

# **University of California, Merced Foundation**

**Financial Statements  
June 30, 2017 and 2016**

# University of California, Merced Foundation

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June 30, 2017 and 2016

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## **Report of Independent Auditors**

To the Board of Trustees of the  
University of California, Merced Foundation:

We have audited the accompanying financial statements of the University of California, Merced Foundation, a component unit of the University of California, which comprise the statements of net position as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position and of cash flows for the years then ended.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of the 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.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the 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 our 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, we consider 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 Foundation'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 University of California, Merced Foundation as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



### ***Other Matters***

#### ***Required Supplementary Information***

The accompanying management's discussion and analysis on pages 3-6 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*PricewaterhouseCoopers LLP*

San Francisco, California  
September 22, 2017

# **University of California, Merced Foundation**

## **Management's Discussion and Analysis (Unaudited)**

### **June 30, 2017 and 2016**

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The following discussion and analysis presents an overview of the financial performance of the UC Merced Foundation (the Foundation) during the years ended June 30, 2017 and 2016, with selected comparative information for the year ended June 30, 2015. It should be read in conjunction with, and is qualified in its entirety by, the related financial statements and footnotes. The financial statements, footnotes, and this discussion and analysis were prepared by management and are the responsibility of management.

#### **Overview**

The annual report consists of a series of financial statements prepared in accordance with the statements of the Governmental Accounting Standards Board. These statements focus on the financial condition of the Foundation, its changes in net position, and its cash flows, taken as a whole.

One of the most important questions asked about Foundation finances is whether the Foundation is better off or worse off as a result of the year's activities. The key to understanding this question are the statements of net position, statements of revenues, expenses, and changes in net position, and the statements of cash flows. These statements present financial information in a form similar to that used by private sector companies. The Foundation's net position (the difference between assets and liabilities) is one indicator of the Foundation's financial health. Over time, increases or decreases in net position are an indicator of the improvement or erosion of the Foundation's financial health when considered with other nonfinancial information.

The statements of net position include all assets and liabilities. The statements of revenues, expenses, and changes in net position present revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating, with gifts from donors and disbursements to The Regents of the University of California reported as operating revenues and expenses, respectively, and investment results reported as nonoperating revenues or expenses. These statements are prepared using the accrual basis of accounting.

Another way to assess the financial health of the Foundation is to look at the statements of cash flows. Their primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statements of cash flows help users assess an entity's ability to generate future net cash flows and its ability to meet its obligations as they come due.

**University of California, Merced Foundation**  
**Management's Discussion and Analysis (Unaudited)**  
**June 30, 2017 and 2016**

**Condensed Summary of Net Position**

	<b>June 30</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Assets</b>			
Current assets	\$ 1,728,137	\$ 1,219,261	\$ 852,328
Noncurrent assets	10,674,425	9,237,408	9,661,869
Total assets	\$ 12,402,562	\$ 10,456,669	\$ 10,514,197
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable	\$ 89	\$ -	-
Total current liabilities	89	-	-
Total liabilities	\$ 89	\$ -	\$ -
<b>Net position</b>			
Unrestricted	\$ 290,428	\$ 311,173	\$ 225,545
Restricted			
Nonexpendable (endowment)	8,327,440	7,591,604	7,119,797
Expendable (endowment income and appreciation)	2,936,726	1,843,889	2,453,390
Expendable (gift)	847,879	710,003	715,465
Total net position	\$ 12,402,473	\$ 10,456,669	\$ 10,514,197

**Assets**

Current assets of the Foundation consist of cash, funds held by the University, and pledges receivable expected to be collected in the current year. In 2017, current assets increased by \$508,876 as compared to 2016, primarily due to an increase in funds held by the University. The increase is a result of several large endowment and current use gifts received during the year. In 2016, current assets increased by \$366,933 as compared to 2015, primarily due to an increase in funds held by the University and an increase in pledge receivables. Funds held by the University increased substantially due to Board of Trustee gifts towards an endowed chair, which are currently being accumulated until they reach the \$500,000 goal. Once the goal is met, the Foundation will create an endowment and invest the proceeds in the UC Regents General Endowment Pool (GEP), a noncurrent asset of the Foundation. As of June 30, 2017, the Foundation has received approximately \$471,000 towards the \$500,000 goal and expects to meet the goal in the coming year. In 2016, pledge receivables increased primarily as a result of reversals in previous years allowances due to improvements in collectability of pledges outstanding.

