



U.C. SANTA CRUZ FOUNDATION

Financial Statements

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

THE U.C. SANTA CRUZ FOUNDATION

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KPMG LLP
Suite 1400
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San Francisco, CA 94105

Independent Auditors' Report

The Board of Trustees
U.C. Santa Cruz Foundation:

We have audited the accompanying financial statements of the U.C. Santa Cruz Foundation (the Foundation), a component unit of the University of California, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Foundation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance 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 from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 U.C. Santa Cruz Foundation as of June 30, 2014, and the changes in its financial position and its cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

June 30, 2013 Financial Statements

The accompanying financial statements of the Foundation as of and for the year ended June 30, 2013 were audited by other auditors, whose report thereon dated September 17, 2013 expressed an unmodified opinion on those financial statements.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 7 be presented 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 (GASB) 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.

KPMG LLP

San Francisco, California
October 2, 2014

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

U.C. Santa Cruz Foundation (the Foundation) has been dedicated to supporting UC Santa Cruz's core endeavors – teaching, research, and public service since 1974. The Foundation encourages financial support for University of California, Santa Cruz (UCSC) through private gifts. The Foundation provides a convenient and efficient vehicle for accepting all types of private donations and gifts as an adjunct to money also raised for UCSC through The Regents of the University of California (the Regents).

The following Management's Discussion and Analysis (MDA) presents an overview of the financial performance of the Foundation for the fiscal years ended June 30, 2014 and 2013 (2014 and 2013, respectively). The MDA has been prepared by management and should be read in conjunction with and qualified in its entirety by the accompanying audited financial statements and notes.

Overview

This report consists of financial statements prepared in accordance with the statements of the Governmental Accounting Standards Board (the GASB). These financial statements focus on the financial condition of the Foundation, its changes in financial position and its cash flows, taken as a whole.

One of the most important questions asked about the Foundation finances is whether the Foundation is better or worse as a result of the year's activities. The key to understanding the answer is the Statements of Net Position; Statements of Revenues, Expenses, and Changes in Net Position; and the Statements of Cash Flows. The Foundation's net position (the difference between assets and liabilities) is one indicator of the Foundation's financial health. Over time, an increase or decrease in net position is one indicator of the improvement or erosion of the Foundation's financial health when considered with other nonfinancial information. In 2014, the Foundation improved its financial condition as indicated by an increase in net position by \$17.4 million.

The Statements of Net Position includes all assets and liabilities. The Statements of Revenues, Expenses, and Changes in Net Position presents revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. Operating revenues include current use (nonendowed) gifts to the Foundation and operating expenses include grants to the campus. Investment results are reported as nonoperating revenues or expenses, and gifts to permanent endowments are reflected in change in net position. Unlike for-profit enterprises, a loss in the Statement of Revenues, Expenses, and Changes in Net Position in the Foundation's financial statements is not necessarily indicative of poor financial performance since the Foundation's mandate is to make grants and disbursements for campus support.

Another way to assess the financial health of the Foundation is to look at the Statement of Cash Flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of the Foundation. The Statement of Cash Flows helps readers assess the Foundation's ability to generate future net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

U.C. SANTA CRUZ FOUNDATION
Management's Discussion and Analysis (Unaudited)
June 30, 2014 and 2013

Condensed Financial Information

	<u>2014</u>	<u>FY 2014-2013 change percentage</u>	<u>2013</u>	<u>FY 2013-2012 change percentage</u>	<u>2012</u>
Assets:					
Cash	\$ 1,035,054	199%	\$ 346,160	(43)%	\$ 603,721
Pledges receivable, net	5,755,274	(8)	6,288,152	15	5,477,465
Investments:					
SSgA Charitable Asset Management	2,568,460	3	2,503,331	4	2,408,141
General Endowment Pool	79,266,685	29	61,462,351	10	55,916,462
Beneficial interest in third party CRTs	—	—	—	(100)	258,167
Total investments	<u>81,835,145</u>	<u>28</u>	<u>63,965,682</u>	<u>9</u>	<u>58,582,770</u>
Total assets	<u>88,625,473</u>	<u>26</u>	<u>70,599,994</u>	<u>9</u>	<u>64,663,956</u>
Liabilities:					
Current liabilities	1,420,851	88	754,580	(25)	1,012,530
Noncurrent liabilities	5,582,700	—	5,591,940	—	5,605,280
Total liabilities	<u>7,003,551</u>	<u>10</u>	<u>6,346,520</u>	<u>(4)</u>	<u>6,617,810</u>
Net position:					
Restricted net position	85,083,526	25	67,839,081	10	61,615,931
Unrestricted net position (deficit)	(3,461,604)	(3)	(3,585,607)	—	(3,569,785)
Total net position	<u>\$ 81,621,922</u>	<u>27%</u>	<u>\$ 64,253,474</u>	<u>11%</u>	<u>\$ 58,046,146</u>
Revenues and expenses:					
Operating revenues:					
Contribution revenue	\$ 9,226,845	4%	\$ 8,908,095	(27)%	\$ 12,154,986
Total operating revenues	<u>9,226,845</u>	<u>4</u>	<u>8,908,095</u>	<u>(27)</u>	<u>12,154,986</u>
Operating expenses:					
Disbursements to UCSC	10,166,252	2	9,919,240	6	9,366,238
Management and general expenses	60,661	(27)	83,400	19	69,821
Total operating expenses	<u>10,226,913</u>	<u>2</u>	<u>10,002,640</u>	<u>6</u>	<u>9,436,059</u>
Net operating (loss) gain	<u>(1,000,068)</u>	<u>(9)</u>	<u>(1,094,545)</u>	<u>(140)</u>	<u>2,718,927</u>
Nonoperating revenues (expenses):					
Change in fair value of investments	11,472,199	92%	5,983,975	(592)%	(1,217,155)
Other nonoperating revenues	397,549	(38)	643,025	(24)	848,314
Total nonoperating revenues (expenses)	<u>11,869,748</u>	<u>79</u>	<u>6,627,000</u>	<u>(1,897)</u>	<u>(368,841)</u>
Additions to permanent endowments	<u>6,498,768</u>	<u>597</u>	<u>933,040</u>	<u>(52)</u>	<u>1,946,302</u>
Change in net position	<u>\$ 17,368,448</u>	<u>169%</u>	<u>\$ 6,465,495</u>	<u>50%</u>	<u>\$ 4,296,388</u>

