Foundation (the foundation), a nonprofit corporation, supports transformational ideas that promote quality journalism, advance media innovation, engage communities, and foster the arts. The foundation believes that democracy thrives when people and communities are informed and engaged. A significant part of the foundation's activities focus on 26 U.S. communities where the Knight brothers owned newspapers.

## 2. Significant Accounting Policies

### Cash and Cash Equivalents

Cash and cash equivalents are composed of various operating accounts and highly liquid investments with original maturities of 3 months or less.

### Investments

The Foundation's investments are stated at fair value. Fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. See Note 3 for discussion of fair value measurements. Realized and unrealized gains and losses are recognized as changes in net assets in the period in which they occur, and investment income is recognized as revenue in the period earned.

### Fair Value of Certain Financial Instruments

The carrying amounts of cash and cash equivalents, interest, dividends and other investments receivables/(payable), and liabilities approximate fair value due to the short maturity or discounting of these financial instruments.

### Furniture and Equipment

The foundation records furniture and equipment as an expense in the year purchased. Furniture and equipment purchased for 2012 and 2011 was approximately $350,000 and $850,000, respectively, of which approximately $330,000 and $801,000, respectively, is included in "General and administrative expenses" with the remainder being included in "investment expenses" in the Statements of Activities.

## 2. Significant Accounting Policies (continued)

### Knight Investments LLC

In 2011, the foundation established Knight Investments LLC (Knight Investments), a single member Delaware limited liability company, to assist in the execution of its mission. The results of Knight Investments' operations are consolidated with the foundation's financial statements and all inter-entity activities are eliminated.

### Program-Related Investments (PRIs)

In accordance with Section 4944 of the Internal Revenue Code (the code), the foundation is permitted to make investments that are related to its philanthropic programs. These investments are anticipated to have a return lower than fair value. In the year of the investment, the foundation receives a credit toward its distribution requirement. These investments are treated as grants in the year they are distributed. To the extent the investment is recovered by the foundation, the recovery is recognized as a negative distribution, increasing its distribution requirement, in the year it is received. "PRI's" consist of investments which are recorded at their net realizable value. Recoveries are reflected as a reduction in "Investment expenses" in the Statements of Activities. The foundation recovered $45,000 and $100,000 in 2012 and 2011, respectively. Any costs associated with originating these investments are expensed in the year incurred. Management regularly reviews the collectability of these investments and determines any valuation allowance based on several factors including the borrower/investee's underlying business conditions and risks and performance of the investment. The foundation will discontinue the accrual of interest if interest payments are over 90 days past due.

"Program-related investments" in the Statements of Financial Position consist of an amortizing loan with a principal amount of $2,500,000 and fifteen convertible promissory notes representing a maximum potential investment of $8,890,500 and total outstanding principal of $3,236,650. The yield on all these investments is at rates below market.

The amortizing loan is a 13 year loan that began in 2007, bearing interest at 1% per annum. The loan terms provide for interest payments only during the first 10 years and principal amortization in years 11 through 13. As of Dec. 31, 2012, all interest payments have been received on schedule. The foundation intends to hold this loan to maturity. The foundation has recognized a valuation allowance of $1,125,000 against this loan and as a result they are reflected on the Statement of Financial Position at $1,375,000.

**2. Significant Accounting Policies (continued)**

The notes have a five year term and do not bear interest. The notes are convertible to equity at a premium to the company valuation established by a third-party investor as part of a qualifying future round of investment. The premium declines over the term of the note. With the exception of one note that has a 50% reserve and is reflected on the Statement of Financial Position at $206,250; the foundation has fully reserved the value of these notes and as a result they have a zero value on the Statement of Financial Position.

**Use of Estimates**

The presentation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. The most significant estimate involves the determination of the fair value of the investments. Estimates also affect the reported amounts of investment activity and expenses during the reporting period. Actual results could differ from those estimates.

**Deferred Taxes**

The foundation follows the policy of providing for federal excise tax on the net appreciation (both realized and unrealized) of investments. The deferred federal excise tax in the accompanying financial statements represents tax provided on the net unrealized appreciation of investments.

**Subsequent Events**

The foundation has evaluated subsequent events through May 17, 2013 noting no impact on the foundation’s financial statements.

**Reclassifications**

Certain amounts in the prior year’s financial statements have been reclassified to conform to the current year’s presentation.

## 2. Significant Accounting Policies (continued)

### Net Asset Accounting

The foundation reports information regarding its financial position and activities according to the following two classes of net assets:

- Unrestricted net assets are not subject to donor-imposed stipulations or the restrictions have expired.

- Temporarily restricted net assets are subject to donor-imposed stipulations that can be fulfilled by actions of the foundation or that expire by the passage of time. As of December 31, 2012 and 2011, the temporarily restricted net assets consist solely of the Foundation's beneficial interest remainder trusts which are discussed further in Note 10.

The foundation has no permanent restriction on its net assets imposed by its founders.

### Recent Accounting Pronouncements

In May 2011, FASB issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which requires, among other things, new disclosures, including quantitative disclosures about the fair value measurements for each class of assets that helps users to understand the nature, characteristics, and risks of the investments by class.

The foundation has adopted this provision for the fiscal year ended December 31, 2012.