Noncurrent assets consist of investment balances primarily pertaining to endowment principal funds as well as pledges receivable expected to be collected after the end of the next fiscal year. In 2017, noncurrent assets increased by \$1,437,017 due to a combination of a \$1,254,661 increase in the fair value of investments and approximately \$166,000 in endowment contributions net of endowment payouts. In 2016, noncurrent assets decreased by \$424,461 due to a combination of a decline in investments and noncurrent pledges. Investments decreased by \$291,002 due to a \$477,413 decrease in the fair value of investments offset by contributions to new and existing endowments invested in the GEP. Pledge receivables declined due to shifts to current receivables, offset by reversals in allowances due to improvements in collectability.

**Liabilities**

Current liabilities represent sales tax owed to Merced County for items auctioned at a UC Merced Foundation fundraiser held during the year.

**Net Position**

Net position represents the residual interest in the Foundation's assets after liabilities, if any, are deducted. The Foundation's net position increased to \$12,402,473 in 2017, compared to \$10,456,669 in

# University of California, Merced Foundation

## Management's Discussion and Analysis (Unaudited)

### June 30, 2017 and 2016

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2016, and \$10,514,197 in 2015. Net position is reported in three major categories restricted nonexpendable, restricted expendable, and unrestricted.

Restricted nonexpendable net position includes the corpus of the Foundation's permanent endowments. Such funds are subject to donor restrictions requiring that the principal be invested in perpetuity for the purpose of producing income that may be expended or added to principal in accordance with the donor's wishes. Substantially all of the increase in 2017 as compared to 2016 is attributable to five endowment gifts, two of which, totaling approximately \$485,000 where new this year. Substantially all of the increase in 2016 as compared to 2015 relates contributions to existing endowments totaling approximately \$500,000.

Expendable restricted net position is subject to externally imposed restrictions governing their use. The net position may be spent only in accordance with the restrictions placed on them and may include endowment income and gains, subject to the Foundation's spending policy, or other third-party receipts. In 2017, expendable restricted net position increased by \$1,230,713 as a result of the increase in the fair value of endowment investments. In 2016, expendable restricted net position decreased by \$614,963 due primarily as a result of a decrease in fair value of endowment investments.

Under accounting principles generally accepted in the United States of America, net position that is not subject to externally imposed restrictions governing their use are classified as unrestricted for financial reporting purposes. Although unrestricted net position is not subject to externally imposed restrictions, it is allocated for the benefit of UC Merced and is available for expenditure by the Board of Trustees of the Foundation at their discretion.

#### Condensed Summary of Revenues, Expenses, and Changes in Net Position

	June 30		
	2017	2016	2015
Operating revenues	\$ 1,207,964	\$ 1,468,956	\$ 1,369,681
Operating expenses	1,378,408	1,684,413	1,709,681
Operating loss	(170,444)	(215,457)	(340,000)
Nonoperating income (loss)	1,336,831	(328,193)	487,919
Additions to permanent endowments	779,417	486,122	1,046,617
Increase (decrease) in net position	1,945,804	(57,528)	1,194,536
<b>Net position</b>			
Beginning of year	10,456,669	10,514,197	9,319,661
End of year	<u>\$ 12,402,473</u>	<u>\$ 10,456,669</u>	<u>\$ 10,514,197</u>

#### Revenue and Support

The primary source of the Foundation's operating revenues is philanthropic gifts to the Foundation in support of the mission of UC Merced. Operating revenues generally consists of current-use gifts, including pledges and income from other fund-raising activities, although they do not include additions to permanent endowments and investment income. Operating expenses include grants to campus and can only be made after cash has been received by the Foundation and is available for use. Additionally, grants to campus include the payout of investment income generated by the endowments, which is classified within nonoperating income. Therefore, operating losses can occur when grants distributed to the campus in any particular year exceed contribution revenue.

