2017 FINANCIAL STATEMENTS

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
W. M. Keck Foundation

We have audited the accompanying financial statements of the W. M. Keck Foundation, which comprise the statements of financial position as of December 31, 2017 and 2016, 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 conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the W. M. Keck Foundation as of December 31, 2017 and 2016, and the results of its activities and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

May 8, 2018

STATEMENTS OF FINANCIAL POSITION

December 31 (in thousands)	2017	2016
Assets		
Cash and cash equivalents	$ 23,032	$ 26,790
Interest and dividends receivable	1,492	1,224
Prepaid federal excise taxes	432	293
Investments	1,236,616	1,041,259
Unsettled trade	12,739	53,633
Other assets	399	415
Total assets	$ 1,274,710	$ 1,123,614
Liabilities and net assets		
Payable to brokers	$ 925	$ 441
Accounts payable and accrued expenses	1,606	1,732
Grants payable	13,800	4,475
Deferred federal excise taxes payable	5,082	2,434
Total liabilities	21,413	9,082
Unrestricted net assets	1,253,297	1,114,532
Total liabilities and unrestricted net assets	$ 1,274,710	$ 1,123,614

See accompanying notes.

STATEMENTS OF ACTIVITIES

Year Ended December 31 (in thousands)	2017	2016
Revenue		
Interest	$ 5,813	$ 5,111
Dividends	9,859	7,203
Other income	321	101
	15,993	12,415
Realized and unrealized gains and losses on investments:		
Net realized gains	70,381	61,208
Change in net unrealized gains (losses)	132,411	(20,761)
	$ 202,792	$ 40,447
Total revenues and net realized gains and change in net unrealized gains or losses on investments	218,785	52,862
Expenses		
Grants	$ 64,655	$ 35,458
Management and general services	7,076	6,534
Investment management fees	4,676	4,217
Federal excise tax provision	3,309	925
Taxes withheld	304	286
Total expenses	$ 80,020	$ 47,420
Change in unrestricted net assets	138,765	5,442
Unrestricted net assets, beginning of year	1,114,532	1,109,090
Unrestricted net assets, end of year	$ 1,253,297	$ 1,114,532

See accompanying notes.

STATEMENTS OF CASH FLOWS

Year Ended December 31 (in thousands)	2017	2016
Operating activities		
Change in unrestricted net assets	$ 138,765	$ 5,442
Adjustments to reconcile change in unrestricted net assets to net cash used in operating activities:		
Depreciation and amortization	44	48
Net realized gains on investments	(70,381)	(61,208)
Net unrealized gains or losses on investments	(132,411)	20,761
Changes in operating assets and liabilities:		
Interest and dividends receivable	(268)	(180)
Other assets	(5)	89
Prepaid federal excise taxes	(139)	1,340
Payable to brokers	484	139
Accounts payable and accrued expenses	(126)	69
Deferred federal excise taxes payable	2,648	(415)
Grants payable	9,325	(4,335)
Net cash used in operating activities	(52,064)	(38,250)
Investing activities		
Purchases of investments	(357,083)	(398,973)
Proceeds on disposition of investments and return of capital	405,412	444,921
Acquisition of fixed assets	(23)	(17)
Net cash provided by investing activities	48,306	45,931
Net increase (decrease) in cash and cash equivalents	(3,758)	7,681
Cash and cash equivalents, beginning of year	26,790	19,109
Cash and cash equivalents, end of year	$ 23,032	$ 26,790
Supplemental disclosures		
Unsettled trade at year end	$ 12,739	$ 53,633
Taxes paid during the year	$ 800	$ –

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

December 31, 2017

1. Organization

Formation and Goals of the Foundation

W. M. Keck established the W. M. Keck Foundation (the Foundation) as a charitable trust in 1954. In 1959, Mr. Keck changed the trust entity to a corporate entity by forming the W. M. Keck Foundation as a Delaware corporation and by transferring the trust's assets, and eventually by bequeathing the residue of his estate, to the corporation. It is this Delaware corporation which exists today and continues to be known as the W. M. Keck Foundation. The Foundation's goals are principally to identify and support university and college research and education programs in the areas of science, engineering, and medicine. In addition, the Foundation gives some consideration to promoting liberal arts education and, in Southern California, to supporting community services, health care, pre-collegiate education, and the arts. Operations are funded by the Foundation's returns on its investment portfolio.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make 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.