## 3. Investments

The investment goal of the foundation is to invest its assets in a manner that will achieve, over the long term, a total rate of return sufficient to replace the assets utilized for grants and expenses and to recoup any value lost due to inflation and to increase the spending power of the portfolio while adhering to the risk and asset allocation parameters established by the investment committee.

To achieve this goal, some investment risk must be taken. To minimize such risk, the foundation diversifies its investments among various financial instruments and asset categories, and uses multiple investment strategies and investment managers. Key decisions in this regard are made by the foundation's investment committee, which has oversight responsibility for the foundation's investment program. The committee identifies appropriate asset categories for investments, determines the allocation of assets to each category and approves the investment strategies employed. The foundation has engaged Cambridge Associates LLC (Cambridge), an independent consulting firm, to execute the investment program, including the engagement of

**3. Investments (continued)**

investment managers, legal advisers, and strategic allocations to index funds and limited partnerships. All financial assets are held in custody for the foundation in proprietary accounts by BNY Mellon, a major commercial bank, or are invested in limited partnerships, hedge funds or in certain products with multiple investors, such as index funds, all of which have separate custodial arrangements appropriate to their legal structure.

Highly liquid investments with original maturities of three months or less are reported as cash equivalents.

As required by ASC 820, Fair Value Measurements, investments are measured and reported at fair value in one of the following categories based on valuation inputs:

Level 1 – Quoted prices are available in active markets for identical investments as of the reporting date. The types of investments which are included in Level 1 include listed equity securities, commingled funds traded in active markets with daily pricing. As required by ASC 820, the foundation, does not adjust the quoted price for these investments.

Level 2 – Pricing inputs are observable for the investment, either directly or indirectly, as of the reporting date but are not the same as those used in Level 1. Fair value is determined through the use of models or other valuation methodologies. The types of investments included in this category are all other commingled funds, publicly-traded securities in less active markets or restrictions on disposition, fixed income securities and cash equivalents such as cash management accounts custodied and traded by BNY Mellon.

Level 3 – Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The foundation uses the net asset value of the hedge funds and limited partnerships as fair value except where certain conditions exist. Those conditions include; changes to key personnel, material amendments to key terms, material pending litigations, imposition of gates, redemption fees and material amendments to key terms. Investments in hedge funds, alternative equity and real estate investments are included in this category.

The Foundation's policy is to recognize transfers within the fair value hierarchy as of the date of the event or change in circumstances that caused the transfer.

### 3. Investments (continued)

The following tables summarize the levels in the ASC 820 fair value hierarchy into which the foundation's investments fall as of Dec. 31, 2012 and 2011:

| | | Fair Value Measurement at the end of Dec. 31, 2012 Using | | | |
|---|---|---|---|---|---|
| | | Total | Quoted Prices in Active Markets for Indentical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| **Description** | | | (Level 1) | (Level 2) | (Level 3) |
| Cash equivalents | | $ 30,170,668 | $ - | $ 30,170,668 | $ - |
| Fair value of derivative instruments | | 544,111 | | | 544,111 |
| U.S. government and agency obligations | (a) | 26,254,028 | | 26,254,028 | |
| Government-sponsored enterprises obligations | (a) | 26,607,424 | | 26,607,424 | |
| International government bonds | (a) | 8,914,453 | | 8,914,453 | |
| Corporate bonds and other obligations | (a) | 157,852,516 | | 157,852,516 | |
| Equity securities | (a)(b)(c) | 716,997,506 | 506,569,256 | 210,428,250 | |
| Hedge fund investments | (d) | | | | |
| Multi-strategy and credit focused | (e) | 105,554,240 | | | 105,554,240 |
| Open mandate | (f) | 94,749,980 | | | 94,749,980 |
| Global and regionnal long/short | (g) | 254,420,763 | | | 254,420,763 |
| Alternative equity investments | (h) | | | | |
| Private equity | (i) | 412,354,684 | | | 412,354,684 |
| Private natural resources | (j) | 116,280,827 | | | 116,280,827 |
| Real estate investments | (h)(k) | 113,934,856 | | | 113,934,856 |
| Total investments measured at fair value | | $ 2,064,636,056 | $ 506,569,256 | $ 460,227,339 | $ 1,097,839,461 |
| Cash (net, outstanding checks) | | (7,793,198) | | | |
| Interest, dividends and other Investment receivables | | 38,978,797 | | | |
| Total investments | | $ 2,095,821,655 | | | |

### 3. Investments (continued)

| Description | | Total | Quoted Prices in Active Markets for Indentical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|---|
| | | Fair Value Measurement at the end of Dec. 31, 2011 Using | | | |
| Cash equivalents | | $ 14,554,624 | $ - | $ 14,554,624 | $ - |
| Fair value of derivative instruments | | 1,856,258 | - | - | 1,856,258 |
| U.S. government and agency obligations | (a) | 83,829,152 | - | 83,829,152 | - |
| Government-sponsored enterprises obligations | (a) | 20,765,913 | - | 20,765,913 | - |
| bonds | (a) | 3,467,737 | - | 3,467,737 | - |
| Corporate bonds and other obligations | | 88,840,883 | - | 88,840,883 | - |
| Equity securities | (a)(b)(c) | 633,961,262 | 431,020,235 | 202,941,027 | - |
| Hedge fund investments | (d) | 488,636,129 | - | - | 488,636,129 |
| Alternative equity investments | (h) | 538,768,213 | - | - | 538,768,213 |
| Real estate investments | (h) (k) | 113,723,732 | - | - | 113,723,732 |
| Total investments measured at fair value | | $1,988,403,903 | $ 431,020,235 | $ 414,399,336 | $1,142,984,332 |
| Cash | | 23,755,523 | | | |
| Interest, dividends and other investment receivables | | 22,915,207 | | | |
| Total investments | | $2,035,074,633 | | | |