Total operating revenues decreased by \$260,992 in 2017 compared to 2016 due to prior year collection of pledges previously written off. Excluding last year's write-off reversals, contribution revenue decreased

## **University of California, Merced Foundation Management's Discussion and Analysis (Unaudited) June 30, 2017 and 2016**

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by approximately \$118,000. While the Foundation received 9 new pledges and overall saw an increase in the number of gifts, the average gift received declined by approximately 27%. In 2016, total operating revenues increased by \$99,275 compared to 2015 due to improvements in collectability on pledges outstanding offset by declines in gift giving in the current year.

Operating expenses, a majority of which is composed of grants to campus, typically follow the pattern indicated by contribution revenue; however, the campus' programmatic needs are also taken into consideration, subject to the restricted purposes of gifts to the endowment and the amounts available for grants in any particular year. Total operating expenses, composed primarily of grants to campus and administrative operating expenses, decreased by \$306,005 and 25,268 in 2017 and 2016, respectively. In 2017, total operating expenses decreased in line with the pattern indicated by contributions revenue; however, administrative and other expenses increased as a result of an \$80,000 gift returned because the Foundation could not accommodate the program stipulated by the donor's terms. In 2016, total operating expenses remained relatively unchanged from the prior year.

Nonoperating income includes the result of investment activities. In 2017, the foundation experienced an appreciation in financial results due to an increase of \$1,637,962 compared to a decrease of \$818,837 in unrealized appreciation on investments in 2017 and 2016, respectively. The Foundation invests exclusively with the UC Regents General Endowment Pool (GEP) which saw a net return of 14.8% for fiscal year 2017, driven largely by the University's investments in public equity which represents almost half of the University's endowment investments.

Additions to permanent endowments increased by \$293,295 in 2017 and decreased by \$560,495 in 2016. In 2017, additions to permanent endowments increased due to \$401,000 received for a public humanities endowment. In 2016, the Foundation didn't experience the large concentrated donations to endowments it experienced in years past. In 2017, the top five donations to new and existing endowments totaled approximately \$677,000 compared to 2016 where the top five new endowments totaled approximately \$415,000.



**University of California, Merced Foundation**  
**Statements of Net Position**  
**June 30, 2017 and 2016**

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	2017	2016
<b>Assets</b>		
Current assets		
Cash	\$ 4,545	\$ 4,545
Funds held by the University	1,343,279	782,117
Pledges receivable, net	<u>380,313</u>	<u>432,599</u>
Total current assets	<u>1,728,137</u>	<u>1,219,261</u>
Noncurrent assets		
Investments	10,462,277	8,958,986
Pledges receivable, net	<u>212,148</u>	<u>278,422</u>
Total noncurrent assets	<u>10,674,425</u>	<u>9,237,408</u>
Total assets	<u>12,402,562</u>	<u>10,456,669</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 89	\$ -
Total current liabilities	<u>89</u>	<u>-</u>
Total liabilities	<u>\$ 89</u>	<u>\$ -</u>
<b>Net position</b>		
Unrestricted	\$ 290,428	\$ 311,173
Restricted		
Nonexpendable (endowment)	8,327,440	7,591,604
Expendable (endowment income and appreciation)	2,936,726	1,843,889
Expendable (gift)	<u>847,879</u>	<u>710,003</u>
Total net position	<u>\$ 12,402,473</u>	<u>\$ 10,456,669</u>

The accompanying notes are an integral part of these financial statements.