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

Financial Highlights

In 2014, the Foundation's total assets increased 25.5% or \$18.0 million to \$88.6 million at June 30, 2014, from \$70.6 million at June 30, 2013. The 2014 increase is primarily due to appreciation in the fair market value of investments, and to increased gifts for endowments and fund functioning as endowment. The 2013 increase in assets was primarily due to appreciation in the fair market value of investments.

The Foundation's endowment investments comprise of shares of the UC General Endowment Pool (GEP). The share price of the GEP increased 16.9% from \$26.04 at June 30, 2013 to \$30.44 at June 30, 2014. The GEP share price increased 10.6% in the prior year, from \$23.55 at June 30, 2012 to \$26.04 at June 30, 2013.

Gifts to the Foundation increased by \$5.9 million to \$15.7 million for 2014 from \$9.8 million for 2013. The 2014 increase in gifts is primarily due to more permanent endowment contributions in 2014 than in the prior year. In 2014, gifts to the Foundation classified as operating revenue were \$9.2 million and additions to permanent endowments was \$6.5 million for a total of \$15.7 million. In 2013, gifts to the Foundation classified as operating revenue were \$8.9 million and additions to permanent endowments was \$933 thousand for a total of \$9.8 million.

The Board of Trustees approved endowment payout for fiscal year 2014 of \$2.4 million and \$2.1 million for fiscal year 2013, representing net payout rates of 4.2% times the three-year moving average fair market values, respectively for each year to qualifying endowments. The payout is distributed to UCSC departments, including financial aid for student assistance, in August of the following fiscal year. The 4.65% payout also includes .45% of the three year average, \$248 thousand in 2014 and \$238 thousand in 2013 for endowment administration, to support costs of administering and carrying out the terms of the endowment.

Total Assets

The total assets of the Foundation increased 25.5% or \$18.0 million to \$88.6 million at June 30, 2014, from \$70.6 million at June 30, 2013. Total assets include cash (bank balances), and cash equivalents (the Short Term Investment Pool, STIP), investments in shares of the GEP, charitable trust investments (held by State Street Global Advisors), pledges receivable, and proceeds from gifts of securities in transit. The 2014 increase is primarily due to \$11.5 million of appreciation in the fair market value of investments, and to increased gifts of \$6.5 million for endowments and funds functioning as endowments.

The increase in total assets during fiscal year 2013 from the prior year was \$5.9 million. This change was primarily due to appreciation in the fair value of investments.

Total Liabilities

The Foundation's liabilities at June 30, 2014 increased 10.4% or \$657 thousand, to \$7.0 million from \$6.3 million at June 30, 2013. The increase was primarily due to an increase of \$628 thousand of gifts in process which were distributed to UCSC in the following month. The Foundation's liabilities at June 30, 2013 were basically unchanged from the June 30, 2012 balance.

The repayment terms of the Center for Ocean Health (COH) loan require the Foundation to pay all loan interest accrued during a fiscal year to UCSC in that same fiscal year, and therefore, the unpaid interest amount of \$395 thousand has been classified as a current liability at June 30, 2014. The unpaid interest on the COH loan was \$374 thousand at June 30, 2013.

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

June 30, 2014 and 2013

Operating and Nonoperating Revenues and Expenses

The Statement of Revenues, Expenses, and Changes in Net Position presents operating and nonoperating revenues and expenses. In 2014, there was an increase in Contributions revenue of \$319 thousand. The Foundation's disbursements to UCSC increased by \$247 thousand, from \$9.9 million in 2013 to \$10.1 million in 2014, primarily due to greater endowment payout distributions to campus of \$2.4 million in 2014, compared to \$2.1 million in the previous year. In 2014, the Foundation reported a net operating loss of \$1.0 million, compared to a net operating loss of \$1.1 million for 2013.

Nonoperating income (revenues and expenses) includes net investment income, changes in the fair value of investments, and changes or adjustments to charitable trust liabilities. Net nonoperating income increased \$5.2 million to \$11.8 million in 2014, mainly due to favorable investment performance.