The following tables summarize the Foundation's investments for December 31, 2012 whose fair value is calculated using NAV per share:

| Description | | Fair Value 12/31/12 | Unfunded Commitments | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|---|
| <u>Hedge fund investments</u> | (d) | | | | |
| Multi-strategy and credit focused | (e) | $ 105,554,240 | N/A | Monthly-every 2 years | 45-90 days |
| Open mandate | (f) | 94,749,980 | N/A | Monthly-every 2 years | 60-180 days |
| Global and regionnal long/short | (g) | 254,420,763 | N/A | Monthly-every 2 years | 30-184 days |
| <u>Alternative equity investments</u> | (h) | | | | |
| Private equity | (i) | 412,354,684 | 85,638,705 | N/A | N/A |
| Private natural resources | (j) | 116,280,827 | 28,363,507 | N/A | N/A |
| Real estate investments | (h) (k) | 113,934,856 | 33,751,569 | N/A | N/A |
| Total investments | | $1,097,295,350 | $147,753,781 | | |

**3. Investments (continued)**

(a) Approximately 45 percent and 38 percent of the foundation's total investments at Dec. 31, 2012 and 2011, respectively, are invested in institutional mutual funds, publicly traded securities that are listed on national and international exchanges, treasury and agency bonds of the U.S. government, bonds of sovereign foreign governments and investment and non-investment grade corporate bonds for which trading markets exist. Such assets are valued at quoted closing prices at year end in accordance with GAAP and are classified as Level 1 or Level 2. Realized gains and losses and increases and decreases in fair value on such investments are reflected in the Statements of Activities.

(b) As of Dec. 31, 2012 and 2011, respectively, these assets include an equity interest in a publicly traded investment management company valued at $78.8 million and $88.4 million or 3.7 percent and 4.3 percent of the foundation's total investments. As of Dec. 31, 2012 this interest consisted of approximately 2.1 million ownership units, which are convertible to publicly traded shares at the management company's discretion. The shares are valued using a lattice model that takes into account assumptions for volatility, availability of opportunity to convert and sell units, the closing price of publicly traded shares in the secondary market, and discounted growth rate and is classified as Level 2. Management of the investment management company has a right of first refusal on any stock sales as well as certain other contractual rights associated with any sale of stock. This investment gives rise to a significant portion of the Foundation's unrelated business income tax liability.

(c) On the basis of its analysis of the nature, characteristics, and risks of the securities, the reporting entity has determined that presenting them as a single class is appropriate. The class consists of publicly traded equity securities that are listed on national and international exchanges including amounts in less active markets which are classified as Level 2. As of Dec. 31, 2012, 46% of these assets were invested in international equities and 54% were invested in domestic equities.

(d) Approximately 25 and 27 percent of the foundation's total investments at Dec. 31, 2012 and 2011, respectively, were invested in hedge funds and derivative instruments. The derivative instruments consisted of a "portable alpha" product. These investments are not publicly listed or traded, and are not liquid investments. Investments in hedge funds are generally subject to a "lock up" period of between 12 and 36 months from the date of investment. During that period, funds may not be withdrawn from the fund. The redemption terms of hedge funds may vary, but in general terms after the lock up period, redemption requests may be made by the foundation on a pre-set basis as specified in each hedge fund's operating agreement. As of year-end 2012 and 2011, no additional restrictions on redemptions were implemented by hedge funds within the foundation's portfolio. Each fund's investment manager calculates the fair value of investments on a monthly basis using the valuation guidelines stipulated in the respective investment agreement in accordance with fair value methods accepted under GAAP less related liabilities (the "NAV"). The NAV, as provided by the investment manager, is used as a practical expedient to estimating fair value. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. All hedge

**3. Investments (continued)**

funds are audited annually by independent certified public accounting firms. Realized gains and losses and increases and decreases in fair value on the investments in hedge funds and derivative instruments are reflected in the Statements of Activities.

(e) Multi-strategy funds generally invest in event-driven securities (both debt and equity) which seek to exploit situations in which announced or anticipated events have inefficiencies in the pricing of securities. These funds invest in the securities of companies involved in mergers, agreed upon and unsolicited, spin-offs, recapitalizations, etc. Also included are securities of companies experiencing financial distress that are attempting to complete an out-of-court restructuring, are involved in a bankruptcy or similar proceeding, and/or are involved in substantial litigation. Some multi-strategy funds also invest in value equities where there is a perceived mispricing that will be corrected in a defined period of time. The value equity book in these funds generally has very low net exposure, with shorts offsetting most of the longs. These funds employ leverage in that longs plus shorts generally exceed more than 100% of capital.