**University of California, Merced Foundation**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended June 30, 2017 and 2016**

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	2017	2016
<b>Revenues</b>		
Operating revenues		
Contributions revenue	\$ 1,084,488	\$ 1,398,165
Other operating revenue	<u>123,476</u>	<u>70,791</u>
Total operating revenues	<u>1,207,964</u>	<u>1,468,956</u>
<b>Expenses</b>		
Operating expenses		
Grants to campus	1,258,922	1,662,003
Administrative and other operating expenses	<u>119,486</u>	<u>22,410</u>
Total operating expenses	<u>1,378,408</u>	<u>1,684,413</u>
Operating loss	(170,444)	(215,457)
Nonoperating revenues:		
Investment income, net	82,170	70,236
Net (decrease) increase in the fair value of investments	<u>1,254,661</u>	<u>(398,429)</u>
Total nonoperating (loss) income, net	<u>1,336,831</u>	<u>(328,193)</u>
(Loss) income before other changes in net position	<u>1,166,387</u>	<u>(543,650)</u>
Other changes in net position:		
Additions to permanent endowments	<u>779,417</u>	<u>486,122</u>
(Decrease) increase in net position	<u>1,945,804</u>	<u>(57,528)</u>
<b>Net position</b>		
Beginning of year	<u>10,456,669</u>	<u>10,514,197</u>
End of year	<u>\$ 12,402,473</u>	<u>\$ 10,456,669</u>

The accompanying notes are an integral part of these financial statements.

**University of California, Merced Foundation**  
**Statements of Cash Flows**  
**Years Ended June 30, 2017 and 2016**

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	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities</b>		
Receipts from contributions	\$ 1,203,048	\$ 1,382,690
Grants to campus	(1,258,922)	(1,662,003)
Gifts returned to donors	(80,000)	-
Payments for administrative expenses	(39,397)	(22,410)
Other receipts, net	123,476	70,791
Net cash used in operating activities	<u>(51,795)</u>	<u>(230,932)</u>
<b>Cash flows from noncapital financing activities</b>		
Private gifts for endowment purposes	779,417	486,122
Net cash provided by noncapital financing activities	<u>779,417</u>	<u>486,122</u>
<b>Cash flows from investing activities</b>		
Proceeds from sales of investments	217,769	2,161,816
Purchases of investments	(1,027,561)	(2,487,252)
Interest and dividends, net	82,170	70,236
Net cash used in investing activities	<u>(727,622)</u>	<u>(255,200)</u>
Net change in cash	-	(10)
<b>Cash</b>		
Beginning of year	4,545	4,555
End of year	<u>\$ 4,545</u>	<u>\$ 4,545</u>
<b>Reconciliation of operating loss to net cash used in operating activities</b>		
Operating loss	\$ (170,444)	\$ (215,457)
Changes in operating assets and liabilities		
Pledges receivable	118,560	(15,475)
Accounts payable	89	-
Net cash used in operating activities	<u>\$ (51,795)</u>	<u>\$ (230,932)</u>

The accompanying notes are an integral part of these financial statements.

# University of California, Merced Foundation

## Notes to Financial Statements

### June 30, 2017 and 2016

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#### 1. Organization

The University of California, Merced Foundation (the Foundation), a not-for-profit organization, was formed on August 30, 1996 for the purpose of encouraging voluntary private gifts, trusts, and bequests for the benefit of the University of California, Merced (UC Merced). The Foundation provides financial support for various UC Merced related programs, including faculty research and teaching activities, student scholarships, equipment purchases, and capital improvements. The Foundation grants monies to UC Merced, which assumes responsibility for actual disbursements.