Additions to permanent endowments were \$6.5 million in 2014. This was the highest amount of gifts for endowment received by the Foundation in a single year. The comparable amount received in 2013 was \$933 thousand.

Net Position

Effective July 1, 2012, the Foundation changed its accounting policy for recording its remainder interests in trusts administered by outside trustees. The revised policy states that the Foundation will not record these gifts until the time requirements have been met and the gifts are received. The impact of this change in accounting treatment resulted in a reduction to the beginning of the year net position for the fiscal year ended June 30, 2013 of \$258 thousand. 2014 Net Position increased \$17.4 million compared to an increase year of \$6.5 million for 2013. The 2014 increase was primarily due to increases in fair market value of investments and significantly increased gifts for endowment purpose. The 2013 year increase was primarily driven by an increase in the fair market value of investments.

Investments

Total investments include shares of the UC General Endowment Pool (GEP) and funds held by State Street Global Advisors (SSgA), which totaled \$81.8 million at June 30, 2014 and \$64.0 million at June 30, 2013. This represents an increase in 2014 of \$17.9 million over the prior year, and an increase in 2013 of \$5.4 million over the prior year.

A substantial portion of the Foundation assets are invested in the GEP. The Pool, and therefore the Foundation, invests in developed and emerging market equities, domestic and foreign fixed income securities, marketable alternatives, private equity/venture capital partnerships, real estate, natural resources and commodities. The June 30 fair value for the GEP was \$79.3 million in 2014 and \$61.5 million in 2013. The GEP grew \$17.8 million in 2014, and in 2013 the GEP grew \$5.5 million over the prior year. An Investment Policy Statement revised annually by the UC Regents and adopted by the Foundation's Board of Trustees, sets policy long-term risk and performance targets and investment asset allocations for the GEP.

Annuity and life income (charitable remainder trust, or CRT) assets are invested by SSgA in fixed income, equities, real estate, commodities, and cash, totaling \$2.6 million and \$2.5 million as of June 30, 2014 and 2013 respectively.

U.C. SANTA CRUZ FOUNDATION

Management's Discussion and Analysis (Unaudited)

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The Foundation's short term cash-equivalent funds are invested in the UC Regents Short Term Investment Pool (STIP) that comprise of a broad spectrum of high-quality money-market and fixed income instruments (domestic and foreign). The STIP is dollar-denominated so the unit price is fixed at \$1, and fair market value changes if any, are adjusted through the Pool's current income yields (the STIP rate). The asset mix for STIP consists of commercial paper, federal agency and government securities, corporate notes, and bank notes (certificates of deposits and repurchase agreements). The objective for STIP is to maximize returns consistent with safety of principal, liquidity, and cash flow requirements. The Foundation's cash-equivalent funds held in the Regents STIP were \$926 thousand and \$277 thousand, respectively, as of June 30, 2014 and 2013.

Endowment Payout

The Foundation's payout policy is 4.65% of a three year moving average market value of the endowment principal. The endowment expenditure formula is reviewed annually. The Board approved payout rates of 4.65% and 4.65%, respectively, for fiscal years 2014 and 2013. The rates produced payout dollar amounts of \$2.37 million in 2014 and \$2.09 million in 2013. The payout is distributed to UCSC departments in August of the following fiscal year.

Disbursements to UCSC

Total disbursements to UCSC comprise of Gifts to UCSC for current use and capital projects, which were received and transferred by the Foundation, GEP payouts and related withdrawals, and other fees paid for UCSC and reimbursements.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Gifts for current use and capital projects	\$ 7,766,611	7,805,340	6,791,268
Endowment payouts and withdrawals	2,375,093	2,089,764	2,552,014
Other	24,548	24,136	22,956
Total disbursements to UCSC	<u>\$ 10,166,252</u>	<u>9,919,240</u>	<u>9,366,238</u>

Long Term Debt Activity

The Foundation did not incur new debt or make any note payments during FY14 or FY13. On June 30, 2014 the Center for Ocean Health (COH) note unpaid interest was \$395 thousand and outstanding principal was \$1.5 million. The Seymour Marine Discovery Center (SMDC) note interest payable was \$934 thousand and outstanding principal was \$2.2 million. On June 30, 2013 the Center for Ocean Health (COH) note unpaid interest was \$374 thousand and outstanding principal was \$1.5 million. The Seymour Marine Discovery Center (SMDC) note interest payable was \$900 thousand and outstanding principal was \$2.2 million.

