

University of California, Merced Foundation

**Financial Statements
June 30, 2018 and 2017**

University of California, Merced Foundation

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Report of Independent Auditors

The Board of Trustees
University of California Merced Foundation

We have audited the accompanying financial statements of the University of California, Merced Foundation (the Foundation), a component unit of the University of California, which comprise the statements of net position as of June 30, 2018 and 2017, 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, 2018 and 2017, 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.

Emphasis of Matter

As discussed in Note 2 to the financial statements, the Foundation changed the manner in which it accounts for irrevocable split-interest agreements in fiscal year 2018. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

The accompanying management's discussion and analysis on pages 3-6 is 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, CA
October 9, 2018

University of California, Merced Foundation

Management's Discussion and Analysis (Unaudited)

June 30, 2018 and 2017

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, 2018 and 2017, with selected comparative information for the year ended June 30, 2016. 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, 2018 and 2017

Condensed Summary of Net Position

	June 30		
	2018	2017	2016
Assets			
Current assets	\$ 1,126,029	\$ 1,728,137	\$ 1,219,261
Noncurrent assets	13,615,004	12,276,997	10,672,092
Total assets	\$ 14,741,033	\$ 14,005,134	\$ 11,891,353
Liabilities			
Current liabilities			
Accounts payable	\$ 71	\$ 89	\$ -
Total current liabilities	71	89	-
Total liabilities	\$ 71	\$ 89	\$ -
Deferred inflow of resources			
Third party split interest agreements	1,755,976	1,602,572	1,434,684
Net position			
Unrestricted	\$ 60,188	\$ 290,428	\$ 311,173
Restricted			
Nonexpendable (endowment)	8,412,086	8,327,440	7,591,604
Expendable (endowment income and appreciation)	3,490,654	2,936,726	1,843,889
Expendable (gift)	1,022,058	847,879	710,003
Total net position	\$ 12,984,986	\$ 12,402,473	\$ 10,456,669

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 2018, current assets decreased by \$602,108 as compared to 2017, primarily due to large gifts received in prior years that were transferred and invested in the General Endowment Pool investments included in noncurrent assets offset by an increase in allowances against pledge receivables. The increased allowance is a result of a deterioration in collectability on certain pledge receivables outstanding. 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.

Noncurrent assets consist of investment balances primarily pertaining to endowment principal funds, beneficial interest in split interest agreements, and pledges receivable expected to be collected after the end of the next fiscal year. In 2018, noncurrent assets increased by \$1,338,007 due primarily to increase in the fair value of investments and approximately \$639,303 in new endowments, net of endowment payouts. Pledge receivables declined due to shifts to current receivables. In 2017, noncurrent assets increased by \$1,604,905 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.

Liabilities

Accounts payable remained relatively flat from year to year.

Deferred Inflows of Resources

Deferred inflows of resources consist of the beneficial interests in irrevocable split-interest agreements that are administered by third parties. In 2018 and 2017, deferred inflows increased by \$153,403 and

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\$167,888 respectively due to a combination of an increase in the fair value of the underlying investments held by the third party trust administrator and a decrease in the net present value of the obligation to the lead beneficiaries. As lead beneficiaries to the related split-interest agreements age and as regular payments are distributed to the lead beneficiaries from the related third-party trust, the related obligation tends to decrease, which has an inverse effect to deferred inflows.

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 \$12,984,986 compared to \$12,402,473 in 2017, and \$10,456,669 in 2016. 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 2018, as compared to 2015 is attributable to two large endowment gifts received during the year. In 2017, when compared to 2016, is attributable to five endowment gifts, two of which, totaling approximately \$485,000 where new that year.

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 2018, expendable restricted net position increased by \$728,107 as a result of increases in the fair value of endowment investments offset by increases in grants to campus, net of contributions received from donors. In 2017, expendable restricted net position increased by \$1,230,713 as a result of the increase in the 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		
	2018	2017	2016
Operating revenues	\$ 1,164,792	\$ 1,207,964	\$ 1,468,956
Operating expenses	1,619,331	1,378,408	1,684,413
Operating loss	(454,539)	(170,444)	(215,457)
Nonoperating income (loss)	951,590	1,336,831	(328,193)
Additions to permanent endowments	85,462	779,417	486,122
Increase (decrease) in net position	582,513	1,945,804	(57,528)
Net position			
Beginning of year, as previously reported	12,402,473	10,456,669	10,514,197
Cumulative effect of accounting change			-
Beginning of year, restated	12,402,473	10,456,669	10,514,197
End of year	\$ 12,984,986	\$ 12,402,473	\$ 10,456,669

University of California, Merced Foundation

Management's Discussion and Analysis (Unaudited)

June 30, 2018 and 2017

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 \$43,172 in 2018 compared to 2017 due to a combination of a slight increase in average gift giving to the Foundation which was offset by pledge receivable allowances due to a deterioration in collectability of one of the pledges to the Foundation. In 2017, total operating revenues decreased by \$260,992 compared to 2016 due to prior year collection of pledges previously written off. Excluding 2015's write-off reversals, contribution revenue decreased 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% when compared to 2016.