The Foundation is subject to the policies and procedures of The Regents of the University of California (the UC Regents) and is a component unit of the University of California (the University) and as such, discretely presented in the University of California's financial statements. The University established administrative guidelines for the Foundation's ability to conduct operations through its Policy on Campus Foundations. The University's policy limits the ability of the Foundation to make certain expenditures and provides a general framework for its operations. The Foundation was established solely to support the mission of UC Merced and, accordingly, is considered a governmental not-for-profit organization, subject to reporting under the Governmental Accounting Standards Board (the GASB).

#### 2. Summary of Significant Accounting Policies

##### Basis of Accounting

The accompanying financial statements have been prepared using U.S. generally accepted accounting principles, including all applicable statements of the GASB. The statements are prepared using the economic resources measurement focus and accrual basis of accounting.

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, is effective for the Foundation's fiscal year beginning July 1, 2017. This Statement addresses when irrevocable split-interest agreements constitute an asset for accounting and financial reporting purposes when the resources are administered by a third party. The Statement also provides expanded guidance for circumstances in which the government holds the assets. The Foundation is evaluating the effect that Statement No. 81 will have on its financial statements.

GASB Statement No. 84, *Fiduciary Activities*, is effective for the Foundation's fiscal year beginning July 1, 2019. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. The Foundation is evaluating the effect that Statement No. 84 will have on its financial statements.

GASB Statement No. 85, *Omnibus 2017*, is effective for the Foundation's fiscal year beginning July 1, 2017. The purpose of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application and postemployment benefits. The Foundation is evaluating the effect that Statement No. 85 will have on its financial statements.

# University of California, Merced Foundation

## Notes to Financial Statements

### June 30, 2017 and 2016

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#### **Cash**

Cash consists of demand deposits that are insured by the Federal Deposit Insurance Company (FDIC).

#### **Funds Held by the University**

Funds held by the University consist of funds held by UC Merced on behalf of the Foundation. Interest earned on the funds is retained by UC Merced.

#### **Investments**

Investments are measured and recorded at fair value. Investments consist of investments in the UC Regents General Endowment Pool (GEP), a University-managed investment pool which the Foundation considers to be an external investment pool. The Foundation's investment in external investment pools are reported at net asset value and excluded from the fair value level hierarchy. The basis of determining the fair value of pooled funds or mutual funds is determined as the number of units held in the pool multiplied by the price per unit share.

The net change in the fair value of investments represents both realized and unrealized gains and losses on investments. Realized gains or losses are computed based on specific identification of investments sold or units held in pooled funds. Any gains or losses recognized on the sale of investments are included with investment income.

Endowment funds are invested in accordance with the Endowment Investment Spending Policies and Guidelines, adopted by the Board of Trustees (the Board) and the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Investment decisions are based on a long-term investment strategy, with an objective of maximizing the endowment portfolio's long-term total return (yield plus appreciation). The Foundation currently invests with the UC Regents and follows the UC Regents' asset allocation policy. The current allowable range for the portfolio is 20.0% to 52.5% equity securities, 28% to 81% alternatives, and 0% to 17.5% in liquidity (income) investments.

It is the goal of the Foundation that the total return from endowment investments should be adequate to meet the following objectives:

- Preserve investment capital and its purchasing power.
- Generate sufficient resources to meet spending needs (payout).
- Attain reasonable capital appreciation through prudent acceptance of risk to enhance the future purchasing power of the investment capital.

#### **Contributions and Pledges Receivable**

Pledges are written unconditional promises to make future payments. Pledges, other than pledges for endowment purposes, are included in the financial statements as pledge receivables and recognized as revenue in the period unconditionally pledged. Pledges are discounted at a risk-free rate of return if payments extend beyond one year. The discount is accreted and recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any. In addition, an allowance for uncollectible pledges is recorded as determined by management.

Conditional pledges, including all pledges for endowment purposes, which depend on the occurrence of a specified future or uncertain event, such as matching gifts from other donors, are recognized when the conditions are substantially met.