Credit focused funds generally attempt to generate equity-like returns while taking fixed income-type risk. Focus is generally on long/short credit, and event-driven opportunities, including distressed, stressed, and out-of-favor situations, capital structure trades, shorting investment grade or high yield debt, etc. These funds can invest in a range of credit instruments at any level of an issuer’s capital structure including bank debt, corporate bonds, trade claims, credit-default swaps, equities, options, and other derivative instruments. These funds employ leverage in that longs plus shorts generally exceed more than 100% of capital.

(f) Open Mandate funds take an opportunistic approach seeking to invest in investment opportunities that provide the best risk-adjusted returns. While these funds may focus principally on debt or equity investments, at any given point in time, the portfolio might consist entirely of debt, either distressed or stressed, or equities, long and short. Balance sheets are generally levered in that longs and shorts total more than 100% of capital. When equities are in the portfolio, net exposure is generally less than 50%.

(g) Global and Regional Long/Short Funds invest primarily in publicly traded equity securities. Longs consist of investing in companies that appear to be trading at a discount to their intrinsic value and shorts consist of selling companies that appear to be trading at a premium to their intrinsic value. Longs and shorts are generally not paired, and net exposures range from 30% to 60% net long. Global funds will search for equity securities around the world, while regional fund will focus on securities of a specific geographic region (e.g. Asia, Europe, etc.). These funds frequently employ leverage in that longs plus shorts exceed more than 100% of capital.

**3. Investments (continued)**

(h) Approximately 31 percent and 32 percent of the foundation's total investments at Dec. 31, 2012 and 2011, respectively, were invested in alternative equity investments including private equity and private natural resources and real estate investments with numerous partnerships, in which the foundation is a limited partner. As of Dec. 31, 2012, pursuant to its limited partnership agreements, the foundation is committed to contributing $147,753,781 in additional capital over the next 10 years to various partnerships. Unpaid commitments at Dec. 31, 2011, were approximately $191,194,341. Investments in private partnerships generally have terms of approximately ten years plus several years of optional extensions. Following the investment period, the general partner sells assets of the partnership over the partnership's remaining term and distributes funds to the partners as mandated in the partnership agreements. The foundation cannot, generally, redeem its interest in a partnership prior to the termination date of the partnership. The value of such investments is determined by the partnerships' general partners, who must follow the valuation guidelines, such as appraisals and comparable company trade data, stipulated in the respective limited partnership agreements and in accordance with fair value methods accepted under GAAP less related liabilities (the "NAV"). The NAV, as provided by the investment manager, is used as a practical expedient to estimating fair value. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Realized gains and losses and increases and decreases in fair value on the investments in limited partnerships are reflected in the Statements of Activities. All limited partnerships are audited annually by independent certified public accounting firms. Realized gains and losses and increases and decreases in fair value on such direct investments are reflected in the Statements of Activities.

(i) Private Equity includes buyout, venture capital, and illiquid opportunistic partnerships that invest in U.S. and international companies.

(j) Private Natural Resources includes partnerships that invest in U.S. and international upstream oil & gas assets and royalties, midstream energy companies, oilfield service companies, mining and metals companies, power generation assets and companies, and timber and infrastructure assets.

(k) Private Real Estate includes partnerships that invest primarily in U.S. real estate, but also ones that invest in international real estate.

## 3. Investments (continued)

The changes in investments classified as Level 3 are as follows for the years ended Dec. 31, 2012 and 2011:

**Level 3 Reconciliation**
**Fair Value Measurements Using**
**Significant Unobservable Inputs**

| | Hedge Funds | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Multi-Strategy and Credit Focused | Open Mandate | Global and Regional long/short | Private Equity | Private Natural Resources | Real Estate | Other | Total |
| Opening Balance, Jan. 1, 2012 | $ 114,321,523 | $ 95,649,473 | $ 278,665,133 | $ 422,763,726 | $ 116,004,487 | $ 113,723,732 | $ 1,856,258 | $ 1,142,984,332 |
| Purchases | 667,001 | 12,000,000 | 21,187,846 | 28,861,671 | 14,643,703 | 17,634,720 | - | $94,994,941 |
| Sales and settlements | (20,003,223) | (23,900,307) | (76,789,717) | (63,864,256) | (13,301,045) | (18,548,752) | - | $ (216,407,300) |
| Total gains or losses for the period included in changes in net assets | 10,568,939 | 11,000,814 | 31,357,501 | 24,593,543 | (1,066,318) | 1,125,156 | (1,312,147) | $76,267,488 |
| Closing Balance, Dec. 31, 2012 | $ 105,554,240 | $ 94,749,980 | $ 254,420,763 | $ 412,354,684 | $ 116,280,827 | $ 113,934,856 | $ 544,111 | $ 1,097,839,461 |
| Change in unrealized gains or losses for the period included in changes in net assets for assets held at the end of the reporting period. | $ 10,179,134 | $ 7,132,814 | $ 26,033,178 | $ 11,939,620 | $ (1,066,318) | $ (173,646) | $ (1,312,147) | $ 52,732,635 |