U.C. SANTA CRUZ FOUNDATION

Statements of Net Position

June 30, 2014 and 2013

Assets	2014	2013
Current assets:		
Cash and cash equivalents	\$ 1,035,054	346,160
Pledges receivable, net – current	1,789,607	2,083,917
Current assets	<u>2,824,661</u>	<u>2,430,077</u>
Noncurrent assets:		
Investments – General Endowment Pool	79,266,685	61,462,351
Investments – other	2,568,460	2,503,331
Pledges receivable, net – noncurrent	3,965,667	4,204,235
Noncurrent assets	<u>85,800,812</u>	<u>68,169,917</u>
Total assets	<u>88,625,473</u>	<u>70,599,994</u>
Liabilities		
Current liabilities:		
Accounts payable and other accrued liabilities	817,913	190,183
Current portion of long-term debt	395,176	374,143
Trust liabilities	207,762	190,254
Current liabilities	<u>1,420,851</u>	<u>754,580</u>
Noncurrent liabilities:		
Long-term debt	4,663,577	4,629,294
Trust liabilities	919,123	962,646
Noncurrent liabilities	<u>5,582,700</u>	<u>5,591,940</u>
Total liabilities	<u>7,003,551</u>	<u>6,346,520</u>
Net Position		
Restricted:		
Nonexpendable:		
Endowments	34,830,206	28,331,439
Annuity and life income funds	320,025	330,729
Total nonexpendable	<u>35,150,231</u>	<u>28,662,168</u>
Expendable:		
Endowments	25,980,745	19,012,856
Annuity and life income funds	1,121,550	1,019,702
Funds functioning as endowments	18,008,717	12,962,814
Gifts	4,822,283	6,181,541
Total expendable	<u>49,933,295</u>	<u>39,176,913</u>
Total restricted	85,083,526	67,839,081
Unrestricted (deficit)	<u>(3,461,604)</u>	<u>(3,585,607)</u>
Total net position	<u>\$ 81,621,922</u>	<u>64,253,474</u>

See accompanying notes to financial statements.

U.C. SANTA CRUZ FOUNDATION

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Contributions revenue	\$ 9,226,845	8,908,095
Total operating revenues	<u>9,226,845</u>	<u>8,908,095</u>
Operating expenses:		
Disbursements to University of California, Santa Cruz	10,166,252	9,919,240
Management and general expenses	60,661	83,400
Total operating expenses	<u>10,226,913</u>	<u>10,002,640</u>
Net operating loss	<u>(1,000,068)</u>	<u>(1,094,545)</u>
Nonoperating revenues (expenses):		
Investment income, net	608,263	657,374
Change in fair value of investments	11,472,199	5,983,975
Change in value of gift annuities and trust liabilities	(210,714)	(14,349)
Total nonoperating revenues, net	<u>11,869,748</u>	<u>6,627,000</u>
Income before other changes in net position	10,869,680	5,532,455
Other changes in net position:		
Additions to permanent endowments	6,498,768	933,040
Change in net position	<u>17,368,448</u>	<u>6,465,495</u>
Net position:		
Beginning of year	64,253,474	58,046,146
Cumulative effect of change in accounting treatment	—	(258,167)
Beginning of year	<u>64,253,474</u>	<u>57,787,979</u>
End of year	\$ <u><u>81,621,922</u></u>	\$ <u><u>64,253,474</u></u>

See accompanying notes to financial statements.

U.C. SANTA CRUZ FOUNDATION

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Receipts from contributions	\$ 7,151,123	6,597,298
Payments to the University of California	(9,538,522)	(10,210,695)
Payments to trust and annuity beneficiaries	(140,413)	(141,354)
Payments for administrative or operating expenses	(60,661)	(83,400)
Other receipts	47,489	42,130
Net cash used in operating activities	<u>(2,540,984)</u>	<u>(3,796,021)</u>
Cash flows provided by noncapital financing activities:		
Private gifts for permanent endowments	<u>6,382,660</u>	<u>921,965</u>
Cash flows from investing activities:		
Proceeds from sale and maturities of investments	5,486,528	3,786,189
Investment income, net	639,827	705,031
Purchases of investments	<u>(9,279,137)</u>	<u>(1,874,725)</u>
Net cash provided by (used in) investing activities	<u>(3,152,782)</u>	<u>2,616,495</u>
Net increase (decrease) in cash and cash equivalents	688,894	(257,561)
Cash and cash equivalents – beginning of year	<u>346,160</u>	<u>603,721</u>
Cash and cash equivalents – end of year	\$ <u><u>1,035,054</u></u>	\$ <u><u>346,160</u></u>
Reconciliation of net operating loss to net cash used in operating activities:		
Net operating loss	\$ (1,000,068)	(1,094,545)
Adjustments to reconcile net operating loss to net cash used in operating activities:		
Contributions of securities	(2,598,684)	(1,500,109)
Changes in value of annuity and life income liabilities	(102,841)	160,629
Change in operating assets and liabilities:		
Contributions receivable	532,878	(810,687)
Beneficial interest in charitable remainder trust	—	(258,167)
Accounts payable and other accrued liabilities	627,731	(293,142)
Net cash used in operating activities	\$ <u><u>(2,540,984)</u></u>	\$ <u><u>(3,796,021)</u></u>
Supplemental noncash activities:		
Contributions of securities – operating	\$ 2,598,684	1,500,109
Contribution of securities – endowment	124,326	—
Interest added to principal	55,316	71,727
Beneficial interest in charitable remainder trust	91,144	(113,103)

See accompanying notes to financial statements.

U.C. SANTA CRUZ FOUNDATION

Notes to Financial Statements

June 30, 2014 and 2013

(1) Organization

The U. C. Santa Cruz Foundation (UCSCF or the Foundation) is a not-for-profit organization dedicated to providing to the University of California, Santa Cruz (UCSC) the financial benefits generated from its fundraising efforts and investment earnings.