# University of California, Merced Foundation

## Notes to Financial Statements

### June 30, 2017 and 2016

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#### **Net Position**

When possible, the Foundation uses restricted resources when an expense is incurred for which both restricted and unrestricted resources are available. To ensure observance of limitations and restrictions placed on the resources available to the Foundation, net position and revenues, expenses, and gains and losses are classified and reported as follows, based on the existence or absence of donor-imposed restrictions or other externally imposed restrictions.

#### ***Unrestricted***

The unrestricted component of net position is the net amount of the assets of the Foundation that are not subject to donor-imposed restrictions.

#### ***Restricted, Nonexpendable (Endowments)***

The restricted component of net position - nonexpendable endowments are used to account for restricted assets reduced by liabilities that are subject to restrictions of gift instruments requiring, in perpetuity, that the principal be invested, and permitting only a certain amount of the annual return generated by the investment to be distributed (spent).

Net losses in the permanent endowment fair values from the historic gift values are classified as a reduction in restricted nonexpendable net position. As a result of market declines, the fair market value of certain donor-restricted endowments may be less than the historical gift value of such endowments. As of June 30, 2016, the fair market value of endowments fell below the historical gift value for six individual endowments by \$14,315. There were no underwater endowments as of June 30, 2017.

#### ***Restricted, Expendable (Endowments and Gifts)***

Components of net position from gifts whose use by the Foundation is subject to externally imposed restrictions that can be fulfilled by actions of the Foundation pursuant to those restrictions or that expire by the passage of time are classified as expendable component of restricted net position. Additionally, income and appreciation on endowments as limited by the Foundation's spending policy are included in this category of net position.

#### **Classification of Revenues and Expenses**

Operating revenues and expenses are distinguished from nonoperating items and generally result from providing services in connection with ongoing operations and stewarding of gifts received. The principal operating revenues is derived from gifts and other fund-raising activities. Operating expenses include grants to the University and administrative expenses.

Nonoperating revenues and expenses include investment income and changes in the fair value of investments.

Gifts for permanent endowment purposes are classified as other changes in net position.

#### **Spending Policy of Endowments**

The Foundation follows UPMIFA, which was adopted by the State of California in January 2009. UPMIFA does not set specific expenditure limits; instead, a charity can spend the amount the charity deems prudent after considering the donor's intent that the endowment continue permanently, the purpose of the fund, and relevant economic factors. The Foundation's Board of Trustees has approved a 4.75% spending policy of the endowment fund's average fair value (after deducting all investment management fees) for fiscal 2017 and 2016. The average fair value is calculated using a 60-month (five-year) rolling average market value. This policy is consistent

# University of California, Merced Foundation

## Notes to Financial Statements

### June 30, 2017 and 2016

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with the Endowment Investment and Spending Policy and Guidelines adopted by the Board of Trustees. Earnings in excess of the payout rate are reinvested in the endowments.

#### Income Tax Status

The Foundation is an organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code and is generally not subject to federal or state income taxes. However, the Foundation is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purpose for which it is granted exemption. No income tax provision has been recorded as the Foundation did not earn net income from any unrelated trade or business in 2017 or 2016.

#### Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### 3. Investments

The Foundation's investments are reported at fair value in the schedule of investments below, along with the various types of investment risks based on the type of investment, as well as stated policies adopted by the Foundation to manage those risks.

Investments consist of the following at June 30, 2017 and 2016:

	2017	2016
Under management of The Regents of University of California (not subject to categorization)		
General endowment pool (GEP)	\$ 10,462,277	\$ 8,958,986
Total investments	<u>\$ 10,462,277</u>	<u>\$ 8,958,986</u>

The Foundation invests primarily in the University of California commingled funds (UC pooled funds). A description of the fund used is as follows:

The General Endowment Pool (GEP) is a balanced portfolio containing equity and fixed-income securities that provide diversification and economies of scale. The primary goal is to maximize long-term total return, growth of principal, and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained. This fund is used as the core investment vehicle for the Foundation's endowed contributions and may be redeemed monthly with 30 days notice; however, a withdrawal from corpus of more than five percent for endowments with a market value of more than \$5.0 million must have the University President's approval. The Foundation has no unfunded commitments. The GEP is considered to be an external investment pool from the perspective of the Foundation.