Grant Payments

In accordance with accounting standards for not-for-profit entities, unconditional grant payments are recognized as an expense in the period in which they are approved. If these grants are to be paid over a period exceeding one year, they are recorded at the net present value of the future cash payments, using an applicable Treasury Bill rate. Grants that are conditioned upon a future and uncertain event are expensed when these conditions are met. A conditional promise to give is considered unconditional if the possibility that the condition will not be met is remote.

Cash and Cash Equivalents

Cash and cash equivalents are defined as liquid investments with remaining maturities of three months or less at time of purchase.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. Fair value is established based on quoted prices from recognized securities exchanges.

Investments in private equity funds and hedge funds are measured at fair value, using the net asset value (NAV) as a practical expedient, which is based on net asset values reported by the fund managers. Pursuant to provisions of Accounting Standards Update (ASU) 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*, the Foundation believes that the net asset value of these investments as of December 2017 and 2016 approximates their fair value as of that date. However, because of the inherent uncertainty of valuation, the estimated fair values for the aforementioned securities and interests may differ from the values that would have been used had a ready market for the investments existed, and the differences could be material.

Purchases and sales of securities are recorded on the trade date. Dividend income is recorded based upon the ex-dividend date. Interest income is recorded as earned on an accrual basis. Realized gains and losses are recorded upon disposition of securities based on the specific identification method. Unrealized gains and losses are included on the statements of activities and represent the net change in fair value for investments held at the end of the year.

Fair Value of Financial Instruments

The Foundation's statements of financial position include, but are not limited to, the following financial instruments: cash and cash equivalents, accounts payable, and accrued liabilities. The Foundation considers the carrying amounts of these assets and liabilities on the statements of financial position to approximate the fair value of these financial instruments because of the relatively short period of time between origination of the instruments and their expected realization.

Concentrations of Credit Risk

Financial instruments that potentially subject the Foundation to concentrations of credit risk consist of cash and cash equivalents and investments. The investment portfolio is managed within the Foundation's established investment guidelines.

Fixed Assets

Fixed assets are carried at cost, less accumulated depreciation, and are included in other assets on the statements of financial position. Depreciation is computed on the straight-line method over the estimated useful life of each type of asset or the term of the related lease, whichever is shorter. The depreciable lives for leasehold improvements are ten years and for furniture and equipment are five years.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standard Board (FASB) issued ASU 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements for Not-For-Profit Entities*, which will require not-for-profit entities to revise financial presentation to include net asset classification, quantitative and qualitative information as to available resources and management of liquidity and liquidity risk, information on investment expenses and returns, and the presentation of operating cash flows. The standard aims to help the reader of the financial statements to better understand the financial position of the organization and enhance consistency among similar organizations. ASU 2016-14 is effective for annual periods beginning after December 15, 2017. The Foundation is currently evaluating the future impact of the new standard on the financial statements.

In February 2016, FASB issued ASU 2016-02, *Leases*. This standard introduces the new leases standard that applies a right-of-use (ROU) model and requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating based on five criteria. Balance sheet recognition of finance and operating leases is similar, but the pattern of expense recognition in the income statement, as well as the effect on the statement of cash flows, differs depending on the lease classification. This ASU is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Foundation is currently evaluating the future impact of the new standard on the financial statements.

Fair Value Measurement

The Foundation applies the principles of Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements. This standard defines fair value, establishes a consistent framework for measuring fair value, and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. The standard clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the Foundation establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 – Assets that have readily observable prices (quoted prices in active markets accessible at the measurement date for assets). The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 – Assets that are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include assetbacked securities, corporate bonds and loans, municipal bonds, forward contracts, future contracts, interest and credit swap agreements, options, and interest rate swaps.

Level 3 – Assets whose fair value cannot be determined by using observable measures, and can only be calculated using estimates or risk-adjusted value ranges, when little or no market data is available. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are, therefore, determined using factors that involve considerable judgment and interpretations, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates. The fair value hierarchy gives lowest priority to Level 3 inputs.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted below:

(a) *Market approach.* Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
(b) *Cost approach.* Amount that would be required to replace the service capacity of an asset (replacement cost).
(c) *Income approach.* Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing, and excess earnings models).