**3. Investments (continued)**

**Level 3 Reconciliation**

| | Hedge Funds | Alternative Equity | Real Estate | Other | Total |
|---|---|---|---|---|---|
| Beginning Balance, Jan. 1, 2011 | **$ 524,764,092** | **$ 558,455,559** | **$ 102,908,666** | **$ 3,702,299** | **$ 1,189,830,616** |
| Purchases | **160,501,902** | **66,820,588** | **15,105,885** | **-** | **242,428,375** |
| Sales and settlements | **(187,535,703)** | **(96,592,013)** | **(15,478,740)** | **-** | **(299,606,456)** |
| Total gains (losses) (realized/unrealized), net | **(9,094,162)** | **10,084,079** | **11,187,921** | **(1,846,041)** | **10,331,797** |
| Ending Balance, Dec. 31, 2011 | **$ 488,636,129** | **$ 538,768,213** | **$ 113,723,732** | **$ 1,856,258** | **$ 1,142,984,332** |

| | | | | | |
|---|---|---|---|---|---|
| Change in unrealized gains or losses and realized gains or losses for the period included in charges in net assets for assets held at the end of the reporting period | **$ (9,076,712)** | **$ 10,903,926** | **$ 11,665,232** | **$ (1,846,041)** | **$ 11,646,405** |

**4. Securities Lending**

The Foundation lends certain securities to generate investment income. Selected securities are loaned and securitized primarily by collateral in the form of cash or cash equivalents equal to at least 102% of the fair market value of the securities. As of December 31, 2012, the Foundation recognized an asset under "Securities pledged to creditors" for the fair market value of securities on loan of approximately $38,340,000 and a corresponding liability under "Payable under securities loan agreement" of approximately $39,379,000 was recognized for collateral received on the Statement of Financial Position. As of December 31, 2011, the asset for securities pledged was approximately $112,597,000 and the corresponding liability of approximately $115,165,000 for collateral received.

At December 31, 2012, the liability for collateral received by the Foundation, consisted of $25,794,000 in cash and $13,585,000 in short-term government obligations which are considered level 2 in the fair value hierarchy; and $60,198,000 in cash and $54,967,000 in short-term government obligations, which are considered level 2 in the fair value hierarchy as of December 31, 2011. Of the cash collateral received, $10,857,000 was invested in securities with maturities of 3 months or less and $14,130,000 was invested in corporate obligations which were considered level 2 in fair value hierarchy as of December 31, 2012; and $31,933,000 was invested in securities with maturities of 3 months or less and $27,190,000 was invested in corporate obligations which were considered level 2 in fair value hierarchy as of December 31, 2011.

At December 31, 2012, the fair market value of the reinvested collateral was $39,367,000 of which $11,652,000 was included in cash and cash equivalents, $13,585,000 was included in US government and agency obligations and $14,130,000 was included in corporate bonds and other obligations in the Statement of Financial Position which were considered level 2 in fair value hierarchy. At December 31, 2011, the fair market value of collateral was $115,109,000, of which $33,009,000 was included in cash and cash equivalents, $54,967,000 was included in U.S. government and agency obligations and $27,133,000 was included in corporate bonds and other obligations which were considered in level 2 in fair value hierarchy in the Statement of Financial Position.

The Foundation recognized an unrealized loss of $12,038 and $56,730 for the years ended Dec. 31, 2012 and Dec. 31, 2011, respectively, included in "Net change in fair value of investments" in the Statements of Activities related to the changes in the value of collateral investments related to corporate obligations.

**5. Derivative Financial Instruments**

Some investment managers retained by the foundation have been authorized to use certain derivative financial instruments in a manner set forth by the foundation's written investment policy, specific manager guidelines or partnership/fund agreement documents. Specifically, derivative financial instruments may be used for the following purposes: (1) currency forward contracts and options may be used to hedge non-U.S. dollar exposure in foreign investments; (2) covered call options may be sold to enhance yield on major equity positions; (3) futures contracts may be used to equitize excess cash positions, rebalance asset categories within the portfolio, adjust risk exposures within the portfolio, or to rapidly increase or decrease exposure to specific investment positions in anticipation of subsequent cash trades; and (4) futures contracts and options may be used by hedge fund managers to hedge or leverage positions in portfolios in their respective funds. Authorization to use these derivative financial instruments currently is restricted to 31 hedge fund managers, who manage investments totaling $454,724,983.

Cambridge is also authorized to use derivatives to execute certain investment strategies. Derivative financial instruments are recorded at fair value in the Statements of Financial Position with changes in fair value reflected in the Statements of Activities.

During 2012 and 2011, the foundation invested in a "portable alpha" product which is designed to provide a return in excess of a certain benchmark and requires the use of a derivative swap agreement. The investment manager invests the principal in a basket of securities that replicates the benchmark, and then leverages the principal investment and invests in fixed income strategies. The foundation's investment benchmarked to the Standard & Poor's 500 Index is valued at $37,061,056 and $30,926,525 at December 31, 2012 and December 31, 2011, respectively. The foundation's investment benchmarked to MSCI EAFE is valued at $27,026,815 at December 31, 2012 and $22,914,715 at December 31, 2011, respectively. The total of $64,087,871 and $53,841,239 are reflected on the respective Statements of Financial Position in "Equity securities." A receivable related to the fair value of the derivative swap of approximately $544,000 and $1,856,000 at December 31, 2012 and December 31, 2011, respectively, reflecting the fair value of the leveraged investments was reported in "Fair value of derivative instruments" on the Statements of Financial Position, and the change in fair value is included in "Net change in fair value of investments" in the Statements of Activities.