The Foundation is subject to the policies and procedures of the Regents of the University of California (the Regents). The Regents established administrative guidelines for the Foundation with regard to the Foundation's ability to conduct operations through its Policy on Campus Foundations. The Regents' policy limits the ability of the Foundation to make certain expenditures and provides a general framework for its operations. The Foundation is governed by an independent Board of Trustees, the membership of which includes the Chancellor of UCSCF. The Foundation was established solely to support the mission of UCSC. The Foundation is a component unit of the University of California. Accordingly, its financial statements are included in the financial statements of the University of California. Upon dissolution, liquidation or winding up of the Foundation, the assets remaining after payment, or provision for payment, of all debts and liabilities of the Foundation shall be distributed to the Regents for the benefit of UCSC, provided the Regents of the University have maintained tax-exempt status under the Internal Revenue Code and relevant California laws. Accordingly, the Foundation 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

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements is presented below.

(a) *Basis of Accounting*

The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles, including all applicable statements of the GASB. The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. All intercompany balances and transactions have been eliminated.

(b) *Cash and Cash Equivalents*

Cash and cash equivalents consist of demand deposits and investments in the University of California Regents (the Regents) short-term investment pool (STIP), since such amounts are readily convertible to known amounts of cash. All cash and cash equivalents are reported at cost, which approximates fair value.

(c) *Investments*

Investments are reported at fair value. Investments consist principally of investments in the UC Treasurer's General Endowment Pool (GEP) and the Charitable Remainder Trust (CRT) investments held by State Street Global Advisors (SSgA). Realized gains and losses on the sale of marketable securities are determined using the historical cost of the securities sold. Investment income consists of dividend and interest income and is shown net of investment management fees.

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Notes to Financial Statements

June 30, 2014 and 2013

Because certain investments are not readily marketable, the estimated fair value may differ from the value that would have been used had a ready market for the investments existed and such differences could be material.

The change in the fair value of investments represents the difference between the fair value of investments at the beginning of the year and the end of the year, taking into consideration investment purchases, sales, and redemptions.

Trust assets are invested in a diversified portfolio of institutional quality, exchange-traded index funds, and are recorded at quoted market values at fiscal year-end.

(d) Pledges Receivable

Pledges receivable represent written unconditional promises to give by donors. Pledges receivable, other than endowment pledges, are recognized as contribution revenue at the time the pledge is made by the donor if the pledge is verifiable, measurable, probable of collection and meets all applicable eligibility requirements. These eligibility requirements require 1) the Foundation to be stated as the recipient of the pledge; 2) the pledge is considered available for use and can be sold, disbursed, consumed, or invested for a term or in perpetuity; 3) any contingencies on the pledge are met and 4) if a reimbursement of expenses, allowable costs have been incurred. Endowment pledges are recognized as additions to the endowment at the time payment is received. Contributions that are expected to be collected during the next fiscal year are recorded at estimated net realizable value. Contributions recognized during the years ended June 30, 2014 and 2013, which are expected to be collected after one year have been discounted at 1.45% and 2.10% for 2014 and 2013, respectively, and are reflected in the financial statements at their net present value. Contributions recognized prior to June 30, 2013 have been discounted at a range of 0.8% - 2.2%.

Management has established an allowance for uncollectible contributions, which represents 4.56% of the pledge balance as of June 30, 2014 and 4.97% as of June 30, 2013, plus scheduled pledge payments in arrears.

Endowment pledges receivable are conditional upon the Foundation's preserving the endowment and are therefore recognized as revenue in the period payment is received rather than the period pledged. Conditional endowment pledges receivable approximated \$355,025 at June 30, 2014 and \$1,501,267 at June 30, 2013.

(e) Trust Liabilities

The Foundation has been designated as the trustee for ten and eleven charitable remainder trusts (the Trusts, or CRTs) as of June 30, 2014 and 2013, respectively. The Trusts are established by donors to provide income to designated beneficiaries. Upon maturity, the principal of the Trusts will be distributed to the Foundation for use as designated by the donor. Trust assets are recorded at fair value at date of receipt.

A corresponding liability, trust distributions payable, is established for the present value of the future estimated payments for annuities and life income amounts payable; calculated on the basis of standard gift annuity tables and applicable Internal Revenue Service guidelines. The remaining

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amount is classified as restricted nonexpendable net position in the case of permanent endowments or restricted expendable net position in all other instances.

The Foundation periodically receives notification that it has a financial interest in various charitable trusts where the assets are invested and administered by outside trustees. Effective July 1, 2012, the Foundation changed its accounting policy and does not record these gifts until the time requirements have been met and the gifts are received. The impact of this change in accounting treatment resulted in a reduction to the beginning of the year net position for the fiscal year ended June 30, 2013 of \$258,167. Consistent with the Foundation's recognition policy for pledges of endowment, receivables and contribution revenue associated with these trusts are not reflected in the accompanying financial statements.

For the years ended June 30, 2014 and 2013, liabilities for trust payments to beneficiaries are discounted based on the risk-free discount rate as of the date of the gifts, which ranged from 2.9% to 6.0%.