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, increased by \$240,923 in 2018, compared to a decrease of \$306,005 in 2017. In 2018, while there was a decrease in the number of gifts transferred to the Campus for spending purposes, the average gift transferred was larger than the previous year. In addition, endowment payout provided to the Campus increased by approximately \$80,000 due to higher investment earnings from 2017, which are distributed in 2018. 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.

Nonoperating income includes the result of investment activities. In 2018 and 2017, nonoperating income totaled \$951,590 and \$1,336,831 respectively. Nonoperating income is the result of investment income and the net increase in the fair value of investments. In both 2018 and 2017, the foundation experienced an appreciation in financial results due to unrealized appreciation in the fair value of investments totaling \$720,520 and \$1,160,550, respectively. While the Foundation experienced a slowdown in investment appreciation in 2018 compared to 2017, the Foundation still saw positive results in investment performance driven by strong market gains during the year. In 2017, the foundation's investments performed remarkably well compared to previous years, with a weighted average one-year return of 14.8% compared to 3-year and 5-year returns of 5.5% and 9.4% respectively. The Foundation invests exclusively with the UC Regents General Endowment Pool (GEP) and the investment return was largely driven by the University's investments in public equity which represents almost half of the University's endowment investments.

Additions to permanent endowments decreased by \$693,955 in 2018 and increased by \$293,295 in 2017. In 2018, additions declined as a result of overall decreases in endowed giving. In the prior year, the Foundation received several large one time donations as opposed to 2018 where the average endowed gift was approximately \$6,900 compared to an average of \$30,800 in 2017. In 2017, additions to permanent endowments increased due to \$401,000 received for a public humanities endowment.

University of California, Merced Foundation
Statements of Net Position
Years Ended June 30, 2018 and 2017

	2018	2017
Assets		
Current assets		
Cash	\$ 4,545	\$ 4,545
Funds held by the University	863,358	1,343,279
Pledges receivable, net	258,126	380,313
Total current assets	1,126,029	1,728,137
Noncurrent assets		
Investments	11,822,100	10,462,277
Beneficial interest in split interest agreements	1,755,976	1,602,572
Pledges receivable, net	36,928	212,148
Total noncurrent assets	13,615,004	12,276,997
Total assets	\$ 14,741,033	\$ 14,005,134
Liabilities		
Current liabilities		
Accounts payable	\$ 71	\$ 89
Total current liabilities	71	89
Total liabilities	\$ 71	\$ 89
Deferred inflow of resources		
Third party split interest agreements	\$ 1,755,976	\$ 1,602,572
Net position		
Unrestricted	\$ 60,188	\$ 290,428
Restricted		
Nonexpendable (endowment)	8,412,086	8,327,440
Expendable (endowment income and appreciation)	3,490,654	2,936,726
Expendable (gift)	1,022,058	847,879
Total net position	\$ 12,984,986	\$ 12,402,473

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, 2018 and 2017

	2018	2017
Revenues		
Operating revenues		
Contributions revenue	\$ 1,055,427	\$ 1,084,488
Other operating revenue	<u>109,365</u>	<u>123,476</u>
Total operating revenues	<u>1,164,792</u>	<u>1,207,964</u>
Expenses		
Operating expenses		
Grants to campus	1,568,595	1,258,922
Administrative and other operating expenses	<u>50,736</u>	<u>119,486</u>
Total operating expenses	<u>1,619,331</u>	<u>1,378,408</u>
Operating loss	(454,539)	(170,444)
Nonoperating revenues:		
Investment income, net	87,775	82,170
Net increase (decrease) in the fair value of investments	<u>863,815</u>	<u>1,254,661</u>
Total nonoperating income (loss), net	<u>951,590</u>	<u>1,336,831</u>
Income (loss) before other changes in net position	<u>497,051</u>	<u>1,166,387</u>
Other changes in net position:		
Additions to permanent endowments	<u>85,462</u>	<u>779,417</u>
Increase (decrease) in net position	582,513	1,945,804
Net position		
Beginning of year	<u>12,402,473</u>	<u>10,456,669</u>
End of year	<u>\$ 12,984,986</u>	<u>\$ 12,402,473</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, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Receipts from contributions	\$ 1,352,834	\$ 1,203,048
Grants to campus	(1,568,595)	(1,258,922)
Gifts returned to donors	-	(80,000)
Payments for administrative expenses	(50,754)	(39,397)
Other receipts, net	109,365	123,476
Net cash used in operating activities	<u>(157,150)</u>	<u>(51,795)</u>
Cash flows from noncapital financing activities		
Private gifts for endowment purposes	85,462	779,417
Net cash provided by noncapital financing activities	<u>85,462</u>	<u>779,417</u>
Cash flows from investing activities		
Proceeds from sales of investments	898,829	217,769
Purchases of investments	(914,916)	(1,027,561)
Interest and dividends, net	87,775	82,170
Net cash provided by (used in) investing activities	<u>71,688</u>	<u>(727,622)</u>
Net change in cash	-	-
Cash		
Beginning of year	<u>4,545</u>	<u>4,545</u>
End of year	<u>\$ 4,545</u>	<u>\$ 4,545</u>
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	\$ (454,539)	\$ (170,444)
Changes in operating assets and liabilities		
Pledges receivable	297,407	118,560
Accounts payable	(18)	89
Net cash used in operating activities	<u>\$ (157,150)</u>	<u>\$ (51,795)</u>