In Cambridge's opinion, the use of derivative financial instruments in its investment program is appropriate and customary for the investment strategies employed. The foundation's management concurs with this opinion. Using those instruments reduces certain investment risks and generally adds value to the portfolio. The instruments themselves, however, do involve some investment and counterparty risk not fully reflected in the foundation's financial statements. Cambridge does not anticipate that losses, if any, from such instruments would materially affect the financial position of the foundation and the foundation's management concurs.

## 6. Charitable Distributions

Charitable distributions include grants, direct charitable activities (DCAs) and program related investments (PRIs). All charitable distributions are made to promote the charitable purpose of the foundation and are "qualifying distributions" as defined by the IRS. The foundation made charitable distributions of $112,063,584 and $112,604,594 in 2012 and 2011, respectively.

The foundation records grants in full as expenses when approved. Grants payable at December 31, 2012 and 2011 represent the present value of multiyear grants using a 3.25 percent discount rate based on the U.S. prime rate, in each year. The foundation made grant payments of $99,205,159 and $99,473,590 in 2012 and 2011, respectively.

As of December 31, 2011, the foundation had future grant commitments, which are scheduled for payment in future years as follows:

| | |
|---|---|
| 2013 | $ 59,216,180 |
| 2014 | 36,883,638 |
| 2015 | 23,418,367 |
| 2016 | 16,229,610 |
| 2017 | 6,414,522 |
| Discounted to present value | (9,188,845) |
| Grants payable | $ 132,973,472 |

The foundation conducts certain activities, such as holding conferences which build the field and promote charitable issues and conducting challenges to deal with charitable topics, which promote its charitable purpose. These activities are DCAs. The foundation made DCA payments of $10,635,525 and $11,682,992 in 2012 and 2011, respectively.

A PRI is defined as an investment (i) whose primary purpose is to further the exempt objectives of the foundation, (ii) where the production of income or appreciation in property is not a significant purpose and (iii) which is not used to lobby or support lobbying. The foundation made PRI payments of $2,222,900 and $664,000 in 2012 and 2011, respectively.

## 7. Federal Excise Taxes and Other Taxes, net

The foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the code and, with the exception of unrelated business income from debt-financed, passive investments, is not subject to federal or state income tax. However, the foundation is classified as a private foundation and is subject to a federal excise tax of 2 percent (or 1 percent under certain circumstances) on net investment income and net realized gains, as defined by the code. The foundation expects to qualify for the 1 percent tax rate in 2012 and was subject to the 1 percent tax rate in 2011.

**7. Federal Excise and Other Taxes, net (continued)**

The Foundation files tax returns in the U.S. federal jurisdiction. The Foundation is generally only subject to U.S. federal tax examinations by tax authorities for all years since 2009. The foundation's management analyzed its tax positions and determined that no additional income tax adjustment related to the ASC 740, Income Taxes, is necessary for the fiscal years ended Dec. 31, 2012 and Dec 31, 2011.

Total excise and other taxes paid, net of refunds received, by the foundation for the years ended Dec. 31, 2012 and 2011 amounted to approximately $4,223,000 and $3,437,000, respectively. The foundation recognized an increase of approximately $1,162,000 in its deferred tax liability in 2012, and a reduction of $608,000 in 2011. No valuation allowance is applied against either amount. No deferred taxes are provided for unrelated business income on unrealized appreciation as such amount cannot be estimated.

**8. Employee Pension Plan and Other Postretirement Benefit Plans**

The foundation sponsors a pension plan with defined benefit and cash balance features for its eligible employees. The pension benefits for all employees hired prior to Jan. 1, 2000, will be the greater of the benefits as determined under the defined benefit feature of the pension plan or the cash balance feature of the pension plan. The pension benefits for all employees hired on or subsequent to Jan. 1, 2000, will be determined under the cash balance feature of the pension plan. The foundation also sponsors postretirement medical and life insurance benefit plans.

The following table sets forth the pension and other postretirement benefits plans' funded status and amounts recognized in the foundation's Statements of Activities and Financial Position:

| | Pension Plan Year Ended Dec. 31 | | Other Postretirement Benefit Plan Year Ended Dec. 31 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| **Funded status** | | | | |
| Fair value of plan assets | **$ 12,927,424** | **$ 12,029,434** | **$ 1,571,207** | **$ 1,357,299** |
| Benefit obligation | **(13,738,554)** | **(12,360,254)** | **(2,811,214)** | **(2,722,544)** |
| Funded status of the plan | **$ (811,130)** | **$ (330,820)** | **$ (1,240,007)** | **$ (1,365,245)** |
| Prior service credit | **$ 11,542** | **$ 13,898** | **$ 444,945** | **$ –** |
| Accumulated loss | **(4,912,096)** | **(4,852,393)** | **(575,803)** | **(343,198)** |
| Pension and postretirement changes other than net periodic pension and postretirement costs | **(4,900,554)** | **(4,838,495)** | **(130,858)** | **(343,198)** |
| Cumulative employer contribution in excess (deficiency) of net periodic benefit costs | **4,089,424** | **4,507,675** | **(1,109,149)** | **(1,022,047)** |
| Accrued benefit asset (liability) recognized in the Statements of Financial Position | **$ (811,130)** | **$ (330,820)** | **$ (1,240,007)** | **$ (1,365,245)** |