(f) *Classification of Current and Noncurrent Assets and Liabilities*

The Foundation considers assets to be current that can reasonably be expected, as part of normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the statement of net position date. Liabilities that reasonably can be expected, as part of normal business operations, to be liquidated within 12 months of the statement of net position date are considered to be current. All other assets and liabilities are considered to be noncurrent.

(g) *Net Position*

Net Position includes the following:

Restricted nonexpendable net position consists of permanent endowments and annuity and life income funds, which will become permanent endowments. Such funds are generally subject to donor restrictions requiring that the principal be invested in perpetuity for the purpose of producing investment income and appreciation that may be expended or added to principal in accordance with donors' wishes, subject to Foundation expenditure policy. The Foundation classifies the original endowment gift and any amounts added to principal per the donor's wishes as restricted nonexpendable net position. In addition, any net loss in the permanent endowment fair values from the historic gift values is classified as a reduction in restricted nonexpendable net position. Trust resources that are not expendable upon maturity are also classified as restricted nonexpendable net position.

Restricted expendable net position relates to contributions designated by donors for use by particular entities or programs or for specific purposes or functions of the University. They also include funds functioning as endowments, which are restricted net position which can be expended. Investment income and appreciation of endowment investments are classified as restricted expendable net position unless otherwise specified by the donor. Trust resources that are expendable upon maturity are classified as restricted expendable net position.

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When the Foundation receives amounts that are for both restricted and unrestricted purposes, it is the Foundation's policy to first apply the amounts to restricted purposes.

Unrestricted net position is net position of the Foundation that are not subject to donor-imposed restrictions.

(h) *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 current funds. The principal operating revenues are derived from gifts and other fund-raising activities. Operating expenses include distributions to the University and administrative expenses.

Nonoperating revenues and expenses include investment income, the change in the carrying value of gift annuities and trust liabilities, interest and dividends, the change in fair value of investments, which consists of the net realized gain (loss) on the sale of investments, and change in unrealized appreciation (depreciation) in the fair value of investments.

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

(i) *Gift Fees*

In accordance with policies established by the UCSC Chancellor to offset costs incurred in the management, administration, and processing of gifts, 6% of all gifts are transferred to University Relations division.

(j) *Disbursements and Expenses*

Disbursements and expenses consist primarily of payments made to the University in support of University programs and departments. Disbursements related to facility construction projects are reflected as expenses in the Foundation's financial statements since the facilities are used exclusively by the University, deeded to the University upon completion, and reflected as assets in the University's financial statements.

(k) *Accounts Payable*

The Foundation transfers gifts for current use to UCSC departments on a monthly basis, as receipts are identified and designated for uses according to donors' intended purposes. As of June 30, 2014 the current gift amount to be transferred in July 2014 of \$817,913 was recorded in Disbursements to UC Santa Cruz as an accrued expenditure in the Statement of Revenue, Expenses, and Changes in Net Position and as an Accounts Payable liability in the Statement of Net Position. At June 30, 2013 the corresponding amount subsequently transferred in July 2013 was \$190,183.

(l) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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

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statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(m) Taxes

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 net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the basic financial statements taken as a whole.

(n) Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

(3) Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2014 and 2013 consist of the following:

	<u>2014</u>	<u>2013</u>
Checking and savings accounts	\$ 108,830	69,539
UC Short-Term Investment Pool	926,224	276,622
	<u>\$ 1,035,054</u>	<u>346,161</u>

At June 30, 2014, and 2013, the carrying amount of the Foundation's demand deposits was \$108,830 and \$69,539, respectively.

The Foundation manages its cash through a major banking institution. The UC Treasurer's Short-Term Investment Pool (STIP) invests primarily in U.S. Treasury securities, prime grade commercial paper and short-term corporate notes with cost approximating market value. The Foundation earns income based on its average investment in the pool. Bank balances are fully insured by the Federal Deposit Insurance Corporation (FDIC) up to the applicable limits.

The Foundation does not have exposure to foreign currency risk in its demand deposit accounts.

The Foundation is cognizant that cash balances are exposed to custodial credit risk. To mitigate custodial credit risk, the Foundation conducts business with a fiscally sound bank with national recognition.

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(4) Investments

The composition of the Foundation's investments as of June 30, 2014 and 2013 is as follows (in thousands of dollars):

<u>Investment type</u>	<u>2014</u>	<u>Percentage</u>	<u>2013</u>	<u>Percentage</u>
Commingled funds:				
Balanced funds	\$ 79,267	96.9	\$ 61,462	96.0
U.S. equity funds	889	1.1	866	1.4
Non-U.S. equity funds	517	0.6	484	0.8
U.S. bond funds	892	1.1	890	1.4
Real estate investment trusts	126	0.2	117	0.2
Short term investments	29	—	31	—
Commingled funds	81,720		63,850	
Commodities	115	0.1	116	0.2
	<u>\$ 81,835</u>	<u>100.0%</u>	<u>\$ 63,966</u>	<u>100.0%</u>

The UC Treasurer's General Endowment Pool (GEP)'s indexed securities represent U.S. and foreign equities, high-yield U.S. equities, U.S. and foreign bonds, and real estate. The equity securities include common stocks, alternative investments (private equity and venture capital partnerships; and absolute return investments), emerging market indexed funds, and real estate. Each individual fund within the GEP subscribes to or disposes of units on the basis of the fair value per unit at the end of the month in which the transaction takes place.