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

University of California, Merced Foundation

Notes to Financial Statements

June 30, 2018 and 2017

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 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 establishes standards for accounting and financial reporting for irrevocable split-interest agreements. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts –or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements – in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interest in real estate. This statement requires that the Foundation recognize assets, liabilities and deferred inflows of resources for split-interest agreements administered by the University at the inception of the agreement. This statement also requires the Foundation to recognize assets and deferred inflows representing its beneficial interests in irrevocable split-interest agreements that are administered by third parties. This statement requires the Foundation to recognize revenue when the resources become available to spend.

University of California, Merced Foundation
Notes to Financial Statements
June 30, 2018 and 2017

The effects of reporting Statement No. 81 in the Foundation's financial statements as of and for the year ended June 30, 2017, were as follows:

	As previously reported	Effect of adoption of Statement No. 81	As restated
Statement of Net Position			
Beneficial interest in split interest agreements	\$ -	\$ 1,602,572	\$ 1,602,572
Total noncurrent assets	10,674,425	1,602,572	12,276,997
Total assets	12,402,562	1,602,572	14,005,134
Deferred inflows of resources	-	1,602,572	1,602,572

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. There is no impact to the financial statements as a result of adopting this standard.

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. The Foundation's investments 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 31.0% to 73.5% equity securities, 10.5% to 66% alternatives, and 8% to 28.0% in liquidity (income) investments.

University of California, Merced Foundation

Notes to Financial Statements

June 30, 2018 and 2017

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.

Beneficial Interests in Split Interest Agreements

Beneficial interests in split interest agreements represent the Foundation's beneficial interest in irrevocable split-interest agreements administered by third parties. The Foundation's beneficial interest in irrevocable split-interest agreements are recorded at fair value, classified as a level 3 in the fair value hierarchy. Level 3 assets have significant unobservable inputs, as they trade infrequently or not at all. The inputs into the determination of fair value are based upon the best information in the circumstance and may require significant management level judgement.

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.

Deferred Inflows of Resources

Deferred inflows of resources represent an acquisition of net position that apply to a future period. The Foundation classifies changes in irrevocable split-interest agreements as deferred inflows of resources.

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).

University of California, Merced Foundation

Notes to Financial Statements

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Net losses in the permanent endowment fair values from the historic gift values are classified as a reduction in restricted nonexpendable net position.

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 2018 and 2017. The average fair value is calculated using a 60-month (five-year) rolling average market value. This policy is consistent 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 2018 or 2017.

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.

University of California, Merced Foundation
Notes to Financial Statements
June 30, 2018 and 2017

New Accounting Pronouncements

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*, 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.

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, 2018 and 2017:

	2018	2017
Under management of The Regents of University of California (not subject to categorization)		
General endowment pool (GEP)	\$ 11,822,100	\$ 10,462,277
Total investments	<u>\$ 11,822,100</u>	<u>\$ 10,462,277</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.

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, 2018 and 2017:

	2018	2017
Unrealized (depreciation) appreciation on investments	\$ 720,520	\$ 1,160,550
Realized gain on investments, net	<u>143,295</u>	<u>94,111</u>
Net increase (decrease) in the fair value of investments	<u>\$ 863,815</u>	<u>\$ 1,254,661</u>

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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 \$11,822,100 and \$10,462,277 at June 30, 2018 and 2017, respectively, in the GEP balanced fund managed by the University of California, which held 30% and 34% of its assets at June 30, 2018 and 2017, respectively, in various investments denominated in foreign currencies. The Foundation's endowment asset allocation policy includes an allocation to non-U.S. equities.

4. Pledges Receivable

Included in pledges receivable at June 30, 2018 and 2017 are the following unconditional promises to give:

	2018	2017
Amount due in		
Less than one year	\$ 258,126	\$ 380,313
One to five years	38,350	219,550
	<u>296,476</u>	<u>599,863</u>
Unaccrued discount	(1,422)	(7,402)
Net pledges receivable	<u>\$ 295,054</u>	<u>\$ 592,461</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, 2018 were due from 12 individuals, corporations, or foundations.

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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, 2018 and 2017, 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 \$93,581 and \$66,018 were incurred by the Foundation for the years ended June 30, 2018 and 2017, respectively. These fees are included in grants to campus on the statements of revenues, expenses, and changes in net position.