## 8. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

| | Pension Plan Year Ended Dec. 31 | | Other Postretirement Benefit Plan Year Ended Dec. 31 | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| **Components of net periodic benefit cost** | | | | |
| Service cost | $ 565,638 | $ 574,619 | $ 239,949 | $ 246,644 |
| Interest cost | 490,783 | 510,729 | 106,484 | 114,600 |
| Expected return on plan assets | (936,119) | (957,620) | (117,336) | (113,604) |
| Amortization of prior service cost | (2,356) | (2,356) | (63,564) | – |
| Recognized actuarial (gain) | 300,303 | 182,161 | 10,032 | – |
| Net periodic benefit cost | $ 418,249 | $ 307,533 | $ 175,565 | $ 247,640 |
| Actual return on plan assets | $ 1,568,008 | $ 233,366 | $ 213,908 | $ (43,666) |
| Employer contributions | – | – | 88,463 | 87,066 |
| Employee contributions | – | – | 34,916 | 30,783 |
| Benefits paid | 670,018 | 448,259 | 123,379 | 117,849 |
| **Actuarial assumptions** | | | | |
| Discount rate | 3.73% | 4.34% | 4.21% | 4.63% |
| Expected return on plan assets | 8.00 | 8.00 | 8.00 | 8.00 |
| Rate of compensation increase | 4.50 | 4.50 | 4.50 | 4.50 |
| **Health care cost trend rate assumptions** | | | | |
| Initial trend rate | N/A | N/A | 8.30% | 8.60% |
| Ultimate trend rate | N/A | N/A | 4.50 | 4.50 |
| Year ultimate trend is reached | N/A | N/A | 2028 | 2028 |

The expected long-term rate of return on plan assets for determining net periodic pension cost is chosen by the foundation from a best estimate range determined by the actuary by applying anticipated long-term returns and long-term volatility for various asset categories to the target asset allocation of the plan.

The calculations related to other postretirement benefit plans do not anticipate any savings from the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

**8. Employee Pension Plan and Other Postretirement Benefit Plans (continued)**

Expected benefit payments are as follows:

| | Pension Plan | Other Postretirement Benefit Plan |
|---|---|---|
| 2013 | $ 851,528 | $ 106,571 |
| 2014 | 962,228 | 114,266 |
| 2015 | 1,056,607 | 105,802 |
| 2016 | 885,544 | 110,071 |
| 2017 | 860,759 | 116,041 |
| 2018-2021 | 4,730,292 | 867,277 |

During 2012, the foundation is not required to make any contributions to the pension plan. The foundation will be required to make a contribution of $106,571 to the other post-retirement benefit plan. The foundation may choose to make additional contributions to either plan during 2013.

The investment goal for plan assets is to provide sufficient liquidity to meet payout requirements while maintaining safety of principal through prudent diversification. During 2012 asset allocation targets for the pension plan and other postretirement benefit plan were domestic equities, 30 percent; international equities, 25 percent; emerging market equities, 5 percent; fixed income, 30 percent; and commodities 10 percent.

## 8. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

A detail of the fair value of plan assets by investment class follows:

| | Pension Plan | | | | Other Postretirement Benefit Plan | | | |
|---|---|---|---|---|---|---|---|---|
| | Dec. 31 | | | | Dec. 31 | | | |
| | 2012 | % | 2011 | % | 2012 | % | 2011 | % |
| Cash and cash equivalents | $ 79,057 | 1 | $ 198,461 | 2 | $ 16,044 | 1 | $ 195,046 | 14 |
| Interest, dividends and other investment receivables | 10 | 0 | 24 | 0 | 5 | 0 | 23 | 0 |
| U.S. government and agency obligations | 2,662,186 | 20 | 761,594 | 6 | 311,261 | 20 | – | – |
| Corporate bonds and other obligations | 1,138,029 | 9 | 3,302,170 | 27 | 138,966 | 9 | 234,860 | 17 |
| Equity securities | 7,789,894 | 60 | 7,159,225 | 60 | 956,053 | 61 | 927,370 | 69 |
| Commodities | 1,258,248 | 10 | 607,960 | 5 | 148,878 | 9 | – | – |
| Total | $12,927,424 | | $12,029,434 | | $ 1,571,207 | | $ 1,357,299 | |

In addition, the foundation sponsors a defined contribution plan for its eligible employees for which it has no fixed liabilities. Effective Jan. 1, 2002, the foundation's defined contribution plan was amended to add an employer matching contribution component. During 2012 and 2011, the foundation made contributions to the defined contribution plan of approximately $269,000 and $244,000, respectively.