The basis of determining the fair value of the underlying investments held by the GEP is the readily determinable sales price or current exchange rate of the investments based on prices or quotations from over-the-counter markets where such markets exists. The fair value of interests in alternative investments are based upon valuations provided by the general partners and fund managers. As alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. The basis of determining the fair value of the underlying investments held in the CRT pools at SSgA is the readily determinable sales price or current exchange rate of the underlying investments based on prices or quotations from over-the-counter markets as all underlying investments have readily available prices at year end.

As noted above, the Foundation holds units in the GEP and other shares in CRT investments. The CRT investments held by SSgA were established in August, 2011 and are maintained to approximate the investment composition of the GEP, except the CRT investments do not include alternative investments and real estate.

At June 30, 2014 and 2013, net appreciation on donor restricted permanent endowments of \$26.0 million and \$19.0 million respectively is included in restricted expendable net position in the accompanying Statement of Net Position.

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In 2009, the Foundation adopted the provisions contained in the Uniform Prudent Management Institutional Funds Act (UPMIFA) in management of its endowment and similar funds. UPMIFA eliminates the concept of 'historic dollar value' and states that "the institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established." Under this approach, during fiscal years 2014 and 2013, the Foundation approved an endowment payout of 4.65% and 4.65% of the three-year moving average fair values of the endowment as of December 31, 2013 and 2012, respectively. To the extent that net income earned (interest and dividends reduced by investment management fees) is less than distributable endowment income, net gains are appropriated in order to meet the approved payout rate.

(5) **Investment Risk Factors**

There are many factors that can affect the value of investments. In addition to market risk, credit risk, custodial credit risk, concentration of credit risk, and foreign currency risk may affect both equity and fixed income securities. Equity securities are affected by such factors as economic conditions, individual company earnings performance, and market liquidity, while fixed income securities are particularly sensitive to credit risk, inflation, and changes in interest rates.

The Foundation's targeted investment risk level will be consistent with the UC Regents approved pro forma total investment risk level, and will be in compliance with the GEP's risk level.

The UC Regents Chief Investment Officer is responsible for managing GEP total and active risk and implements procedures and safeguards so that the combined risk exposures of all portfolios in the aggregate are kept within limits established by the Regents Committee on Investments. Further, within limits of prudent diversification and risk budgets, the GEP total and active risk exposures are fungible, that is the Chief Investment Officer may allocate risk exposures within and between asset classes in order to optimize investment return.

(a) ***Credit Risk***

Fixed income securities are subject to credit risk, which is the chance that a bond issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the security price to decline. The circumstances may arise due to a variety of factors, such as financial weakness or bankruptcy. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are considered to have little credit risk.

A bond's credit quality is an assessment of the issuer's ability to pay interest on the bond, and ultimately, to pay the principal. Credit quality is evaluated by one of the independent bond-rating agencies, such as Moody's Investors Service or Standard and Poor's. In the rating agency's opinion, the lower the rating, the greater the chance, that the bond issuer will default, or fail to meet its payment obligations. Generally, the lower a bond's credit rating, the higher the yield to compensate for the additional risk. Credit agencies' opinions, and therefore, ratings can change as market conditions change.

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The Foundation recognizes that a limited amount of credit risk, properly managed and monitored, is prudent and provides an incremental risk adjusted return above the relevant benchmark.

The credit risk profile for fixed income securities at June 30, 2014 and 2013 is as follows (in thousands of dollars):

	<u>2014</u>	<u>2013</u>
Commingled funds (including GEP):		
U.S. bond funds:		
Not rated	\$ 892	890
Non-U.S. bond funds:		
Not rated	<u>29</u>	<u>31</u>
Total commingled funds	<u>\$ 921</u>	<u>921</u>

(b) Custodial Risk

Custodial credit risk is the risk that in the event of the failure of the custodian, the Foundation's investment may not be returned. A majority of marketable securities held by the Foundation are in external investments and pools (GEP and SSgA), in which their existence is not evidenced by securities that exist in physical or book entry form. As a result, custodial risk is remote.

(c) Concentration of Credit Risk

Financial instruments that potentially subject the Foundation to concentrations of credit risk consist principally of investments with the University of California Treasurer's Office, which may invest in cash equivalents, U. S. Government and federal agency obligations, common stocks, and corporate debt securities; the remainder of the UC Treasurer's portfolio is diversified and issuers of the securities are dispersed throughout many industries and geographies. The Foundation does not directly hold nor does it intend to purchase any of the more volatile types of derivative mortgage securities.

(d) Interest Rate Risk

Interest rate risk is the risk that the value of fixed income securities will decline with rising interest rates. The market prices of fixed income securities with a longer time to maturity, measured by effective duration, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter durations.

The effective duration (in years) of the Foundation's fixed income securities at June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Fixed income securities:		
Commingled funds – U.S. bond funds	5.41	5.41
Commingled funds – short term investments	2.21	2.69

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(e) Foreign Currency Risk

Exposure from foreign currency risk results from investments in foreign currency denominated equity or fixed income securities.