**University of California, Merced Foundation**  
**Notes to Financial Statements**  
**June 30, 2017 and 2016**

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**Change in the Fair Value of Investments**

The components of the change in fair value of investments are as follows for the years ended June 30, 2017 and 2016:

	2017	2016
Unrealized (depreciation) appreciation on investments	\$ 1,160,550	\$ (477,413)
Realized gain on investments, net	<u>94,111</u>	<u>78,984</u>
Net increase (decrease) in the fair value of investments	<u>\$ 1,254,661</u>	<u>\$ (398,429)</u>

**Investment Risk Factors**

There are many factors that can affect the value of investments. Some, such as foreign currency risk may affect both equity and fixed income securities. Equity securities respond to such factors as economic condition, individual company earnings performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. The Foundation has established investment policies to provide the basis for the management of a prudent investment program appropriate to the particular fund type.

**Interest Rate Risk**

Interest rate risk is the risk that the fair value of fixed income securities will decline because of rising interest rates. The Foundation measures interest rate risk using the effective-duration method. The Foundation has adopted the University's GEP Investment Policy to manage interest rate risk. The policy is that the average weighted effective duration of portfolio security holdings shall not vary from that of the benchmark index by more than +/-50%.

The Foundation considers the effective duration to be zero for money market funds because they are designed to have a constant \$1 share value due to the short-term, liquid nature of the underlying securities.

**Foreign Currency Risk**

Exposure from foreign currency risk results from investments in foreign currency-denominated equity, fixed income, and private equity securities. The Foundation held \$10,462,277 and \$8,958,986 at June 30, 2017 and 2016, respectively, in the GEP balanced fund managed by the University of California, which held 34% and 28% of its assets at June 30, 2017 and 2016, respectively, in various investments denominated in foreign currencies. The Foundation's endowment asset allocation policy includes an allocation to non-U.S. equities.



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**Notes to Financial Statements**  
**June 30, 2017 and 2016**

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**4. Pledges Receivable**

Included in pledges receivable at June 30, 2017 and 2016 are the following unconditional promises to give:

	2017	2016
Amount due in		
Less than one year	\$ 380,313	\$ 432,599
One to five years	219,550	290,150
	<u>599,863</u>	<u>722,749</u>
Unaccrued discount	(7,402)	(11,728)
Net pledges receivable	<u>\$ 592,461</u>	<u>\$ 711,021</u>

New pledges due beyond one year have been discounted at an annual rate of 1.2%. Prior year pledges due beyond one year were discounted at annual rates varying between 1.2% and 5%. All of the pledges receivable outstanding as of June 30, 2017 and 2016 were due from 11 and four individuals, corporations, or foundations, respectively.

**5. Related Parties**

The University provides certain services to the Foundation, including bookkeeping, treasury, and financial reporting services. No amounts were paid for the years ended June 30, 2017 and 2016, respectively.

The Foundation does not have any employees. All functions and activities are conducted by employees of the University. The University employees serving Foundation functions are participants in The Regents of the University of California pension plan and postretirement healthcare plan.

All of the Foundation's office space is provided by the University. The cost of the office space is not included in the accompanying financial statements.

**6. Administrative Fees**

Unless waived, a one time, administration fee of five percent is assessed by UC Merced on all gifts made to the Foundation based on the principal value of the gift. Administration fees of \$66,018 and \$76,156 were incurred by the Foundation for the years ended June 30, 2017 and 2016, respectively. These fees are included in grants to campus on the statements of revenues, expenses, and changes in net position.