**8. Employee Pension Plan and Other Postretirement Benefit Plans (continued)**

The following table summarizes the levels in the ASC 820 fair value hierarchy into which the pension and other postretirement benefit plans assets fall as of December 31, 2012 and December 31, 2011:

| **2012**<br>**Pension Plan** | **Total** | **Level 1** | **Level 2** |
|---|---|---|---|
| Cash and cash equivalents | $ 79,057 | $ 79,057 | $ – |
| Interest, dividends and other investment receivables | 10 | N/A | N/A |
| U.S. government and agency obligations | 2,662,186 | – | 2,662,186 |
| Corporate bonds and other obligations | 1,138,029 | – | 1,138,029 |
| Equity securities | 7,789,894 | 7,789,894 | – |
| Commodities | 1,258,248 | 1,258,248 | – |
| | $ 12,927,424 | $ 9,127,199 | $ 3,800,215 |
| | | | |
| **Other Postretirement Benefit Plans** | | | |
| Cash and cash equivalents | $ 16,044 | 16,044 | $ – |
| Interest, dividends and other investment receivables | 5 | N/A | N/A |
| U.S. government and agency obligations | 311,261 | – | 311,261 |
| Corporate bonds and other obligations | 138,966 | – | 138,966 |
| Equity securities | 956,053 | 956,053 | – |
| Commodities | 148,878 | 148,878 | – |
| | $ 1,571,207 | $ 1,120,975 | $ 450,227 |

N/A – Not applicable

## 8. Employee Pension Plan and Other Postretirement Benefit Plans (continued)

**2011**

| **Pension Plan** | **Total** | **Level 1** | **Level 2** |
|---|---|---|---|
| Cash and cash equivalents | $ 198,461 | $ 198,461 | $ – |
| Interest, dividends and other investment receivables | 24 | N/A | N/A |
| U.S. government and agency obligations | 761,594 | – | 761,594 |
| Corporate bonds and other obligations | 3,302,170 | – | 3,302,170 |
| Equity securities | 7,159,225 | 7,159,225 | – |
| Commodities | 607,960 | 607,960 | – |
| | $ 12,029,434 | $ 7,965,646 | $ 4,063,764 |
| **Other Postretirement Benefit Plans** | | | |
| Cash and cash equivalents | $ 195,046 | 195,046 | $ – |
| Interest, dividends and other investment receivables | 23 | N/A | N/A |
| Corporate bonds and other obligations | 234,860 | – | 234,860 |
| Equity securities | 927,370 | 927,370 | – |
| | $ 1,357,299 | $ 1,122,416 | $ 234,860 |

N/A – Not applicable

**9. Leases**

The foundation has a lease for approximately 21,300 square feet of office space in Miami, Fla., which expires in 2020. Under the terms of the lease, the rentable square feet will increase to approximately 22,800 on August 1, 2013. Rental expense for office leases for 2012 and 2011 was approximately $829,000 and $772,000, respectively. Future minimum lease payments for the Miami office lease are as follows:

| | |
|---|---|
| 2013 | $ 814,091 |
| 2014 | 872,713 |
| 2015 | 898,959 |
| 2016 | 925,889 |
| 2017 | 953,731 |
| Thereafter | 3,036,011 |
| Total | $ 7,501,394 |

**10. Beneficial Interest in Remainder Trusts**

The foundation has a beneficial interest in charitable remainder trusts established by John S. Knight. Under the terms of the trusts, distributions are made from the trusts to designated beneficiaries for the remainder of their lives. The remainder of the assets in the trusts will be transferred to the foundation. All of the assets of the trusts are administered and held in the custody of First Merit Bank. The trusts were established in 1975 and became irrevocable in 1981.

The foundation values its interest in the trusts using the methodology described in the *Financial Reporting Whitepaper: Measurement of Fair Value for Certain Transactions of Not-for Profit Entities,* issued by AICPA. This methodology is a two-step process starting with the fair market value of the assets. The first step uses a 5 percent payout rate, life expectancy based on IRS Mortality Tables and assumed investment returns to determine the value of the interest at its projected termination. The second step discounts this future value using an estimated investment return rate of 8%. As of December 31, 2012 and 2011 the value of the foundation's estimated interest in the remainder trusts reported on the Statements of Financial Position was approximately $40,665,000 and $41,518,000, respectively. This compares to a current fair market value of the trusts of approximately $77,056,000 and $79,051,000 in December 31, 2012 and 2011, respectively.

During 2012, the foundation received a distribution of approximately $5,225,000 which represents fair market value of the distributed trust assets received. Distribution was due to the termination of one of the charitable remainder trusts.

**10. Beneficial Interest in Remainder Trusts (continued)**

For the purposes of applying ASC 820, all beneficial interest in remainder trust assets are classified as Level 3 for the years ended December 31, 2012 and 2011. The changes in beneficial interest in remainder trust assets classified as Level 3 are as follows for the years ended December 31, 2012 and 2011:

**Level 3 Reconciliation**

| | Remainder Trust |
|---|---|
| Beginning Balance, January 1, 2011 | $ 82,805,824 |
| Change in value of beneficial interest in remainder trusts | (41,287,779) |
| Ending Balance, December 31, 2011 | $ 41,518,045 |
| | |
| Beginning Balance, January 1, 2012 | $ 41,518,045 |
| Distributions | (5,225,536) |
| Change in value of beneficial interest in remainder trusts | 4,372,158 |
| Ending Balance, December 31, 2012 | $ 40,664,667 |

Change in value of beneficial interest in remainder trusts are included in “Changes in temporary restricted net assets” in Statement of Activities for the years ended December 31, 2012 and 2011.