At June 30, 2014 and 2013, the U.S. dollar balances of Foundation investments that carry foreign currency risk type are as follows (in thousands of dollars):

	<u>2014</u>	<u>2013</u>
Commingled funds:		
Various currency denominations:		
Balanced funds	\$ 17,963	14,037
Non-U.S. and U.S. equity funds	<u>517</u>	<u>484</u>
Total	<u>\$ 18,480</u>	<u>14,521</u>

(6) Endowment Payout

For the years ended June 30, 2014 and 2013, the approved endowment payout comprises the following (in thousands of dollars):

	<u>2014</u>	<u>2013</u>
Investment (loss) income, net	\$ 664	729
Net gains	<u>1,711</u>	<u>1,361</u>
Endowment payout	<u>\$ 2,375</u>	<u>2,090</u>

At June 30, 2014 and 2013, net appreciation on donor-restricted permanent endowments of \$26.0 million and \$19.0 million, respectively, is included in restricted expendable net position in the accompanying statement of net position. At June 30, 2014 and 2013, net appreciation on fund functioning as endowment of \$5.5 million and \$3.3 million, respectively, is included in restricted expendable net position in the accompanying statement of net position.

(7) Related Parties

The Foundation supports the University and has the following organizational relationship with the University:

(a) Administrative Costs

The Foundation has a Board of Trustees, and designated officers; however, 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 covered by the Regents pension plan and post-retirement health care plan. All of the Foundation's office space is provided by the University.

Further, Gift fees are levied by UCSC, collected by the Foundation, and distributed by the Foundation along with the gifts to UCSC for campus administrative costs, described above in

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accordance with relevant University policies. Gift fees and other reimbursements are included in Disbursements to UCSC in the accompanying financial statements and totaled \$559 thousand and \$576 thousand for the years ended June 30, 2014 and 2013, respectively.

(8) Pledges Receivable

Promises to give, net of discount of present value and allowance for doubtful accounts, as of June 30, 2014 and 2013 are as follows (in thousands of dollars):

	<u>2014</u>	<u>2013</u>
Pledges receivable due in one year or less	\$ 2,258	2,733
Less allowance for doubtful pledges	(468)	(649)
Pledges receivable, current	<u>1,790</u>	<u>2,084</u>
Pledges due between one and five years	4,385	4,769
Less:		
Allowance for doubtful pledges	(200)	(237)
Unamortized discount	(219)	(328)
Pledges receivable, noncurrent	<u>3,966</u>	<u>4,204</u>
Total pledges receivable, net	\$ <u>5,756</u>	<u>6,288</u>

Approximately, \$4.8 million and \$6.4 million of the gross pledges receivable as of June 30, 2014 and 2013, respectively, were due from five individuals, corporations or foundations.

(9) Long-term Debt

The changes in Long Term Debt payable to UCSC are as follows for the years ended June 30, 2014 and 2013 (in thousands of dollars):

	<u>Amount</u>
Long-term debt at July 1, 2012	\$ 4,932
Interest added to Principal	<u>71</u>
Long-term debt at July 1, 2013	5,003
Interest added to Principal	<u>56</u>
Long-term debt at July 1, 2014	\$ <u>5,059</u>

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Payments due on notes payable to UCSC are as follows for the year ending June 30 (in thousands of dollars):

	<u>Amount</u>
2015	\$ 395
2016	143
2017	145
2018	147
2019	149
2020-2024	3,917
2025-2029	<u>163</u>
	<u>\$ 5,059</u>

Long-term debt consists of two amounts borrowed from the University. The first loan was borrowed in 1999 and was in the original amount of \$2,500,000 to construct Seymour Marine Discovery Center (SMDC). The building was subsequently gifted to UCSC. The note bears interest at the STIP annual rate (1.45% at June 30, 2014) and had an outstanding balance of \$3,135,229 at June 30, 2014. Interest due and payable has been classified as a noncurrent liability since the University has informed the Foundation it will not seek payment of the amounts due in the current year. The Foundation intends to repay the loan with the entire proceeds of certain CRTs. The University has agreed to forgive any amount payable in excess of the proceeds from these trusts. Such forgiveness, if any, will be accounted for in the year of final proceeds. At June 30, 2014 and 2013, the assets in such trusts totaled approximately \$1,470,417 and \$1,355,979, respectively.

The Foundation also has a loan outstanding in the amount of \$1,923,524 at June 30, 2014, which was borrowed from the University in 2001 to fund the construction of the UCSC Center for Ocean Health (COH). The COH was subsequently gifted to UCSC. The note repayment terms require the Foundation make interest-only payments for the first five years, and principal and interest thereafter, with final payment due June 30, 2026. The loan and accrued interest is to be paid in full by gift funds raised in support of this project. The note also bears interest at the STIP rate (1.45% at June 30, 2014). The payments for the accrued interest obligation on long-term debt due in fiscal years 2014 and 2013 were not paid. The repayment terms of the COH loan require the Foundation to pay all loan interest accrued during a year to UCSC in that same year and therefore, the unpaid interest of \$395,176 at June 30, 2014 and \$374,143 at June 30, 2013 have been classified as current liabilities.