The Foundation's assets measured at fair value on a recurring basis at December 31, 2017, were as follows (in thousands):

	Level 1	Level 2	Investments at NAV	Total
Assets:				
Common and preferred stock	$ 421,401	$ –	$ –	$ 421,401
Corporate bonds	–	17,677	–	17,677
Municipal bonds	–	2,901	–	2,901
Government bonds	22,837	91	–	22,928
Foreign investments	84,649	14,060	–	98,709
Mortgage- and asset-backed securities	–	35,743	–	35,743
Mutual funds	412,805	–	–	412,805
Private equity funds	–	–	145,748	145,748
Hedge funds	–	–	78,704	78,704
Total	$ 941,692	$ 70,472	$ 224,452	$ 1,236,616

The Foundation's assets measured at fair value on a recurring basis at December 31, 2016, were as follows (in thousands):

	Level 1	Level 2	Investments at NAV	Total
Assets:				
Common and preferred stock	$ 374,461	$ –	$ –	$ 374,461
Corporate bonds	–	18,233	–	18,233
Municipal bonds	–	2,272	–	2,272
Government bonds	23,802	133	–	23,935
Foreign investments	61,074	13,665	–	74,739
Mortgage- and asset-backed securities	–	32,354	–	32,354
Mutual funds	287,276	–	–	287,276
Private equity funds	–	–	117,588	117,588
Hedge funds	–	–	110,401	110,401
Total	$ 746,613	$ 66,657	$ 227,989	$ 1,041,259

The Foundation has classified its mutual funds, equity securities, preferred stock, and certain of its government bonds and foreign investments that have quoted prices in active markets as Level 1 within the fair value hierarchy. These securities are valued under the market approach using inputs observable in active markets for identical securities. The Foundation has classified certain of its government bonds, corporate bonds, municipal bonds, foreign bonds, and mortgage- and asset-backed securities as Level 2 investments. The fair value of these assets is valued under the market approach using inputs observable in active markets for similar assets. The Foundation has measured its investments in hedge funds and private equity funds at fair value using the net asset value as a practical expedient, which is based on net asset values reported by the fund managers. These investments that use net asset value as a practical expedient are not classified in the fair value hierarchy. The fair value of the underlying assets in private equity funds is valued under the income approach using discounted cash flows and other inputs not observable in active markets. The hedge funds in which the Foundation is invested hold a mix of Level 1, 2 and 3 instruments.

3. Investments

The cost and fair value of investments are as follows (in thousands):

	Year Ended December 31, 2017		Year Ended December 31, 2016	
	Cost	Fair Value	Cost	Fair Value
Common and preferred stock	$ 273,135	$ 421,401	$ 281,876	$ 374,461
Corporate bonds	16,333	17,677	16,905	18,233
Municipal bonds	2,279	2,901	1,799	2,272
Government bonds	23,160	22,928	24,081	23,935
Foreign investments	73,385	98,709	71,248	74,739
Mortgage- and asset-backed securities	36,001	35,743	32,341	32,354
Mutual funds	360,665	412,805	280,448	287,276
Private equity funds	131,558	145,748	119,131	117,588
Hedge funds	66,000	78,704	91,741	110,401
	$ 982,516	$ 1,236,616	$ 919,570	$ 1,041,259

The change in net unrealized gains on investments is reflected on the statements of activities and is summarized as follows (in thousands):

Year Ended December 31	2017	2016
Net unrealized gains, beginning of year	$ 121,689	$ 142,533
Net unrealized gains (losses) on investments for the year	$ 132,411	$ (20,761)
Other cost basis adjustment	$ –	$ (83)
Net unrealized gains, end of year	$ 254,100	$ 121,689

The Foundation has made total capital contributions (net of distributions/return of capital) of $197,558,000 to private equity funds and hedge funds it held as of December 31, 2017. The hedge funds can be redeemed on a quarterly or an annual basis and are invested in Level 1, Level 2 and Level 3 investments. One hedge fund was partially redeemed in December 2017. Proceeds from this redemption totaling $12,739,000 had not been received as of December 31, 2017, and are separately reported as unsettled trade in the statement of financial position. These proceeds were received in the first quarter of 2018. The private equity funds are primarily invested in assets valued using Level 3 inputs and, as of December 31, 2017, are subject to lock-up provisions up to 12 years subject to certain further extension adjustments. The Foundation had total future capital commitments related to private equity funds of $145,621,000 as of December 31, 2017.

4. Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income taxes. However, the Foundation is classified under the Internal Revenue Code (IRC) as a private foundation and, as such, is subject to a 2% (1% if certain criteria is met) federal excise tax on net investment income.

During 2017, the Foundation accrued a 1% excise tax on net investment income. Private foundations are required to distribute annually, in qualifying charitable distributions, an amount equal to approximately 5% of the average fair market value of the Foundation's assets (the minimum distribution). If the Foundation does not distribute the required minimum distribution, a one-year grace period is granted to distribute the undistributed income. Under IRC Section 4942(a), if undistributed income is not distributed by the close of the following year, a minimum penalty of 30% of such undistributed income will apply. In 2016, the Foundation's qualifying distributions were in excess of the required minimum, and therefore, the Foundation was not subject to the 30% penalty. Although the Foundation does have cumulative undistributed income at December 31, 2017, based on the Foundation's distribution history, the Foundation will be able to, and intends to, distribute the cumulative undistributed income at December 31, 2017 in 2018. Accordingly, the Foundation has not accrued a liability for the penalty on undistributed income.

The Foundation uses the liability method for accounting for excise taxes. The federal excise tax provision (benefit) consists of the following (in thousands):

Year Ended December 31	2017	2016
Current	$ 661	$ 1,340
Deferred	$ 2,648	$ (415)
	$ 3,309	$ 925

Deferred federal excise taxes arise primarily from the net unrealized appreciation in the fair value of investments and the Foundation uses the maximum federal excise tax rate of 2% for the years presented.

4. Taxes (continued)

The Foundation completed an analysis of its tax positions, in accordance with FASB ASC 740, *Income Taxes*, and determined that there are no uncertain tax positions taken or expected to be taken. The Foundation has recognized no interest or penalties related to uncertain tax positions. The Foundation is subject to routine audits by the taxing jurisdictions; however, there are currently no audits in progress for any tax periods (tax years 2013 through 2017 remain open and subject to selection for such routine audits).

5. Grants Payable and Conditional Grant Commitments

Grants payable and conditional grant commitments as of December 31, 2017, are as follows (in thousands):

	Unconditional	Conditional
2018	13,800	2,050
2019	–	14,500
2020	–	14,500
2021 and thereafter	–	114,500
	$ 13,800	$ 145,550

Projected timetable and payment amounts shown above for conditional grants are estimated. Conditional grants will be recorded as an expense in the period when the conditions to the grant are met. These grants are conditioned upon other donors matching the amounts contributed by the Foundation, receipt of building permits and other regulations, and compliance with budget, timetable, and grant agreements requirements.

Conditional grants outstanding as of December 31, 2017, consist of the following (in thousands):

Grantee	Date of Original Commitment	Original Commitment	Additional Commitment	Amount Outstanding*
University of Southern California	2011	150,000	10,000	107,500
Great Public Schools Now	2015	30,000	–	20,000
Others grants approved in 2015	2015	800	–	800
KIPP LA Schools	2016	500	–	500
Chapman University	2017	20,000	–	16,000
Others grants approved in 2017	2017	750	–	750
		$ 202,050	$ 10,000	$ 145,550

** Only reflects the portion of the grant that remains conditional.*

In 2016, the Board approved an amendment to its conditional grant agreement with University of Southern California to add a $10 million payment in 2032. The parties agreed to the terms and entered into the amendment in February 2017.

6. Lease Commitments

The Foundation leases its main office space. Annual base rent is $544,000, which is payable through the end of the lease term in 2019. Rent expense is recognized on a straight-line basis over the lease term. As of December 31, 2017, the approximate future minimum scheduled lease obligation for the lease is as follows (in thousands):

Year ending December 31	
2018	544
2019	498
	$ 1,042

Total rental expense for each of the years ended December 31, 2017 and 2016, was approximately $413,500. Deferred rent was approximately $249,000 and $380,000 at December 31, 2017 and 2016, respectively.

7. Employee Retirement Plan

The Foundation maintains a qualified 401(k) Profit Sharing Plan (the Plan) for eligible employees. Employees can contribute a percentage of their pretax compensation subject to Internal Revenue Service (IRS) limitations. The Foundation matches 200% of the employee's deferral, but not more than 6% of the employee's compensation in total until IRS compensation limits are reached. The Foundation's matching contributions to the Plan were approximately $292,000 and $287,000 for the years ended December 31, 2017 and 2016, respectively.

8. Subsequent Events

The Foundation's management has evaluated subsequent events through May 8, 2018, which is the date these financial statements were available to be issued. Management has determined that no material subsequent events have occurred during that period that would require the Foundation to either recognize the financial impact of such events in the accompanying financial statements or disclose any such events to ensure the financial statements are not misleading.